

Moral Hazard

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TRAVERS SMITH



Overview

- Debt on employer
- Contribution notices
- Financial support directions

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- Avoidance of section 75 debt

Overview

- Financial support directions
- Employer with insufficient resources to meet pension liabilities
- Support for pension liabilities
 - section 75 debts
 - contributions shown in schedule

Debt on employer

- Scheme wind up
- Employer withdraws from a multi-employer scheme
 - “ceases to be an employer employing persons in the description of employment to which the scheme relates”
- Employer insolvency

Debt on employer

- Buy-out basis
 - wind-up
 - employer's withdrawal
 - insolvency
- Employer's share

Debt on employer: withdrawal arrangement

- Voluntary withdrawal from multi-employer scheme
- Pay reduced amount immediately
- Further payment guaranteed

Debt on employer: withdrawal arrangement

- Trustees and TPR must agree
- Payment “more likely” under guarantee
- Must alternative be insolvency of the employer?

Debt on employer

- Sectionalised schemes
- Different apportionment of debt

Contribution notices

- Person party to an act or deliberate failure to act
- Includes knowing assistance
- Amount of s.75 debt
- TPR's opinion that reasonable

Contribution notices

Main purpose or one of main purposes

- to prevent the recovery of the whole or part of a debt what was, or might become, due under s.75

Contribution notices

Main purposes or one of main purposes

- Otherwise than in good faith
 - to prevent a s.75 debt becoming due
 - to compromise a s.75 debt
 - to reduce the amount of a s.75 debt that would otherwise become due

Contribution notices

- On or after 27 April 2004
- Within 6 years before CN issued

Contribution notices: reasonableness

- Degree of involvement in act/failure
- Relation to employer
- Connection with scheme
- Failure to notify a notifiable event
- All the purposes
- Financial circumstances

Financial support directions

- Direction that FS put in place for scheme
 - group companies jointly and severally liable
 - holding company liable
 - additional resources for scheme
 - other arrangements

Financial support directions

- Apply to
 - s.75 debt
 - liabilities under schedule of contributions
- Non-compliance: TPR can issue CN

Financial support directions

- Employer
- An associate or person connected with employer
- Not an individual unless employer is an individual
- Look-back period of 12 months

Financial support directions

- Employer is a service company
- Employer is insufficiently resourced
 - resources less than 50% of estimated s.75 debt
 - an associate/connected person has resources sufficient to make up shortfall

Financial support directions

- Regulator's opinion that FSD is reasonable
 - relationship with employer
 - value of benefits from the employer
 - connection with scheme
 - financial circumstances

Clearance statements

- Conditions for CN not met
- Employer not a service company/
insufficiently resourced
- Not reasonable to issue CN/FSD
- Binding unless circumstances
materially different

Guidance on clearance

- Specified events
 - “An event affecting an entity which is financially detrimental to the ability of a defined benefit scheme to meet its pension liabilities”
- Relevance to
 - CN?
 - FSD?

Clearance: financially detrimental

- Only if scheme in deficit
- Scheme specific funding?
- FRS 17
- But only where
 - “there is no doubt that the employer will continue as a going concern”
 - trustees do not have higher funding target

Type A events

- Changes in priority (e.g. charges)
- Return of capital
 - dividends
 - share buy backs
- Change in control structure
- Tests of materiality

Type B events

- Arm's length transactions which are not detrimental

Type C events

- Event which points towards a deterioration in the employer's covenant

Sale of principal employer

- May be Type A event
- Seller and buyer at risk of FSD
- Sale itself unlikely to meet CN test
- Subsequent restructuring/refinancing?

Sale of participating employer

- Withdrawal leads to s.75 debt
- Continued participation in sectionalised scheme

Dividends/charges/debt

- Type A/Type C event possible
- CN: depends on purpose
- FSD: risk

Sale of business (TUPE transfer)

- If employer withdraws, s.75 debt
- Sale itself neutral
- Key point is use of proceeds

The role of the trustees

- Support effectively required for clearance
- Disclosure to trustees
- Must deal with conflicts
- Should trustees exploit their power?

Clearance

- Avoiding risk
 - transactions
 - on-going
- The arguments against clearance
- Clearance is voluntary

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