Department
for Work &
Pensions

Section 75 Employer Debt in Non-Associated Multi-Employer Defined Benefit Pension Schemes

Call for Evidence

March 2015

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Executive Summary

A number of stakeholders have approached the Department for Work and Pensions to express their concerns about the workings of the employer debt provisions set out in the Pensions Act 1995 and the Occupational Pension Schemes (Employer Debt) Regulations 2005.

The employer debt regime was created to ensure that members of an occupational pension scheme are appropriately protected from the risk of the scheme failing to meet its liabilities. Where an employer becomes insolvent or where the scheme itself winds up, the sponsoring employer(s) are required to pay off their share of any shortfall in their total accrued liabilities to the scheme at the full buy-out price – the cost of buying annuities to cover all of that employer's accrued liabilities in the scheme. In a multi-employer scheme, this liability is also triggered if an employer ceases to employ active members in the scheme (i.e. no longer employs anyone who is in pensionable service under the scheme).

Some employers in certain non-associated multi-employer schemes have raised concerns that the requirement to pay the difference between the scheme's relevant assets and their proportion of the liabilities at full buy-out price if an employer stops employing active members is overly onerous for employers seeking to rationalise their pension costs.

While a number of easements exist for employers in this situation, some stakeholders feel they do not go far enough, and have suggested further easements they believe will help them better manage their pension liabilities.

Other stakeholders, however, argue that the employer debt regime is extremely important in preserving scheme stability and should not be amended in any way. There are risks associated with any amendment to the employer debt regime for non-associated multi-employer schemes, some of the possible long-term impacts of which we cannot easily predict in advance. We are very clear that employer debt is an important and complex area of legislation and that any changes need to be considered carefully.

We are therefore seeking views and evidence about the operation of the current employer debt regime for non-associated multi-employer schemes, the effectiveness of the current easements open to employers in such schemes, and the possible impacts of changes to the regime that have been suggested to us by stakeholders.

1. Introduction

This call for evidence looks at the employer debt regime for employers in non-associated multi-employer pension schemes offering benefits other than money purchase benefits. It sets out and discusses the current arrangements, existing easements, and suggested changes raised by stakeholders, and seeks the views of all interested parties. An executive summary is provided on p.3.

About this consultation

Whom this consultation is aimed at

We are aiming this call for evidence at stakeholders with an interest in the employer debt regime for non-associated multi-employer pension schemes offering non-money purchase benefits. This would include schemes, sponsoring employers, members, trade unions, lawyers, actuaries, administrators, representative bodies, and others with an involvement or interest in this kind of scheme.

Purpose of the call for evidence

This call for evidence is intended to help us better understand the situation regarding employer debt for non-associated multi-employer schemes and the employers who sponsor them. Evidence and views submitted will help inform Government thinking in this area, allowing us to develop a better understanding of whether the current arrangements are delivering the right balance of protection and sustainability for all concerned, and to assess whether any changes might be helpful.

Scope of consultation

This consultation applies to England, Wales and Scotland

Duration of the consultation

The consultation period begins on 12 March 2015 and runs until 22 May 2015.

How to respond to this consultation

Please send your consultation responses to:

Employer Debt Team

Department for Work and Pensions

6-12 Caxton House

Tothill Street

London

SW1H 9NA

Email: Private.pensionspublicconsultation@dwp.gsi.gov.uk

Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator
2nd Floor
Caxton House
Tothill Street
London
SW1H 9NA

Email: caxtonhouse.legislation@dwp.gsi.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team:
Email: freedom-of-information-request@dwp.gsi.gov.uk

The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the Freedom of Information Act.

2. Why we are asking for views now

A number of stakeholders have approached the Department for Work and Pensions with concerns about the way the employer debt regime operates for employers in non-associated multi-employer schemes.

