EMPLOYER DEBT: CONSULTATION ON DRAFT REGULATIONS

COMMENTS OF SACKER & PARTNERS LLP

The purpose of this document is to set out our comments on the consultation on the draft Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2010 published by the Department for Work and Pensions (DWP) on 17 September 2009[1] (the Consultation).

Sacker & Partners LLP (Sackers) is a firm of solicitors specialising in pensions law. With over 50 pension lawyers, we act for in excess of 800 pension schemes, including household names and a number of FTSE-100 clients. The views expressed in Sackers' response to this consultation have been collated following discussions with a sub-group of the firm's solicitors.

General comments

1. We note that the aim of the present consultation is to ensure that, while maintaining member protection, an "employment-cessation event" does not arise on corporate restructurings where this would be inappropriate. The overall intention is to address concerns that the Occupational Pension Schemes (Employer Debt) Regulations 2005 (the Employer Debt Regulations), as currently drafted, can "unnecessarily inhibit corporate activity". We support this policy aim.

2. However, in our view, the easements put forward in the Consultation are likely to be of only very limited use in practice. This is particularly so as the general easement, as drafted, can only apply in one-to-one transactions and so not all reorganisations will meet the complicated conditions to pass the test.

3. With regard to the de minimis easement, from our approximate calculations we estimate that it would only apply to schemes of up to £5 million in value (or around 0.01% of the membership in larger schemes). The bar has been set so low that only a very small number of schemes are likely to be able to take advantage of this easement.

[1] http://www.dwp.gov.uk/docs/consultation-employer-debt-draft-regs.pdf

4. We do however welcome the policy intention to assist those entities which may change their legal status, for example, partnerships which become limited liability partnerships.

5. Nevertheless, the "general easement" and the "de minimis easement" are, we believe, unnecessarily complicated. There are a number of steps which have to be completed in a prescribed order. Any legislation at this level of complication brings with it the risk that mistakes may be made, leaving the risk of an employer debt having arisen and requiring action to remedy. Similarly the risk of non-compliance means that the certainty of there being no debt is unrealistic and may mean that the policy objective is not met. We believe that the arrangements - as drafted - have the potential, therefore, to be both time consuming and costly.

Use of existing legislation on Scheme Apportionment Arrangements

6. Although we support the Government's policy aim of removing unnecessary restrictions to corporate activity, we wonder whether the consultation proposals add much to the arrangements already available. As there is, quite properly, still a requirement for a legally enforceable agreement, it may be appropriate to use the existing mechanism of a Scheme Apportionment Arrangement (SAA) to achieve the stated policy aim. In a multi-employer scheme, the power to apportion the liabilities of a departing employer under an SAA has proved a popular option for dealing with employer debts and is one which works well in practice. We therefore suggest that where easements are required, these could be built into this existing framework. We set out an overview of our thoughts on the possible expansion of the scheme apportionment provisions below. We note that this is just one option and that the DWP may have other suggestions. We would be happy to discuss these with the DWP in more detail if that would be helpful.

7. As the general easement has at its heart the "Restructuring Test", we would propose making an amendment to the definition of SAA to provide that where the Restructuring Test is met, only a limited Funding Test would apply (along the lines of draft Regulation 6ZB(7)). We would also propose a similar amendment to provide for the de minimis easement. The use of the SAA has the double benefit of the industry being familiar with the requirements and simple amendments being required,

lessening the possibility of inadvertently making incorrect consequential amendments to the already complicated Employer Debt Regulations.

8. Furthermore, this approach would mean that the departing employer's liabilities would not become orphan liabilities. The designation of existing liabilities as orphan liabilities under the proposed easements is unlikely to be favoured, either from the corporate perspective, or by trustees, for whom the current approach of apportioning liabilities prevents orphan liabilities outstripping named liabilities. The proposed approach also carries the real risk that liabilities will be double counted.

9. The existing approach used for SAAs ensures certainty for the employer to whom the liabilities have been attributed, as they can carefully monitor the extent of this liability via the regular valuation process. It also provides certainty for trustees, allowing them to monitor the covenant of the employer with named responsibility for the liabilities.

Technical Amendments - Issue 5: Definition of "scheme apportionment arrangement"

10. In our view, the existing provisions of the Employer Debt Regulations are sufficiently widely drafted to permit an amount to be apportioned under an SAA, to be a floating amount that will crystallise when the amount ultimately becomes payable (as well as a fixed amount). This approach has been commonly adopted in practice. It is therefore unnecessary to insert a specific mechanism in the regulations to permit this.

11. For the reasons outlined under paragraph 8 above, our preferred approach is that it should be possible for the liabilities to be apportioned, as currently, to a specific employer, rather than creating additional orphan liabilities.

12. We set out details of a case study in the Appendix to our response to illustrate the difficulties in this area.

Sacker & Partners LLP
19 November 2009

APPENDIX

Case study

A multi-employer scheme has 4 employers.

The scheme has assets of 120 and liabilities of 200 on a buyout basis.

The scheme's liabilities are attributable to each of five employers in the company group as follows:

Employer A (principal employer): 75

Employer B: 20

Employer C: 5

Employer D: 25

Employer E: 25

The balance of the scheme's liabilities (50) are not attributable to any of Employers A to E - i.e. they are orphan liabilities.

Employers D and E operate in the same business sector as Employer A so the company group decides to amalgamate those two companies with Employer A. The vast majority of the assets and liabilities of belonging to Employers D and E are transferred to Employer A, although some employees are made redundant at the time of the transfer and a very small number of duplicate assets are disposed of at the time of the reorganisation.

The company approaches the trustees of the scheme to agree an apportionment arrangement so that only de minimis debts are triggered on the cessation of participation by Employers D and E in the scheme.

Employer A has a strong covenant. Employer B has a weak covenant.

If the liabilities attributable to Employers D and E were not specifically addressed the scheme's liabilities after the reorganisation would be as follows:

Employer A (principal employer): 75

Employer B: 20

Employer C: 5

Orphan liabilities: 100

It is neither desirable to the company nor the trustees for there to be such a large amount of orphan liabilities in the scheme, particularly as Employer B has a weak covenant and would under the above breakdown be responsible for 20% of those orphan liabilities (20/(75+20+5).

The Trustees and the company would much rather that the liabilities previously attributable to Employers D and E were from the moment of reorganisation deemed for all purposes to be attributable to Employer A, the scheme's principal employer.

The scheme's liabilities after the reorganisation would therefore, instead be as follows:

Employer A (principal employer): 125

Employer B: 20

Employer C: 5

Orphan liabilities: 50

Two years after the reorganisation Employer C ceases to have any active members in the scheme. It is agreed that it will pay a section 75 debt. By that time the assets and liabilities of the scheme have increased as follows:

The scheme has assets of 160 and liabilities of 260 on a buyout basis.

The scheme's liabilities are attributable as follows:

Employer A (principal employer): 160

Employer B: 30

Employer C: 10

Orphan liabilities: 60

Employer C's cessation debt is easy to calculate in these circumstances as that employer's liability share: i.e. (10/(160+30+10)) x (260-160) = 5

There is no need to perform complicated double-counting calculations.