Securing the future of pensions

DWP Call for evidence: Section 75 Employer Debt in Non-Associated Multi-Employer Defined Benefit Pension Schemes

A response by the National Association of Pension Funds

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Summary

1. In response to the DWP's call for evidence, the NAPF has undertaken an in depth consultation with a number of its DB multi-employer schemes that serve non-affiliated employers and are therefore affected by the proposed changes to the current employer debt regime.

2. The consultation confirmed that employer debt under The Occupational Pension Schemes (Employer Debt) Regulations 2005 (the "**Employer Debt Regulations**") is a live and difficult issue for some but not all affected schemes. The extent to which it is an issue is influenced largely by the nature of the employers in the scheme, in particular the size of the employers in the scheme, their financial circumstances, and the extent to which they are obliged by law or contract to provide DB benefits for some or all employees.

3. Under the Employer Debt Regulations, a debt based on the cost of buying annuities (a "**buyout debt**" or "**section 75 debt**") for employees of the employer is triggered not only when the scheme or an employer's business is being wound up (as it is under section 75 Pensions Act 1995 ("**section 75**")), but also when an employer that remains in business no longer employs an active member in a scheme that is open to accrual. In this last circumstance, the buyout debt is artificial. The trustees will not usually be contemplating purchasing annuities with the funds obtained, but rather will continue to pay benefits out of the scheme at a lower projected cost. This can lead to distorted behaviour. An employer may artificially retain a single active member in the scheme to avoid triggering the debt. It also encourages a game of "chicken" among employers in which each employer must weigh whether it is more advantageous to remain active in the scheme while other employers pay buyout debts or to trigger the debt in order to avoid shouldering liabilities of other employers in the future.

4. Although NAPF members are clear that it is the departure of the last active member (and not other employer cessation events) under the Employer Debt Regulations that creates the most difficulties, there is not unanimity about what should happen when an employer loses its last active member, or even whether the loss of the last active member should trigger a debt at all. Among those who believe that change is necessary, some would allow the trustees more discretion about the timing of the debt payment while others would prefer that the debt be calculated based on the technical provisions basis. Generally, the schemes that are comfortable, or relatively comfortable, with the current regime are those that have been in a position to use the flexibilities it offers to avoid triggering the full section 75 liability. Those that service employers with fewer resources or who are not in a position to use the flexibilities agree that there are problems.

5. In this response we have therefore sought to undertake a qualitative evaluation of the current regime and the alternatives put forward. The criteria against which we have assessed them are:

    a. Are scheme members afforded appropriate protection?

    b. Do trustees feel able to meet their responsibilities in a way which is appropriate?

c. Is the solution fair to other employers in the scheme?

d. Is the scope for unnecessary insolvency reduced?

e. Does the solution avoid distorted behaviour on the part of an employer who wishes to stop accruals?

6. On balance, the solution that best satisfies these criteria is probably option (c): to trigger a debt on the departure of an employer's last active member, but to calculate that debt on the basis of the technical provisions. Under this solution, the employer would not be given a discharge (unless it opted to pay the full section 75 debt at that point or later) and would remain liable for any section 75 debt attributable to it on the occurrence of another cessation event. We would modify the solution from that proposed by DWP by opening this solution to all employers, not just those with strong covenants. However, in our view any of the solutions would represent improvement on what is now seen with some justification as an unfair situation for the employer that is stopping accruals.

The NAPF

7. The NAPF is the voice of workplace pensions in the UK. We speak for over 1,300 pension schemes that provide pensions for over 17 million people and have more than £900 billion of assets. We also have 400 members from businesses supporting the pensions sector.

8. We aim to help everyone get more out of their retirement savings. To do this we promote policies that add value for savers, challenge regulation where it adds more cost than benefit and spread best practice among our members.

Introduction

9. The NAPF welcomes the DWP's call for evidence regarding section 75 employer debt in non-associated multi-employer defined benefit pension schemes. Since the introduction of the Employer Debt Regulations, the DWP has been open to industry feedback on the way those regulations affect employers and multi-employer schemes and has adjusted them from time to time. Those adjustments have allowed the regime to operate more flexibly while allowing for more rapid funding of schemes in which employers cease to participate.

