

Pensions Bulletin

Fact Sheet 3

Summer 2010 Issue 8

Employer Debt

1 Employer debt on withdrawal regulations

- 1.1 Regulations applicable to employers ceasing to participate in multi-employer defined benefit pension schemes took effect in September 2005.
- 1.2 Clients of The Pensions Trust who participate in the Growth Plan (whether for their employees' pension provision or for their Additional Voluntary Contributions) will be aware of the effect of these Regulations as several mailings have been issued since Autumn 2005 and employer forums have been held every year. Mailings have also been issued to employers participating in the Trust's other multi-employer schemes.
- 1.3 In summary, if an employer ceases to participate in such a scheme (whether by consciously withdrawing, or unintentionally as a result of corporate restructuring such as incorporation, merging or being taken over) then it becomes liable for a debt to the scheme, calculated on the very expensive 'buy-out basis'.
- 1.4 Changes to the Regulations took effect from 6 April 2008 under The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008 (SI 2008/731). Key changes are detailed in sections 2 to 7 below.

2 Definition of ceasing to participate in a scheme

- 2.1 Under the terms of the previous regulations an employer was deemed to have ceased to participate in a multi-employer scheme if it did not have any active members and did not have any employees eligible to join the scheme. An employer could therefore continue to participate in the scheme indefinitely whilst it waited to enrol a new member.
- 2.2 Under the new regulations an employer will be deemed to have ceased to participate on the date that it ceases to employ at least one person that is an active member of a scheme, when at least one other employer continues to employ active members. However, the Regulations do introduce a 'period of grace' which is designed to prevent employers with a small number of members from inadvertently triggering a debt when the last active member leaves.
- 2.3 If an employer notifies the Trustee that he intends to employ at least one person who will be an active member of the scheme, it will be treated for a twelve month period as if it employed a person who is an active member of the scheme. If at the end of the twelve month period the employer still has no active members a cessation event will be deemed to have occurred as at the date that the employer's last active member left.
- 2.4 **In order to take advantage of the 'period of grace' provisions, a participating employer must give notice to The Pensions Trust either before the last active member leaves the scheme or, at the latest, within one month of the last active member leaving the scheme.**



2.5 Giving notice to The Pensions Trust can be done by completing the standard notice form that is available on our website at www.thepensionstrust.org.uk, or by writing to The Pensions Trust.

2.6 **If the necessary notice is not received within one month of the last active member leaving, an employer will not be able to take advantage of the 'period of grace' provisions and will be immediately liable for a withdrawal debt. The law allows no leeway in this timing.**

3 Options available for dealing with cessation events

3.1 As an alternative to calculating the debt as the employer's share of the deficit on the full buy-out basis, there are now four options open to the Trustee. These are:

- Scheme Apportionment Arrangements.
- Regulated Apportionment Arrangements.
- Withdrawal Arrangements.
- Approved Withdrawal Arrangements.

4 Scheme Apportionment Arrangements

4.1 Under the rules the Trustee has the power to apportion a withdrawing employer's share of the deficit to one or more of the other participating employers. The Regulations continue to permit apportionment but introduce a new funding test. This funding test has been introduced following concerns from The Pensions Regulator that the apportionment rule was being used by employers to facilitate the abandonment of pension liabilities. The new funding test is broadly in-line with the principles that the Trustee of The Pensions Trust has always followed before agreeing to an apportionment.

4.2 The Scheme Apportionment Arrangement will be an agreement to which the Trustee and the continuing employer are parties.

4.3 The Regulations say that an Apportionment Arrangement can be entered into 'before, on or after the applicable time'. This differs from the previous position which required apportionment to be agreed before the cessation event. It would be good practice though to put the Scheme Apportionment Arrangement in place before the cessation event. The new rules do, however, offer greater flexibility.

4.4 Before entering into a Scheme Apportionment Arrangement, trustees will have to:

- agree the proportion which will be the withdrawing employer's share of the deficit (a £1 apportionment is acceptable here); and
- be satisfied that at the date of the agreement the remaining employers will be able to fund the scheme up to the level of its technical provisions and continue to make payments in-line with the schedule of contributions and the recovery plan (the funding test).

4.5 In its explanatory memorandum the Department for Work and Pensions (DWP) says that its intention is ***'to prevent a debt being apportioned to weak employers or shell employers, whilst allowing maximum scope for apportionment in corporate restructurings and reorganisations'***.

4.6 The Pensions Trust has effectively already been applying the funding test as apportionments have only been agreed in cases of incorporation, transfers of engagements or mergers, none of which would usually reduce the remaining employers' ability to fund the scheme up to the level of its technical provisions.

5 Regulated Apportionment Arrangements

5.1 A Regulated Apportionment Arrangement is a new provision which will require The Pensions Regulator's involvement as there are some limited circumstances when it may be in the best interests of the scheme and/or members and the Pensions Protection Fund (PPF) for apportionment to take place in situations where the Trustee could not approve an Apportionment Arrangement.

5.2 A Regulated Apportionment Arrangement can only take place where a scheme:

- is in a PPF assessment period; or
- where a PPF assessment period is likely to commence in the near future; and
- the Board of the PPF agree to the arrangement (usually because they think the apportionment will result in a higher level of funding for the scheme than if an employer becomes insolvent).

