

Guidance on Contingent Assets
Part 3
Type B Contingent Assets

2024/25

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1 THE GUIDANCE

1.1 General introduction

1.1.1 The Guidance in relation to Contingent Assets is comprised of four Parts. These are:

- (a) Part 1 - General Requirements;
- (b) Part 2 - Type A Contingent Assets (group company guarantees);
- (c) Part 3 - Type B Contingent Assets (charges over assets); and
- (d) Part 4 - Type C Contingent Assets (letters of credit / bank guarantees)

(the "**Contingent Asset Guidance**").

1.1.2 This Part 3 of the Contingent Asset Guidance covers specific requirements in respect of Type B Contingent Assets and should be read in conjunction with Part 1 of the Contingent Asset Guidance.

1.1.3 Parties should note the Board's requirements, in place for the 2019/20 Levy Year onwards, in respect of re-execution of certain Contingent Assets. In order for Type A and Type B Contingent Assets to meet the Board's definition of Standard Form, any such agreements that contain fixed monetary caps must be in the format that was published in early 2018 or thereafter. For Type B contingent assets, the Board's expectation is that (as a matter of normal legal practice) contingent assets are re-executed afresh rather than (for example) amended or restated. See paragraph 2.10 below for more information.

2 TYPE B CONTINGENT ASSETS

2.1 Overview

2.1.1 Type B Contingent Assets comprise security granted by a company (the "**Chargor**") to the trustees of the scheme. The assets must comprise one of the types listed at paragraph 9 of the Contingent Asset Appendix, and will only be taken into account where the trustees have the first priority charge over the asset and there are no prior or pari passu security interests.

2.1.2 One issue that has caused some concern is whether Contingent Assets (particularly of Type B) fall foul of the statutory restrictions on employer-related investments. Ultimately this is a question of statutory interpretation and trustees should seek their own advice. However, the Board's view is that contingent assets of the types it will recognise for levy purposes do not constitute an investment of scheme assets/resources of the scheme by the trustees, and that therefore the restrictions are not relevant.

2.2 Security over cash (Type B(i))

2.2.1 Full details of the certification and documentation requirements are contained in paragraphs 28 – 30 of the Contingent Asset Appendix.

2.3 Security over land (Type B(ii))

2.3.1 Type B(ii) contingent assets must be valued on a market value basis. However, if the land (or any part of it) is occupied by the Chargor, any of the employers covered by the security, or any of their associates, it must be valued on a basis which excludes any value attributable to the

Chargor/employer/associate's occupation of the property. The trustees must therefore ensure that the valuation they provide is prepared on the appropriate basis, as a valuation wholly or partly on the wrong basis will result in the Contingent Asset being rejected. Full details of the certification and documentation requirements can be found at paragraphs 31-34 of the Contingent Asset Appendix.

2.3.2 The wording of paragraph 32(3) of the Contingent Asset Appendix, including references to "valuation date", "market value", and "special assumptions", is drawn from the Glossary in Part 2 of the Royal Institute of Chartered Surveyors 'Red Book Global' issued in November 2021.

2.3.3 When certifying a new Type B(ii) Contingent Asset, the following should be submitted:

- (a) A full valuation which was less than three months old at the certification date; or
- (b) A full valuation which was more than three months old at the certification date AND a desktop / short-form valuation updating the full valuation which was less than three months old.

2.3.4 When recertifying a Type B(ii) Contingent Asset, the following should be submitted:

- (a) A full valuation which was less than 15 months old at the recertification date; or
- (b) A desktop valuation which was less than 15 months old updating a previously submitted full valuation.

2.3.5 Where there are multiple properties contained in a single Contingent Asset, and the properties were valued on different dates, the date entered on the contingent asset certificate should be the oldest of those valuation dates (to ensure that the Board's requirements are met in respect of all valuations).

2.4 Security over securities (Type B(iii))

2.4.1 Full details of the certification and documentation requirements are contained in paragraphs 35 - 37 of the Contingent Asset Appendix.