10. However, the easements are often unavailable to employers who participate in non-associated multi-employer schemes. This is because the easements usually involve arrangements under which employers who continue accruals agree to take on at least a portion of the departing employer's liabilities. Where, as is the case with non-associated multi-employer schemes, the remaining employers do not share an economic interest with the employer that has ceased accruals (and indeed are often competitors) they will wish to do this only in a few circumstances – such as where there has been a merger and the resulting entity steps into the departing employer's shoes. Usually, the interests of the employers that continue accruals, like the interests of the trustees, are served when the employer that ceases accruals pays its debt to the scheme calculated on the basis of a worst case scenario – that is, the wind-up of the scheme. However, a question of fairness arises because the employer who has ceased accruals will subsidise the remaining employers when he pays a different, higher debt in respect of past service liability than those who continue.

11. So, while there is little question that in a non-associated multi-employer scheme a departing employer must cover its liabilities to the scheme, there are nevertheless some legitimate questions relating to the basis on which the liabilities are calculated and the timing of the payments where the employer remains in business and is able to pay section 75 liabilities should they arise. We have spent some time discussing the question of calculation and timing with NAPF members who run non-associated multi-employer schemes and explore what we found below.

The current regime

12. The Employer Debt Regulations currently provide that, subject to a grace period, where an employer no longer employs an active member of a multi-employer scheme in which other employers continue accruals, a debt on that employer to the scheme arises and becomes due for payment. This buyout debt is calculated based on the cost of buying annuities for all the members whose service is attributable to that employer, plus a share of the liabilities (calculated on the same basis) that are not attributable to any employer (the "**orphan liabilities**").

13. The debt, calculated on the same basis, also will arise where the employer ceases participation in the scheme, ceases to do business or becomes insolvent, and where the scheme winds up. When the debt is paid, the employer is discharged under the statute from any further liability to the scheme (although the employer may retain a liability under the scheme rules in some cases).

14. Where the employer is unable to pay the debt, the scheme trustees have some ability to extend the period over which the debt can be paid, but cannot compromise the repayment of the debt. Where it is found that the trustees have compromised a section 75 debt, the scheme (and its members) will no longer be eligible for Pension Protection Fund ("**PPF**") protection under the Pension Protection Fund (Entry Rules) Regulations 2005 (the "**PPF Entry Rules**").

The case for re-examining the regulations

15. Three aspects of the current regime are highlighted by schemes and employers as problems. However, it is important to note that these are only in relation to the debt being triggered by an employer's last active member leaving the scheme. Where an employer ceases to exist whether due to a merger, a wind-up or an insolvency, we would expect a full section 75 debt to be payable.

16. The first problem is the scope for triggering insolvency or economic distress in the employer who ceases accruals and is required to suddenly repay the debt. The second is the perverse tactics that employers find themselves using to avoid triggering the debt. The final problem relates to the basis on which the debt is calculated.

17. In respect of the first problem, the timing of debt repayment heightens the risk of an employer facing insolvency or technical insolvency simply because it has lost its last active member, even though it could continue to pay their past service debt calculated on the technical provisions and continue in business. Some schemes report this happening in practice, although it is recognised that it is difficult to precisely lay the insolvency at the door of the s75 debt. The reason this would occur is that the section 75 debt is much larger than the debt on the technical provisions and moreover appears on the balance sheet as crystallised, and due and payable immediately. Even when payment, at least over time, may be possible, suppliers and banks often are unwilling to provide credit where this debt has crystallised.

18. In respect of the second problem, it is not clear that there is a connection between the employer's wish to end accruals in a particular scheme and its ability to continue as an ongoing business. Although several of our members say that the departure of the last active member is a good proxy for economic distress in their schemes, others disagree. In any case, the employer can avoid triggering the debt by continuing to keep just one or a very small number of employees in the scheme and accruing benefits, although in many cases this will run counter to a rational economic decision to move employees out of DB and into DC pension provision or into another scheme. Most employers will prefer to minimize disparity of treatment of employees, and so this is not an ideal solution. Where the employer is distressed, employing this tactic will only increase the amount due and unpayable at the end of the day.

