alert

sackers extra

DRAFT REGULATIONS – FOREVER IN YOUR DEBT?

1 INTRODUCTION

Companies routinely cease participating in occupational pension schemes following transactions or group re-organisations. Whenever this happens in a multi-employer defined benefit (DB) scheme, the employer debt legislation is always a consideration. But the Employer Debt Regulations[1] have become increasingly unwieldy and difficult to operate in practice.

Draft amending regulations (Amendment Regulations[2]) have now been published which are intended to cure some of the ills, but might they make the condition worse in certain cases? In this Alert we look at what the Amendment Regulations are designed to do, focusing on the position of ongoing multi-employer schemes.

2 KEY POINTS

- The Amendment Regulations introduce five potential ways of dealing with a deficit when an employer exits a multi-employer scheme.
- Although it will still be possible to apportion liability between employers, trustees will need to ensure that certain conditions are met (see section 6).
- Amendments will be made to the operation of Approved Withdrawal Arrangements (AWAs) and the test used by the Pensions Regulator (TPR) for approving them (see section 7).
- “Cessation Agreements” are proposed as a new, simpler, alternative to AWAs (see section 8).

[1] Section 75 of the Pensions Act 1995 as amended by the Occupational Pension Schemes (Employer Debt) Regulations 2005
[2] Link: http://www.dwp.gov.uk/publications/dwp/2007/occ-pen-consult/occ-pen-emp-debt.pdf

SACKER & PARTNERS

Solicitors specialising in pensions law

Sacker & Partners LLP
29 Ludgate Hill London EC4M 7NX
Tel 020 7329 6699 Fax 020 7248 0552
enquiries@sackers.com
www.sackers.com

sackers extra

alert

Continued
DRAFT REGULATIONS – FOREVER IN YOUR DEBT?

3 THE CURRENT LAW IN BRIEF

When an employer leaves an ongoing multi-employer DB scheme and the value of the scheme's assets is less than its liabilities, a share of this deficit generally becomes a debt due from the employer to the scheme trustees. This is the statutory default position but, under the Employer Debt Regulations, scheme rules can include a mechanism for apportioning a deficit (which would otherwise hit an exiting employer) between the remaining participating employers.

If a debt is payable, it is calculated on the buy-out basis (namely, the cost of securing members' benefits with an insurance company). The exiting employer is only liable to pay its share of the overall debt (the other participating employers pay their share of the scheme deficit through ongoing contributions). The debt which arises is payable immediately. The only exception is if TPR and the trustees agree to an AWA (see section 7 below).

4 TRIGGERING A DEBT

A debt calculation is currently triggered when an employer "ceases to be an employer employing persons in the description of employment to which the scheme relates" leaving behind at least one other employer (this is known as an "employment-cessation event"). The Amendment Regulations will make it clear that:

- A debt will be triggered where an employer ceases to have active scheme members (and not merely when it no longer has employees).
- A "period of grace" of up to a year will be introduced. No debt will be triggered if an employer stops employing active members expecting to take on someone else within that time frame and does so[3].

Currently, if all employers withdraw from a scheme simultaneously (for example, by closing the scheme to future accrual), no debt is triggered. The Amendment

[3] This was suggested by the Deregulatory Review - see our Sackers Extra Alert: "Deregulatory Review - the Simple Life?" dated 27 July 2007

SACKER & PARTNERS
Solicitors specialising in pensions law
Sacker & Partners LLP
29 Ludgate Hill London EC4M 7NX
Tel 020 7329 6699 Fax 020 7248 0552
enquiries@sackers.com
www.sackers.com

Continued
DRAFT REGULATIONS – FOREVER IN YOUR DEBT?

Regulations will close this perceived "loophole" so that the legislation will apply whenever an employer stops employing active members. (This could cause issues in a number of circumstances, not least where the scheme does not begin to wind-up immediately afterwards.)

5 THE NEW DEFAULT

As now, there will be a statutory default mechanism for assessing a debt which will be called the "liability share". It will be relevant if there is no apportionment arrangement, AWA or cessation agreement put in place (see generally below).

Essentially, the exiting employer will be responsible for any liabilities attributable to scheme members which arose during pensionable service with that employer. This will include transfer payments made into the scheme in respect of those members.

However, where members move around different employers within a group, it can often be difficult to pinpoint which employer might be liable for any deficit. (This is a prime reason why the apportionment route is commonly used under the existing law.) In these circumstances, the Amendment Regulations will place the members' last employer squarely in the firing line, by attributing all of the liabilities outlined above to it.

6 NEW APPORTIONMENT PROVISIONS

The consultation paper identifies the policy intention underlying the new provisions as being to "frustrate any attempts to use apportionment as a method to abandon a scheme, whilst retaining its flexibility for employers in corporate transactions and restructurings"[4].

The Amendment Regulations will introduce two new arrangements for apportioning a deficit on an employment-cessation event – the Scheme Apportionment Arrangement

---

[4] See our Sackers Extra Alert: "Scheme Abandonment – discussion paper and guidance issued" dated 15 December 2006

SACKER & PARTNERS
Solicitors specialising in pensions law
Sacker & Partners LLP
29 Ludgate Hill London EC4M 7NX
Tel 020 7329 6699 Fax 020 7248 0552
enquiries@sackers.com
www.sackers.com

sackers extra

Continued
DRAFT REGULATIONS – FOREVER IN YOUR DEBT?