2.5 Liability caps

2.5.1 Type B security agreements require the amount recoverable from the Chargor in respect of Secured Scheme Liabilities to be capped. There are, broadly speaking, five types of cap:

- (a) a fixed sum;
- (b) a fluctuating cap based on the scheme's s179 funding level;
- (c) a fluctuating cap based on the scheme's s75 funding level;
- (d) a combination of (a) and (b) above, i.e. the lower of a fixed sum and a fluctuating cap based on the scheme's s179 funding level; and
- (e) a combination of (a) and (c) above, i.e. the lower of a fixed sum and a fluctuating cap based on the scheme's s75 funding level.

2.5.2 The standard form agreements published in January 2018 and thereafter have changed the structure of the fixed element caps, to clarify the circumstances in which payments by the

Chargor under the agreement will reduce the cap. The forms introduce the concept of pre-insolvency and post-insolvency caps. All Contingent Assets that include a fixed cap must include a figure for the post-insolvency cap (which will be the relevant figure to be taken into account for levy calculation purposes). In addition, parties to an agreement with a post-insolvency fixed cap may choose to insert a cap on their pre-insolvency liabilities, so that their agreement contains two caps.

2.5.3 To explain the pre-insolvency caps available for use in the post-January 2018 standard forms, where the parties have chosen a fixed cap for post-insolvency demands:

- (a) Option A is expressed to be "unlimited". What this means is that the Chargor must pay out the full amount of the Secured Scheme Liabilities. It is up to the Chargor to ascertain what the extent of that might mean in the context of the scheme in question.
- (b) Option B, which envisages a pre-insolvency cap of a fixed sum, provides that the pre-insolvency cap shall not be less than (but may be greater than) the post-insolvency cap, less any pre-insolvency demands. Option B is structured in this way so as to ensure that a fixed sum pre-insolvency cap is meaningful for those who wish to include it (i.e. not trivial). This fixed sum cap will be reduced over time by any pre-insolvency demands made.
- (c) Option C is a fluctuating cap rather than a fixed sum, and is defined by reference to the employer's funding obligations under the scheme-specific funding provisions of the Pensions Act 2004 (e.g. schedule of contributions and recovery plans) and (if selected) any further funding obligations under the scheme rules during the Reference Year in question. This Option C refreshes every Reference Year. The reason it is drafted with specific reference to the scheme-specific funding requirements is so that the Chargor can ascertain what the limitation means in concrete terms, and can explain this (as may be needed) within their business.

2.5.4 Parties who wish to cap the pre-insolvency liabilities therefore have the option of choosing a fixed cap at a robust level, or a fluctuating cap (refreshing each year) based on anticipated annual liabilities.

2.5.5 For post-insolvency demands in a fixed cap agreement (i.e. caps including a fixed monetary sum element), post-insolvency demand payments erode the post-insolvency cap. No pre-insolvency demand payments erode the post-insolvency fixed cap - this is because a cap that may not protect a scheme's position on insolvency would involve a fundamental reworking of our levy calculation for schemes with Contingent Assets (which may lead us to conclude that no levy recognition could be given). So, in a multi-employer scheme scenario, if a post-insolvency demand is made in respect of one employer, the amount paid by the Chargor will reduce the overall remaining cap.

2.5.6 For fluctuating caps (i.e. by reference to s75 or s179 funding levels), there is no cap to erode, so any payments made by the Chargor as a result of any demands (whether pre or post insolvency) will not affect the way that the cap continues to be calculated for any future demands.

2.5.7 For caps where there is a "lower of" formulation, paragraph 2.5.5 above applies to the fixed element, and paragraph 2.5.6. above applies to the fluctuating element.

2.5.8 A Type B charge granted to the trustees of schemes or sections where the employers are not associated by a permanent community of interest ("non-associated schemes") must have a

fixed cap (and not one of the other formulations) to ensure that the credit given for such assets in the levy calculation is fair.

2.5.9 Alternative formulations for the liability caps are not generally allowed. However, caps of the form "the higher of Cap(a) and Cap(b)", where Cap(a) is one of the five caps set out above and Cap(b) is an alternative measure, are acceptable. They will be valued by the Board as though only Cap(a) applies, and should be certified accordingly.

2.5.10 Parties should note that the caps described in this section apply across (a) the Chargor's covenant to pay (in clause 2 of the agreement) and (b) the ability of the trustees to apply any proceeds of enforcement against the charged asset against scheme liabilities.

