Draft Occupational Pension Schemes (Employer Debt) (Amendment) and Pension Protection Fund (Multi-employer and Entry Rules) (Amendment) Regulations 2007

Response to Consultation

The comments contained below are Sackers' formal comments ("the Response") on the Draft Occupational Pension Schemes (Employer Debt) (Amendment) and Pension Protection Fund (Multi-employer and Entry Rules) (Amendment) Regulations 2007 ("the Amendment Regulations"). Amongst other things, the Amendment Regulations make changes to the Occupational Pension Schemes (Employer Debt) Regulations 2005 ("the Employer Debt Regulations").

We met to discuss these points on 18 September 2007. As we explained then, this was preceded by a meeting of the whole firm on 17 September. Therefore, comments from a broad spectrum of opinion at Sackers were fed through to the 18 September meeting and are now reflected in this Response. The Response covers the same points as at our meeting, providing amplification where necessary.

1. General Comments on Regulations

- Both clients and lawyers are concerned generally at the level of regulation in this area and we wonder how this squares with the aims of the Deregulatory Review. However, our understanding from our meeting, is that the Employer Debt Regulations are not currently a candidate for deregulation.

- Our perception is that just a few changes to the Employer Debt Regulations could have met the majority of concerns in this area. Without detailed analysis, we would pick out the following as being the key changes on a wish list:

    - the change to the "more likely to be met" test for Approved Withdrawal Arrangements (AWAs);
    - clarification of the definition of "employment-cessation event" (ECE);
    - flexibility for trustees to deal pragmatically with deficient records;
    - designation generally of responsibility for orphan liabilities; and

  - provision of a period of grace.

- There is a proliferation of methods for dealing with deficits in the Amendment Regulations. It may be possible to amalgamate these to cover the same ground but to simplify the structure, although this may not alter the options available, from a presentational perspective it may be more favourable. For example, this could be achieved:

  - by amalgamating Scheme Apportionment Arrangements (SAA) and Regulated Apportionment Arrangements (RAA) into a single category of Apportionment Arrangements, with the Pensions Regulator's (TPR) approval (and the Board of the Pension Protection Fund involvement) only in certain circumstances; and
  - by amalgamating Cessation Agreements (CA) and AWAs into a single category of Withdrawal Arrangements, and for which, again, you would need TPR's approval only in certain circumstances.

- There are no transitional provisions. The provision of transitional arrangements in some areas may be very helpful – this will be picked up under each topic heading.

2. Employment-Cessation Event – Simultaneous Withdrawal

- From speaking to you (and having received Allyson Brook's email of 27 September 2007) we understand that you are looking to review policy in this area and in relation to the issues highlighted in paragraph 3 below. However, if weight were needed, we would add our voice to the request for review. This is the area that the majority of our clients are concerned about.

- We understand that this change has been introduced in order to prevent schemes being abandoned (in light of TPR guidance on this issued in May 2007). Although it is the expressed policy of the DWP to trigger a debt in these circumstances, it should be open to employers to be able to choose to close schemes to future accrual without the requirement to pay a debt immediately, provided that the employer continues to support the scheme as regulated by the scheme funding provisions (via the Schedule of Contributions and the Recovery Plan, if applicable).

- There is real concern from clients already part way down the route to closing accrual as to what date the Amendment Regulations will come into force – particularly because of long lead-in times as a result of consultation requirements (both statutory and non-statutory). For example, at least one client of the firm (Halcrow) have set a long lead-in time to meet pre-agreed consultation arrangements and, if this comes into force as drafted, are now looking like they will be caught by the new definition of ECE.

- There is concern from lawyers at Sackers that some employers will join a “gold rush” to close schemes, without meeting the proper consultation requirements (and taking the risk of being fined) in order to close schemes to accrual before the changes come into force.

- It is difficult to understand why there is a difference in treatment between multi-employer and single employer schemes. In particular circumstances, if the changes proposed are implemented, it may be an option for employers to de-merge schemes in order to create a number of single employer schemes which can then each be closed to future accrual. Clearly, however, this would be unnecessarily complicated.

- As drafted, the Amendment Regulations are likely to trigger debts on scheme mergers when accrual ceases in the transferring scheme immediately before the transfer. This cannot have been an intended consequence.