19. Finally, the problem of enforcing the repayment of the debt is compounded by the method of calculating the value of the debt. Employers have raised an issue of fairness. A non-associated multi-employer scheme is less likely to wind up insolvent, because stronger employers support the weaker covenants of the less strong, and this is acknowledged in a lower PPF levy. Therefore,

the logic of imposing a debt based on a notion that the scheme will be purchasing annuities is unclear, especially since when it is paid it serves to reduce the past service liability payments (based on technical provisions) of the remaining employers rather than to purchase annuities for the departing employer's employees.

20. All of this said, the threat of a section 75 debt arising, blunt instrument that it may be, is useful to trustees. Where an employer is chronically late with contributions, the threat that the trustee will trigger a buyout debt by refusing future accruals will get that employer's attention, and usually, compliance. There are a number of other situations in which trustees' ability to trigger the debt or refuse cooperation in an easement is a valuable weapon. To take this tool away without replacing it may lead to a less optimal environment for defense of member interests.

21. In arriving at a solution for the problems posed by the Employer Debt Regulations as they stand, it is important to strike the right balance between the protection of members in the scheme; the responsibilities of the trustees; and the interests of, on the one hand, the employer triggering the debt and the other, employers in the scheme.

Solutions suggested in consultation

22. Three solutions were suggested in discussions with NAPF members to the problems outlined above fall, namely amendments to the Employer Debt Regulations that would:

    a. allow more flexibility around the timing of debt repayment;

    b. no longer trigger the debt on the event of an employer's last active member accruing benefits in the scheme; or

    c. value the debt on a different basis but still require rapid repayment of the debt.

23. We consider each of these in turn below against the following criteria:

    a. Are the scheme members afforded appropriate protection?

    b. Do trustees feel able to meet their responsibilities in a way which is appropriate?

    c. Is the solution fair to other employers in the scheme?

    d. Is the scope for unnecessary insolvency reduced?

    e. Does the solution avoid distorted behavior on the part of the employer who wishes to stop accruals?

24. Our discussions below assume that the current regime will continue to apply where the employer wishes to depart the scheme altogether, winds up or becomes insolvent, and that the full section 75 debt will remain payable in those situations.

Option a: allow more flexibility around timing of debt repayment

25. The first solution suggested in the call for evidence is to allow more flexibility around the timing of debt repayment.

26. Currently, many trustee boards interpret the PPF Entry Rules to require immediate repayment of the section 75 debt when it arises, and are therefore reluctant to allow payment over years for fear that this would be considered a forbidden compromise of the debt should the employer ultimately be unable to pay it in full.

27. Under the suggested change, trustees would apply to The Pensions Regulator ("**TPR**") for approval of an extended payment arrangement. Where TPR approves the arrangement, the trustees could spread payment of the debt over a number of years, so as to make it more affordable.

28. Evaluated against our suggested criteria this solution would:

    a. afford less protection for members where the employer's covenant weakens over the period of payment, and more protection where it allows the employer to remain in business, and perhaps to grow, while paying the debt;

    b. allow trustees to exercise some judgment, subject to TPR approval, concerning whether member's interests are likely to be served by a longer payment period, but would increase their costs because even strong employers will request this treatment and the trustees will be obliged to consider it and engage in discussions with TPR in order to implement it;

    c. not add significantly to the risks to remaining employers;

    d. reduce somewhat the scope for insolvencies occasioned or hurried by the section 75 debt, although that debt will still have crystallised and will interfere with the employer's ability to get from suppliers and banks; and

    e. go some way to preventing some of the distorted behaviours inherent in the current regime.

29. This suggestion would appear to be the least disruptive of the current regime and has at least limited appeal to most of our members who run defined benefit multi-employer schemes.

30. The two major issues with this approach are that:

    - a debt based on buyout costs when no buyout is contemplated is still arguably unfair because it forces the employer who has ceased accruals to pay its debt on a different basis than those who maintain active members, and

- the views of TPR and PPF as to when such arrangements are acceptable would need to be clear.