2.5.11 The recovery upon enforcement of a Type B security will, of course, also be limited by the value of the underlying assets over which the security is granted. Both the liability cap and the value of the underlying assets will therefore affect the value of the Contingent Asset credited for the purposes of the risk-based levy.

2.6 Requirements as to the Chargor as Employer's Associate

2.6.1 The Chargor must be an Employer's Associate, as defined in paragraph 4(7) of the Contingent Asset Appendix, of at least one (but not necessarily all) of the scheme employers.

2.6.2 To fall within the wider definition of Employer's Associate in paragraph 4(7)(b), the Board must be satisfied that:

- (a) the Contingent Asset was given or paid for because of such an existing relationship between the person and the employer(s); and
- (b) the person giving or paying for the Contingent Asset had a genuine and substantial reason for doing so regardless of any payment or other consideration received by it as a result of doing so.

2.6.3 The Board must be satisfied that a sufficiently strong relationship exists between the employer and the Chargor. This could be evidenced, for example, via long-term contracts between the parties that recognise a sharing of the pension scheme liabilities, but will ultimately depend on the individual case.

2.6.4 Similarly, whether or not there is a genuine and substantive reason for giving the Contingent Asset will depend on the individual case. If, for example, the Chargor will ultimately (through the particular relationship) bear the cost of higher levies if no Contingent Asset were in place, that Chargor would appear to have a genuine reason for giving the Contingent Asset.

2.6.5 The Board does not expect to receive evidence but if provided, for example, via a letter to the Board, the writer of the letter should base their view on having seen the requisite documentation. It is acceptable to include a statement as to associateship in the legal opinion, on the basis that the legal advisor has had sight of the relevant documentation or confirmations from the relevant parties and can therefore provide the confirmation as a matter of fact.

2.7 Deemed value based on liability cap

- 2.7.1 The value of Type B Contingent Assets for the purposes of the levy calculation is based on the liability cap and the value of the underlying assets. Further details are at paragraph 5 of the Contingent Asset Appendix.
- 2.7.2 The deemed maximum liability is calculated based on asset and liability information (including deficit-reduction contributions) certified to the Board prior to the start of the relevant Levy Year. Valuations (usually on a s179 basis) are rolled forward to a consistent date, on the basis published by the Pension Protection Fund.
- 2.7.3 The deemed maximum liability under the Type B security is then calculated as the actual limit on the Chargor's liability that would apply on the date referred to in paragraph 2.7.2, based on the asset and liability information referred to in that paragraph.
- 2.7.4 The deemed liability limit under a single Type B Contingent Asset is not affected by the existence of any other Contingent Assets.
- 2.7.5 The value of the Type B Contingent Asset taken into account for the purposes of the levy will be the lower of (a) the deemed value of the liability cap and (b) the actual value of the underlying charged assets, based on the bank statement/valuation (as appropriate) provided to the Board. No adjustment is made to the value as per the bank statement or valuation to take account of any accrual of interest or fluctuations in value since the valuation date.

2.8 Recognition for levy purposes

- 2.8.1 Where there is more than one Type B Contingent Asset, the values are simply added together for the purposes of the levy and are treated as assets, including being subject to stressing and smoothing.
- 2.8.2 Full details of how Type B Contingent Assets are recognised for levy purposes can be found at paragraph 18 of the Contingent Asset Appendix.

2.9 Release of underlying assets where over secured

- 2.9.1 The standard forms of security agreement allow the Chargor to request that some of the assets are released. Following a request, the trustees must release assets to the extent their value exceeds the assumed value of the liability cap. Clearly it will be more feasible to release assets that are easily divisible, such as a proportion of the cash in a charged bank account or part of a portfolio of securities, than indivisible assets such as real estate.
- 2.9.2 The standard form agreements do not require the Chargor to "top up" the assets if their value falls or if the actual funding situation deteriorates (even if some of the assets have previously been released under the provision described in paragraph 2.9.1). Trustees are however free to negotiate such "top-up" arrangements in addition to the standard terms. If the Contingent Asset arrangement is not "topped-up" the next year's levy will reflect the deterioration in the funding position. If a "top-up" arrangement is put in place, the next year's levy will reflect this "topped-up" position.