3. Employment Cessation Event – Active members

- The definition of ECE now includes reference to active members. In general, it was agreed that certainty is preferable, although we have numerous examples at Sackers where the ambiguity in the current definition has created helpful flexibility for clients. We know that there are a number of trustee boards that have agreed that a debt has not arisen where the employer has retained deferred employed members or has retained employees eligible for active membership. Under the Amendment

Regulations, a debt would arise in these circumstances. Transitional provisions would be beneficial to assist schemes that have taken this view under the existing legislation.

- Where the employer is being sold out of the group (and therefore outside the control of the principal employer and the trustees) it may be appropriate to call in a debt, but where the scheme is being closed to future accrual it is difficult to justify why the continuing contribution obligation should be accelerated into the payment of an immediate debt. Perhaps a better way to ensure that a debt is paid on change of control is to ensure that in a closed scheme a debt is paid when one employer ceases to pay contributions to the scheme under its Schedule of Contributions. This might also meet TPR's apparent concern regarding scheme abandonment in a rather more proportionate way to the current drafting.

- It is not clear when the trigger would be for schemes which currently have eligible members but no active members. Our understanding is that the Amendment Regulations are not retrospective. We therefore assume that, as the event which would constitute an ECE under the Amendment Regulations occurred prior to the Regulations coming into force, no ECE has occurred or will occur once they are in force. If the suggestion above regarding triggers in a closed scheme were adopted, this could negate the need for specific transitional provisions in this area.

- We understand that the definition of "active members" is contained in the Pensions Act 1995, section 124. However, as this definition could include life cover only members, perhaps an employer debt specific definition may be more appropriate if this is not intentional. Some schemes will still have life cover only members, for example, in waiting periods and the like.

- Finally, a more minor point is that at present the drafting suggests that even if one member left active service, perhaps because they went to work somewhere else, an ECE would be triggered. Presumably this is not the intention and an amendment should be made to make it clear that all members have to leave service to trigger the calculation.

4. Employment Cessation Event - 12 month period of grace

- We believe that this will be a useful piece of flexibility. However, the notification requirements will need some further thought if the provision is to be effective. At the moment, the employer would have to notify the trustees *on the cessation date*. We are concerned that in many circumstances this date will be missed, for example, if the cessation date was on a weekend or because of the sudden death of the member. Simply adding the words “or as soon as possible thereafter” would meet these concerns.

5. Default Apportionment – Liability Share

- The introduction of greater certainty, by providing that where records are unclear liabilities are allocated on a default basis to the member’s last employer, is useful. We anticipate that there will be some discussion about the meaning of “disproportionate cost” in this context, but find it difficult to suggest an alternative. However, there may be circumstances where this prescriptive allocation is not desirable.

- In general, we expect that employers and trustees would welcome more flexibility to attribute liabilities among employers in a manner most appropriate to the circumstances of the scheme in question. For example, it might be that the last employer of employees is a service company (or otherwise of weak covenant). In these circumstances, notwithstanding that a member's last employer is Company A, trustees might prefer to agree with Company B (a scheme employer with a stronger covenant) that it assumes this responsibility. The member(s) would then be treated as having had all their pensionable service with Company B instead of Company A. In the definition of liability share in the Amendment Regulations, the result would be that the value of K in the fraction K/L would reduce for Company A, but would increase for Company B.

- This flexibility to attribute <u>liabilities</u> (or members’ pensionable service) to different companies would also provide a useful mechanism for schemes to deal with orphan liabilities. So that, instead of spreading these across all employers in a scheme, the trustees could agree to deem all orphan liabilities to be attributable to the scheme's strongest employer. This would assist in covenant monitoring and would allow trustees and employers to take a pragmatic approach to tidying up historic deficiencies in scheme records.

- It should be pointed out that the current ability to enter into SAAs does not provide a solution to the above difficulties, since it requires an apportionment arrangement to be entered into every time a cessation event occurs. The ability to have a standing policy about which employer will take on responsibility for certain of the scheme's liabilities (for example, orphan liabilities or those arising on a restructuring) is not possible under the Amendment Regulations, but it would be a welcome addition.

- Concerns about allowing trustees and employers the above flexibility should be allayed by requiring trustees to consult with the scheme actuary (who is, of course, under a duty to “whistle blow”).

