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Making employer debt easier

May 2016

Introduction

When an employer leaves a multi-employer occupational defined benefit pension scheme, that employer may have to pay more funds into the scheme. Understanding when such a liability can arise and how to deal with it is crucial to both the pension scheme and corporate activity.

10 steps to understanding employer debts in multi-employer schemes

1. When an employer leaves a pension scheme, there should be enough funds in the scheme to pay for the benefits of its employees. If there is not, the departing employer will be responsible for its share of any underfunding. This is known as a section 75 or employer debt.
2. The amount of any employer debt is the difference between the assets relating to the particular employer and the cost of buying out the employer's share of the benefits with an insurance company. In many cases this cost is significant. The trustees must ensure that any employer debt is paid within a reasonable period.
3. The debt can be triggered in a number of different situations – such as on the sale of a subsidiary or when the employer stops employing any contributing members. No debt, however, will arise in some internal group restructurings as long as another employer in the scheme agrees to take on the leaving employer's liabilities. The restructuring must meet certain fairly narrow conditions so the trustees and employers should take independent professional advice.
4. There are certain permitted ways of dealing with the debt which can help the employer.
5. The leaving employer can ask the trustees to allow it to pay a reduced amount if another company guarantees to pay the rest of the debt at a future date – usually when the scheme winds up or the last employer becomes insolvent. This is known as a withdrawal arrangement. The trustees should only agree to the arrangement if the remaining employers can fund the pension scheme and the guarantor has sufficient financial resources to pay the outstanding debt when it is due.
6. Another option is to ask the trustees to agree to an arrangement in the scheme rules (known as an apportionment arrangement or a flexible apportionment arrangement) which allows the employer who is leaving to pay less (often only a nominal amount) than the full amount of its debt. Some or all of the other remaining employers must agree to pay the rest. The trustees will need to make sure that the remaining employers can fund the pension scheme.
7. In both these cases, the trustees must first consider carefully whether it is in the best interests of the members to agree to the employer's request. Trustees need to understand the implications of the employer's departure on the ability of the remaining employers to support the scheme going forward. Trustees may need to ask for additional financial support for the pension scheme. This is a complicated area and trustees should seek independent professional advice.
8. An employer needs to be particularly careful if it employs very few contributing employees as a debt may be payable if its last contributing employee leaves the scheme or dies. However, if the employer intends to offer membership to another employee within a year, no debt will be payable. To take advantage of this, the employer must tell the trustees in writing within one month of its last employee leaving the scheme. Employers in this position should therefore have systems in place to monitor when the last employee leaves as it is very easy to miss this deadline.
9. If the scheme is closed to all further benefits no debt is payable immediately. However, the employers and trustees should check the rules to make sure that the scheme does not go into winding-up by mistake. An employer remains liable for its share of any underfunding if it becomes insolvent or if the scheme winds up at a later date.
10. The Pensions Regulator has powers to require other companies within the group to provide support. Employers can apply for confirmation from the Regulator that it will not use these powers. This is known as clearance. Although neither a withdrawal arrangement nor an apportionment arrangement needs Regulator approval, the Regulator expects clearance to be sought in some cases.

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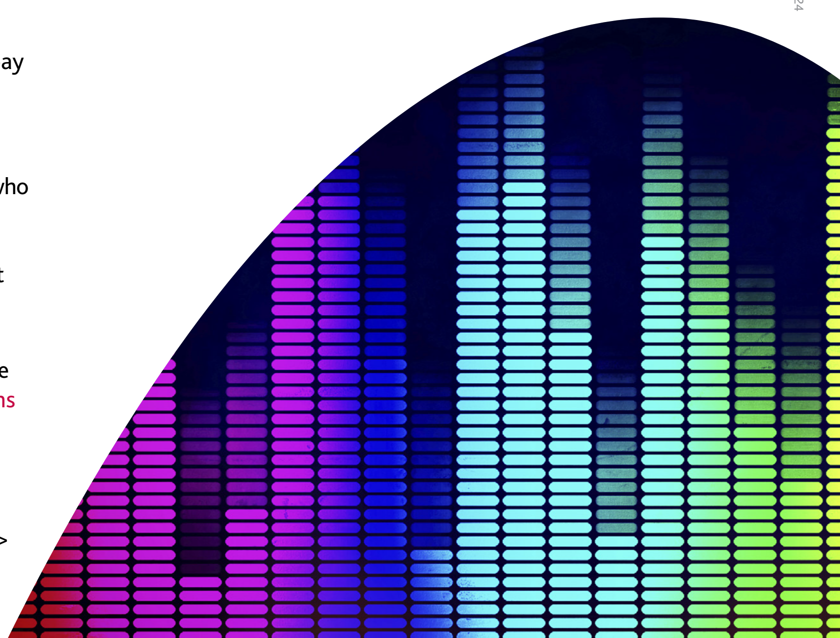

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Further reading

The Pensions Regulator has published guidance on multi-employer schemes and employer departures. It also includes useful information in its clearance guidance.

Pensions law can be tricky… but it doesn't have to be. These 'making it easier' guides explain key issues in simple terms, giving practical help to trustees and employers.

The series is growing; additional copies can be downloaded from www.pinsentmasons.com

Current topics include: Using advisers; Scheme changes and Becoming a trustee

Comments and ideas for further topics are welcome…

Email: Stephen Scholefield