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Pensions Quick Guide

Employer Debt

What Do We Mean When We Talk About "Employer Debt"?

The funding of a defined benefit occupational pension scheme is measured in a variety of different ways, to assess the extent to which:

1. The scheme would be able to meet its liabilities if it were to enter the Pension Protection Fund (PPF)
2. The scheme has sufficient and appropriate assets to meet its "technical provisions" (meaning the amount required on an actuarial calculation to make provision for the scheme's liabilities)
3. The scheme can be terminated and wound up, by buying out all benefit liabilities with annuity policies purchased from an insurer

In the current economic and investment circumstances, the third of the above funding measures, assessing the scheme's termination liabilities, is usually by far the most severe, leading to the largest level of deficit (often referred to as the "buyout deficit" or "section 75 deficit"). In a sense, it is the ultimate test of funding – and the only way in which most defined benefit pension schemes can be brought to their conclusion on a fully-funded basis.

Under government legislation passed in the early 1990s, the funding deficit is translated into a potential debt that employers owe to their defined benefit pension schemes. This employer debt is a "statutory debt", meaning that the amount of the debt and the circumstances in which it arises are defined in legislation.

Which Schemes Are Covered?

The employer debt legislation applies to most occupational pension schemes that are not money purchase schemes and are not expressly excluded by the legislation. The debt will, therefore, apply to most defined benefit occupational pension schemes, but not to public sector pension schemes, schemes that are not registered under the Finance Act 2004, small self-administered pension schemes or certain overseas pension schemes (schemes recognised under section 615 of the Income and Corporation Taxes Act 1988).

Why Do We Have Employer Debt Legislation?

The purposes of the employer debt legislation are:

- To ensure that, if a scheme is wound up (or an employer becomes insolvent) at a time when the value of the assets of the scheme is less than the amount of the scheme's liabilities, an amount equal to the difference is treated as a debt due from the employer
- To ensure that the trustees of the scheme will rank as creditors in relation to any dividend paid out on the insolvency of the employer
- To prevent an employer from leaving a multi-employer scheme without meeting its share of the overall deficit in the scheme

How Much Is the Employer Debt?

The employer debt is equal to the buyout deficit in the scheme (see above), as estimated by the pension scheme appointed actuary. This deficit will represent the extent to which the value of the scheme assets is less than the amount of the scheme's liabilities (plus winding-up expenses), assuming that the liabilities will be secured by the purchase of annuity policies. Where the scheme has more than one employer, each employer's share is a proportion of the overall deficit, using a formula that is specified in legislation.

When Will the Employer Debt Usually Be Triggered?

An employer debt can be triggered:

- During a scheme wind up (at a point in time decided by the scheme trustees)
- When a "relevant event" occurs in relation to the employer of the scheme

A "relevant event" generally means some kind of insolvency event, such as administration, court ordered winding up, administrative receivership or some form of voluntary company winding up or arrangement.

An additional trigger exists if the pension scheme has more than one employer (see below).

Who Owes the Debt?

The legislation says that the employer debt is payable by the person who is (or who has been, in the case of a closed scheme) "the employer of persons in the description or category of employment to which the scheme in question relates".

In a single employer scheme, it is usually easy to identify the "employer". In certain circumstances, however, corporate reorganisations might make the issue less clear. This is why The Pensions Regulator (TPR) is keen for trustees to know, at all times, the identity of the "statutory employer" (meaning the employer, as described above), because this is the entity that the trustees can ultimately pursue, by legal process, for payment of the employer debt.

What If Our Pension Scheme Has More Than One Employer?

The situation is more complex if a scheme has more than one employer – the so-called "multi-employer scheme". The following complexities arise:

- There is, of course, likely to be more than one statutory employer
- There may be less clarity about which employers actually owe a debt – employers may have participated in a scheme in the past, but may retain an unpaid debt obligation to the scheme, and the trustees need to be aware of, and keep track of, all employers in this category
- In addition to the above debt trigger events, there is a further possible event – an "employment cessation event"

An "employment cessation event" is an event where a particular employer ceases to employ active members of the scheme, at a time when at least one other employer still does.

