Institute and Faculty of Actuaries

The draft Occupational Pension Schemes (Employer Debt) (Amendment) Regulations 2017

IFoA response to Department for Work and Pensions

18 May 2017

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Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

Employer Debt Team
Department for Work and Pensions
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London
SW1H 9NA

18 May 2017

Dear Sirs

IFoA response to DWP Consultation: The draft Occupational Pension Schemes (Employer Debt) (Amendment) Regulations 2017

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation. Members of the IFoA's Pensions Board, most of whom have experience advising trustees and/or sponsors, have overseen our response.

Q1. We would welcome your views on the deferred debt arrangement proposal. In particular, will it be helpful to employers of non-associated multi-employer schemes in managing an employer debt when they cease to employ an active member?

2. Yes, the proposed Deferred Debt Arrangement ('DDA') will be helpful. Employers in Non-Associated Multi-Employer Schemes ('NAMES') cannot typically use the other methods available for dealing with a debt (for example, flexible apportionment arrangements and scheme apportionment arrangements). They cannot do so because there is no other employer in the scheme willing to take on their liabilities. Consequently, the ability to defer payment of a debt, whilst continuing to be treated as an employer in the scheme, will avoid an immediate debt payment that could endanger the employer's survival.

3. We note that debts can sometimes be delayed by the artificial continued employment of a single member, or by entering a period of grace, but a DDA should be a more straightforward and transparent option for trustees and exiting employers.

4. DDAs also appear to be possible in associated-employer multi-employer schemes. For these schemes, there are already various options for dealing with a debt, but the DDA is a welcome additional option which does not require the co-operation of other scheme employers. They may be more straightforward to implement, at least initially (albeit the ongoing monitoring of the deferred employer may be more onerous).

5. Finally, we note that DDAs grant welcome parity for NAMES alongside single employer schemes, where an employer ceasing to employ active members does not automatically trigger a debt. In both cases, a debt will only be triggered on a subsequent employer insolvency event, or during the winding up of the scheme (unless the conditions for a DDA to cease are met and the trustees decide to do so).

Q2. Will the proposed conditions to enter into a deferred debt arrangement work in practice for the employer and the trustees and managers of the scheme?

6. Yes, the proposed conditions should work. Requiring trustee agreement is essential, in our view, since trustees will have to weigh up the risk of the exiting employer (who may be sold and no longer have links with the existing employers) not engaging in future scheme funding negotiations, or providing adequate covenant information.

7. The funding test is not, in our view, a particularly strong control, since it is typically easy to be satisfied the scheme's recovery plan will be sufficient to meet the deficit and, if the employer covenant is unchanged, member security will not be adversely affected. However, this is also the case when a funding test is used in conjunction with other arrangements, so we are ambivalent about its inclusion in the conditions and acknowledge that it can serve a useful purpose.

8. We note that, although the consultation document suggests that DDAs are not intended to be used in restructuring situations, the draft regulations do not include this restriction within the conditions for a DDA to occur. We assume this is intentional.

Q3. Do you envisage any difficulties in the practical operation of the deferred debt arrangement?

9. We have identified three potential difficulties. We do not agree that the freezing of the scheme should be one of the circumstances for terminating a DDA and believe this condition would largely prevent a DDA being a practical solution. It is also inconsistent with the treatment of other scheme employers when a scheme freezes, since a debt does not trigger if all remaining employers cease simultaneously. A more logical provision would see deferred employers remaining as deferred in a freezing scenario and, like other former employers, having the option to elect to trigger a debt at any time, without trustee agreement, under Employer Debt regulation 9(5).

10. Another proposed circumstance for ceasing a DDA is when a deferred employer 'restructures'. However, the regulations do not define 'restructuring' (either for the purposes of restricting the use of a DDA, or for terminating one). We question whether, or not, there is intended to be a link to the definition required for a Restructuring Arrangement under regulation 6ZC of the existing regulations.

11. Also, there are potential difficulties for trustees in encouraging a deferred employer to engage in scheme funding negotiations when its covenant is not deteriorating, particularly where the deferred employer retains few if, any, links to the scheme or to other scheme employers. However, the power afforded to trustees to terminate a DDA should provide a 'stick' with which the trustees can remind reluctant deferred employers of their obligations.

