Institute
and Faculty
of Actuaries

Employer debt in non-associated multi-employer defined benefit pension schemes

IFoA response to the Department for Work and Pensions

22 May 2015

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

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
6-12 Caxton House
Tothill Street
London
SW1H 9NA

22 May 2015

Dear Sirs

IFoA response to the Call for Evidence into the Section 75 Employer Debt for Non-Associated Multi-Employer Schemes

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the DWP's consultation on the Section 75 employer debt legislation for Non-Associated Multi-Employer Schemes. In preparing this response, we have consulted with some of our members who work as Scheme Actuaries to Defined Benefit schemes and members who advise employers on pensions. Many of our comments reflect the discussion members of our Pensions Board previously had with Anna Smith-Sparks.

General Comments

2. While the IFoA's responses to the questions raised in the consultation cover a lot of detail, the general points we would highlight from our response are:
   - Section 75 debt legislation is very complex and any further options are likely to make increase the complexity;
   - There is a delicate balance between paying the debt by means of a lump sum and scheduling a series of regular payments; and
   - Introducing some flexibility around the timing of the effective calculation could lead to advisory cost savings but could also lead to variations in debt amounts.

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

3. If new provisions were limited to Non-Associated Multi-Employer Schemes, it would further complicate an already very complex set of provisions. The initial challenge is that there is not currently a definition of Non-Associated Multi-Employer Schemes. We have also not been able to identify any areas where the application of the sort of changes discussed in the paper would increase the risk to members' benefits more significantly, if also applied to associated multi-employer schemes than if applied to Non-Associated Multi-Employer Schemes.

4. Conversely, we consider that there may be more risk in applying any new provisions to a Non-Associated Multi-Employer Scheme than to an associated multi-employer scheme. It would be harder for associated employers to avoid liability than for non-associated employers.

For example, the Pensions Regulator (tPR) would find it easier to connect liabilities to associated companies than to non-associated companies.

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

5. As noted above, we cannot see any reason to do this. Associated multi-employer schemes may be able to avoid any such restriction by temporarily including a non-associated employer. The Scheme Return may be an appropriate place to indicate if a scheme is a Non-Associated Multi-Employer Scheme.

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?

6. As all Non-Associated Multi-Employer Schemes must have a Scheme Actuary, a number of IFoA members act (or have acted in the past) for such schemes.

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?

7. We have taken as our starting point the government's policy intent that, to protect members' benefits, employers generally must make up any buy-out shortfall when they cease to be linked to the scheme. Consequently, any easements from this fundamental starting point should only be permitted if there is no detriment to the security of members' benefits. The IFoA is conscious that the current easements are generally less applicable to Non-Associated Multi-Employer Schemes. However, we would comment that talking, generally, rather than how it applies to Non-Associated Multi-Employer Schemes:
   - Provided trustees only agree to easements that protect the security of members' benefits, the use of easements would not necessarily be inappropriate. In theory, the funding test is relatively weak; however, our members' experience is that trustees are cautious in agreeing to easements.
   - The underlying debt regime works in most cases as it currently stands.

8. It is worth noting that when the current employer debt provisions were originally introduced, it would have been possible to introduce fundamentally different arrangements. Such arrangements might have struck a different balance between flexibility for employers and the security of members' benefits. For example, legislation could have allowed employers to retain indefinite liability to contribute to deficits for any scheme in which they had participated, rather than legislating for a debt payable at cessation. Legislation could have continued to impose a smaller debt while accepting continuation of weaker security for members' benefits. The IFoA does not consider that different regimes for different schemes would be appropriate.

9. However, in our responses to other questions, we have suggested alternative ways in which the IFoA believes the operation of the employer debt regime could be improved for all schemes.

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

10. The IFoA does not have data in respect of this.

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

11. As noted above, a number of IFoA members act (or have acted in the past) as Scheme Actuaries for both associated multi-employer schemes and Non-Associated Multi-Employer Schemes. Apportionment arrangements are the most common form of easement used. In practice, there is less use of withdrawal arrangements or the easement for immaterial debts.

Question 5.2 – how effective are the easements:

• For schemes?
• For employers?

12. We have set out our detailed response to this question in our answer to Q 5.3.

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

13. Some employers regard the employer debt regime as onerous. However, to a large extent the burden that employers perceive is a consequence of the policy decision to impose a debt equal to the buy-out shortfall at the point that an employer ceases to participate. Employers will not always be able to defer (e.g. by apportioning) payment of the debt, but, given the policy intent, deferral (when it applies) is an easement, not an entitlement. We do not necessarily consider the fact that employers in Non-Associated Multi-Employer Schemes do not have an associated company willing and able to accept apportionment of the liability as a problem with the regime; rather it is a reflection of the original policy intent. Government could initially have chosen a different policy outcome, with a different balance between member security and employer burden.