Some stakeholders have expressed the view that some smaller and less financially robust employers are finding the employer debt regime overly onerous: rather than protecting the interests of members, stakeholders argue that the arrangements and liabilities may risk driving some employers out of business unnecessarily. This can have implications for jobs and for future support for the scheme. They have indicated that they think the regulations need to be changed to rebalance the relationship between individual employers and the scheme.

Other stakeholders, however, have expressed concerns that making changes to the employer debt regime could be potentially destabilising for schemes, with financial implications for sponsoring employers and increased risks for members.

The Government is determined to maintain strong member protection and scheme stability. It is important to emphasise that the employer debt regime as it currently stands is designed to protect schemes, and therefore members. In the case of non-associated multi-employer schemes, the regime is also designed to protect those sponsoring employers who remain in the scheme when one or more employers have ceased to employ active members (i.e. those in pensionable service under the scheme), and who may be left with ‘orphan liabilities’. Any changes to the employer debt regime would have to be carefully considered to ensure that they would not result in an unacceptable increase in risk to members, other employers and the Pension Protection Fund (PPF) and its levy payers.

We therefore want to gather evidence and views about ways of managing employer debt in non-associated multi-employer schemes in the context of employers seeking to reduce their exposure to risk, whilst also taking into account member protection and the future stability and viability of non-associated multi-employer schemes. A number of possible changes have been suggested by stakeholders; we are seeking views and evidence about these proposals. But at this stage the Government is not making any proposals, nor committing to any future changes.

3. Employer Debt in Non-Associated Multi-Employer Schemes

3.1. Employer debt

It is extremely important that all members of a pension scheme are appropriately protected from the risk of the scheme failing to be able to pay its liabilities. In occupational pension schemes offering non-money purchase benefits, this protection is provided by the sponsoring employers, who are required to make up any short-fall in the scheme's funding. Employers cannot, therefore, be allowed to walk away from their liabilities to the scheme.

The collective structure of non-associated multi-employer schemes means that all sponsoring employers support each other and share risks and liabilities. This offers members a high level of protection, and reduces the risk to the Pension Protection Fund.

It would not be fair to either scheme members or other employers if an individual employer was able to leave the scheme without paying its liabilities, leaving the other sponsoring employers - or ultimately, the Pension Protection Fund (PPF) and those who pay its levy - to make up the shortfall.

A key way of ensuring employers cannot avoid their liabilities to the scheme is through the employer debt legislation set out in section 75 of the Pensions Act 1995 and the Occupational Pension Scheme (Employer Debt) Regulations 2005 ('the Employer Debt Regulations').

Section 75 of the Pensions Act 1995 provides that, if a relevant event occurs to trigger the employer debt, the sponsoring employer concerned is required to pay a sum of money equal to that employer's share of the total difference between the value of the assets and the amount of the liabilities of the scheme, calculated on a buy-out basis (see below). This is known as the 'employer debt' or 'section 75 debt'.

The debt is required to be calculated with regard to the cost of purchasing annuities to the level of the guaranteed retirement income for the members of the scheme. However, in practice the money is usually invested in the scheme and is not used to purchase annuities.

Because the employer debt is calculated on the difference between the liabilities and the assets of the scheme, if the scheme is in surplus on a buy-out basis, the debt triggered is calculated at zero. The scheme would have sufficient funding to meet the promises made to the departing employer's members and would not need any additional funding from the departing employer. However, in recent years it has been unusual for a scheme to be in this position.

Calculating the Employer Debt in a Multi-Employer Scheme

An employer debt is based on the difference between the liabilities and assets of the scheme – the scheme deficit.

The value of the liabilities is calculated by reference to the cost of buying out the liabilities through an annuity purchased from an insurance company - a full buy-out.

The date by reference to which the employer debt is calculated is usually a point immediately before the debt event itself. This is called the applicable time.

Example: The scheme deficit is £10 million on a buy-out basis. There are three employers A, B, and C, participating in the scheme. Liabilities are attributed to the employers in the following proportions:

- A = 50%
- B = 25%
- C = 25%.

