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## SCHEME DEBT – FULL BUY-OUT ON EMPLOYER INSOLVENCY

### 1 BACKGROUND

The Occupational Pension Schemes (Winding Up, Deficiency on Winding Up and Transfer Values) (Amendment) Regulations 2005 were laid on 25 January 2005, and will come into force on 15 February 2005. These Regulations were the subject of a consultation paper issued in September 2004.

The Government has stated that these Regulations are designed to protect the position of members whose defined benefit scheme winds up by ensuring that “the pension scheme will have a claim more akin than presently to the members’ pension expectations”. 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.

We summarise below the main implications of the Regulations.

### 2 FULL BUY-OUT DEBT ON EMPLOYER INSOLVENCY

In short, the Regulations will impose a full buy-out debt on or after 15 February 2005 in two new circumstances:

- where a scheme begins winding-up on or after that date and the sponsoring employer (or last remaining employer) is insolvent;
- in an ongoing 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”).

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### **3 WHY THE CHANGES?**

Since 11 June 2003, 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.

Another key reason for the change was to close a potential loophole in the existing legislation. Currently, an employer counts as "insolvent" if it has entered into a members' voluntary liquidation, regardless of whether or not it has sufficient assets to meet the full buy-out debt.

### **4 WHAT IMPACT WILL THE REGULATIONS HAVE?**

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

The Government recognises that because the debt will not be preferential the introduction of the Regulations may result in "only a fraction of the debt, perhaps a few pence in every pound, [being] collected". But in the Government's quest to protect against calls upon the Pension Protection Fund, every penny may make a difference for some schemes.

### **5 TRANSFER PAYMENTS DURING WIND-UP**

The Government has also taken the opportunity, quite separately, to introduce new disclosure requirements for trustees where members seek a transfer payment from a scheme in wind-up. When issuing a statement of entitlement to a guaranteed cash equivalent, trustees must notify the member that:

- their transfer may be affected by the scheme's winding up;

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- a decision to take a transfer should be given careful consideration; and
- the member should consider seeking independent financial advice on whether to take a transfer.

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 (for example, until the employer has paid the debt).

## **6 CONCLUSION**

The Regulations come into force on 15 February 2005.

The last key situation, in which an MFR (as opposed to a buy-out) debt is still generally payable, is where an employer leaves an on-going multi-employer scheme. However, the Pensions Act 2004 includes provision to increase this debt to full buy out as well. We understand that the current plan is to introduce these changes from 6 April 2005.