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sackers extra

WHOSE DEBT IS IT ANYWAY?

1 INTRODUCTION

If a company exits an underfunded multi-employer defined benefit (DB) scheme (the cessation employer), its share of the deficit becomes a debt due to the trustees (the employer debt). Since September 2005, the employer debt has been calculated on the buy-out basis. Coupled with rising deficits in DB schemes, this increase in the level of potential debt has meant that the ability to shift responsibility for an employer debt (for instance, on a group re-organisation or sale) is critical to the smooth running of schemes.

Increasingly, the Occupational Pension Schemes (Employer Debt) Regulations 2005 have been seen as inflexible and out of step with these new pressures. Draft amendments were therefore published for consultation in August 2007[1]. Finally, after prolonged negotiation behind the scenes, the Amendment Regulations[2] were laid on 14 March and come into force on 6 April 2008.

2 KEY POINTS

- Changes are made to the statutory trigger for calculating an employer debt on exit (the "employment-cessation event") (section 3)
- The possible use of existing scheme apportionment rules will be subject to complicated transitional arrangements going forward (section 4)
- The availability of scheme apportionment arrangements (SAAs) will hinge on a new "funding test" (section 5)
- There will be two categories of withdrawal arrangement – those sanctioned by the trustees and those "approved" by the Regulator (section 6)

[1] In this Alert we focus on the changes made, for more details of the proposals see Sackers Extra Alert "Draft Regulations – Forever in Your Debt?" dated 10 August 2007
[2] The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008

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3 TRIGGERING A DEBT

A debt calculation is currently triggered when an employer "ceases to be an employer employing persons in the description to which the scheme relates", leaving behind at least one other employer in the scheme (this is known as the "employment-cessation event").

This key definition has been revised after a false start. As originally drafted, the definition would have applied when a scheme was closed to future accrual (by all employers withdrawing simultaneously) as well as when a company left the group, for instance, as a result of a transaction. Following representations made during consultation[3], the Department for Work and Pensions announced[4] it was merely their intention to tackle the problem of scheme abandonment, not to create a debt where the employer remains involved in the scheme (because it is continuing to fund past service liabilities).

New definition

The revised definition now applies where an employer has "ceased to employ at least one person who is an active member" where another employer (who is not an employer who employs only members with defined contribution benefits) continues to employ at least one active member. Although the drafting is slightly ambiguous, we believe the legislative intention is to ensure that the new definition only bites when an employer has ceased to employ *all* active members.

With this interpretation in mind, closing a scheme to future accrual will therefore not trigger a debt calculation, as all the employers withdraw at the same time. However, if one employer in a multi-employer scheme withdrew pension benefits, the debt calculation would be triggered.

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[3] Including by us - see our Response to Consultation dated 27 September 2007 – available from the client area of our website

[4] See our Sackers Extra 7days dated 1 October 2007, for further details

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Period of grace

A period of grace of up to a year has been built into the definition of "employment-cessation event" so that no debt calculation will be triggered if an employer stops employing active members but expects to take on someone else within that time frame. If he does not in fact do so, a debt calculation is triggered at the original "employment-cessation event" (as if the period of grace had not applied).

Transitional arrangements

Transitional provisions are designed to provide leeway to cessation employers who, by reason of an ambiguity in the definition in the Old Regulations[5], were not fixed with a debt when they ceased to employ active members but continued to employ deferred members. With no end-date built into the transitional provisions, the debt will not be triggered until it would have been under the Old Regulations.

But if the employer recommences employing active members it will bring itself within the new employer debt regime.

4 EXISTING APPORTIONMENT RULES

Under the Old Regulations, it was possible for an apportionment rule to be inserted into scheme rules (which would allow any deficit to be assigned between employers, thus overturning the use of the statutory default position for calculating employer debts).

After 6 April 2008, this route will not be available, except by use of a Scheme Apportionment Arrangement (SAA) – see section 5.

