September 2011

Review

Pensions

Statutory employers – time to dig and delve

The Pensions Regulator has issued a statement for trustees of defined benefit pension arrangements entitled: *Identifying your statutory employer.* Trustees should identify the nature and extent of support that current and former participating employers are obliged to provide to the pension plan, if they have not already done so. Statutory employer information will need to be provided on future scheme returns and changes should be reported via the Regulator's online service 'Exchange'.

Background

A key area of responsibility for trustees of DB pension plans is to identify which employers have an obligation to provide financial support to the plan and the extent of the obligation. This identification forms the basis of the employer covenant assessment, funding negotiations with the employer and the investment strategy.

Trustees should understand which employers may owe a debt to the pension plan if those employers cease to participate or become insolvent. This is a complicated process, as the legislation has changed over time and has been informed by case law. Former employers may still be statutory employers if, for example, they have not discharged debts owed to the plan. It is also important to identify employers whose insolvency would trigger the plan's entry into the Pension Protection Fund – this is key for member security.

There are no changes to current legislation, and the Regulator has already covered the above issues in its existing guidance. What is new is the increased focus from the Regulator on trustees scrutinising the status of employers who support their pension plans and the requirement for this information to be included on scheme returns from November this year.

Although the Regulator's statement is aimed at pension plan trustees it is also important for employers to understand the obligations owed by other employers to the pension plan. We anticipate that current employers and trustees will wish to work together to confirm the correct position.

What is a statutory employer?

Different definitions of the term 'employer' are found in different areas of legislation – there is no single legal definition for pensions purposes. The Regulator uses the term 'statutory employer' to mean those legally responsible for:

- meeting the funding objective of the pension plan
- paying the section 75 debt when an employment cessation event occurs on an employer departure from a multi-employer pension plan, on wind-up or on employer insolvency
- triggering entry to a PPF assessment period on insolvency.

Not all employers participating in a pension plan will be statutory employers. It is important to understand which obligations apply to each employer.

Did you know...

… that the first old age state pension was introduced in the UK in 1909 for those of 'good character' (excluding the habitually drunk)? A single person was paid 5 bob per week. Apparently this was enough to pay the rent, heat and light the home, and buy: half a bag of flour, 2 pounds of mutton, a pound of lard, a loaf of bread and 5 pints of beer. Mutton pie sandwiches and beer anyone? How times (and diets) have changed…

Examples

Here are two common examples of where a participating employer does not fulfil all of the statutory employer criteria.

1. Due to corporate restructuring, an employer with a DB pension plan which is closed to future accrual, is replaced by a new employer that does not employ (and has never employed) an active DB member. The new employer would not be liable for a section 75 debt if it ceased to participate in the plan. Nor would the new employer be considered an 'employer' for the purposes of assessing whether the pension plan would be eligible to enter the PPF.

2. A hybrid pension plan has a DB section which is closed to future accrual. New employees are offered membership of a DC section. A new employer joining the plan may never have employed a DB member and so may not be liable for any section 75 debt that could arise. Emphasis cannot be placed on such DC employers for covenant assessment purposes. If the only participating employers have never employed DB members, this should be reported to the Regulator.

Identifying statutory employers

The identification of statutory employers may be relatively straightforward for pension plans that are not closed to accrual or those that do not have a complicated history of employers joining and leaving. Some trustees will already have gone through processes to identify their statutory employers, possibly as part of a comprehensive employer covenant assessment.

To identify statutory employers, the Regulator recommends that trustees collate records such as legal documents, employment records, contracting-out certificates, information from Companies House and past scheme accounts. We suggest that the plan's last annual return is a good place to start, as this will often name a whole host of companies that the Regulator considers to be potential "employers". Trustees should request information from employers, where necessary, and should inform the Regulator if the employers persistently fail to co-operate.

The extent of any investigation required will depend entirely on the plan's circumstances.

What if an investigation reveals that …

… there is no statutory employer?

The trustees should discuss the position with any contributing employers and inform the Regulator. The trustees should investigate how the situation arose, involving the Regulator at the outset, and the Regulator will consider use of its anti-avoidance powers where appropriate.

… the statutory employer position is not as the trustees thought?

The trustees should consider the impact on their covenant assessment and may wish to revisit the assumptions used to set the plan's technical provisions.

Future vigilance

Due to the growing number of DB plans that are closed to future accrual, the Regulator believes that there is an increasing risk, over time, of pension plans ceasing to have any statutory employer. Trustees need to be vigilant to circumstances in which their plan might lose a statutory employer, especially where it is the only remaining statutory employer. Scenarios that trustees need to be particularly aware of include:

- an employer substitution – where the new employer does not meet the statutory definition or is a DC only employer
- a bulk transfer of DB liabilities to a pension plan in which no DB liabilities have accrued or will accrue
- an employer departure from the plan under the employer debt regulations which leaves an employer which is not a statutory employer, or is a DC employer
- a 'phoenix event' – an arrangement resulting in the employer's business being sold to a new entity following an insolvency event, where the new entity has never employed any active DB members.

Did you know...

… that the first 'organised' pension plan in the UK was set up for Royal Navy Officers in the 1670s? Some of our Partners remember it well…

If an employer substitution or bulk transfer takes place in the future the Regulator expects trustees to ensure that the new employer takes on responsibility for the DB liabilities as a statutory employer, ensuring that any detrimental effect is mitigated. The most robust way of doing this is for the new employer to employ an active member – this may mean that a pension plan that is closed to new entrants is re-opened for this purpose.

