

Employer Debt

A response by

The National Association of Pension Funds

19th November 2009

Introduction

1. The National Association of Pension Funds (NAPF) is the leading voice of workplace pensions in the UK. We speak for 1,200 pension schemes with around 15 million members and assets of £800 billion. The NAPF's membership also includes 400 businesses that provide essential services to the pensions sector.
2. The NAPF welcomes the opportunity to respond to this consultation exercise. We have consulted with members of our Retirement Policy Council and our Multi-employer Schemes Forum. This response is based on comments from members of both groups.

Executive summary

- The NAPF's objective is to ensure that legitimate corporate restructurings can go ahead without triggering Section 75, while at the same time ensuring that the legislation continues to protect members.
- Most members who submitted comments are concerned that the proposed General Easement will prove to be of little benefit in practice because of (i) the specific difficulties arising from the individual 'steps' set out in the General Easement; and (ii) the cumbersome nature of the process as a whole.
- The specific difficulties include:
 - the 'Restructuring Test' – determining whether the receiving employer is 'at least as likely' as the exiting employer to meet liabilities.
 - the requirement that the exiting and receiving employers must be part of the same group;
 - the requirement that the exiting and receiving employers must be part of the same scheme;
 - the requirement that the receiving employer's head office must be in the UK.
- Some members have suggested that the General Easement could be radically simplified so that it consists solely of the Restructuring Test. This would answer the key question about which members will wish to be satisfied: 'Will the new employer be just as likely to pay my pension?'

- However, a minority of members take the view that a thorough series of tests is essential in order to ensure that there is no scope for unscrupulous employers to use the revised rules simply in order to avoid their rightful responsibilities as scheme sponsors.
- The NAPF suggests an additional measure for the simplest of restructuring processes: Section 75 would not be triggered where the proposed restructure simply involves transferring wholly-owned subsidiary companies into their parent company.
- The *de minimis* easement is pitched too low to be of practical value. It would be better to base it on a percentage of liabilities or £10 million, whichever is the lower.
- There was no support for the proposal outlined in Paragraph 1.7 – that restructuring could be allowed between more than two employers in the same group if all the employers involved were to agree to give a legal guarantee that any debt would be paid.

The NAPF's approach

3. The NAPF welcomes the Government's decision to address the difficulties that arise from Section 75 of the Pensions Act 1995. These rules are a longstanding source of concern for many pension schemes.
4. We responded to the initial consultation document (published in November 2008) and we are pleased to respond to this latest consultation that sets out the Government's policy proposals.
5. Throughout this process our objective has been to ensure that legitimate corporate restructurings can go ahead without triggering Section 75, while at the same time ensuring that the legislation continues to protect members. In fact we recognise that, although Section 75 debts may be substantial, they can provide an important protection for members' interests in certain circumstances.

The General Easement

6. The General Easement is undoubtedly a step in the right direction. The thrust of the policy – that no debt will be triggered if certain conditions are met – marks a welcome change of approach in the legislation governing exits from multi-employer schemes.
7. The reservation expressed by most NAPF members who submitted comments – and it is a major reservation – is about whether the proposed easement will prove sufficiently practicable to make a real difference.
8. The problems lie in two related areas: the specific difficulties that could arise with each of the individual 'steps' set out in the General Easement; and the cumbersome nature of the process as a whole.
9. The specific difficulties include the following:
 - *The 'Restructuring Test' (Step 3, para. 2.12)*. This will require trustees to consider whether the receiving employer is 'at least as likely' as the exiting employer to

meet the scheme liabilities. It is not clear how this will be achieved and we note that the Pensions Regulator will be asked to provide advice. It seems likely that this could involve procuring actuarial advice – presumably at some significant cost.

