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Further proposed changes to winding-up legislation

1 BACKGROUND

In an attempt to protect further the position of members whose defined benefit scheme is winding-up, the Government has published proposals to change the winding-up legislation. The main changes focus on raising the level of debt triggered on scheme wind-up to full buy-out in all cases. However, there are also new disclosure requirements for trustees where members seek a transfer payment from a scheme winding-up with a solvent employer.

Comments are invited on the draft Regulations, the Occupational Pension Schemes (Winding Up, Deficiency on Winding Up and Transfer Values) (Amendment) Regulations 2004, by 15 October 2004. We summarise below the main implications of the draft Regulations.

2 FULL BUY-OUT ON INSOLVENT WINDING-UP

In short, the draft Regulations will impose a full buy-out debt in two new circumstances:

- where a scheme is in wind-up and the sponsoring employer (or last remaining employer) is insolvent; and
- in a multi-employer scheme where a participating employer becomes insolvent.

This is in contrast to the current level of debt triggered in these circumstances, which is based on the minimum funding requirement ("MFR").

3 WHY THE CHANGE?

Since 11 June 2003 (by Regulations which came into force on 15 March 2004), where a scheme winds up with a solvent employer, a full buy-out debt becomes due. The Government's amendments will therefore create a level playing field on winding-up, by triggering a full buy-out debt regardless of whether the sponsoring (or last remaining) employer is solvent or insolvent.

One of the main drivers behind the draft Regulations seems to be to close a potential loophole in the existing legislation. Currently, an employer is "insolvent" if it has entered into a "members' voluntary liquidation", regardless of whether or not

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it has sufficient assets to meet the full buy-out debt. The Government is seemingly keen to prevent employers using this route to circumvent the purpose of the legislation.

4 WHAT IMPACT WILL THE REGULATIONS HAVE?

The new legislation will increase the size of a debt owed by an insolvent employer to a pension scheme, but it will not increase its priority over other creditors. The full buy-out debt will still rank alongside other unsecured creditors in the employer's insolvency.

Therefore, the Government recognises that the introduction of the draft Regulations will probably not have a major impact on the majority of scheme wind-ups and that, in some situations, it may result in "only a fraction of the debt, perhaps a few pence in every pound, [being] collected".

5 TRANSFER PAYMENTS DURING WINDING-UP

Quite separately, the draft Regulations also introduce new disclosure requirements for trustees where members seek a transfer payment from a scheme winding-up with a solvent employer. When issuing a statement of entitlement to a guaranteed cash equivalent, trustees must advise a member to seek independent financial before taking a transfer value.

This change takes account of the fact that a decision to transfer in these circumstances should be taken "with great care", as the member may well do better financially by waiting to the end of the winding-up process rather than jumping ship early.

6 CONCLUSION

The Consultation Paper anticipates the draft Regulations coming into force early in 2005 (although the wording of the draft Regulations themselves seems to suggest that this could be 2004). This will leave just one key situation in which an MFR debt is still generally payable, where an employer leaves a multi-employer on-going scheme. However, the Government has already announced plans to raise the bar here to full buy-out (unless financial support is put in place) and has reserved powers in the Pensions Bill to facilitate this.

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