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The 2004 Pensions Convention

7-8 June 2004, Sheraton Skyline Hotel, Heathrow

Employer debt payments – past, present and future

David Everett

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Past

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No statutory protection

The 1980s

when salary link is lost / employer ceases to sponsor scheme

- But scheme cessation not immediately associated with deficiencies
  - Many schemes had funding surplus (on cautious bases)
  - Preservation benefits significantly less than continuing (only post 1.1.85 accruals revalued)
  - Buyout rates based on high interest rates
- There was a surplus access worry
  - dependent on scheme rules
  - Some North American evidence of surplus raiding

Social Security Act 1990

- Following Feb 1989 OPB report
  - Pre 1.1.85 service revalued (for post 1.1.91 leavers)
  - "Debt due from the employer" on scheme winding up or employer insolvency
    - Insolvency narrowly defined
    - Debt non-preferential
- Maxwell dies (4 November 1991)
- Requirement introduced 29 June 1992, effective 1 July 1992
- GN19 issued 1 April 1993

Period One

1.7.92 – 5.4.97

Regime	Debt on the employer	Applicable to
1	Pensioners on buyout Non-pensioners on cash equivalent Expenses on actuary's estimate	Winding up and insolvency
2		
3		
4		

Pensions Act 1995

- New trigger – cessation of participation
- "New" basis – MFR (approximates to old)
- Accrued rights would be higher in value (LPI on post 6.4.97 service)

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Period Two 6.4.97 – 18.3.02

Regime	Debt on the employer	Applicable to
1	Pensioners on buyout Non-pensioners on cash equivalent (inc MFR underpin) Expenses on actuary's estimate	Wind up commenced before 19 December 1996; or Applicable time before 6 April 1997
2	All liabilities including expenses on MFR	Post 6 April 1997 applicable times – during wind up, at insolvency or on cessation of participation
3		
4		

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Issues: 1997 - 2002

- MFR became weaker than pensioner buyout
- MFR gilts matching examined
- Relevant insolvency event too narrow
- Debt remained non-preferential
- Compliance niggles
  - Too much trustee freedom during wind up?
  - No bill of health for departing employers from well-funded schemes
  - No leeway over applicable time for departing employers
  - Scope for argument over debt apportionment

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Winding up debt is ‘strengthened’

Unless completed wind up by 19 March 2002

- But only if employer solvent at commencement
  - Pensioners on buyout
  - Expenses on trustees’ estimate
  - Non-pensioners remain on MFR (which was weakened)
- Niggles
  - *“The actuary shall estimate the cost of purchasing any such annuities”*
  - Who knows what the expenses will be
- Problem
  - Solvent / Insolvent divide opens up scope for ‘planning’

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Period Three 19.3.02 – 14.3.04

Regime	Debt on the employer	Applicable to
1	Pensioners on buyout Non-pensioners on cash equivalent (inc MFR underpin) Expenses on actuary’s estimate	Wind up commenced before 19 December 1996; or Applicable time before 6 April 1997
2	All liabilities including expenses on MFR	Post 6 April 1997 applicable times – during wind up (but see 3), at insolvency or on cessation of participation
3	Pensioners on buyout Non-pensioners on MFR Expenses on trustees’ estimate	Wind up commenced on or after 6 April 1997 with a solvent employer at commencement
4		

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Present

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The government changes the rules
11 June 2003

- Pension Protection Fund
  - To *"guarantee members a specified minimum level of pension when the sponsoring employer becomes insolvent"*
- No walking away
  - *"A solvent employer who chooses to wind up a scheme should ensure that there are sufficient funds in the scheme to meet the full costs of the rights accrued by scheme members unless doing so would put the company itself at risk"*
- The retrospection fig leaf
  - "*We will have to introduce protection against engineering designed to circumvent the intent of our proposals"*

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No walking away means…
For post 11 June 2003 winding ups with a solvent employer

- No more MFR debt
  - Pensioner and non-pensioners on buyout
  - Expenses on trustees' estimate
  - Applies regardless of who triggers wind up
- But trustees can always compromise
  - Employer should meet full costs *"unless doing so would put the company itself at risk, in which case the trustees, exercising their fiduciary duties, can agree a lower amount"*

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Bradstock
Opra's seven points for trustees

1. Avoid conflicts of interest
2. Consider all options
3. Obtain appropriate advice
4. Be assertive in negotiations
5. Consider obtaining contributions from other employers
6. Apply equal diligence to wind ups and ongoing cases
7. Don't assume the PPF will rescue you

And by the way….we can unwind post 11 June 03 compromises

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Period Four 15.3.04 – 5.4.05?

