

August 2007

## Proposed Changes to the Employer Debt Regulations

On 7<sup>th</sup> August 2007 the Department for Work and Pensions (the "DWP") issued its consultation document on draft amendments to the Occupational Pension Schemes (Employer Debt) Regulations 2005. These regulations are commonly known as the "Employer Debt Regulations" and arise from Section 75 of the Pensions Act 1995 which places a debt on the employer where an employer withdraws from a pension scheme.

### Background

Under the existing Employer Debt Regulations which came into force on 6<sup>th</sup> April 2005 a debt is triggered when a scheme has commenced wind-up, the employer has become insolvent or an employer ceases to participate in a multi-employer scheme. A cessation event occurs when an employer ceases to employ people in the description of employment to which the scheme relates at a time when at least one other employer employs such individuals.

The statutory debt triggered on cessation is the leaving employer's share of the scheme's deficit assessed on a buy-out basis, i.e. the basis used to assess the cost of securing the scheme's benefits with an insurance company.

If a scheme's rules provide for a different apportionment of the buy-out deficit among the participating employers, then the scheme's rules override the provisions in the legislation.

Amending regulations, which came into effect from September 2005, introduced the concept of an Approved Withdrawal Arrangement whereby it was possible for the withdrawing employer to pay an amount below its share of the full buy-out debt into the scheme as long as a guarantor agreed to meet the additional amount payable. However, these arrangements can only be entered into if the Pensions Regulator is satisfied that the statutory debt is "more likely" to be met under the agreement put in place.

### Proposed Changes

The DWP intends to make the Employer Debt Regulations easier to operate and provide more flexibility for employers and schemes. Further, it is intended that the revisions should also provide better protection for scheme members.

The proposed changes cover a number of areas; providing clarification of certain technical points and also introducing a

number of new concepts. We have set out details of the main changes proposed below.

The first technical clarification is that any money purchase assets and liabilities should be disregarded in the calculation of the employer debt payable.

This closes an existing loophole whereby an employer participating only in a defined contribution section of a scheme may become liable on withdrawal for a share of the deficit existing in the defined benefit section. The DWP have stated that it was never their intention for money purchase benefits to fall within these regulations.

Secondly, the draft regulations create some flexibility for the trustees and actuary when calculating the debt payable. The trustees will be able to decide whether to use an updated asset valuation rather than obtain audited accounts if appropriate, and the actuary has greater freedom in assessing the liabilities when the actuary considers it not to be practicable to make an assessment based on the usual cost of purchasing annuities.

The third significant technical change is to the definition of a cessation event. This modification is such that cessation is defined to occur when an employer ceases to have any active members within a scheme. A grace period of 12 months is provided for where an employer may expect to employ an active member within the scheme.

Whilst the current definition has often been interpreted in this way, this change simplifies the definition of a cessation event and reduces the possibility of a debt being triggered accidentally, particularly by small employers and charities.

Further, the revised definition removes the current possibility of avoiding triggering debt on employer payments by structuring any employer withdrawal to be such that all participating employers cease to participate within a scheme at the same time.

Finally, the draft regulations set out a method for allocating liabilities to each participating employer based on members' pensionable service with each employer and the method to be used where the trustees are unable to follow this approach. In the latter case members' liabilities should be associated with the last employer of the member, or, if this is also unknown, the liabilities should be left as unattributable to any employer.

The draft regulations set out the following methods for calculating the debt on the employer triggered. It should be noted that it is intended that none of the agreements outlined below would be considered to be compromise agreements for the purpose of assessing a scheme's entry to the Pension Protection Fund ("PPF").

- **The Default Position**

The default position is as provided for under the current regulations i.e. the debt on the withdrawing employer is that employer's share of the full buy-out deficit.

- **Scheme Apportionment Arrangements**

The draft regulations allow apportionment arrangements to be entered into with the agreement of the trustees regardless of the provisions set out in the scheme rules. To agree to such an arrangement the trustees must be satisfied that the remaining employers within the scheme are able and willing to fund the scheme in accordance with the scheme's funding valuation and make the payments required under the scheme's schedule of contributions and recovery plan.

- **Regulated Apportionment Arrangements**

These arrangements are similar to the Scheme Apportionment Arrangements outlined above but will be used when a scheme is likely to enter a PPF assessment period in the next 12 months and the Pensions Regulator believes that such an arrangement will result in better funding for the scheme than if an insolvency event occurs in relation to one of the employers.

Regulated Apportionment Arrangements require the approval of the Pensions Regulator and the PPF. Therefore, it is likely that these arrangements will be very rare.

- **Cessation Agreements**

These agreements are a simplified form of the current Approved Withdrawal Arrangements and it is expected that 75% of the employers who would currently use an Approved Withdrawal Arrangement will use a Cessation Agreement instead.

Under a Cessation Agreement the withdrawing employer pays an amount into the scheme below the level of the full buy-out debt triggered and a guarantor agrees to guarantee the additional amount required. The amount that the withdrawing employer must pay is determined to be at least that employer's share of the scheme's deficit as measured on the scheme specific funding basis. Where a scheme has not undertaken its first funding valuation under the scheme specific funding regime a scheme's Section 179 valuation (the valuation used for assessing a scheme's risk-based levy payable to the PPF) should be used for assessing the minimum payment required.

The guarantor must agree to pay the balance of that employer's share of the buy-out debt when the scheme eventually winds-up or ceases to have any solvent employers.

Upon entering into such an agreement the trustees must be

satisfied that this agreement will not impact on any of the other employers' commitments to the scheme and that the guarantor is likely to have sufficient assets to make good its commitment. The draft regulations also introduce a number of Notifiable Events that will cover the guarantor.

- **Withdrawal Arrangement**

A Withdrawal Arrangement is similar to a Cessation Agreement but requires the approval of the Pensions Regulator. Further, it is possible for the Pensions Regulator to approve a Withdrawal Arrangement where the amount paid by the withdrawing employer is lower than that employer's share of the funding deficit.

Whilst such arrangements exist currently, a number of changes have been proposed with respect to these arrangements. In particular, the requirement for the Pensions Regulator to be satisfied that the full debt is more likely to be paid under the Withdrawal Arrangement has been removed and instead the Pensions Regulator must simply be satisfied that it is reasonable to approve such an arrangement.

## General comments

The draft regulations complicate an area of legislation where arguably the current apportionment rules already provide sufficient flexibility. However, the regulations do provide a useful framework for agreements to be reached between employers and trustees to facilitate corporate restructuring.

We will be interested to see whether the proposal to change the definition of a cessation event to include the situation where all employers cease to have active members within a scheme at the same time will provoke a strong reaction during the consultation process since it will trigger debts where previously none would have occurred.

## Next Steps

The DWP's consultation period runs until 1<sup>st</sup> October 2007 and it appears that the DWP's intention is for the draft regulations to be implemented in December 2007. Therefore, depending on the outcome of the consultation, we can expect new regulations to be in force by the end of the year.

## Where can I get further information?

This briefing note is provided for general information only and should not be relied upon as advice on your specific circumstances. For specific advice, please get in touch with your usual Punter Southall Transaction Services contact.

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