31. The call for evidence does not specify whether this treatment would be available when any cessation event occurs or only where the employer has lost its last active member and continues as a business. We suggest that it only makes sense in this latter situation. When the employer wishes to cease participation, ceases doing business or becomes insolvent, the full section 75 debt should be payable, as it is for frozen, non-associated multi-employer and single employer schemes.

32. There is a strong case for allowing trustees to spread payments relating to section 75 debt in this situation over longer time periods than those with which they now feel comfortable due to the PPF Entry Rules. It would ease some of the pressure on employers, and in some cases schemes, if this option were broadly available. The PPF's views on when such agreements would be considered a compromise of a section 75 liability, and TPR's views on when they are acceptable would need to be clarified.

Option b: no longer trigger debt on cessation of active membership

33. A second suggested solution would be to allow participating employers to continue as employers in the scheme when they lose their last active member, so long as they remain as extant businesses. No debt would crystallise until such time as it would arise in a frozen scheme or a single employer scheme – that is, when the scheme is being wound up; when the employer's business is insolvent or being wound up; or when the employer chooses to crystallise it and thereby receive a discharge under the statute.

34. This approach would be the most useful to employers and would appear to have logic on its side. After all, the pensions environment has moved on in the ten years since the promulgation of the Employer Debt Regulations, and the fact that an employer's employees are no longer active members of a defined benefit scheme does not necessarily reflect on the employer's solvency or the likelihood the likelihood that it will maintain a strong covenant. It may simply reflect a prudent shift to defined contribution provision.

35. Evaluated against our suggested criteria, this solution would:

    a. afford less protection for members where the employer's covenant is strong enough to pay up front but weakens over time and more protection where it allows the employer to remain in business, and perhaps to grow, while paying the past service liability, with the added advantage that the employer remains a statutory employer;

    b. impose more risk, expense and responsibility on trustees because it will slow funding of the scheme by those able to pay more, and will require additional resource in order to monitor the covenant and indeed the existence of the employer over the life of the scheme;

c. pose more risk to remaining employers in the event the employer that no longer retained active members became insolvent or went out of business, although there is some compensation in that the employer will remain a statutory employer should a buyout later be necessary;

d. considerably reduce the scope for unnecessary insolvency; and

e. reduce or even eliminate distorted behavior.

36. For the most part, the members we consulted believe that this change would be manageable (and in some cases preferable), but that it would result in higher costs and more risk for schemes. Some of our members warned that inasmuch as this would be a big departure from current practice, the risks are not at this point knowable, and that unintended consequences were likely to be greatest if this approach were adopted. They point out that under the current regime, the debt arises on a date certain (the date of the departure of the last active member, subject to grace period provisions), and moreover on a date that will not escape the scheme's notice. In contrast, the gradual erosion of covenant or even the disappearance of an employer could occur without the scheme becoming aware. In addition, the present ability to impose a section 75 liability on recalcitrant employers is a valuable tool for trustees.

37. In our view, this solution would be most helpful to employers and to schemes that cater to smaller employers who simply cannot pay a buyout debt, particularly a buyout debt that arises and must be paid in a short period of time. It seems more fair – after all, employers in single employer schemes and frozen multi-employer schemes are not required to cope with a sudden section 75 debt on ceasing accruals. Certain distorted behaviours, such as maintaining unaffordable accruals, and playing "chicken" with other employers, will end if this solution is adopted. However, we agree that this approach will remove a weapon from the trustee arsenal, and that there may be unintended consequences to removing that weapon.

Option c: calculate the debt differently once triggered

38. The third suggested solution is to calculate the debt on the employer that arises when it loses its last active member on a basis other than a buyout basis. The proposition is that where an employer ceasing accruals could demonstrate a strong continuing covenant, it would be allowed to pay a debt calculated on a technical provisions (rather than buy-out) basis. The employer would not be given a discharge as is currently the case when the section 75 debt is paid. Rather, it would remain responsible for its share of any eventual buy-out debt. Weaker employers would be required to pay the debt on a buy-out basis up front.

