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Multi-Employer, Charity Sector DB Schemes – The Section 75 Paradox

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Tuesday 6th June 2017

David Davison

- Owner / Director of Spence – Actuaries, Consultants & Administrators
- Public Sector & Charity Not For Profit Practice Head
- Worked with 100's of 3rd Sector organisations over the past 11 years
- Work with professional bodies
  - CFG – 'Pensions Maze' publications
  - PLSA – LGPS Guides
  - ICAS – variety of ME publications
- DWP 'multi-employer working party'

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Agenda

- Stand alone & segmented ME schemes
- Multi-employer DB – background, cessation & impact
- Timing of S75
- Schemes and organisations impacted
- LGPS
- DWP Consultation 2017
- Questions

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Standalone & Segmented Multi-Employer Schemes

- Well worn path to manage risk
- Closure to new entrants
- Closure to future accrual
- Funding agreement – 'on-going' basis
- Move towards buyout longer term when affordable based on:-
  - Employer assets / covenant
  - Market conditions suitable

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Multi-employer DB last man standing schemes

- Many employers joined these schemes historically as seen as a way of sharing costs and risk
- Charities looked to provide comparative benefits to public sector
- Risks were not clearly identified at outset (and even subsequently)
  - Funding risks
  - Last man standing risk
  - Cessation risk
- Schemes have built considerable on-going deficits and even more meaningful exit / cessation deficits
- Structure of these schemes makes managing these deficits more problematic than in stand-alone or segmented schemes

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Multi-employer DB – S75 Debt / Cessation

- The Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678)
- Employer Debt referred to as Section 75 Debt (Pensions Act 2005)
- If an employer participating in an MEDBS ceases to employ active members while other participating employers continue to do so then this triggers a S75 debt
- Debt calculated on a ‘gilts basis’ (equivalent to buyout) – much higher liabilities than technical provisions (‘on-going’) or accounting basis
- Protection for members, other employers and the PPF
- Covers both associated and non-associated employers
- Legislative focus on debt avoidance – particularly restructures – primarily associated employers
- Can be addressed by complete scheme closure to future accrual – potential for ‘hostage’ scenario

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Multi-employer DB – S75 Debt / Cessation

- Stronger basis understandable – commonality of interest
  - Trustees last opportunity to obtain funds and want to ensure that one employer's liabilities are not required to be funded by other employers in the scheme
- Mechanisms introduced to add flexibility
  - Period of grace
  - Flexible Apportionment Agreements
- No flexibility exists to allow participants to manage risk by closing to future accrual without triggering cessation debt
- Impact on behaviours
  - Continue participating beyond the point of affordability
  - Inventive 'structures' to limit risk and avoid debt e.g. maintain single member / DC membership under DB Trust
  - Trustees cannot manage covenant risk by forcing cessation of accrual

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Multi-employer DB – S75 Debt / Cessation

- Continue participating beyond the point of affordability - cannot be in the interests of that employer, other employers or members to do this
- Limits ability to focus contributions on paying down deficit for accrued liabilities rather than contributions to build additional liabilities
- No flexibility on asset mix
- Notice periods and cessation figure uncertainty
- Impact on merger activity
- Undoubtedly resulting in insolvencies

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Multi-employer DB last man standing schemes

- S75 Debt – repayment flexibility
- Spread payments
- Still unaffordable for many
- Even if affordable does not 'secure' member benefits
- MEDBS Structure does not encourage higher funding
- Doesn't deal with timing of calculation

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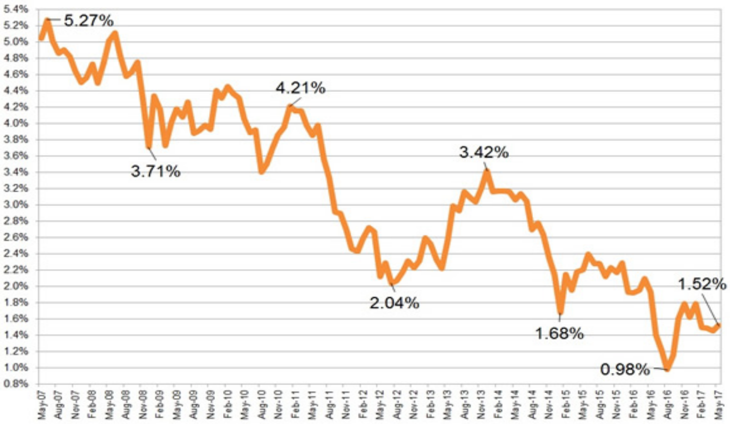
Timing of S75 Debt – 15 year gilt yields to May 2017



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Multi-employer DB last man standing schemes

- S75 Debt – repayment flexibility
- Spread payments
- Still unaffordable for many
- Even if affordable does not 'secure' member benefits
- MEDBS Structure does not encourage higher funding
- Doesn't deal with timing of calculation
- Membership evolution issues
  - Deaths
  - Transfers
  - Early retirements