Employer A leaves the scheme. His share of the deficit is therefore 50% of £10 million = £5 million.

If the scheme is in surplus at the full buy-out price at the applicable time, no employer debt is triggered.

3.2. Employment-cessation events

For non-associated multi-employer schemes, a relevant event is considered to have occurred in a number of different circumstances:

- The scheme winds up
- The employer becomes insolvent
- The employer ceases to employ any active members in the scheme at a time when at least one other employer continues to employ one or more active members – known as an employment-cessation event. The employer may continue to have deferred and retired members in the scheme.

If any of these events occurs, a section 75 debt is triggered.

In the event of the employer becoming insolvent, the employer can no longer be considered able to meet its on-going liabilities in the scheme. It is therefore important that a claim is made in the employer's insolvency proceedings to recover money for the scheme and try to ensure the employer's proportion of the liabilities can be met.

In the event of an employer ceasing to employ any active members in the scheme (for example, because all remaining active members leave the company or elect to cease making contributions, or the employer choses to move them to a different pension scheme going forwards) the employer will be required to pay their section 75 debt at the point the last active member ceases to make active contributions, even if nothing else changes and they continue to exist as a viable financial entity. The fact that they have ceased having active members in the scheme is treated as severing their relationship with the scheme.

3.3. ‘Freezing’ a scheme

In a single employer defined benefit scheme (or the single employer section of a segregated multi-employer scheme), the employer can choose to close the scheme to new members and new accruals. This is referred to as ‘freezing’ the scheme. The scheme only has retired or deferred members, and no active members. No new contributions in respect of future service are made to the scheme by the employer or the members, although deficit contributions may continue to be payable. Members’ accrued benefit entitlements are preserved at the point the scheme was frozen but cannot continue to accrue (although they will be uprated to manage the effects of inflation), and no new members can join the scheme.

Freezing the scheme does not trigger an employer debt. The sponsoring employer remains liable for all on-going liabilities to the scheme, and makes funding payments as necessary on an on-going basis until all of the scheme’s liabilities are extinguished.

A multi-employer scheme, by contrast, can only be ‘frozen’ if all the sponsoring employers cease employing active members at the same time. An individual employer cannot freeze their participation in the scheme. If an individual employer ceases to employ an active member while another employer continues to employ active members in the scheme, this would trigger an employer debt.

This is intended as a protection measure for all employers in a multi-employer scheme, as it prevents one employer from freezing their liabilities and attempting to walk away from the scheme, leaving the other employers to pick up their accrued liabilities. It is also easier for a scheme with only one employer to choose to wind-up and call in the debt – this would be far more difficult in a multi-employer scheme.

3.4. ‘Participating employers’

In some multi-employer schemes, scheme rules may require an employer who has paid their employer debts as a result of an employment-cessation event to continue to have an on-going liability to the scheme in respect of any deficit. These employers remain as ‘participating employers’. Their payment of the employer debt does not, under scheme rules, end their on-going financial obligations to the scheme.

In this situation, the trust deed and rules or contractual arrangements between the employers and the scheme impose additional obligations on a departing employer.

Therefore, while an employer may be considered to have severed its relationship with the scheme for the purposes of section 75 of the 1995 Act, it may still be considered to have an on-going liability to the scheme by virtue of the individual scheme rules or contractual arrangements.

3.5. Rationale for the employer debt legislation

It is important to make clear that the employer debt regime for non-associated multi-employer schemes was designed for the protection of the employers and members of the scheme as a whole.

The requirement that an employer-cessation event (amongst other situations) triggers an employer debt liability is intended to ensure that the scheme is able to meet its liabilities to members who are, or have been, employed by the departing employer at the date of cessation. Without this provision, there is a risk that an employer might simply walk away from the scheme and not meet its liabilities, leaving the other employers – and potentially ultimately the PPF - to bear the cost. The collective principle underlying the basic structure of a non-associated multi-employer scheme means that it depends on all the employers in the scheme supporting each other.