(SAA) and the Regulated Apportionment Arrangement (RAA). A shortfall apportioned in accordance with one of these arrangements will be called an "apportionment share".

Scheme Apportionment Arrangement

Trustees must approve any SAA. In order to do so, they must be satisfied that the remaining employers will be "able and willing" to:

- fund the scheme so that it will have "sufficient and appropriate assets to cover its technical provisions"[5] after the employer's departure; and
- make the payments under the schedule of contributions and any recovery plan.

This test may not apply though where the "apportionment share" results in a higher sum being payable than would have arisen under the default "liability share" method (see section 5).

Regulated Apportionment Arrangement

Requiring approval by both TPR and the Board of the Pension Protection Fund (PPF), an RAA is only intended to be used where there is a reasonable likelihood of the scheme entering into a PPF assessment period within the next 12 months (an evaluation to be made by the trustees).

7 APPROVED WITHDRAWAL ARRANGEMENTS

Under the Employer Debt Regulations, if an AWA is put in place an employer only has to meet "Amount A" (broadly, the MFR debt plus expenses) when it withdraws from a scheme. Payment of "Amount B" (essentially, the remaining amount up to the full buy-out debt), is postponed but is guaranteed either by the employer itself or by a third party, the "guarantor".

[5] This wording tracks the statutory funding objective (or scheme specific funding requirement) in the Pensions Act 2004

SACKER & PARTNERS
Solicitors specialising in pensions law
Sacker & Partners LLP
29 Ludgate Hill London EC4M 7NX
Tel 020 7329 6699 Fax 020 7248 0552
enquiries@sackers.com
www.sackers.com

Continued

DRAFT REGULATIONS – FOREVER IN YOUR DEBT?

AWAs will be retained going forward and can be entered into in advance of the employment-cessation event. However, one of the big stumbling blocks under the existing legislation is that TPR can only approve an AWA if it is satisfied that the guarantor's financial health is such that the debt is "more likely to be met" if the arrangement is approved. Although the financial health of the guarantor will still be a relevant consideration for TPR when deciding whether to give its approval, the Amendment Regulations move away from this restrictive test.

There are a number of additional amendments made to AWAs, including introducing a new concept for calculating the sum to be paid by the exiting employer, the "withdrawal arrangement share". Broadly, this comprises either Amount A (updated to reflect the scheme specific funding target[6]) or an amount agreed by the trustees with the employer (which may be lower than this).

8 CESSATION AGREEMENTS

As well as including amendments to make the AWA process easier to operate, the Amendment Regulations propose a simpler alternative – a Cessation Agreement (CA). Key features include:

- CAs will be agreed by the trustees, employer and guarantor(s) only (TPR is not involved).
- In common with an AWA, the CA debt is split into two amounts. The first is the amount of the employer's debt to be paid under the CA, the "cessation agreement share" (calculated in the same way as Amount A under an AWA but with no flexibility to pay less). "Amount B" is then the difference between that amount and the debt arising if the default "liability share" calculation were used instead. The guarantor(s) will be liable to pay Amount B.
- Trustees must be satisfied that "the remaining employers' ability and willingness to fund the scheme is not adversely affected by the payment of the cessation agreement share and the existence of a guarantee for

[6] If the scheme has not yet done an "SFO" valuation, this will be based on its PPF valuation

SACKER & PARTNERS

Solicitors specialising in pensions law

Sacker & Partners LLP
29 Ludgate Hill London EC4M 7NX
Tel 020 7329 6699 Fax 020 7248 0552
enquiries@sackers.com
www.sackers.com

sackers extra

alert

Continued
DRAFT REGULATIONS – FOREVER IN YOUR DEBT?

[Amount B], rather than the payment of the liability share by the cessation employer".

This test is intended to be "less prescriptive" than for an SAA because the guarantor(s) explicitly stand behind the debt (as opposed to simply apportioning the deficit between remaining employers).

9 MISCELLANEOUS

- Largely the preserve of the scheme actuary until now, trustees will be involved in calculating the scheme's assets and liabilities.
- In future, actuaries may be able to estimate the cost of buying-out benefits when calculating scheme liabilities (where it is difficult to obtain quotes for this purpose).
- Defined contribution (DC) benefits were never intended to fall within the Employer Debt Regulations (although this can occur in a hybrid scheme which is not segregated). Changes will exclude DC benefits from the regulations.
- Amendments will ensure that CAs, RAAs and SAAs are not treated as compromise agreements and as such result in schemes being barred from future entry to the PPF.
- Although a parent company could give a guarantee under an AWA, a payment made under that arrangement might not be tax deductible. The DWP has asked HM Revenue & Customs to look into this issue.
- The Regulations are slated to come into force in December 2007. However, they are not retrospective, so should only affect employment-cessation events occurring on or after that date.

SACKER & PARTNERS

Solicitors specialising in pensions law

Sacker & Partners LLP
29 Ludgate Hill London EC4M 7NX
Tel 020 7329 6699 Fax 020 7248 0552
enquiries@sackers.com
www.sackers.com

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual solicitor with whom you deal. **© Sacker & Partners LLP September 2007**