Regime	Debt on the employer	Applicable to
1	Pensioners on buyout Non-pensioners on cash equivalent (inc MFR underpin) Expenses on actuary's estimate	Wind up commenced before 19 December 1996; or Applicable time before 6 April 1997
2	All liabilities including expenses on MFR	Post 6 April 1997 applicable times – during wind up (but see 3 & 4), at insolvency or on cessation of participation
3	Pensioners on buyout Non-pensioners on MFR Expenses on trustees' estimate	Wind up commenced before 11 June 2003 with a solvent employer at commencement
4	Pensioners and non-pensioners on buyout Expenses on trustees' estimate	Wind up commenced from 11 June 2003 (applicable time on or after 15 March 2004) with a solvent employer at commencement

Some problem areas
arising from 11 June announcement

- Trustees could deliberately trigger wind up. Or if they don't have the power, ask Opra to trigger *"to protect the interests of the generality of the members of the scheme"* (s11(1)(c) PA 1995)
- Employers could try some buyout 'planning' (but danger of retrospective challenge):
  - Use a member's voluntary liquidation to close down subsidiaries and avoid buyout tests (as with 2002 changes)
  - Use cessation of participation route to close down multi-employer scheme – each exit generates an MFR debt - remaining employer could be an insolvent shell subsidiary. Buyout test avoided
- The actuary can't readily determine buyout debts
- Government took 9 months to update the debt calculation

Future

The pension protection fund will one day be regarded by historians as one of the proudest achievements of this Labour Government, because it brings a real sense of assurance and security to 10 million scheme members and their families.

Malcolm Wicks, 20 May 2004, on completion of the third reading in the House of Commons of the Pensions Bill 2004.

Protect the Pension Protection Fund

From debts that should have been met elsewhere

Initiative	Backdated?
The restoration requirement	11 June 2003
The contribution requirement	11 June 2003
Financial support arrangements	Apparently not

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The restoration requirement

What's done can be undone

- If a post 11 June 2003 transaction at undervalue, involving scheme assets, has taken place and the insolvency provisions are triggered within two years, the Pensions Regulator can require the effect of the transaction to be undone
  - Assets can be be transferred back including property (presumption that not acquired in good faith)
  - Failure to comply may result in a notice requiring a contribution to be paid comprising the whole or part of the shortfall arising from the transaction
- Includes Bradstock agreements
- But limited usefulness given employer now insolvent?

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The contribution requirement

Lifting the corporate veil – part one

- If the Pensions Regulator is of the opinion that a post 11 June 2003 act (or failure to act) has taken place whose main purpose is to avoid the debt due from the legal employer
  - a person or company that is involved may be required to pay a contribution into the scheme
  - Which could be up to the full buyout debt
- Regulator can estimate debt
- Persons may be jointly and severally liable

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Financial support arrangements

Lifting the corporate veil - part two

- If the Pensions Regulator is of the opinion that the employer is either a service company or is insufficiently resourced, financial support arrangements may be put in place which include:
  - All the companies in the group becoming jointly and severally liable
  - The holding company of the group, meeting prescribed requirements, becoming liable
  - An arrangement meeting prescribed requirements whereby additional financial resources are provided to the scheme
- Financial support = accept liability for contributions and any future debt on the employer
- Failure to comply with a direction may result in the Pensions Regulator demanding a contribution to the scheme (which might be a full buyout debt)

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Anti-avoidance

Overview reaction

- Is the backdating legal?
- Is breaking the corporate veil legal?
- Pensions Regulator demanding debt increases its impact without it becoming “preferential”
- Reliance on the Pensions Regulator to act reasonably
- Risks and liabilities in relation to DB schemes increase significantly
- Potential frustration of normal corporate re-organisations

⇨ More work for advisers as less clear what is allowable and what is not

⇨ More acquisitions in future on assets and not shares basis?

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Anti-avoidance

Specifics

- Pension liability can contaminate the corporate group and could go beyond
  - Placing a poorly performing subsidiary into insolvency may just spread the pension deficit and put the whole group at risk
  - Venture capitalists will have to underwrite pension liabilities of their trading subsidiary investments.
  - Insolvency of one venture capitalist enterprise could contaminate other unrelated enterprises of the same venture capitalist
- “Insufficiently resourced”
  - Does not depend on an “act” for the Pensions Regulator to intervene. Just need to find a suitable connected or associated person
  - Bargaining counter for trustees to improve covenant?
  - But how will net assets of employer be measured?
  - How does it work for multi-employer schemes? And will such be ‘fair’ and make sense?

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Period Five 6.4.05 onwards?

Details yet to be fully disclosed

- Winding up
  - Solvent employer at commencement: accrued benefits on buyout?
  - Insolvent employer at commencement: PPF benefits on buyout?
- Insolvency
  - PPF benefits on buyout?
- Cessation of participation
  - Accrued benefits on buyout unless appropriate financial support put in place in which case a “scheme-specific” debt is payable

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Wider and earlier insolvency trigger

Consistent with that for the Pension Protection Fund

- “Qualifying insolvency event”
  - Proposal of a company voluntary arrangement
  - Appointment of an administrative receiver
  - Entering by the company into administration
  - Appointment of a liquidator either by the creditors or the court

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The debt on the employer

past, present and future

1. Conceived so that revaluation requirement would be delivered
2. Then to ensure MFR funding
3. Now designed to ensure that the pension promise is delivered
4. And in so doing protect the PPF
5. But will fear of heavy-handed anti-avoidance diminish future DB provision?

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