Ultimately, occupational pension schemes are run for the benefit of their members, and trustees need to act prudently to ensure the scheme can pay out members' benefits. If an individual is promised a pension by their employer, that promise needs to be honoured by the employer through the provision of sufficient funds to the scheme.

3.6. Associated Multi-Employer Schemes

The proposals suggested by stakeholders are currently limited to non-associated schemes. We think this is a reasonable approach.

Whilst the majority of employers in non-associated schemes will be unrelated and may indeed be in direct competition with each other, employers who are associated by definition have a mutual relationship which could greatly increase the possibility of collusion for avoidance purposes. We would not want to make any changes that might open the door to such abuse. For example, we would be concerned that a group of associated companies with a pooled pension scheme might make use of any changes to the employer debt regime to move pension liabilities into a shell company which would then be unable to meet its obligations to the scheme.

It is important to note that the concepts of ‘associated’ and ‘non-associated’ apply at scheme level, not employer level. A non-associated scheme may contain both associated and non-associated employers[1]. For example, a non-associated scheme could contain twenty employers, of whom:

- fifteen are entirely unrelated
- three are a group of related companies
- two are unrelated but share a non-executive director.

As a result, it is potentially quite difficult to define a ‘non-associated multi-employer scheme’. Associated and non-associated multi-employer schemes are not defined in legislation, which only refers to ‘multi-employer schemes’.

<u>Question 3.1</u> – if we were to make any changes, should we exclude associated multi-employer schemes / limit the provisions to multi-employer schemes?

<u>Question 3.2</u> – if we were to exclude associated schemes / limit the provisions to non-associated schemes, how could we best achieve this?

[1] Regulation 2 (3A)(b) of the 2005 Employer Debt Regulations defines associated employers within the meaning of section 435 of the Insolvency Act 1986 / section 74 of the Bankruptcy (Scotland) Act 1985.

4. Stakeholder views

A number of employers in multi-employer schemes have approached the Department for Work and Pensions with concerns about their experiences of the section 75 employer debt regime.

4.1. Cost of the employer debt

A number of employers have suggested that their pension liabilities are becoming increasingly unaffordable in the current economic climate, but that they cannot move their staff to a more suitable pension option without triggering an even more unaffordable employer debt as a result of the employment-cessation event provisions.

Because employer debt is calculated at full buy-out level on the employer's total accrued liabilities to the scheme, the amount due up-front if an employer triggers an employment-cessation event can be significantly higher than their on-going contributions – especially if an employer is required to pay the debt up-front. If an employer does not have a source of capital available to them with which to pay the employer debt, they can therefore find themselves tied to the scheme indefinitely, even if it is not in their best interests to continue.

4.2. 'Accidental' triggering of section 75 debt

Some small employers can 'accidentally' trigger the debt as a result of an employment-cessation event – for example, if members retire or otherwise leave their employment. For an employer with a very small number of employees, this can leave an on-going risk of triggering the debt.

Employers can mitigate this problem by invoking the period of grace provisions (see 5.4 below). Some employers may resort to artificially employing a staff member who remains in the scheme. However, there is anecdotal evidence that this is not a very sustainable solution in the long term.

<u>Question 4.1</u> – has your organisation had any experience with the section 75 employer debt regime as it applies to non-associated multi-employer defined benefit schemes?

<u>Question 4.2</u> – do you think that the employer debt regime for these schemes needs to be changed, or does it work as it currently stands?

<u>Question 4.3</u> – what data do you have that might support your answer to questions 4.1 – 4.2?

5. Existing easements designed to help employers manage employer debt

A number of easements are in place to support employers who may find the requirement to pay the full employer debt up-front onerous. These easements have been drawn up to ensure member protection whilst offering exiting employers a greater level of flexibility around debt payment.

The easements applicable to non-associated multi-employer schemes are:

- Withdrawal arrangement
- Approved withdrawal arrangement
- Period of grace.