14. Despite that, some employers are concerned by the uncertainty of outcomes. Under most of the easement routes, the trustees are able to refuse the employer proposals and to collect the debt in full. This is even where the employer considers its proposals as properly addressing the impact of the employer cessation while protecting the overall employer covenant. While some employers may therefore regard the regime as giving the trustees too much power, some trustees may disagree. Consequently, it should be recognised that where current methods result in decisions on debts they can lead to more challenging relationships between sponsors and trustees.

15. Similarly, some employers could see tPR as using the regime as a mechanism for obtaining funding from employers without economic justification (e.g. where the employers have made proposals that ensure there is no adverse impact on the employer covenant from the cessation). They could regard tPR as seeking an unnecessarily high price for "clearance" (which is often linked to events that trigger employer cessation). TPR's views on requiring collection of s75 debts in addition to (rather than integrated with) contributions payable under a schedule of contributions could be regarded as unhelpful (where there is no adverse impact on the overall employer covenant). The IFoA would welcome the opportunity to consider any views tPR would have.

16. As with any legislative change, some employers (and some trustees) are concerned that their scheme rules do not integrate well with the employer debt legislation. While the IFoA is sympathetic to this problem, it is preferable to encourage employers and trustees to work together to adjust their own scheme rules to fit new circumstances, rather than trying to write legislation that covers every unusual eventuality of scheme rules.

17. Nevertheless, there are some problems that we think could readily be addressed:

- The calculation of the s75 debt precisely at the date of an employer's cessation can result in extensive work not otherwise required and therefore additional cost, due to the need for both accounts and an estimate the buy-out shortfall at that date. Trustees could be given the discretion to calculate s75 debts, for example, at the next quarter, half or year end, rather than automatically at the date of cessation. This would also provide economies of scale by carrying out calculations for several employer cessations as a bulk exercise at the same date. This would be particularly useful for Non-Associated Multi-Employer Schemes, which tend to have many smaller employers.
- There is a lack of clarity as to whether accrual in a DC section of the same trust counts as accrual for the test as to whether an employer has ceased accrual for the purposes of the s75 debt legislation. This could discourage some employers from ceasing unaffordable DB provision and offering DC contributions instead. Amending the legislation to provide clarity that DC provision within the same trust counts as accrual would provide reassurance for employers and trustees where an employer is considering this. We note that a recent court determination concluded that, in relation to a similar grey area, continued revaluation (in excess of statutory revaluation), or salary linkage, does not count as continued accrual. This determination will increase concern in relation to replacement of DB by DC accrual.
- Payment of the full debt as a single lump sum in advance may be difficult for the former employer to afford and may drive the employer insolvency (or force the employer to maintain accrual to avoid triggering the debt, even if this is unaffordable). If collection of the full debt triggers employer insolvency, the scheme may not recover as much as it could have recovered via periodic payments. The IFoA notes that the concept of open-ended liability for contributions from former employers could make matters worse rather than better; however, we would not have any objection to payment of s75 debts via instalments over a period that is agreed at cessation by the trustees and employer, with the period being agreed based on an assessment as to what is reasonably affordable. The intention would be to increase overall recovery by allowing pre-agreed staged payments. Such a payment schedule could incorporate interest reflecting the delay in payments by the employer. It would also be possible to specify a maximum payment period.
- We are aware of at least one plan where, under the rules, a former employer remains liable forever for subsequent deficit contributions even after it has paid any s75 debt in full. This could be considered as onerous following the introduction of the s75 debt legislation. As noted above, in general we think it should be for employers and trustees to adapt their plan rules to the legislation rather than the other way around. However, we think this is an exception where it would be helpful for the legislation to be extended. It could clarify that a former employer is no longer liable for deficit contributions under the plan rules once it has paid any s75 debt in full (or following the implementation of an apportionment arrangement etc.). It seems unlikely that the trustees would surrender the power otherwise.

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

18. The regime would be easier to understand and apply if there were fewer options. Over the years, the government has repeatedly introduced new easements without "retiring" the previous ones. Given the relatively few Non-Associated Multi-Employer Schemes in existence, it would be possible to undertake an analysis of what easements have been used.

Question 5.5 – what data do you have that might support your answer to questions 5.1 – 5.4?

19. The IFoA has no data.

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?

20. See our response to Q 6.4 below.

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

21. The IFoA has no data.

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

22. We consider that it would be helpful to amend the employer debt legislation to include explicit arrangements for payment of s75 debts by instalments, with an appropriate allowance for interest. It would be appropriate to include criteria for trustees and employers to consider when agreeing the schedule (see our response to Q6.4 below) and to amend tPR's objectives to be consistent with this.

