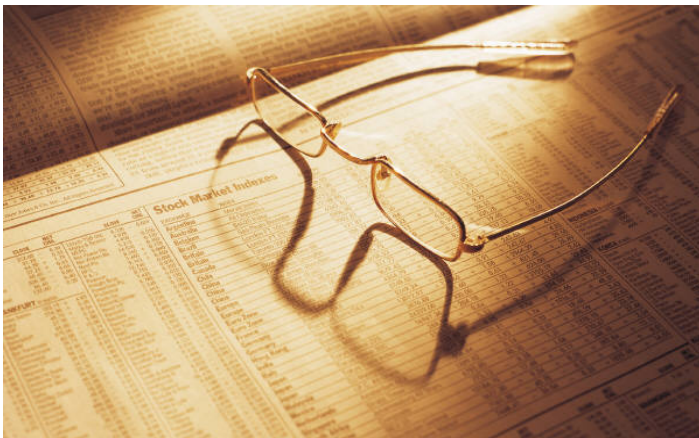


## Changes to the Employer Debt Regulations



**As all those involved in M & A activity or corporate restructuring will know, some of the key issues in any deal or restructure is whether there is a pensions scheme, if it a final salary scheme and how the structure of the deal, or changes to the group structure, interacts with the Employer Debt Regulations.**

For some time now, issues have arisen concerning whether an employer debt is triggered by what is occurring and, if there is a debt triggered, how large it is and how much impact it has on the process.

The basic issue with the regulations is that if the parties involved are not careful they can trigger an employer debt. This debt is worked out at a buy out level rather than the ongoing funding level normally used to work out the employers liability to the scheme. It is therefore possible for a situation to develop where, as a result of a deal or restructure, a company who believed it was dealing with a final salary scheme in surplus suddenly finds itself owing a sum of money to the scheme which often a buyer will insist is paid before conclusion of a transaction.

There have also been situations where simple corporate restructures

involving the moving of employees from one company to another can trigger a debt. Companies often fail to understand that the debt does not relate only to active employees, it relates to all liabilities the company may have to the scheme.

As has been noted this debt is normally at a much higher level than the amount of liabilities the company has disclosed for its pension scheme in its accounts. The reason for this is simple. The debt is based on the situation that the scheme is effectively in wind up and it will be unable to recover any further funds from the company. The trustees are therefore required by the regulations to recover from the company the amount they need to fully fund the members' benefits. If the scheme is ongoing then the company is treated as having an ongoing liability and the amount it is due to pay the scheme is substantially less, until a debt is triggered.

There is however some hope regarding the position of pension scheme debt in these situations. As a result of lobbying, and their own observations of the impact of the regulations, the Government has amended the Employer Debt Regulations

### What's changed?

There are a variety of changes introduced by the revised regulations.

1. There is a change to the definition of employer cessation event – the change clarifies what this is. Previously there has been debate in legal circles as to what constitutes such an event. It is now expressed that a debt is triggered where an employer ceases to have employees who are active members of the scheme. One important result of the clarification is that it is now clear that closing a scheme to future accrual does not automatically trigger a cessation event.
2. There is now a 12 month grace period before a debt must be paid. This is aimed at accidental triggering of a debt in a corporate restructure. It allows those involved time to reverse the position and ensure the debt need not necessarily be triggered. Basically, a debt is not triggered if an employer expects to have an employee who is an active member in the scheme within the 12 month period. If this does not occur the debt will be triggered.
3. Withdrawal arrangements have been revised. These arrangements were intended to allow a situation where the debt due on an event need not be paid immediately. The intention was that other participating

companies or another outside company could agree with the trustees to take responsibility for the debt and therefore the withdrawing company would only need to pay any debt up to the scheme specific level. The problem has been that there has been a very poor take up of these arrangements due to a variety of factors. The changes are intended to promote and encourage such arrangements. This will be discussed in greater detail later in this update.

4. One way to avoid paying the debt immediately has been to use apportionment agreements to effectively rearrange the debt. The government has become concerned that this may have been used as a way of avoiding the debt and has taken action to regulate this approach. Effectively the scheme rules are written in such a way as to ensure that when an employer exits the company the employer debt is shared amongst the remaining companies. The regulator has now overridden such rules; before the rule can function a new funding test must be applied. The trustees must now be comfortable that the remaining employers have sufficient assets to ensure the technical liabilities of the scheme can be met. Members' benefits must not be adversely affected.

There have been some changes to how an employer's share of the debt is calculated. This will remain broadly as the buy-out debt, however there will be circumstances where other ways of paying the debt have been arranged, for instance via a withdrawal arrangement, and this is now taken into account.

### Withdrawal Arrangements

As noted above there have been substantial changes to the regulation of withdrawal arrangements.

The chief and most important change is that not all withdrawal arrangements now require approval from the Pensions Regulator. Previously every withdrawal arrangement had to go through an approval process with the regulator. The strenuous nature of this process and the requirements raised by the regulator discouraged many employers from considering it as an option.

To be able to proceed with an unapproved withdrawal arrangement, which would be negotiated between the trustees, the various companies and their advisors, three tests must be met. These can be summarised as

- a. The existing employer, the employer normally subject to a debt in these situations, must pay a share of the debt. This would not amount to the full buy-out cost. Instead it must only pay any difference between the schemes existing assets and its liabilities as calculated on the scheme specific funding level. This figure will be substantially less than the buy-out figure.
- b. A guarantor or guarantors confirm they will pay the difference

between the scheme specific funding level and the buy out level and the trustees are satisfied that they have sufficient assets to meet this commitment if called upon to do so.

- c. The trustees must be satisfied that the employers remaining in the scheme after the leaving company has exited have sufficient wherewithal to fund the technical provisions of the scheme.

Obviously there is more detail around the basic statements above. However, it is now possible that these arrangements can be used to effectively redistribute the debt at the time of a company ceasing to have employees who are active members and this may negate the need for substantial sums to be paid to the scheme.

There will still be Regulator Approved Withdrawal Arrangements and here also changes have been made.

A withdrawal arrangement will require formal Regulator approval if

1. The trustees agree that the exiting employer may pay to the scheme an amount less than that required to bring any shortfall up to the scheme specific funding level.
2. The employers and trustees cannot agree the terms on which the departing company will depart.

One very important change, and one of the reasons withdrawal arrangements have so far proved unpopular, is that the previous test that the Regulator required - that as a result of the arrangement the employer debt was "more likely to be paid" - is now no longer to apply. This should allow for such arrangements to be easier to enter.

One other clarification has been that the regulator has confirmed that withdrawal arrangements can be approved both before and after a cessation event, this was not previously clear.

**“it may well be easier for companies to cease participation in pension schemes”**

### Possible Impact

The possible impact of all these changes is that it may well be easier for companies to cease participation in pension schemes provided that the right circumstances are available and that the trustees of the pensions scheme are able to agree. The revisions to withdrawal arrangements allow for greater flexibility in dealing with this issue in future.

One important thing to note is that it doesn't look like the changes will stop here. The DWP has indicated it may change the regulations again, watch this space!

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