39. Evaluated against our suggested criteria, this solution would:

a. provide a good level of protection for members, inasmuch as the current projected cost of providing their benefit would be covered up front;

b. provide a similar or arguably better level of protection to trustees to that now pertaining inasmuch as they would collect an up-front contribution but would also be able to continue to call on that employer as a statutory employer, albeit at a higher cost due to the expenses associated with calculating (and negotiating) a debt on the technical provisions out of cycle, monitoring ongoing covenant, and considering collection of additional liabilities arising;

c. promote fairness among employers – the employer who no longer employs active members would only be asked for a "fair share" of current liabilities on the basis that the scheme and the employer will continue, while the other employers have the benefit of the continued covenant of that employer in exchange for the loss of a windfall payment based on buyout;

d. reduce the scope of unnecessary insolvencies somewhat, especially if it is understood that there is some room for compromise concerning the payment schedule;

e. reduce distorted behaviours inasmuch as the debt on the technical provisions should be payable on a relatively short timeframe in any case.

40. We do not think this proposition would solve all of the problems that schemes and employers currently encounter with the Employer Debt Regulations. The stronger employers to which this easement would be available are more able to pay, and might actually prefer to pay, the buyout debt in exchange for the discharge. It is the weaker employers who might be able to contribute more or pay in full if the debt were calculated based on the projected cost of paying the benefit, rather than buying an annuity. Therefore we suggest that this treatment be extended to all employers, not simply those with strong covenants. This will reduce the cost to schemes of wrangling with employers concerning whether their covenant merits this treatment (although there still will be considerable wrangling around the margins as to what a debt based on technical provisions should look like). In practice, we suspect that employers who cannot pay a section 75 debt will encounter similar problems with a debt on the technical provisions, and that therefore monies collected will be very similar where the covenant is weak.

41. A regime under which a debt calculated on the technical provisions, rather than a buy-out basis, arises when an employer no longer employs any active members occupies a middle ground compared to the current regime. It goes some way towards levelling the playing field between employers who do and do not have active members and in many ways mimics the situation of employers in associated multi-employer schemes, who use the current easements to pay a debt based on technical provisions up front while leaving section 75 liabilities latent with a remaining employer.

Conclusion

42. There is a strong case for re-examination of the Employer Debt Regulations as they apply to non-associated multi-employer schemes. While they work well for some, the schemes that have the

most need for innovative approaches to funding are constrained by them and employers are not being unreasonable when they complain that the current regime sometimes creates an artificial debt at an artificial moment in time.

43. The departure of an employer's last active member is the most problematic of the cessation events. It would be useful to employers and even to many schemes, especially where the employers are not associated, if this cessation event could be treated differently from the others.

44. Having evaluated each of the options above, on balance, the approach whereby an employer, upon losing its last active member, becomes immediately liable for its debt calculated on a technical provisions basis rather than on a buyout basis appears to best satisfy our criteria for a reasonable accommodation of reasonable employer complaints. If an employer wishes to obtain a full statutory discharge, it can pay the debt on a buyout basis. Otherwise, it will pay its debt on the technical provisions immediately but remain undischarged and liable for the remaining debt should the scheme's funding position deteriorate or another cessation event arise.

Further information

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Appendix A: Answers to consultation questions

Question 3.1 – if we were to make any changes, should we exclude associated multi-employer schemes / limit the provisions to multi-employer schemes?

It would appear that the current regime, with the easements that have been introduced over time, works reasonably well for associated multi-employer schemes, which are also more likely to be heading for buyout. We do not think that the case for change is as strong for associated multi-employer schemes.

Question 3.2 – if we were to exclude associated schemes / limit the provisions to non-associated schemes, how could we best achieve this?

The regulations could distinguish between associated and non-associated schemes. We would suggest that "non-associated scheme" be defined in the same way that it is in The Occupational Pension Schemes (Miscellaneous Amendments) Regulations 2014, which is that at least two thirds of the participating employers are not associated or connected.