23. We believe it would be unreasonable to ask each scheme's trustees to consider whether agreement to payment by instalments might compromise eligibility for the PPF, as suggested in the consultation paper. We therefore suggest that the amendments to the legislation should include provisions to clarify that agreement to payment of a s75 debt by instalments, with an appropriate allowance for interest, does not affect eligibility for the PPF (in the same way that agreement to apportionment of the debt does not).

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

24. It would be most consistent with the general intent of the legislation for any provision for the debt to be payable over a period, agreed in advance, that would not be subject to subsequent re-negotiation. Against this background we observe:

- If the period for repayment allowed is longer than the shortest period over which the exiting employer can afford to pay the debt, this may increase the risk of deterioration in that employer's financial position and increase the risk of default against the later payments. Such defaults would increase the obligations of the remaining employers and increase the risk to member's benefits (and to the PPF).
- However, minimising the period may prejudice the employer's ability to invest which may impact the government's other objectives. At the extreme, imposing too short a repayment plan (as with requiring payment up front) may push the employer towards insolvency, again increasing the risk of default.

25. It may therefore be appropriate to set some criteria along the lines that the trustees should aim to set a repayment plan in line with what is reasonably affordable for the employer, possibly within a maximum repayment period. It may be appropriate to offer guidance, or examples, of what is meant by "reasonably affordable", setting out what other payments can be taken into account within that definition. For example, payments to shareholders (if any) and allowance for investment. It may be appropriate for the default to be for immediate payment, with any deviation from this being subject to the trustees' approval. Consideration could be given as to whether tPR approval would also be required. It would be important for tPR's objectives in considering such repayment plans to be aligned with the criteria against which the trustees are asked to set them.

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

26. We have outlined the options in our response to Q6.4.

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

27. The IFoA has no data.

Question 6.7 – what could the consequences and risks of making this change be for:

- **The scheme?**
- **The employer?**
- **Other employers in the scheme?**
- **Members of the scheme?**
- **The PPF?**

28. We have outlined the considerations in our response to Q6.4.

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

29. We consider there are no obvious solutions. We can recognise the difficulty of continuing to maintain the link and assess the covenant of an employer that is no longer making regular contributions to the scheme for current employees. This is a major risk of allowing a former employer to remain liable for deficit payments rather than making an up-front exit payment. There would be a requirement for clarity that the employer remains liable for payments even where the scheme has a surplus on a technical provisions basis.

30. If this easement were to be applied to all categories of scheme, in our view the greatest challenges would arise for Non-Associated Multi-Employer Schemes. It could be easier for scheme trustees to monitor the covenant of a former employer which is associated with a continuing employer (probably by sourcing the information via the continuing employers) than for a former non-associated employer.

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

31. With greater flexibility on payment timings, it is likely that more former employers become insolvent before having made the full payments due.

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

32. The IFoA has no data.

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

33. The IFoA is not aware of any obvious alternatives. We recognise the difficulty of continuing to maintain the link and assess the covenant of an employer that is no longer making contributions to the scheme. This is a major risk in allowing a smaller exit payment up front to be followed by the balance if the covenant subsequently weakened.

34. If this easement were to be applied to any category of schemes, in our view the least appropriate category would be Non-Associated Multi-Employer Schemes. It would be easier

for scheme trustees to monitor the covenant of a former employer which is associated with a continuing employer (probably by sourcing the information via the continuing employers) than to monitor a former employer which is not associated with a continuing employer.

Question 6.12 – what could the consequences and risks of making this change be for:
• The scheme?
• The employer?
• Other employers in the scheme?
• Members of the scheme?
• The PPF?

35. The likely outcome of allowing a smaller exit payment up front, to be followed by the balance if the covenant weakens, would be, in some cases, to defer payment of the balance of the buy-out shortfall from a time when it could be afforded to a time when it could not. It would be challenging for the trustees to carefully monitor the covenant so that they could call in the balance while it remains affordable, rather than just after it becomes unaffordable. Imposing conditions for the former employer to provide information to the trustees would mitigate, but not remove, the difficulties.

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

36. The IFoA has no data.

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?

37. As noted under Q5.3 above, trustees could be given the discretion to calculate s75 debts at the next quarter, half or year end, rather than automatically at the date of cessation. The comments made in in our response to Q5.3 form the basis of our thinking in this matter.

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

38. The IFoA has no data.

39. If the DWP wished to discuss any of our comments in any further detail, you should contact our Technical Policy Manager, Philip Doggart, in the first instance. He is available on 01312401319 or at Philip.Doggart@actuaries.org.uk. Members of our Pensions Board would be available for a further meeting, if required.

Yours faithfully

Gareth Connolly, Pensions Board Chair
Institute and Faculty of Actuaries