The Occupational Pension Schemes (Employer Debt) Regulations 2005 also provide for an employer to enter into scheme apportionment arrangement, whereby another employer takes over responsibility for all the departing employer's liabilities in the scheme (regulation 6E). However, it would seem highly unlikely that this arrangement would be made use of in the context of a non-associated scheme. In an associated scheme, an employer taking on the liability would, by definition, have links to the exiting employer – for example, as a part of the same group of companies. In a non-associated scheme, by contrast, the employers are not connected and may indeed be in direct competition with each other. This would make it highly unlikely that one employer would be willing to take on another's liabilities.

5.1. Withdrawal arrangement

Once the debt has been triggered, the exiting employer pays an amount based on scheme funding levels. This is the amount needed to ensure the scheme meets its technical provisions –the amount required on an actuarial calculation to make provision for the scheme's liabilities – and is lower than the full buy-out cost. A guarantor, usually a related company, agrees to pay the balance to full buy-out levels. Provision for a withdrawal arrangement is set out in regulation 6C of the Occupational Pension Schemes (Employer Debt) Regulations 2005.

The exiting employer, the guarantor and the scheme trustee must all be party to the agreement.

A withdrawal arrangement depends on another company being willing and able to pay the balance of the debt. The trustees also need to be satisfied that, when the arrangement takes effect, the remaining employers will be reasonably likely to be able to fund the scheme so that it will have sufficient and appropriate assets to cover its technical provisions, taking into account any changes to the technical provisions that may need to be made.

5.2. Approved withdrawal arrangement

Once the debt has been triggered, the exiting employer pays an amount lower than that based on scheme funding levels. A guarantor, usually a related company, agrees to pay the balance to full buy-out levels. Provision for an approved withdrawal arrangement is set out in regulation 7 of the Occupational Pension Schemes (Employer Debt) Regulations 2005.

The exiting employer, the guarantor and the scheme trustees must all be party to the agreement. Because the exiting employer is only paying a limited proportion of the total employer debt, approval is needed from the Pensions Regulator. The trustees also need to be satisfied that, when the arrangement takes effect, the remaining employers will be reasonably likely to be able to fund the scheme so that it will have sufficient and appropriate assets to cover its technical provisions, taking into account any changes to the technical provisions that may need to be made.

An approved withdrawal arrangement depends on another company being willing and able to pay the balance of the debt.

5.3. Period of grace

Where an employer temporarily ceases to employ any active members, no employer debt will be triggered if the employer gives notice to the scheme trustee that they intend to employ an active member within the next 12 months. This period can be extended up to 36 months at the discretion of the trustees. Provision for a period of grace is set out in regulation 2A of the Occupational Pension Schemes (Employer Debt) Regulations 2005.

The trustee cannot turn down an application for a period of grace for first 12 months. But trustee agreement is needed to extend the period up to 36 months. If the employer does not employ an active member during this period, the debt is then triggered.

During the period of grace, no debt is triggered. The employer remains liable for all accrued liabilities to the scheme, exactly as they would if they had active members in the scheme. The period of grace provisions therefore essentially allow an individual employer to temporarily freeze their part of the scheme.

Question 5.1 – has your organisation had experience of these easements? How often have they been used?

Question 5.2 – how effective are the easements:
- For schemes?
- For employers?

Question 5.3 - are there any weaknesses or problems with the current methods of managing employer debt?

Question 5.4 – could we make the easements easier to understand and to use?

Question 5.5 – what data do you have that might support your answer to questions 5.1 – 5.4?

6. Other Suggested Easements

Other possible mechanisms to ease the burdens on employers in non-associated multi-employer schemes have been suggested by stakeholders. These could make it easier for employers to rationalise their pension arrangements, or protect them from 'accidentally' triggering an employer debt if employees leave.