Trustees should ensure that they take legal advice when any of the above circumstances occur.

Financial Assistance Scheme

In recognition of the fact that some pension plans have in the past lost their last remaining statutory employer, the Government has consulted on a limited extension of the Financial Assistance Scheme for plans which meet specified conditions.

Comment and action

Any changes to statutory employers should in future be updated via the Regulator's online service 'Exchange'.

In our experience, pension plans do not always have a clear audit trail of when employers ceased to participate in the plan and how those employers discharged debts owed to the plan at the time. It is often the case that an employer exit has not been formally documented, or the relevant documentation has been mislaid. Trustees who are not clear on the identities of their statutory employers should seek clarity well in advance of the scheme return deadline, as further investigation may be required.

Squire Sanders Hammonds has considerable experience in conducting audits to identify statutory employers. If you are unclear on whether you need to take action, or if you require assistance, then please talk to us at an early stage and we can help you to establish a proportionate approach for your pension plan.

Further information

Please talk to your usual contact in the pensions team, or any of the partners below.

Francois Barker
Partner
T: +44 (0)121 222 3584
E: francois.barker@ssd.com

Emma King
Partner
T: +44 (0)121 222 3103
E: emma.king@ssd.com

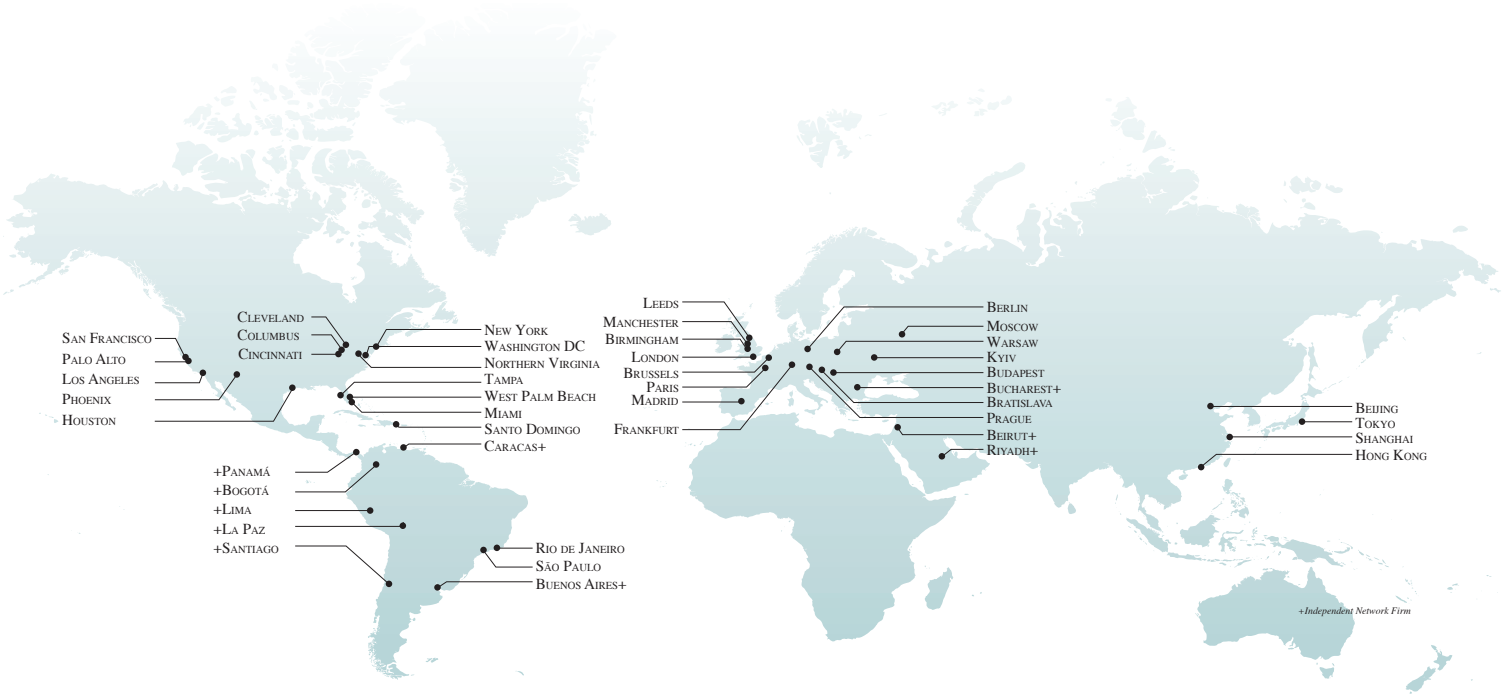
Steve Southern
Partner
T: +44 (0)161 830 5172
E: steve.southern@ssd.com

Wendy Hunter
Partner
T: +44 (0)20 7655 1119
E: wendy.hunter@ssd.com

Catherine McKenna
Partner
T: +44 (0)113 284 7045
E: catherine.mckenna@ssd.com

Did you know...

… that according to NAPF research, 850 pieces of regulation or legislation directly relating to workplace pensions have been issued since 1995? That's roughly one a week. Our pensions lawyers are never short of bedtime reading (or topics for discussion at social gatherings).



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