Proposed amendments to "employer debt" Regulations

The Government is proposing to amend the Regulations as to "employer debts" under s75 Pensions Act 1995. It issued yesterday a consultation paper and draft amending Regulations[1]. The consultation period will run until 1 October 2007. The amending Regulations are likely to come into force in December 2007. They will not be retrospective.

The existing Regulations provide that an employer under a defined benefit scheme is liable to pay a debt if the employer ceases to employ active members under the scheme (while at least one other employer continues to do so), if the employer becomes insolvent, or if the scheme is wound up. The debt is normally calculated by reference to any deficit on a "buy-out" basis, i.e. a basis which reflects the cost of securing benefits by the purchase of annuities.

The Government does not propose to change these basic principles. It does however propose a number of changes which are potentially important where a corporate transaction or restructuring is proposed. The key changes are outlined below.

Triggering events

The Government proposes to make two significant changes as to the circumstances in which an employer debt is triggered:

- Where an employer ceases to employ active members under a multi-employer scheme, there will be a 12-month period of grace, such that a debt will not be triggered if the employer expects to take on a further active member within that period.
- A debt will be triggered where all employers under a multi-employer scheme cease to employ active members at the same point. (Under the existing Regulations, a debt is triggered only if an employer ceases to employ active members at a time when at least one other employer continues to do so.)

Calculation of deficit

Many actuaries have said that the calculation mechanism specified in the existing Regulations is unworkable. The Government proposes to introduce greater flexibility. In particular, it will be possible to calculate the deficit using the estimated cost of buying annuities in cases where a quotation as to the actual cost cannot be obtained.

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1 Available at http://www.dwp.gov.uk/publications/dwp/2007/occ-pen-consult/occ-pen-emp-debt.pdf

Employer’s share of the deficit

The Government proposes new rules for determining an employer’s share of the deficit in a multi-employer scheme:

- Much as under the existing Regulations, the default will be the employer's share of the total buy-out deficit (a “**Liability Share**”), the share being calculated by reference to liabilities attributable to the employer[2]. There will however be greater clarity as to the treatment of transferred-in liabilities, and more flexibility to cater for cases where there are gaps in scheme records.
- It will be possible to put in place an apportionment which allocates a different share of the deficit to an employer (an “**Apportionment Share**”). However, apportionment will be permitted only under one or other of the following arrangements:
  - A “**Scheme Apportionment Arrangement**”. This will require the approval of the trustees. The trustees will have to be satisfied that the remaining employers will be willing and able to fund the scheme in accordance with the Pensions Act 2004 funding regime (or, if the scheme has not yet moved onto the Pensions Act funding regime, that the arrangement will not adversely affect members’ chances of receiving full benefits). The Government hopes that this will prevent apportionments from being used for the purpose of “scheme abandonment”.
  - A “**Regulated Apportionment Arrangement**”. This will be an option only where a scheme is expected to enter the Pension Protection Fund within the following 12 months. The arrangement will require the approval of the Pensions Regulator and the PPF.
- Different rules will apply as to the calculation of an employer's share where an Approved Withdrawal Arrangement or Cessation Agreement is put in place (see below).

Approved Withdrawal Arrangements

Two major changes are proposed as to Approved Withdrawal Arrangements – the arrangements permitted under the existing Regulations whereby the debt due from a withdrawing employer is reduced but a guarantor gives the trustees a long-term guarantee:

- The debt due from the withdrawing employer will be the “**Withdrawal Arrangement Share**”. This will be:
  - the employer's share of the total deficit <u>on the Pensions Act 2004 funding basis</u> (or, if the scheme has not yet moved onto the Pensions Act funding basis, the PPF valuation basis), the share being calculated by reference to liabilities attributable to the employer; or
  - some other amount agreed by the employer and the trustees and approved by the Pensions Regulator.
- The tests which the Pensions Regulator applies when deciding whether to approve an Approved Withdrawal Arrangement will be relaxed. Most importantly, the Regulator will no longer have to be satisfied that the Arrangement makes it "more likely" that the debt will be paid. Instead, the Regulator will have to consider a variety of factors relevant to the proposed Arrangement, including the financial circumstances of the guarantor and how the Arrangement will affect members' chances of receiving full benefits.

2 i.e. using the formula K/L, where K = liabilities attributable to the employer, and L = liabilities attributable to employment with all current employers.

Cessation Agreements

The Government proposes to allow a simpler alternative to an Approved Withdrawal Arrangement – a "**Cessation Agreement**". This will be an arrangement whereby the debt payable by a withdrawing employer is reduced but a guarantor gives the trustees a long-term guarantee. The key proposals are as follows:

- The debt due from the withdrawing employer will be the "**Cessation Agreement Share**". This will be the employer's share of the total deficit on the Pensions Act 2004 funding basis (or, if the scheme has not yet moved onto the Pensions Act funding basis, the PPF valuation basis), the share being calculated by reference to liabilities attributable to the employer.
- The amount to be guaranteed by the guarantor will be calculated much as under the existing Regulations as to Approved Withdrawal Arrangements, on either a fixed or a floating basis.
- The Cessation Agreement will not need to be approved by the Regulator.
- However, the trustees will be able to enter into the Agreement only if they are satisfied that the remaining employers' ability and willingness to fund the scheme is not adversely affected, and that the guarantor's assets are such that the guarantor is "likely to pay" the guaranteed amount.

Tax

At present there is a concern that, in some cases, a payment made by a guarantor under an Approved Withdrawal Arrangement may not be tax-deductible. The Government is going to take this issue up with HM Revenue & Customs.

Comment

Under the existing Regulations, Approved Withdrawal Arrangements are difficult to obtain. We welcome the proposal to relax the tests which the Regulator has to apply when considering a proposed Arrangement.

We also welcome the proposal to introduce a simpler alternative to Approved Withdrawal Arrangements – Cessation Agreements – which, in suitable cases, will mean that employers and trustees need not involve the Regulator at all.

Some of the Government's other proposals are less helpful. It seems that apportionment arrangements may be harder to put in place in future – and existing arrangements may cease to be valid.

Problems may also be caused by the second change described above as to triggering events. If the change is implemented, any future freezing of accrual for members of a multi-employer scheme would seem to trigger a debt for all employers. It seems odd that a debt should be triggered when a multi-employer scheme ceases to have active members, but not when a single-employer scheme does.

We will be lobbying the Government about our concerns. We will send clients a detailed guide to the amending Regulations when they are issued.

If you would like to discuss any of the issues in the Alert, please speak to your regular contact in the Pensions Group or contact:

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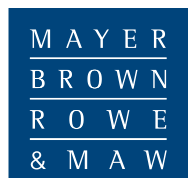

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