In the increasingly common situation of a scheme that no longer has active members, such an "employment cessation event" is unlikely to take place. However, where groups of employers seek to reorganise in a closed scheme, it is feasible for any particular employer to require its debt to be calculated, and once it is satisfied it will be discharged.

Must an Employer Pay Its Debt When It Leaves a Multi-Employer Scheme?

Where an employer of a multi-employer scheme does not wish to pay the full amount of its debt on a liability share basis, there are certain **statutory concessions** available. Some concessions permit a lower debt, plus the balance to be allocated ("apportioned") to some other employer that participates in the pension scheme. The most popular concessions are summarised in the table below, with the most frequently used one being the flexible apportionment arrangement.

What Statutory Concessions Are Available in Multi-Employer Schemes?

	Statutory Concession	Is TPR Involved?	Additional Information
1.	Withdrawal arrangement	✗	The departing employer pays its liability share calculated on the lower "technical provisions" basis, rather than the full buyout basis. A third party guarantees the remainder of the buyout debt.
2.	Approved withdrawal arrangement	✓	Same as for a withdrawal arrangement, but TPR approval is required.
3.	Period of grace	✗	Notice must be served on the trustees within three months of the employment cessation event. The debt may then be deferred for a period of up to three years if the employer intends to, and does in fact, employ an active member of the scheme within that period.
4.	Scheme apportionment arrangement	✗	The employer's share of the debt is calculated on the full buyout basis. The scheme rules will set out how the balance of any debt not paid by the departing employer will be apportioned between the remaining employers.
5.	Regulated apportionment arrangement	✓	This is similar to a scheme apportionment arrangement, but TPR approval and PPF involvement is required. It is generally used where the scheme is likely to enter a PPF assessment period in the next 12 months.
6.	Restructuring easements	✗	This can be used for a straightforward transfer of the whole of the business and assets from one group company to another group company, but conditions apply, making it less popular than a flexible apportionment arrangement.
7.	Flexible apportionment arrangement	✗	This can be undertaken whether or not the scheme rules allow for it. The arrangement apportions a departing employer's share of the liabilities, rather than debt, so there is no need for a debt calculation.
8.	Deferred debt arrangement	✗	This is a new arrangement introduced from 6 April 2018. Non-associated employers in a multi-employer scheme might find this easier to use than some of the other concessions that are designed for group companies. Payment of the debt is deferred by agreement with the scheme trustees and in accordance with statutory conditions.

Do Any Conditions Apply When Using a Statutory Concession?

The pension scheme members' interests are protected when a statutory concession is used, because, in most instances, the concession is not effective unless the pension scheme trustees are satisfied that a "funding test" is met. The conditions of the "funding test" are set out in legislation but, broadly speaking, mean that the trustees must be satisfied the remaining employers could continue to fund the scheme. Additionally, the trustees would also need to be satisfied that the arrangement does not adversely affect the security of members' benefits.

Some Practical Points

Do	Don't
Do keep up to date with scheme data to limit the number of "orphan liabilities", i.e. liabilities unrelated to any statutory employer.	**Don't** place too much faith in your own financial judgement concerning the funding test – employer covenant advice is helpful and a valuable defence against the current regulatory concern about transferring pension liabilities to shell companies.
Do know who your "statutory employers" are at any point in time.	**Don't** forget about orphan liabilities on a debt calculation. Special arrangements apply to allocate these amongst the scheme's statutory employers.
Do be aware of corporate group acquisitions and disposals.	**Don't** forget that the compromise or reduction of any employer debt (such as in the scenarios described in the table above) is an event that must be notified to TPR. TPR can, in extreme circumstances, re-impose the full amount of the prospective debt, by issuing a "contribution notice" under its regulatory powers. TPR also has the power to pursue criminal proceedings against anyone who commits an offence of "avoidance of an employer debt" or "conduct risking accrued scheme benefits".

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