2.10 Re-execution Requirement and moving to the 2018 standard forms

- 2.10.1 If schemes with Type B contingent assets that have some fixed cap element within them wish to seek levy credit for 2024/25, they must have moved to the new standard forms published

from 18 January 2018 onwards. See paragraph 5.3 of Part 1 of the Contingent Asset Guidance (General) for more information on the Re-execution Requirement.

- 2.10.2 Schemes moving to the new Type B standard forms for the first time must prepare their contingent asset submission as if the contingent asset were new. For example, for Type B(ii) (security over property - England and Wales), the documents we expect are contained in paragraph 34(1) of the Contingent Asset Appendix. There are no specific relaxations for Type B contingent assets that are moving onto the new forms; in particular the valuation requirements must be obtained afresh (however note the relaxation in regard to the legal opinions in paragraph 5.3.4 of Part 1 of the Contingent Asset Guidance (General)).
- 2.10.3 We are aware that Type B(ii) contingent assets (security over property) may need to be released early (with the effect that the contingent asset is not in place for the entirety of the 2023/24 levy year) in order to ensure the timings in relation to the new contingent asset are met (for example, managing Land Registry practicalities). Where there are no other changes other than the move to the new standard form, we would not expect that the mid-year removal of a contingent asset in these circumstances would lead to a recalculated 2023/24 levy, but we ask that schemes contact us in the usual way (see paragraph 7.5 of Part 1 of the Contingent Asset Guidance (General)) for mid-year contingent asset changes (see Rule G3 of the Determination), so that it can be managed through the proper process.
- 2.10.4 In relation to the new style of standard forms (published 18 January 2018 onwards), we are including the following guidance to assist schemes and their advisers when considering variations to the standard form. Fundamentally, though, it remains for schemes and their legal advisers to satisfy themselves that any changes to the standard form are not of a materially detrimental effect on the rights of the trustees (see paragraph 3.2 of Part 1 of the Contingent Asset Guidance (General) for more information) and we do not expect to routinely see significant departures from the standard form.
- (a) Example 1 – Type B(ii). One of the drafting comments we have received in relation to Type B(ii)s is in relation to the definition of “Relevant Contracts” in the standard form. In particular that it captures *“all other agreements in which the Chargor has an interest”* (limb (e)). For information, the definition is drafted widely in this way to cover off special purpose vehicles (SPV), where we’d expect everything the entity owns to be charged. We are aware that there are other circumstances in which a Type B(ii) may be used and we’d expect the scheme’s legal advisers to reflect on the standard form when considering whether variations can be made that are not of a materially detrimental effect on the rights of the trustee. Where the Chargor is not an SPV, we expect legal advisers may consider they are able to conclude that an amendment to the standard form to narrow the definition of Relevant Contracts (limbs (c) and (d) specifically) to Mortgaged Property is not materially detrimental to the rights of the trustees as compared to the standard form, because the wider construction of this provision was initially prepared in contemplation of the SPV scenario so the standard form anticipates amendment where these circumstances do not apply.
- (b) Example 2 – Type B(ii). We are aware some stakeholders have queried the effect of clause 3.4(a) of rider 1 of the standard form in relation to pre-insolvency demands on the covenant to pay – specifically because the covenant to pay (clause 2 of the standard form) is drafted by reference to post-insolvency. We expect legal advisers may consider they are able to conclude that an amendment to the standard form as follows is not materially detrimental to the rights of the trustees as compared to the standard form: *“recovered from any Chargor under this Deed in relation to any Company’s Secured Scheme Liabilities”*.

- (c) Example 3 – Type B(iii). Some stakeholders enquired as to how clauses 2.1 and 8.1 of the standard form interact. Note that the covenant to pay is set up as an independent obligation separate from the enforcement of the charge itself and allows the trustees to call on this covenant irrespective of an Event of Default having occurred under the charge (as specified in clause 7 of the standard form). The covenant to pay is applicable only once an Insolvency Event has occurred. However, if any other Event of Default occurred, the charge itself would be enforceable.