6. Scheme Apportionment Arrangements

- We understand SAAs will operate as a statutory overlay on current scheme apportionment arrangements. We have found that, in recent years, scheme apportionments have increasingly found favour. However, in our experience, it is difficult to advise trustees to accept an apportionment arrangement in the context of an at arm’s length transaction, except where stringent commitments on future funding have been given. (We support the suggestion made as part of the consultation, and which you mentioned to us at our meeting, that where a funding commitment has been given in exchange for an apportionment of liability, these arrangements should be grandfathered.)

- However, apportionment arrangements are particularly useful in the context of a group reorganisation (where there is no movement of assets out of the scheme and no diminution of the employer covenant). We have several examples in the firm where liabilities have been apportioned because of this reason. For instance, the debt which was triggered when five companies were amalgamated into a single legal entity as part of a restructuring was apportioned in this way.

- The other key driver for scheme apportionments is the lack of records. We recognise that this concern has been partially met in the context of the default apportionment by allocating the liabilities to the member’s last employer. However, in certain circumstances, as mentioned above, this re-allocation would not be appropriate and the member’s liabilities would be better allocated to an employer with a stronger covenant. Our experience is that, where a solution is necessary for this reason, all parties have adopted a helpful and pragmatic attitude.

- The approach taken in the Amendment Regulations may not assist with the above scenarios because it focuses on apportioning "the difference between assets and liabilities". The consequence is that it simply reduces a debt payable by a cessation employer. Once the apportionment has happened, the liabilities previously attributable to that cessation employer then necessarily fall as orphan liabilities under the Amendment Regulations. Whilst this may be appropriate in some circumstances, this may not always be what the trustees and employer wish to achieve. Indeed, in the example of an internal reorganisation given above, it may be precisely what all parties want to avoid. An ability to attribute <u>liabilities</u> (see 5 above) on an apportionment to a specific employer (or employers) in the scheme would assist.

- This would also make it easier for trustees to assess the covenant of the employer to whom liabilities have been attributed, rather than having to undertake a covenant assessment of all employers in the scheme, which could be a large and expensive exercise with little additional benefit.

- In the context of SAAs, it is unclear who drives the process as both the trustees and actuary are involved at different points. In addition, there is no mechanism for resolving disagreement between the trustees and actuary.

7. Regulated Apportionment Arrangements

- As anticipated in the consultation paper, we believe that these are unlikely to be used often and only in limited circumstances.

8. Cessation Agreements

- Clearly, CAs will be of use to clients, particularly in transaction situations, when the trustees want to be confident of receiving a minimum level of debt at the date of exit. To improve the usefulness of this new arrangement, it would be helpful for additional flexibility to be built in for triggering the payment of Amount B.

- Our major concern though is whether the CA will need clearance. In a transaction, the parties will often not wish to enter into an AWA because of the need to get approval from TPR which could slow down the process. The need to get clearance for a CA could cancel out this benefit. Even though clearance is a voluntary process, TPR's draft guidance on clearance published for consultation on 10 September 2007 suggests that trustees should, in effect, blow the whistle to TPR if clearance is not being sought on a type A event.

9. Approved Withdrawal Arrangements

- The change to the test for approval of an AWA gives welcome flexibility.

- We think that AWAs will still be useful even after the introduction of CAs. This is because TPR's approval may be advantageous in certain circumstances, for instance, where it is necessary to convince the membership that the trustees have taken an appropriate course of action.

- In addition, payment of Amount B by the guarantor under an AWA may be triggered by notice from TPR, rather than on a fixed event as in a CA.

10. Miscellaneous

- The flexibility to use an updated asset valuation and updated actuarial valuation where the ECE is within 12 months of either documents being produced is helpful. Likewise, from a lawyer’s perspective, the flexibility to estimate the buy-out cost is positive.

- We note the following changes made to the interaction between the employer debt legislation and the Pension Protection Fund (PPF):

  - Trustees entering into a CA, SAA or RAA would not exclude the scheme from entering the PPF and we assume that it is appreciated that there may be no involvement of TPR. Further guidance may be appropriate here.
  - We have, for some time, felt that the operation of the Employer Debt Regulations is unsatisfactory in the context of a single employer becoming insolvent in a multi-employer scheme – particularly as only a contingent debt is triggered. We discussed this issue at some length and we provided you with a draft internal paper analysing this issue (which we have also sent to the PPF for comment).

- Finally, the provisions in relation to former employers are difficult to follow and operate and this is also an area which would benefit from further consideration.

SACKER & PARTNERS LLP
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