Question 4.1 – has your organisation had any experience with the section 75 employer debt regime as it applies to non-associated multi-employer defined benefit schemes?

Yes. We have polled members of our Defined Benefit Multi-employer Scheme ("**DB MES**") group, which is composed of non-associated multi-employer schemes that are affected by the Employer Debt Regulations.

Question 4.2 – do you think that the employer debt regime for these schemes needs to be changed, or does it work as it currently stands?

From the employer's point of view, there is a case for changing the current regime, particularly the rules around the debt created when an employer no longer employs an active member in a scheme that is open to accrual. The current regime can result in insolvency for employers that might be able to survive – or at least pay a greater portion of their debt --, if the debt were calculated on a different basis or payable over a longer period. Even those employers who can pay the full buyout debt when they lose their last active member complain with justification that both the debt and the date it arises are arbitrary. Some scheme trustees believe that they would be able to collect more if the regime called for a debt calculated on technical provisions, and/or one that could be collected over a longer time than the current legal environment allows. In addition, employers complain that they should not be required to maintain active members in pension schemes that no longer meet their needs simply in order to avoid incurring an unfairly large debt.

In our view, there is no doubt that a debt based on the cost of purchasing annuities should be payable on scheme wind-up, or where the employer is ceasing to do business, insolvent or wishes to receive a full discharge. However, there is room for other options where the employer continues to do business and simply wishes to cease accrual in a particular scheme.

There is also room for consideration of whether orphan liabilities, especially those attributable to employers who were discharged prior to 2005, should be treated differently than they are now.

Question 4.3 – what data do you have that might support your answer to questions 4.1 – 4.2?

Our evidence was gathered in conversations with members of our DB MES group.

Question 5.1 – has your organisation had experience of these easements? How often have they been used?

Yes. We have polled our members who operate non-associated multi-employer schemes. We find that flexible apportionment and scheme apportionment arrangements are used by schemes when the departing employer has merged with or has historic association with a participating employer. Withdrawal arrangements do not appear to be used. Even apportionment arrangements only work when one or more employers are willing to shoulder some of the liabilities of other employers, a situation that will not pertain where the departing employer has no relationship with other participating employers, as is particularly the case in industry-wide schemes, where employers are often competitors. Periods of grace are often used to prevent the debt arising.

Question 5.2 – how effective are the easements: • For schemes? • For employers?

Where they are available, they appear to be working well. As stated above, periods of grace can be used by employers in non-associated schemes in order to avoid triggering a debt, especially where eligibility for the scheme comes with a position and the employer needs to recruit, or where the employer expects to win a contract that would require participation in the scheme. However, as we have discussed in our evaluation of the options, in some cases the need to maintain at least one employee in the scheme in order to avoid the debt distorts employer behaviour and causes continued participation in a scheme when it is no longer in the employer's interest to do so. The other easements are less likely to be available where there are no participating employers willing to take on the debt of the departing employer, as is usually the case in non-associated schemes.

Question 5.3 - are there any weaknesses or problems with the current methods of managing employer debt?

Yes. The members we polled agree that there are weaknesses and problems with current methods of managing employer debt. The problems include the following:

- Sometimes, the very employers who can least afford continued accrual of benefits are locked into such accruals for fear of triggering a debt that will push them into insolvency: and

- Employers who are able to pay a section 75 debt when it arises complain that unless the benefits are actually bought out, the number bears little relation to the cost of the benefits that will be paid and can constitute a windfall to the scheme and to the remaining employers, who will have their own deficits reduced due to the funding surge.

The extent to which these issues are seen as pressing depends a great deal on the strength of the covenants of the participating employers. We found that schemes in which the employer covenant tended to be strong were happy with the current regime. Schemes in which employers had weaker covenants could see advantages to tweaking the regime so that the effect on participating employers was more like the effect on employers in single employer, frozen and associated multi-employer schemes. That is, they believed that there could be advantages to allowing employers to pay on a technical provisions basis (whether immediately or over time) when they lose their last active member, and remaining a statutory employer responsible for the full section 75 debt when other employer cessation events occur.

