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EXITING ONGOING SCHEMES - THE EMPLOYER DEBT RISES

1 INTRODUCTION

The Occupational Pension Schemes (Employer Debt etc.) (Amendment) Regulations 2005 were finally published on 18 August and come into force on 2 September 2005.

2 KEY POINTS

- If an employer ceases to have employees who are active members of a defined benefit pension scheme on or after 2 September 2005, the employer debt will be calculated on the full buy-out basis rather than MFR.

- The departing employer will not have to pay the full buy-out debt if the Pensions Regulator and the trustees agree to a "withdrawal arrangement". Broadly, under a withdrawal arrangement, a "guarantor" will take responsibility for the difference between the MFR debt and the full buy-out debt.

A copy of the Regulations can be found at:
http://www.opsi.gov.uk/si/si2005/20052224.htm

3 IN BRIEF

Under section 75 of the Pensions Act 1995 a debt is triggered if the assets are less than the liabilities of the scheme when:

- the scheme winds-up;

- an insolvency event happens in relation to one of the participating employers; or

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- one of the employers ("the cessation employer") ceases to participate in the scheme leaving behind at least one other employer.

The debt arising on the first two events has already been increased from MFR to the full buy-out debt. The long-awaited new Regulations increase the debt which arises in the last situation.

4 CALCULATING THE "CESSATION DEBT"

There is no change to the general rule that the cessation employer is only liable to pay its proportion of the overall debt. This is called the "cessation debt". (The other participating employers pay their share of the scheme deficit through ongoing contributions).

The cessation employer is also responsible for "cessation expenses". These could be significant as they could include the cost of an actuarial valuation commissioned to calculate the cessation debt.

5 "WITHDRAWAL ARRANGEMENTS"

Under the new regulations, the cessation employer will have to pay the full buy-out debt, plus cessation expenses, unless the Pensions Regulator approves a "withdrawal arrangement". We consider below the circumstances in which the Pension Regulator will approve a withdrawal arrangement and how such an arrangement would work.

- The Regulator will not approve a withdrawal arrangement unless it is satisfied that the guarantor's financial health will mean that the cessation employer's debt is more likely to be met if the arrangement is approved.

- A guarantor will have, in effect, to comply with the notifiable events regime[1] as though it were an employer in relation to the scheme.

[1] See Sackers Extra Alert "Protecting the PPF – Reporting Notifiable Events" dated 13 April 2005

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- There can be more than one guarantor – but each will be jointly and severally liable for the debt.

- A withdrawal arrangement must also be agreed with the trustees.

6 HOW WILL A WITHDRAWAL ARRANGEMENT WORK?

If the Regulator approves a withdrawal arrangement, the cessation employer only has to meet "Amount A" (explained below) when it withdraws from the scheme. Payment of "Amount B" (again explained below) is postponed but is guaranteed either by the cessation employer or a third party, the "guarantor".

- Amount A is the MFR debt[2] plus the cessation expenses but adjusted by the "transferred liabilities deduction" (if this applies). This is an adjustment to take account of any bulk transfer of liabilities to another scheme, provided the transfer meets certain conditions.

- Amount B can be either:
  - the full buy-out debt plus the cessation expenses; or
  - the full buy-out debt less the MFR debt and the "transferred liabilities deduction".

7 DOCUMENTING THE WITHDRAWAL ARRANGEMENTS

In order for a withdrawal arrangement to be approved by the Regulator it must (amongst other things):

- be an agreement with the trustees that is subject to English law;

[2] It is likely that the MFR debt will replaced by the "scheme funding basis" debt once the scheme has had its first actuarial valuation under the new regime. But for ease of reference we have used the term "MFR debt" in this Alert.

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- provide for the cessation employer to pay "Amount A" at a specified time;
- provide for the guarantor to pay Amount B if certain events happen (see section 8 below);
- provide that the agreement continues in force until the scheme winds up or the Regulator decides the withdrawal arrangement is no longer required or the withdrawal arrangement is replaced with a new approved arrangement; and
- provide for the cessation employer and the guarantor to meet all costs associated with the withdrawal arrangement.

8 WHEN WILL THE GUARANTOR HAVE TO PAY AMOUNT B?

The guarantor will have to pay Amount B to the trustees of the scheme (or the Board of the Pension Protection Fund, if it has assumed responsibility for the scheme) if:

- the scheme begins to wind-up;
- an event occurs such that there is no longer any employer in relation to the scheme (without the scheme actually winding-up); or
- the Regulator considers it reasonable to require the debt to be paid, taking into account:
  - the financial circumstances of the guarantor
  - the guarantor's compliance with the terms of the withdrawal arrangement
  - the guarantor's compliance with the notifiable events regime.

It is unclear from the Regulations what the guarantor would have to pay if, in the interim, there has ceased to be a deficit in the scheme.

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9 CONCLUSIONS

Companies routinely cease to participate in schemes following transactions or group re-organisations. Whilst such exits were often ignored in the past, the change of the default position for calculation of the debt from MFR to full buy-out means that specific arrangements will need to be entered into in future.

Indeed, in order to save time negotiating separate arrangements, some schemes might like to consider asking the Regulator to use its powers to approve "standard" withdrawal arrangements in advance of any exits actually occurring. Another option would be to use the existing statutory power to set the cessation debt under the scheme rules.

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