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Lord McKenzie of Luton
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Dear Bill,

I want to thank you for your contribution to the statement I made to the House on 9 October 2017 about the failure of Monarch Airlines. You asked:

"Is it right that when Greybull Capital purchased Monarch Airlines, it was on the basis that Pension Protection Fund take responsibility for the £600 million pension scheme obligation in return for a derisory stake in the business?"

I promised that I would write to you with more information. I have made enquiries with the Pensions Protection Fund (PPF) into the Regulated Apportionment Arrangement (RAA) agreed in October 2014, and have summarised their response in this letter.

The PPF provides a safety net (funded through a levy on pension schemes) for members whose pension scheme is under-funded and can no longer be supported due to employer insolvency. The vast majority of the c.900 defined benefit pension schemes which have transferred to the PPF since 2005 have done so following an uncontrolled insolvency event.

Occasionally an employer facing insolvency, with a pension scheme in deficit, will propose a rescue or restructuring package which will allow the employer to continue trading with the PPF taking on the pension scheme. This is done through an RAA, which needs to be approved by the Pensions Regulator (TPR) with the PPF asked to provide its non-objection.

TPR and the PPF have criteria that they use to assess the acceptability of an RAA. This includes that the sponsoring employer must be inevitably insolvent, and that the return for the PPF must be significantly better than it would otherwise receive through the insolvency of an employer. Such situations are comparatively rare and TPR and the PPF do not agree RAAs lightly, to guard against potential abuse. If the PPF and TPR criteria for RAA's cannot be met, neither party will engage in RAA or restructuring negotiations.

In the case of Monarch, an RAA was approved by TPR with the PPF issuing its non-objection in October 2014. TPR provided clearance for the transaction,

considering that it could not improve upon the sum negotiated by exercising any rights available under its moral hazard powers. At that time, the pension scheme had a deficit on a buy-out basis of approximately £594 million, and the PPF faced a claim of the order of £200 million.

When negotiating RAAs, the TPR and the PPF will assess the acceptability of any proposal primarily based on the amount of cash offered upfront, though they also give consideration to offers of additional payments to be made after the transaction (such as in this case, secured loan notes).

Under the terms of the RAA, Monarch's previous shareholders agreed to pay £30 million in upfront cash to the pension scheme, which was a significant uplift on what was initially offered. This was sufficient to meet the RAA tests regardless of any further potential future return. Additionally, Greybull provided a 10 per cent 'anti-embarrassment' equity stake in the newly restructured business to the PPF, and a £7.5 million secured loan note to the PPF, payable in instalments from 31 October 2017. The instalments were agreed in order to allow the new business the opportunity to turnaround following significant losses incurred prior to the restructuring.

With regards the equity stake, the PPF practice is to initially value any stake it takes in a restructured business at zero. Its purpose is to provide 'anti-embarrassment' protection so that the PPF does not lose out if the restructured company goes on to become very profitable as a result of losing its pension deficit. On that basis, the PPF has not made a loss on its equity stake.

Overall, the RAA was agreed to provide a better outcome for the PPF than would otherwise have resulted from an uncontrolled insolvency. If the RAA had not been reached in 2014, the Company would have inevitably become insolvent then, with all the members entering the PPF. In agreeing to the final deal, the PPF are £30 million better off, even if the loan notes and equity given at the time do not result in further recoveries.

The recent insolvency event has had no impact on member entitlements. Scheme members have been receiving their benefits at PPF levels since the scheme entered PPF assessment in October 2014 following the RAA. The scheme transferred to the PPF in November 2016, meaning the members of the scheme are now paid their compensation directly by the PPF.

I do hope that I have provided the clarity that you sought. I am placing a copy of this letter in the library of both houses.

Kind Regards.

Martin Callanan

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