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Schemes impacted

Private sector

- The Plumbing Federation Pension Scheme

Charitable Sector

- TPT Retirement Solutions (formerly the Pensions Trust) – multiple schemes
- USS and other University Schemes
- Other charity schemes – e.g. Federated Flexiplan II

Local Government sector (not directly S75 – more later)

- Community Admission bodies
- Transfer Admission Bodies

Could impact as many as 6,000 charities in total

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LGPS Specific Issues

- S75 does not apply – but adopt a similar basis
- On cessation Fund ‘required’ to seek valuation from actuary
- Calculated on least risk basis
  - No requirement to be
  - Will not wind-up / funds remain invested
- Inconsistency between public sector schemes
- Inconsistency between Funds
  - No agreed process / approach
  - Impact on advisory costs

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LGPS Specific Issues

- Inconsistency between Transfer Admission Bodies (TAB’s) and Community Admission Bodies (CAB’s)
  - Contracts and ‘pass through’
  - Impact on advisory costs
- Less pooling more individual segmentation
- Advance cessation trigger
  - <5 members / <10 years to ‘cessation’
  - Move to funding on cessation basis
  - Move assets to gilts?
- Divergence in Scotland

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PWC Report for SAB (London)

Key recommendations

- More flexibility on timing to exit debt trigger
- Establish maximum level of prudence
- Flexible exit arrangements
- Exit on weaker basis
- Did not address legacy liabilities – some movement

- No progress to date

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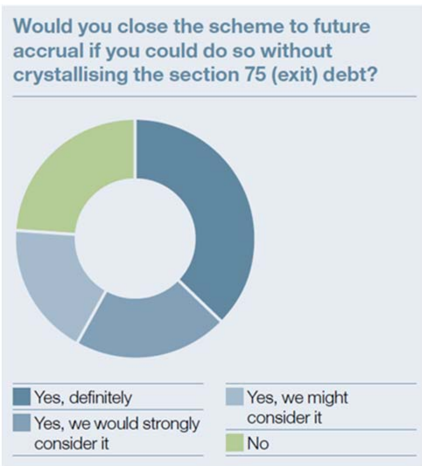
CFG Research - 2014

If could close to future accrual without immediate S75 debt

- 37% would definitely close
- 21% would strongly consider closing
- 18% might consider closing
- 76% in total likely to be influenced by change



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Consultation

- Working Party with DWP – dates back to 2011
- Section 75 Employer Debt – DWP Call for Evidence - April 2015
- DCLG LGPS Consultation – August 2016
- The draft Occupational Pension Schemes (Employer Debt) (Amendment) Regulations 2017 – Public Consultation 2017 – April 2017

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Employer Debt Consultation 2017

- Closed 18th May 2017
- Summarised main findings of 2015 call for evidence
  - Majority advocated some form of change
  - Evenly divided between changes to all MEDBS and those only focussed at non associated employers (as associated employers more likely to be able to utilise existing easements)
  - Some employers couldn't see how the departure of the last member fundamentally altered relationship with scheme
  - Current system a perverse incentive to continue accrual
  - Some caution expressed around change

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Employer Debt Consultation 2017

- Government proposals –
  - Minor amendments to employer debt trigger
  - Limited number of technical amendments
  - Introduction of Deferred Debt Arrangement ('DDA')
- Potential implementation October 2017 – seems challenging deadline

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Deferred Debt Arrangement

- Employers retain all previous responsibilities
- Must fulfil certain conditions
  - Appropriate assets to cover technical provisions – funding test – "reasonably likely to be able to fund the scheme going forwards"
  - Arrangement does not adversely affect security of member benefits
  - Trustees agreement in writing
  - Not in PPF assessment period
  - Not available to employers who are restructuring
  - Available for employers in period of grace
- Defer payment of S75 debt

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Deferred Debt Arrangement – some issues

- Focus needs to be on non-associated employers
- Balance of powers – employer vs trustee.
  - Recognise 'status quo' position
  - Need to have a clear set of parameters, rules on default and timeframes to resolve
  - Trustee should not have unilateral power to end agreement outwith breach of this agreement and should not have veto of employer decision to trigger debt
  - Consistent across scheme
  - Assessment of covenant / security – "on balance would not be detrimental to the scheme or its members."
  - Could be employed by trustees to cease further accrual for certain employers e.g. weak covenant

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Deferred Debt Arrangement – some issues

- Not default arrangement
- Documentation needs to be simple and consistent
- Should apply to restructures
- Should also apply to LGPS

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Summary

- Current S75 legislation encourages perverse actions
- Affecting not just charities
- There is a need for change
- Recent DWP proposals are encouraging after a long period of debate / inaction
- Likely to need some further revisions / refinements
- Need an approach for LGPS
- Need consistency of approach

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