

Pensions Bulletin

Fact Sheet 5

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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, he will be treated for a twelve month period as if he 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, 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 Arrangement

- 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 Future developments

- 8.1 The regulations do not contain any form of exemptions for the transfer of employees between employers that participate in the same scheme. Therefore, incorporations, transfer of engagements and mergers will still all trigger employer cessation events and will still need to be considered by the Trustee on a case by case basis.
- 8.2 However, the DWP announced a four-week consultation in late 2008 on changes to the employer debt on withdrawal regulations. As part of this, the DWP said that, where there was a group reconstruction of employers in a multi-employer pension scheme, it was considering whether the debt should not be triggered where the backing of original sponsoring employers was strong, and if, following the reconstruction, the resulting employers maintained this strength.
- 8.3 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.
- 8.4 The DWP’s consultation was therefore welcomed by the Trust. However, any firm proposals resulting from this consultation will be subject to full public consultation in due course. It is anticipated that any changes will be introduced later in 2009.

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 and 4 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.