

corporate briefing



DWP issues final Section 75 debt regulations

Summary

The long-awaited amendments to the Section 75 debt regulations were laid before Parliament on 14 March 2008.

The regulations introduce new ways for companies and trustees to agree reduced debt payments and remove some of the barriers to corporate activity. While many of the original proposals set out in the consultation have been retained, welcome clarification is provided that no debt is triggered when a scheme closes to future accrual.

However for many sponsors, the new regulations do not go far enough. Although the Government has promised to continue to work to find a 'practical solution', for the time being, concerns over debts triggered by internal corporate restructuring still remain.

The final regulations came into force on 6 April 2008. Potentially beneficial transition provisions may apply in certain cases (see below).

Background

Under the old Section 75 debt regulations, a buyout debt was triggered when a participating employer ceased to have any employees in a scheme where at least one other participating employer continued to do so. It was acknowledged by the Government that these regulations were poorly worded and, as such, could prove a barrier to employers carrying out their business – hindering or even preventing corporate activity.

On 7 August 2007, the Department for Work and Pensions (DWP) issued draft amendments to the regulations with the stated aims of providing more flexibility for employers and making the regulations easier to operate. Following consultation, the final regulations were laid before Parliament on 14 March 2008. The Government has taken on board some of the consultation responses, but others have either been rejected or put aside for further consideration. Most notably, debts can still be triggered by corporate restructuring that does not impact the employer covenant.

In this briefing, we explore how the final regulations differ from the draft regulations and their likely impact on multi-employer schemes.

The detail

Definition of employer cessation event

One of the more welcome changes to the draft regulations relates to the definition of an employer cessation event. This has been amended to ease the concern that a debt could have been triggered if all employers had ceased to employ active members at the same time (for example if a scheme closed to future accrual). This could have caused significant issues for those companies considering such an approach.

Valuation of assets and liabilities

As in the draft regulations, the final regulations give the trustees greater control in determining the assets and liabilities from which the amount of the Section 75 debt is derived. If an actual market buyout cost is not available, the actuary can estimate the cost in an 'appropriate' manner.

Further, the final regulations remove the restriction present in the draft regulations that an update to the assets and liabilities should be based on accounts or an actuarial valuation no more than a year old. Instead this is left as a matter for judgement as to what is appropriate.

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12 month grace period

At what would otherwise be an employment cessation event, a debt is now not triggered where employers who cease to have active members give notice that they expect to employ one or more within the 12 month grace period. This provision remains unchanged from the draft regulations released last year.

Debt calculation methods

As in the draft regulations, the final regulations set out a number of possible methods for calculating the debt when an employer ceases to have active members in a multi-employer scheme (called an 'employer cessation event'). See Figure 1 for further details:

Figure 1 | Final regulations on debt calculation methods

	Original regulations	Draft regulations	Final regulations
Liability share	Unless the scheme rules provide otherwise, the debt is proportionate to the liabilities in respect of service with that employer. The liabilities include a proportionate share of any 'orphan' liabilities not otherwise attributable.	Largely unchanged from the original regulations. Orphan liabilities may be attributed entirely to the member's last employer where scheme records do not allow division between periods of service with more than one employer.	The share of the deficit can now be reduced to reflect liabilities and assets transferred out of the scheme. Orphan liabilities may be attributed 'in a reasonable manner' to any one or more scheme employers.
Scheme apportionment arrangement	Previously it was possible for a clause to be inserted in the scheme's Trust Deed apportioning the debt in whatever way desired, given the agreement of the trustees and employer. It is usual to seek regulator clearance to each apportionment.	Rather than have a clause in the Trust Deed, the trustees and employer may agree, as and when a cessation event occurs, to apportion the overall scheme deficit in a different way, typically allocating a lower amount to the departing employer than the default. The trustees must be satisfied that the remaining employer's ability and willingness to fund the scheme is not adversely affected by the apportionment arrangement. Apportionment rules already put in place almost certainly require some modification.	There is now a requirement for the apportionment to be specified in the scheme's Trust Deed, rather than being agreed as and when a cessation event occurs. The wording has changed to refer to a 'funding test', whereby the remaining employers will be reasonably likely to be able to cover the scheme's technical provisions. A further test has been introduced requiring that the apportionment arrangement has no adverse effect on the security of members' benefits. It remains to be seen how this test will apply in practice. The wording has also been revised so that apportionment rules already put in place may not now need to be revisited.
Withdrawal arrangement /cessation agreement	A departing employer pays a lower debt on the basis that a guarantee is provided for the balance. This requires the agreement of the trustees, the guarantor and the regulator, with the regulator's approval depending on his being satisfied that the full buyout debt is "more likely" to be paid.	As previously, a lower debt is agreed with the guarantor assuming contingent liability for the balance. The minimum debt agreed is based on the scheme's technical provisions, rather than a buyout cost. Under a withdrawal arrangement, the trustees need to be satisfied that the remaining employer's ability and willingness to fund the scheme is not adversely affected by the agreement. Under an approved withdrawal arrangement, regulator approval is required, but the test applied is amended with the intention of making it easier to obtain approval. With regulator approval, the immediate payment can be lower than the departing employer's share of the technical provisions.	Broadly unchanged from the draft regulations. However, here again the wording has changed to refer to a 'funding test' (see above). Whilst the trustees must be satisfied that the guarantor can meet the guarantee being given, they are not required to apply the extra test that there is no adverse effect on the security of members' benefits.

Transition provisions

For those currently considering an action that might trigger a Section 75, debt there are welcome transition provisions. The previous regime continues to apply for 12 months where:

- an agreement is entered into within 12 months after 6 April 2008 on the basis of a scheme apportionment rule put in place before 14 March 2008
- the transaction to which the agreement related was considered before 14 March 2008 by at least one of the parties to the agreement or a connected or associated person of one of the parties.

Commentary

The final regulations are an improvement on the draft version and contain a number of changes that will be welcomed. In particular, as long as the pension scheme is not jeopardised, the regulations introduce new ways for companies and trustees to agree reduced debt payments and remove some of the barriers to corporate activity.

Unfortunately, the final regulations do not change the situation surrounding corporate restructuring. Section 75 debts can still be triggered by corporate actions that do not adversely affect the employer covenant, for example group reorganisations and small sales/acquisitions.

The Government has issued a statement reiterating its commitment to seek a practical solution to such situations. Mike O'Brien, Minister for Pensions Reform, has committed to "see if it is possible to seek a practical solution to the problem of company reorganisations triggering the employer debt provisions, without undermining the principle that employers should fully meet their pension obligations". Whether or not this commitment translates into a workable solution for employers remains to be seen.

Steven Dicker

+44 (0) 7808 176397
steven.dicker@watsonwyatt.com

James Riley

+44 (0) 20 7227 2369
james.riley@watsonwyatt.com

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