5.3 Because of the 'last man standing' principle that applies to The Pensions Trust's multi-employer schemes it is unlikely that any would ever enter the PPF. A Regulated Apportionment Arrangement is therefore unlikely to ever be the appropriate solution for an employer withdrawing from the Trust.

6 Withdrawal Arrangements

6.1 Under the new Regulations a Withdrawal Arrangement is an agreement between the Trustee, the withdrawing employer and a guarantor that does not require the approval of The Pensions Regulator.

6.2 A Withdrawal Arrangement would require the withdrawing employer to pay an initial amount equal to its share of the deficit on the ongoing technical provisions basis (i.e. the scheme specific valuation basis). Because most schemes have a deficit on the technical provisions basis, an employer entering into a Withdrawal Arrangement will have to make an initial payment, albeit less than the full buy-out debt. The guarantor then agrees to pay the balance up to full buy-out either when the scheme winds up or at a point when there are no other employers participating in the scheme.

6.3 A Withdrawal Arrangement may be appropriate in circumstances when an employer is withdrawing altogether, rather than merging or transferring to another employer. However, it will only be suitable if the withdrawing employer can pay its share of the deficit on the technical provisions basis and the guarantor is robust.

7 Approved Withdrawal Arrangements

7.1 If an employer is unable to pay its share of the deficit on the technical provisions basis and apportionment is not possible then an Approved Withdrawal Arrangement approved by The Pensions Regulator remains an option.

7.2 If the initial amount the employer can (or will) pay is less than its share of the deficit on the technical provisions basis, the Regulator must approve the Withdrawal Arrangement. Regulator approval is not required in circumstances where the employer has paid an initial debt equal or greater than its share of the deficit on the technical provisions basis.

7.3 Previously, The Pensions Regulator could only approve a Withdrawal Arrangement if the 'more likely' test could be met. The Regulations contain a new test which now requires the Regulator to consider the following matters when approving a Withdrawal Arrangement:

- the potential effect of the employment-cessation event on the scheme's level of technical provisions;
- the financial circumstances of the proposed guarantor;

- the amount of the withdrawing employer's share of the buy-out deficit;
- the amount the withdrawing employer proposes to pay as its initial debt; and
- the effect of the proposed arrangement on the security of members' benefits under the scheme.

7.4 This new test should make it much easier for the Regulator to approve Withdrawal Arrangements in cases where their approval is required, although it is not yet known how stringent the Regulator will be.

8 Changes from April 2010

8.1 The Pensions Trust recognises that many of its participating employers have encountered difficulties in restructuring their operations as a direct result of the employer debt regime. We have seen several instances of employers wishing to merge in order to benefit from economies of scale, yet the employer debt situation has stifled such situations.

8.2 The DWP conducted a nine-week consultation (which closed on 19 November 2009) proposing two easements to the employer debt regulations, though both of these would only apply in fairly limited circumstances. The DWP issued its response to the consultation on 15 March 2010 with new Regulations being implemented on 6 April 2010.

8.3 The new Regulations mean that in certain (limited) circumstances restructurings that would have until now resulted in a cessation event will no longer do so.

8.4 These circumstances fall under two headings, the 'general easement' and the 'de minimis easement', which are generally being referred to as the 'restructuring easements'.

8.5 The restructuring easements only cover simple restructurings, where there is one exiting employer and one receiving employer. The two employers must either be associated, or the receiving employer must, in effect, be the exiting employer in a new legal form. Therefore the Regulations only seem to be of benefit to The Pensions Trust's employers in cases where two employers in the same group merge or where an unincorporated charity transfers its employees, assets and liabilities to a new corporate entity.

8.6 For the avoidance of doubt, transfers of engagements between non-associated housing associations will still trigger a cessation event. The options available in such cases continue to be; a Scheme Apportionment Arrangement, a Scheme Withdrawal Arrangement or full payment of the debt on withdrawal.

8.7 The restructuring easements require the receiving employer to take over all of the withdrawing employer's assets, liabilities and employees. This must happen within 18 weeks of the Trustee's decision that the requirements of one of the restructuring easements have been met. The Trustee may extend this period by up to another 18 weeks.

8.8 There is a very specific procedure that must be followed in order for the Trustee to agree that the requirements of one of the restructuring easements have been met and therefore a cessation event has not been triggered. Whilst there are provisions in the Regulations to ensure that only a material departure from the procedure will give rise to a cessation event, this has not been tested so there is a risk of inadvertently triggering a debt on withdrawal if the procedure is not followed precisely.

8.9 The de minimis easement could not be applied to any of the Trust's multi-employer schemes at present because all have a deficit on the PPF valuation basis.

8.10 It may be possible to make use of the general easement in cases where two employers within the same group merge or a charity incorporates.



8.11 However, the process is very similar, if not more complex and prescriptive, than the current apportionment process that we have in place for dealing with employer restructurings. The Trust will therefore continue with the existing apportionment procedures.

Any further developments on the employer debt on withdrawal regulations will be reported in future issues of the Pensions Bulletin. Previous information on this topic was included in Issue 7 of Update magazine (pages 16 & 17) and Issues 1, 3, 4 and 5 of the Pensions Bulletin.

While every effort has been made to ensure the accuracy of the information contained in this Fact Sheet, it should not be treated or relied upon as a statement of law. Readers should contact their regular Account Manager at The Pensions Trust in relation to their own circumstances and/or refer to the original source material as appropriate.