March 2010

Review

Pensions

Pensions debt: easing into reform

Broadly, a buy-out debt is triggered in a defined benefit pension scheme if a participating employer ceases to employ any active scheme members (but other participating employers continue to do so). The employer debt regulations[1] will be amended on 6 April 2010, to introduce two 'easements' that companies may wish to use when undertaking corporate transactions and group restructurings. Where the easement provisions are used, a buy-out debt will not be triggered by a company exiting a pension scheme. The easements are intended to be concessions to help reduce barriers to corporate transactions – they do not impact on the rest of the employer debt provisions or the Pensions Regulator's ability to intervene using its anti-avoidance powers.

In September 2009, we reported on the Department for Work and Pensions' consultation on these easements, which appeared to us to be so restrictive that they would be of little practical use. Following consultation, the easements have a broader scope, wider timescales and are slightly less bureaucratic. In spite of these positive changes, the easements still contain a number of restrictions and we suspect they will be of limited use in practice.

THE EASEMENTS

To make use of either of the easement provisions, an exiting employer must transfer all assets, employees, pension scheme members and liabilities attributable to it, to another employer under a legally enforceable agreement. By the time that the transaction is complete the receiving employer must be participating in the scheme and must employ at least one active scheme member. The easements can only be used for "one to one" company transactions (not where there is a transfer from one company to many companies). Specific procedures must be followed by employers and trustees, and timescales must be observed. The process will start with a request to the trustees from the exiting employer (ie the employer that would be on the hook for any pensions debt).

THE 'GENERAL' EASEMENT

Trustees must decide whether a restructuring test is met. They must satisfy themselves that, following the transaction:

- the likelihood of the receiving employer meeting its existing scheme liabilities (if any) has not decreased; and
- the receiving employer is at least as likely as the exiting employer to meet the transferring liabilities.

In considering the restructuring test, trustees need to consider their overall duty to monitor the employer covenant and this may involve trustees looking further than an assessment of the two companies directly involved in the transaction. Trustees can require the companies involved to meet the cost of complying with the easement provisions: the costs associated with the general easement may well be significant in some cases. Before starting this process, companies need to consider all other alternatives to dealing with the debt, such as an apportionment arrangement.

THE 'DE MINIMIS' EASEMENT

The de minimis easement applies to transactions involving a small number of scheme members. The following conditions will need to be met in relation to members who have built up defined benefits as a result of employment with the exiting employer:

1 The Occupational Pension Schemes (Employer Debt) Regulations 2005.

- the transaction must not involve more than 2 members, or 3% of the scheme membership (whichever is greater); and
- the total annual amount of accrued pensions of the members covered by the transaction must not exceed £20,000.

In addition, the de minimis easement can only be used where the pension scheme has sufficient assets to meet the cost of securing benefits for its members at a level which is equivalent to the compensation they would receive from the Pension Protection Fund. To determine whether these criteria are met, trustees must use the information contained in the most recent scheme return and the actuarial valuation carried out for PPF purposes. There are also limits to the amount of de minimis transactions that can be carried out within a 5 year period.

COMMENT

When the proposed new easements were first announced, they were widely criticised by employers for their narrow scope. While some changes have been made, we suspect these do not go far enough to satisfy those large corporate groups who feel unable to restructure because of the pension debts that could be triggered. However, trustee groups who were concerned that these easements could be used to weaken the employer covenant will probably be breathing a sigh of relief.

The DWP has stepped back from using this as an opportunity to address some of the technical issues relating to the employer debt legislation, although the DWP has stated that these issues will be considered as part of a separate process. It may be that we see further (and potentially wider) changes to the debt legislation over time.

Companies planning on using the easement provisions will need to understand what criteria have to be met.

FURTHER INFORMATION

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