We would be interested in views about whether these suggestions are in the interests of all the parties involved and would not give rise to situations whereby either the scheme covenant was weakened or individual employers were able to evade their liabilities, leaving other employers and potentially the PPF responsible for deficits in funding. We want to fully understand what the implications of these suggestions would be, and are particularly interested in views on potential risks to the remaining employers in the scheme, to members, and to the stability and viability of schemes as a whole.

We are also interested in any other approaches to change in this area which stakeholders may think we should consider as part of this exercise.

These suggested approaches are not Government proposals. At present we are simply seeking to better understand the landscape and whether any changes may be helpful.

Question 6.1 – do the current employer debt provisions for multi-employer schemes need to be amended, or could better use be made of existing easements to manage any problems employers or schemes may face?

Question 6.2 – what data do you have that might support your answer to question 6.1?

6.1. Flexibility around debt repayment

A number of stakeholders have suggested that trustees could have greater flexibility to arrange a debt repayment plan with a departing employer.

Once the debt had been triggered, the employer and the trustee would negotiate a longer-term debt repayment plan to allow the employer to pay the employer debt over a period of time. Rather than being called in up-front, the debt could therefore be spread across a period of years. This would make the debt more affordable for an employer. There could also be a possibility for interest to be levied on the debt.

The approval of the Pensions Regulator (tPR) could be required for a debt repayment plan. The Regulator would need to be assured that the debt would be paid by the employer and that the decision not to oblige the employer to make payment up-front was in the best interests of the scheme's members.

Trustees would also need to assure themselves that any arrangement did not constitute a compromise agreement that would lead to PPF ineligibility as set out in regulation 2(2) of the Pension Protection Fund (Entry Rules) Regulation 2005 (SI 2005/590).

Pension Protection Fund eligibility

If the sponsoring employer of an occupational defined benefit pension scheme becomes insolvent, there is no possibility of the scheme being rescued and there are insufficient assets in the scheme to pay pension benefits at Pension Protection Fund (PPF) compensation levels, the scheme may be eligible to enter the PPF. In this situation, the PPF will provide compensation to members of the scheme.

The Pension Protection Fund (Entry Rules) Regulation 2005 (SI 2005/590) state that a scheme will cease to be eligible for the PPF if the trustee enters into a legally enforceable agreement the effect of which is to reduce the amount of debt due to the scheme under section 75 of the 1995 Act.

6.1.1. Benefits

Spreading the cost of the debt would lessen the immediate burden on an employer. Because the debt had been crystallised, the scheme would have greater certainty about the amount of money it was likely to receive, assuming the employer did not become insolvent.

6.1.2. Risks

A delay in the recovery of all or part of the debt has the potential to increase the risk that the full amount owing is not recovered by the scheme. This in turn increases risk to members and other employers.

Because the deficit can fluctuate significantly and over short periods of time, the scheme is exposed to the risk that the debt being paid off does not match the deficit. If the two were to diverge significantly, the risk to the scheme could be significant.

The remaining employers in the scheme could be faced with higher deficit contributions and PPF levies.

There could be a potential for the scheme itself to wind-up before the debt had been paid off.

Question 6.3 – should DWP support and encourage greater flexibility regarding debt repayment plans?

Question 6.4 – how could any repayment plan recognise and balance the needs of employers and the scheme?

Question 6.5 – would a longer timescale increase the risk of default? Are there ways that this risk could be mitigated?

Question 6.6 - what data do you have that might support your answer to questions 6.3 -6.5?

6.2. Amend the provisions so that ceasing to employ active members does not trigger employer debt

A number of stakeholders have suggested that ceasing to employ active members in the scheme should not be treated as a trigger for section 75 debt.

If an employer exits the scheme because it has closed down or become insolvent, there is a clear need to ensure that all accrued liabilities to the scheme are met up front if possible. However, where an employer remains financially active but ceases employing active members in the scheme, some stakeholders argue that the position is different. The employer still exists and could continue to service any liability towards its members.