Question 5.4 – could we make the easements easier to understand and to use?

It is our impression that the easements are relatively well understood at this point.

Question 5.5 – what data do you have that might support your answer to questions 5.1 – 5.5?

N/A

Question 6.1 – do the current employer debt provisions for multi-employer schemes need to be amended, or could better use be made of existing easements to manage any problems employers or schemes may face?

The current easements (other than the period of grace) are seldom useful for employers who do not share an economic interest with other participating employers. Our members found them useful where there are mergers or takeovers and another employer can step into the departing employer's shoes, but in many schemes there are no remaining employers would rationally be willing to take on another employer's debt.

Question 6.2 – what data do you have that might support your answer to question 6.1?

Our conversations with DB MES members indicate that with the exception of the grace period and occasionally reapportionment, the easements are seldom used.

Question 6.3 – should DWP support and encourage greater flexibility regarding debt repayment plans?

As we understand it, some of the lack of flexibility has grown from a fear of "compromising" a debt and thereby losing PPF eligibility under the PPF Entry Rules. There is definitely room here for guidance from TPR or PPF as to what would and would not constitute a compromise. For example, if the trustees agree an extended payment plan, and the employer fails prior to completing payments under the plan, will the trustees be considered to have entered into a "legally enforceable agreement the effect of which is to reduce the amount of any debt due to the scheme under section 75 of the 1995 Act which may be recovered by, or on behalf of, those trustees or managers" under regulation 2(2) of the PPF Entry Rules? How long a payment plan would be considered reasonable?

Question 6.4 – how could any repayment plan recognise and balance the needs of employers and the scheme?

This will differ from employer to employer and scheme to scheme. From the trustees' point of view it is useful that the amount ultimately required is the section 75 debt, which is determined in accordance with a relatively straightforward calculation. Only the payment period is subject to negotiation. For the payment period we would expect that the same sort of balancing of affordability against the likelihood that the covenant will be sustained over the payment period that currently informs funding negotiations.

Question 6.5 – would a longer timescale increase the risk of default? Are there ways that this risk could be mitigated?

Any debt that is not immediately collected will involve a risk of default. Trustees have been learning since the Finance Act 2004 to evaluate and manage that risk. Where the employer is strong and can pay, it might be preferable to have the money up front, but equally in some circumstances it may be preferable to collect on a periodic basis rather than discharge that employer, who could presumably support the scheme to a greater extent in the future if need be. Where the employer is weaker, there is a greater risk of default, but it may be that more can be collected by allowing that employer to continue to contribute.

Question 6.6 - what data do you have that might support your answer to questions 6.3 -6.5?

N/A

Question 6.7 – what could the consequences and risks of [changing the regime so that no debt arises when the employment of the last active member ceases] be for:

- **The scheme?** The scheme will need to expend resource monitoring payments and the financial health of a greater number of employers over a much longer period. Many schemes already do this. In return, fewer employers will have a statutory discharge from further liability to the scheme. There are likely to be defaults on payment of buyout debt when it arises due to employer insolvency, rather than when it arises due to the departure of the last active member. In some cases, it would have been better to have collected the full buyout debt earlier on the departure of that last active member, because the employer covenant subsequently deteriorated. In other cases, it will have been better to have collected past service contributions in the meantime because the employer was never in a position to pay a debt calculated on the buyout basis – or perhaps any large lump sum at all.

- **The employer?** The employer will be able to plan its pension provision without fear that a large debt to the scheme will be triggered by a decision to stop accrual, and instead will be in a position to make these sorts of decisions based on their merits. Weaker employers can continue to pay past service contributions rather than a buyout debt that they cannot pay.

- **Other employers in the scheme?** The playing field will be more even as between those who have active members and those who have only deferred members. Both will remain on the hook for buyout liabilities should the need arise.

• **Members of the scheme?** Assuming that the primary interest of the member that is being served here is rapid funding of the scheme, members in schemes that currently have many strong employers who can pay the section 75 debt may be compromised if the covenants of the employers deteriorate over time. Members of schemes with less strong employers who cannot in any case pay a buyout debt may be advantaged in that this change should increase the likelihood that funds can be collected over time.