[5] i.e. the Occupational Pension Scheme (Employer Debt) Regulations 2005 in force before 6 April 2008

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Transitional Arrangements

Following concern expressed by the pensions industry during consultation, transitional provisions operate to allow the Old Regulations to continue to apply for up to 12 months (enabling the use of an existing scheme apportionment rule) in certain limited circumstances. The transitional arrangements protect a scheme's apportionment rule if:

- "an agreement is entered into before, on or within 12 months after [6 April 2008] on the basis that a scheme's apportionment rule will apply after [6 April 2008] in relation to a specific employment-cessation event" (or on wind-up);
- the scheme's apportionment rule was in force before the Amendment Regulations were laid before Parliament (i.e.14 March 2008); and
- the transaction to which the agreement related was considered by the "managing body" (for example, the board of directors of a company) of at least one of the parties to the agreement before 14 March 2008.

5 SCHEME APPORTIONMENT ARRANGEMENTS

Unless other arrangements are put in place, the cessation employer will be responsible for any liabilities attributable to scheme members which arose during pensionable service with that employer[6] (now called the "liability share"). The liability share is calculated on the buy-out basis.

An SAA is the new method by which a deficit can be apportioned between employers. But before the trustees enter into an SAA the scheme must meet the "funding test" unless the amount payable under the SAA is higher than the liability share.

[6] Including rights resulting from a transfer payment

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The draft Amendment Regulations focused on the strength of employer covenant but in the final version the "funding test"[7] is more prescriptive:

(a) the trustees must be reasonably satisfied that the "remaining employers will be reasonably likely to be able to fund the scheme so that … it will have sufficient appropriate assets to cover its technical provisions" (i.e. to the scheme funding level) taking into account changes made as a result of the arrangements; and

(b) the effect of the arrangement will not "adversely affect the security of members' benefits as a result of any…material change in legal, demographic or economic circumstances" that would justify a change to the method or assumptions used to set the scheme's technical provisions (or necessitate any "material revision" to the recovery plan).

Regulated Apportionment Arrangements (RAAs)

RAAs, which require the involvement of both the Regulator and the Pension Protection Fund (PPF), survive the consultation but will only be available where a scheme is due to enter the PPF within 12 months.

6 WITHDRAWAL ARRANGEMENTS

In the final version of the Amendment Regulations "cessation agreements" (as they were called in the draft Amendment Regulations) have been incorporated into the more general category of withdrawal arrangements. Trustee-sanctioned withdrawal arrangements (TWAs) should be distinguished from Approved Withdrawal Arrangements (AWAs) which still need to be approved by the Regulator.

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[7] The test given here is that which applies if a scheme has completed a valuation under the Pensions Act 2004 (if not completed, a different test applies)

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In both types of withdrawal arrangement the debt due from the cessation employer is split into two amounts – "Amount A" and "Amount B". Amount A is the debt calculated on the scheme funding basis. If a TWA is put in place an amount equal to, or greater than, Amount A must be paid by the cessation employer. To demarcate roles, the Regulator can now only approve an AWA if the cessation employer proposes to pay an amount less than Amount A. In both cases, payment of the balance (Amount B[8]) is postponed but is guaranteed either by the employer itself or by a third party, "the guarantor".

TWAs

The trustees will not be able to agree a TWA unless both the part (a) of the funding test is met (see section 5 for further details) and they are satisfied that at the date of the agreement the guarantors have sufficient financial resources to be "likely to be able to pay Amount B".

AWAs

These have been retained but flexibility added. A common complaint in the past has been that the Regulator could only approve an AWA if, after the arrangement was entered into, the debt was "more likely to be met".

Although again part (a) of the funding test must now also be met, the original test has been watered down so that the Regulator can approve the arrangement if it "is satisfied that it is reasonable to do so having regard to such matters as [it] considers relevant". The Amendment Regulations include a list of factors for the Regulator to consider, including: the financial circumstances of the guarantors, the amount of the cessation employer's liability share and the effect of the arrangement on the security of members' benefits.

[8] Amount B is broadly the liability share either at the employment-cessation event, with a set off for the amount paid under the withdrawal arrangement, or calculated at the date the guarantee is called in (with no adjustment)

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