It has therefore been suggested that an employment-cessation event where the employer remains in existence should not trigger an employer debt. Instead, the employer should be required to continue to fund their existing liabilities under the scheme funding requirements. Those liabilities could still increase. This would place an employer in a non-associated multi-employer scheme on the same footing as an employer in a single employer defined benefit scheme, which is able to cease employing active members without triggering an employer debt.

The debt would still be triggered in the event of:

- employer insolvency
- scheme wind-up.

The trustees would need to have the power to trigger the debt in the event of an employer appearing to renege on their liabilities to the scheme, and potentially also a sudden deterioration in employer covenant strength.

We would also need to consider carefully whether an employer would be able to issue a notice to trigger the debt as and when it chose. Whilst this would have benefits to the employer and would seem a logical provision, there could be implications for the scheme in allowing an employer to choose when it severed its relationship with the scheme in this way.

If the debt was triggered, it would be calculated at the relevant time in relation to the debt event itself, not the date the employer ceased employing active members.

6.2.1. Benefits

Amending the provisions so that ceasing to employ active members did not trigger an employer debt would allow employers greater flexibility around their pension obligations going forward - particularly helpful in the context of automatic enrolment for employers which have not previously had a significant proportion of staff in a pension scheme. This would change the current arrangements in the pensions market whereby an employer is bound to a scheme indefinitely as a result of decisions made several years previously, often in very different financial circumstances.

The idea would also help employers avoid triggering section 75 debts as a result of employee changes or other events potentially beyond their control, giving them greater financial security in the long and short term.

Because the employer would continue to make payments to the scheme in respect of its accrued liabilities, the scheme would still have an on-going source of funding. Whilst this would not have the immediate financial benefits of a substantial payment of capital resulting from the up-front payment of a section 75 debt, it would have the advantage of bringing funds into the scheme in the longer term which would not be received were the employer to be driven insolvent by their section 75 debts.

6.2.2. Risks

Some non-associated multi-employer schemes are very large with substantial assets and liabilities. There are uncertainties around long-term impacts which are difficult to fully understand.

Some stakeholders have indicated that such a change would result in increased scheme instability as a result of a loss of engagement by the employers concerned. Employers who no longer employed active members in the scheme would arguably be less likely to fully support the scheme and more likely to renege on their obligations towards it.

There is a potential for employers to cease employing active members in the scheme at a time when they could have paid the employer debt in full, but then trigger the debt at a later time when they were unable to do so.

Schemes would need to continue to monitor individual employers' financial viability and the resulting covenant strength of the scheme overall. Some stakeholders suggest this could be more expensive to measure for employers who were no longer employing active members in the scheme. Employers who cased making active contributions could therefore be required to pay higher administrative and actuarial costs.

Some stakeholders also suggest that a scheme with a high proportion of sponsoring employers ceasing to have active members in the scheme would need to adopt a more cautious investment risk profile. This could have the effect of reducing investment yields, increasing the scheme deficit as calculated on the technical provisions basis and ultimately requiring either higher on going contributions from all employers to meet the scheme's liabilities or some form of formal sectionalisation between employers with active members in the scheme and those with only deferred and pensioner members.

Question 6.7 – what could the consequences and risks of making this change be for:

- The scheme?
- The employer?
- Other employers in the scheme?
- Members of the scheme?
- The PPF?

Question 6.8 – how could the relationship between a scheme and its non-active employers best be managed?

Question 6.9 – would a scheme's risk profile be affected, and if so how would this be managed? What could the consequences be?

Question 6.10 - what data do you have that might support your answer to questions 6.7 – 6.9?

6.3 Change the way liability is calculated following an employment-cessation event

A number of stakeholders have suggested that the way liability is calculated following an employment-cessation event could be changed.

The rationale for calculating the debt at the full buy-out price and levying it if the employer ceases to employ active members is that it is the only way to ensure that all of an employer's liabilities can be met by the scheme once the main relationship between the employer and the scheme ends. However, as with 6.2 above, it is arguable that an employer which is still financially active but no longer making contributions to the scheme in respect of their employees is in a different position to an employer which has departed the scheme because it has ceased to exist in that form or become insolvent.