Q4. Do you agree with the list of circumstances in which the deferred debt arrangement would end, and can you identify any other circumstances in which it will end?

12. Along with the comments made in response to question 3, we have some concerns about the practicality of trustees monitoring the covenant of an arms-length employer, in order to determine whether its covenant is likely to deteriorate in the next 12 months, and therefore whether the DDA should be terminated. We foresee legal arguments around this point and potential challenges to trustees who could have, but have chosen not to, terminate a DDA. Similarly, there may be challenges from employers where trustees have chosen to terminate a DDA in circumstances disputed by the employer.

13. We have not identified other circumstances for terminating a DDA.

Q5. The deferred debt arrangement is available to employers who have entered into a period of grace. Should the deferred debt arrangement be available to employers who have already used one of the other arrangements for managing their employer debt?

14. We do not believe so. We cannot see how a DDA would apply to an exited employer whose debt and/or liabilities have already been apportioned to other employers in the group (or to external guarantors). Such an employer no longer has a debt to defer.

15. For the avoidance of doubt, we agree that an employer in a period of grace should be capable of using a DDA.

Q6 (i). Will this amendment work in practice where an organisation's restructuring is limited to changing its status and are there any further situations it should cover?

Q6 (ii). Are any changes needed to regulations 6ZA and 6ZB of the Employer Debt Regulations to provide for a restructuring where the receiving employer is the new legal status of the exiting employer?

16. We believe legal commentators are better placed to respond to these questions.

Q7 (i). Is the funding test appropriate for the deferred debt arrangement?

17. Yes, although it is not a strong test, it provides some useful discipline. We refer to our comments in response to question 2.

Q7 (ii). Are any further changes needed to the test to ensure it works in practice?

18. No.

Q7 (iii). Are there any circumstances in which it would be unnecessary?

19. It appears unlikely this would be the case and the test is not usually difficult to determine, so we would not favour exemptions.

Q8 (i). Does this adequately address the problems schemes have faced in calculating an employer debt in relation to more than one employment-cessation event?

20. The proposed changes require some legal scrutiny to ensure they meet the policy intention, but we would question the limitation to cases where the employer has re-employed an active member before 31 March 2017.

Q8 (ii). Is this provision a fair way to attribute liabilities to an employer who has undergone two sequential employment-cessation events?

21. We agree it seems fair that an employer should not be liable for more than one debt based on the same period of service. The proposal to limit the total debt to the amount due at the second employment cessation event seems reasonable.

22. The outcomes in different situations where the employer has, or has not, already settled its initial debt may need some additional legal scrutiny to ensure they work as intended in practice.

Q8 (iii). Does there need to be any related assessment of the scheme's funding position in relation to it?

23. A more accurate approach might seek to reflect changes in the buy-out position between the first and second debt trigger. The provisions must also be relatively simple and avoid encouraging employers to 'game' the system (by giving them the opportunity to recalculate a debt when conditions improve). We therefore prefer a pragmatic approach. For example, where the first debt has been calculated already and the second is a top-up, where required, up to the amount of the second debt (taking into account any debt already paid).

Q8 (iv). Does this provision pose any risk to the funding of pension schemes and members' pensions?

24. The provision to avoid double-counting of debts does not, in our view, pose any material risk. However, the changes proposed in regulations 6 and 9 do potentially pose some risk, as they seem to exclude some former employers from the new 'former employer' definition.

25. We encourage the Government to revisit both these regulations, as their purpose is unclear and their outcomes may not be as intended.

Q9. Will a three month period allow sufficient time for both employers and trustees to process a period of grace application?

26. We do not have strong views on this change and can only assume Government is responding to calls for an extension.

Q10 (i). Will the arrangements enabling a deferred debt arrangement to follow on from a period of grace arrangement work in practice?

27. Yes, we believe so.

Q10 (ii). Are any further changes needed to facilitate this?

28. We do not believe any further changes are required.

Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.doggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours faithfully

Colin Wilson
President, Institute and Faculty of Actuaries