

# Corporate Pensions Bulletin

## *Lessons learned from Marconi*

January 2006

**The sale of Marconi's telecom equipment business to Ericsson in October for £1.2bn received a substantial amount of press coverage. Much of this was related to the treatment of its substantial UK defined benefit pension plan and the involvement of the new Pensions Regulator in the sale process.**

### **Marconi's pension liabilities**

Whilst an ongoing business (renamed telent plc) was left behind, this was very small compared to the pension plan. Marconi's accounts showed an FRS 17 deficit as at 31 March 2005 at £109m. It was estimated, however, that it could have required £3.7bn for Marconi to buy out all of the pension liabilities through annuity contracts – about £1.2bn more than the Plan's assets.

### **The deal agreed**

The principal elements of the deal which was cleared by the Pensions Regulator are:

- Shareholders will receive £2.75 per share (roughly the Marconi share price before takeover talks were announced) plus a share in the telent business
- £185m will be immediately injected into the pension plan
- £490m will be paid into an escrow account which the pension plan can call upon if needed. The funds in the escrow account will return to the Company if not needed to cover pensions.

In summary, the cash received by the pension plan together with the money set aside in the escrow account is significantly less than the notional "annuity buy-out" cost.

### **Lessons for Mergers & Acquisitions**

There are some features of the pensions aspects of the Marconi transaction that mean this solution may not apply generally, but there are several lessons that can be drawn:

#### **1. Transactions involving sizeable pension liabilities are not completely dead.**

*Although there have been a number of high profile deals that have reportedly run aground partly due to pensions issues (e.g. M&S, WH Smith, ITV), some of these pre-dated the formation of the new Regulator and were for reasons specific to the pension plan rules. It should also be remembered that the Regulator is itself still learning and that over time its stance might become more commercial, especially if combined with a general increase in funding levels.*

#### **2. Contingent funding arrangements, such as escrow accounts, are useful tools to balance the interests of pension plan members and shareholders.**

*It may seem wishful thinking to be wary of potential pension surpluses arising in future, but the pension plan is effectively a one-way valve. Under current UK pension rules,*

*refunds of surplus in pension plans are not easily achievable without benefit improvements or high levels of tax.*

- 3. It puts a big question mark over the use of the notional buy-out cost as a benchmark for significant pension liabilities.** *The total to be received by the Marconi pension plan through the transaction will be a maximum of £675m, over £500m short of the notional buy-out cost. It is unlikely that any significant value will have been attributed to the ongoing talent covenant, so it suggests that the notional buy-out cost is greater than a suitable level of reserves required to provide the benefits. In fact for a plan of this size, the concept of a buyout on reasonable terms is, at the present time, no more than notional.*

### **Conclusion**

By engineering a deal that satisfied the pension plan trustees and the Regulator, and delivered what seems to be a fair deal to shareholders, most commentators would agree that the Marconi transaction was a successful ending to a long and painful journey. In a pensions context, it is likely to influence future UK transactions and pension funding in the wider sense.

### **How can we help?**

We would be very happy to share our experiences with you and explore your particular circumstances. Please contact your Watson Wyatt consultant, or call Steven Dicker on 0161 839 1600 or Andrew Reid on 020 7222 8033.

Watson Wyatt Limited is regulated by the Financial Services Authority in the conduct of UK investment business. The information in this document is based on UK legislation and practice. The Watson Wyatt commentary in this document is not intended to be comprehensive, nor to provide professional advice. It should not be treated as a substitute for professional advice on individual circumstances.

#### **Watson Wyatt Limited**

21 Tothill Street, Westminster, London SW1H 9LL, UK

Tel: +44 (0)20 7222 8033 Fax: +44 (0)20 7222 9182

Authorised and regulated by the Financial Services Authority

Visit us at <http://www.watsonwyatt.com>