Some stakeholders suggest that there may be a compromise option so that employers who can demonstrate a strong covenant do not become liable for employer debt at full buy-out price when they cease to employ active members. There are a number of ways that this could be done. For example:

- using a different level of funding requirement to calculate the liability of an employer who could demonstrate a strong covenant; or
- giving the trustee the power to call in the debt if the employer ceases to meet certain conditions, which might include tests of financial health and continuing to meet their liabilities to the non-associated multi-employer scheme.

As a theoretical example, an employer might be required to pay their share of the liabilities calculated on a technical provisions basis rather than the full buy-out basis – i.e. the amount required, on an actuarial calculation, to make provision for the scheme's liabilities, as opposed to the amount required to cover these liabilities through an annuity. Before the Occupational Pension Schemes (Employer Debt) Regulations 2005 came into effect, employer debt was calculated on a minimum funding requirement basis not a full buy-out basis; calculating the debt as on a technical provisions basis would work on a similar principle. (Please note that this example is theoretical and for explanatory purposes only).

Any proposed change to the way liability is calculated would need to take account of a number of factors, including whether the debt calculation was fixed or scheme specific (and, if the latter, who would have responsibility for making the calculation), whether it would need the employer's consent or be imposed on them, and how employer affordability and scheme funding requirements could best be balanced.

6.3.1. Benefits

Changing the way liability is calculated would ease the burden on individual employers whilst bringing some money into the scheme up-front and giving the scheme some assurance of the employer's continuing commitment to meet its liabilities to the scheme.

6.3.2. Risks

There could be difficulties in accurately measuring the strength of an employer's covenant where that employer was not making contributions to the scheme. Covenant strength could also change significantly and potentially very quickly. An assessment would need to be carried out by the scheme, and could have an actuarial and administrative cost for them which would ultimately have to be borne by the scheme and employers.

An employer able to demonstrate a strong covenant might be more likely to be able to meet the employer debt requirements up-front than an employer with a weaker covenant.

As with option 6.1 above, any changes in the way an employer's liabilities were calculated would have the potential to increase the risk that the full amount owing was not recovered by the scheme. This in turn would increase risk to members and other employers.

Because departing employers would have paid a lower amount into the scheme at the point of departure, if that employer was not able to meet any remaining liabilities at a later date the remaining employers could have to pay larger amounts of employer debt in the event of a wider debt event occurring - for example the winding up of the scheme. This would also increase the risk of liabilities ultimately falling on the PPF if the remaining employers could not themselves meet these liabilities, and could increase the rate of the PPF levy payable.

Question 6.11 – are there any other ways in which an employer's covenant strength could be assessed and liability could be calculated?

Question 6.12 – what could the consequences and risks of making this change be for:
- The scheme?
- The employer?
- Other employers in the scheme?
- Members of the scheme?
- The PPF?

Question 6.13 - what data do you have that might support your answer to questions 6.11 – 6.12?

6.4 Other approaches

Question 6.14 - are there are any other approaches not listed here that we should consider that might improve the employer debt regime for employers, schemes, and members?

Question 6.15 – what data do you have that might support your answer to question 6.14?

List of stakeholders consulted

Baptists Together Pension Scheme
British Chamber of Commerce (BCC)
Charity Finance Group
Department for Transport
Ensign Pensions (Merchant Navy pension funds)
Falmouth Harbour Authority
Government Actuary’s Department (GAD)
Non-Associated Multi-Employer Schemes Group (NAMES)
National Association of Pension Funds (NAPF)
Office of the Third Sector
Pension Protection Fund (PPF)
The Pension Regulator (tPR)
Pensions Trust
Pilots National Pension Fund (PNPF)
PlumbingPensions UK
SAUL (Superannuation Arrangements of the University of London)
Universities’ Superannuation Scheme (USS)