- *The same group requirement (para.2.23)*. The proposed Regulations require that the exiting and receiving employers must be ‘associated’. It is disappointing that external transfers have been excluded, as it would be perfectly possible for such transfers to be in the best interest of the pension schemes and their members – a point that would be adequately tested by the Restructuring Test’s requirement for the receiving employer to be ‘at least as likely’ to meet liabilities.
 - *The same scheme requirement (para 2.23)*. The same paragraph requires that both employers are participating in the same scheme. This is particularly restrictive. Requiring employees to stay in the same multi-employer scheme rather than having the flexibility of another scheme within the Financial Group structure will prevent use of the easement quite significantly. Even many restructures within the same employer group would fall outside the scope of the new easement.
 - *The UK head office requirement (para. 2.25)*. Although the NAPF appreciates that this provision is one of a number intended to prevent abuse of the General Easement, we are concerned that it may also rule out perfectly legitimate restructures. For example, multinational companies may well have an ‘agency office’ in the UK, at which employment arrangements will be based, but a corporate head office overseas. We would suggest that a more nuanced approach is needed in order to balance flexibility for employers with protection of members’ rights.
10. Aside from these specific difficulties, there is a broader concern that the processes involved in the General Easement could be unduly cumbersome – and perhaps far more difficult to operate than the DWP has assumed.
 11. It would be a great shame if this well-intentioned easement were to fail to deliver what the Government is hoping to achieve.
 12. There may be a good argument for a radical simplification of the General Easement, so that it consists solely of the Restructuring Test. Clearly, this would satisfy the central question that members will have about any restructure – ‘Will the new employer be just as likely to pay my pension?’
 13. It is important to note a minority view among NAPF members – that a process involving a significant number of ‘hurdles’ actually provides better protection for scheme members’ interests by making it very difficult for unscrupulous employers to use the easement in order to avoid debts that they should rightfully meet.

An additional easement for the simplest restructures

14. The NAPF would like to suggest an additional measure that could be applied in the simplest of restructuring processes.
15. The idea is a simple one: in situations where the proposed restructure simply involves transferring wholly-owned subsidiary companies into their parent company, Section 75 would not be triggered. So there would be no need to go through the series of ‘steps’ proposed under the new ‘General Easement’.

16. This would apply where, for example, parent company A has two subsidiaries – B and C, both of which are 100% owned by A. In the restructure, B and C would become part of A. So all employees would now work for A.
17. Such an additional easement would be directly targeted at the very simplest restructuring processes, and would ensure that they could go ahead without engaging with the more complex requirements of the General Easement.
18. Adding this proposal to the DWP's package (alongside – we would hope – some simplification of the General Easement itself) would make for a far more effective set of reforms and would help the Government to achieve its objectives.
19. There would, of course, need to be some provision that would prevent unscrupulous employers from using this procedure to weaken the covenant. For example, a simple transfer would not be acceptable where the DB scheme is sponsored by an operating company with a strong balance sheet but where the parent company is much weaker. Moving assets from the subsidiary to the parent (or debt from the parent to the subsidiary) would potentially be a type A event and could trigger a contribution notice. It is likely that the Regulator would only be happy for a transfer of a subsidiary into a parent not to trigger a Section 75 debt if it were clear that it could still trigger a contribution notice.

The *de minimis* easement

20. The *de minimis* easement is to be used in cases where the liabilities of the exiting employer do not exceed £100,000.
21. This is a useful measure, but it has to be noted that it is pitched at the very lowest end of what would be considered *de minimis*. There is surely scope for increasing the £100,000 limit to a larger figure.
22. The NAPF would argue strongly that the ceiling should be based on a percentage of the scheme's total liabilities, rather than on an absolute amount. This would allow schemes of all sizes to make use of the *de minimis* easement, as long as the restructure concerns only a small proportion of their liabilities.
23. However, we recognise that a purely percentage-based approach would allow the *de minimis* easement to be used in transfers that affect very large numbers of members, if they are in a very large scheme. This might be contrary to the DWP's intentions. It might be sensible, therefore, to say that the limit should be *either* a certain percentage of liabilities *or* £10 million, whichever is the lower.

A 'Legal Guarantee'

24. The DWP has been particularly keen to receive feedback on the proposal set out in paragraph 1.7 of the consultation paper – that restructuring could be allowed between more than two employers in the same group if all the employers involved were to agree to give a legal guarantee (on the basis of joint and several liability) that any debt would be paid.
25. The NAPF asked members about this specific idea.
26. Although comments were received from only a handful of members, there was no support for the proposal. Members identified two problems.

- It was felt that the point flagged up in para. 1.7 – that ‘banks that might already be lending money to a company in the group might be reluctant to see that company entering into this further type of commitment’ – was a legitimate concern.
- There was no need for the additional complexity that this policy would entail.

Conclusion

27. The NAPF continues to support the DWP’s initiative in tackling the problems presented by the current Section 75 rules. However, we are concerned that the current proposals will not deliver the outcome that is intended.

28. This note identifies our key concerns and sets out an additional proposal for the simplest restructures that would help the Government to achieve its objectives.

29. For further information, please contact me on james.walsh@napf.co.uk.

Yours sincerely,

James Walsh

Policy Adviser: Workplace Pensions