• **The PPF?** We are not in a position to comment on the PPF's position, although we would assume that it would be more concerned with the position of schemes that had a large number of employers with inadequate covenants. If this proposal goes forward, schemes may not be funded to PPF level quite as quickly as they would otherwise be. However, these schemes are unlikely to fall into the PPF, and so it would seem that putting the schemes themselves on a firm footing should take precedence over how quickly the PPF can wash its hands of them.

Question 6.8 – how could the relationship between a scheme and its non-active employers best be managed?

For this we would look to so-called "frozen" schemes for examples of how to remain engaged with employers who no longer have active members. In most schemes, the employers will continue to owe past service contributions, so there will be that point of engagement going forward, at least until the scheme is fully funded on its technical provisions.

Question 6.9 – would a scheme's risk profile be affected, and if so how would this be managed? What could the consequences be?

Trustees would need to consider whether the inability to collect large contributions on the departure of an employer's active membership affects their funding projections. In our conversations with DB MES members, we have gathered that for the most part the collection of section 75 debts does not play a large role in the assumptions concerning scheme funding. It may be that fewer employers will retain active members of the scheme if there is no longer a penalty for leaving DB provision, in which case the funding assumptions may need to change to those appropriate for a mature scheme.

Question 6.10 - what data do you have that might support your answer to questions 6.7 – 6.9?

N/A

Question 6.11 – are there any other ways in which an employer's covenant strength could be assessed and liability could be calculated?

The tools that the trustees use for evaluation of covenant strength for this purpose should be the same that they would use for funding purposes.

Question 6.12 – what could the consequences and risks of [changing the regime so that stronger employers could pay an initial debt based on technical provisions] be for:

- **The scheme?** Our members were split as to whether this would be an improvement over the current regime and as to whether it would be helpful to require trustees to come to a conclusion regarding covenant before determining the arising debt. A section 75 debt is easily calculated and the departure of the last active member provides a solid date -- this reduces haggling about the amount due. A debt on technical provisions, particularly when it must be calculated out of cycle, is more complicated. In addition, some members believe that it would be distracting and disproportionately expensive to negotiate with employers about whether they qualify for the easement when a large amount of money up front is at stake. Others believe that a debt, particularly when it is payable over time and calculated by reference to the technical provisions, would be a good solution to the perceived unfairness to the current regime. Several cautioned that should this proposal be adopted, trustees must be in a position to immediately invoke the full buyout debt where they doubt that the employer will be able to fund it in the future.

- **The employer?** The employer most in need of a reduced up front payment would be the least likely to get it if it is dependent on covenant assessment. It will not resolve the problem of an employer who simply cannot pay the buyout debt, but may be able to pay a reduced debt, because that employer will still need to pay the buyout debt.

- **Other employers in the scheme?** This is more fair as between those employers who are departing and those remaining, in that those who are less likely to be able to stump up if need be must pay more, but it does not alter the arbitrary nature of the payment of a buyout debt.

- **Members of the scheme?** Although it may slow the funding of the scheme**,** We think that this proposal serves the interests of the members of the scheme by providing for an up-front payment while giving the increased covenant protection of continued employer participation
- **The PPF?** See our answer to 6.7 above.

Question 6.13 - what data do you have that might support your answer to questions 6.11-6.12.

N/A

Question 6.14 - are there are any other approaches not listed here that we should consider that might improve the employer debt regime for employers, schemes, and members?

As set forth in more detail in paragraphs 38 through 41 above, we think a modified version of the third proposed change has a great deal to recommend it. It gives both employers and trustees certainty that a debt will arise on the departure of the last active member. However, it does not require a payment based on the cost of annuities to be paid until the circumstances enumerated in section 75 Pensions Act occur – that is, until the scheme is wound up (in the case of a multi-employer scheme this includes where scheme is effectively wound up in respect of the employer because the employer ceases participation altogether) or the employer ceases business or becomes insolvent.

Question 6.15 – what data do you have that might support your answer to question 6.14? N/A