

# alert

## ONCE MORE UNTO THE EMPLOYER DEBT BREACH

### 1 INTRODUCTION

In response to industry concerns that the employer debt legislation<sup>1</sup> unnecessarily inhibits corporate activity (a concern also voiced by the Deregulatory Review<sup>2</sup>), the Department for Work and Pensions (DWP) has published a consultation setting out proposed easements when businesses restructure.<sup>3</sup> If implemented, the consultation and accompanying draft regulations will result in further changes to the Regulations, which were the subject of substantial amendments as recently as April 2008.

The proposals aim to reduce the circumstances in which a corporate restructuring (namely, an internal reorganisation) will trigger a debt in a defined benefit (DB) pension scheme. However, they will only apply in limited circumstances.

The consultation (to which Sackers will be responding) closes on 19 November 2009.

### 2 KEY POINTS

- On a corporate restructuring, no debt to a DB scheme will be triggered provided certain restrictive conditions are met.
- Two new arrangements are proposed, the “general easement” (see section 4) and the “de minimis easement” (see section 5).
- The easements only relate to “one-to-one transactions” between two employers (e.g. where employees of one group company are transferred to a different group company), both of whom must be participating in the same multi-employer DB scheme.
- Certain technical changes to the Regulations are also put forward (see section 6).

<sup>1</sup> Occupational Pension Schemes (Employer Debt) Regulations 2005 (the “Regulations”)

<sup>2</sup> Deregulatory Review of Private Pensions: Chris Lewin and Ed Sweeney - July 2007

<sup>3</sup> <http://www.dwp.gov.uk/docs/consultation-employer-debt-draft-regs.pdf>

# alert

Continued

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### 3 BACKGROUND

Generally, if a company exits an underfunded multi-employer DB scheme, its share of the deficit (if any) becomes a debt due to the trustees (the employer debt). A debt calculation is currently triggered where an employer has “ceased to employ at least one person who is an active member” of the pension scheme, where another employer with DB liabilities continues to employ at least one active member (known as an “employment-cessation event”).

The DWP intends to introduce two new arrangements to ease the way for corporate restructurings, the general easement and the de minimis easement. Where certain conditions are met, no employment-cessation event will be treated as occurring and no employer debt will arise. The new arrangements will add to the existing alternatives for managing an employer debt (such as scheme apportionment arrangements) when an employer exits a multi-employer DB scheme.

Only two employers (within the same corporate group) can be involved in the restructure, the ‘exiting employer’ and the ‘receiving employer’, both of which must be participating in the same multi-employer DB scheme. This is intended to ensure that both the exiting employer’s assets and its liability towards the pension scheme head in the same direction. (However, the easements could potentially be used to facilitate a number of one-to-one transactions between employers.) Unless an employer is changing its legal status (for example, an unincorporated charity becoming a registered company), the two employers must also be “associated” as defined in the draft regulations.

### 4 THE GENERAL EASEMENT

For an internal group restructuring to fall within the “general easement”, the two employers and the trustees of the pension scheme must meet eight statutory steps. The steps provide a framework for assessing whether the transaction meets prescribed conditions and contain several complex procedural requirements. These include the following:

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# alert

Continued

## **ONCE MORE UNTO THE EMPLOYER DEBT BREACH**

- The trustees must be satisfied that the receiving employer will be at least as likely as the exiting employer to meet all the exiting employer's liabilities in relation to the pension scheme after the restructuring, as well as its own liabilities (the "Restructuring Test"). (Trustees will need to consider taking professional advice in reaching this decision.) The trustees must then notify the exiting employer in writing of their decision and, if the Restructuring Test is satisfied, send a copy to the Regulator.
- Both employers must confirm in writing to the trustees that they have not suffered an insolvency event, and that they are unlikely to do so within 12 months (this is assessed on the basis that, for the receiving employer the restructuring goes ahead and, for the exiting employer, it does not).
- All of the assets which the exiting employer is legally able to hand over must be transferred to the receiving employer. The receiving employer must also take over responsibility for the exiting employer's assets, employees and pensions obligations on the same date (although the assets may be physically passed over on another date). This step must be carried out within 12 weeks of the trustees' decision on the Restructuring Test.

### *Moral Hazard*

If it subsequently comes to light that certain steps have not been carried out in accordance with the legislation, an employment-cessation event will occur and a debt will be triggered, with the exiting and receiving employers having joint and several liability. This would provide trustees with protection if, for example, decisions made by the receiving and exiting employers about their likelihood of insolvency prove unreasonably optimistic. However, the DWP view this measure as a deterrent and expect that it will only apply in exceptional circumstances.



# alert

Continued

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### **5 THE DE MINIMIS EASEMENT**

This easement is intended to apply where small-scale corporate restructurings are taking place. Trustees must consider whether four factual conditions are met which, broadly speaking, look at the scheme's funding level and the extent of the exiting employer's liabilities.

For example, the scheme must be at least 100% funded on the Pension Protection Fund (PPF) basis. The exiting employer must also be responsible for less than 2% of the scheme's total DB members, and that percentage when applied to the scheme's overall liabilities (assessed on the PPF basis) must not exceed £100,000. (The exact test set out under the Regulations is somewhat unclear and this is an issue we will be addressing in our response.)

### **6 TECHNICAL AMENDMENTS AND CLARIFICATIONS**

The draft regulations contain a number of technical amendments designed to clarify the Regulations and make them easier to apply. The consultation paper also sets out the DWP's response to several long-standing issues in relation to the Regulations where, in their opinion, a change is not required.

For example, there has been some confusion as to whether life cover only members are included within the definition of "active member" under the Regulations. The DWP has now confirmed that this is not the case, as the definition only applies to "members accruing benefits".

### **7 HERE COMES THE CAVALRY?**

The DWP believes that the proposed changes will help employers restructure without decreasing the protection afforded to members of DB schemes. The draft requirements though are complex and prescriptive, and will not be easily met. Therefore, whilst welcome, it remains to be seen how many restructurings the proposed changes will ultimately benefit, if implemented.