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BRIEFING

Pensions Bill: increased regulator powers to hit corporates

Employment, pensions and benefits: briefing 108

Executive summary

Significant new changes to the Pensions Bill were announced recently. Designed to protect pension funding, they will have major funding implications for employers and others (eg group companies), in particular on internal restructurings and corporate transactions. Sale agreements commonly provide that the transfer of pension rights will take place some months after completion. Therefore, although the Bill will not be in force before 6 April 2005, the changes may affect sellers and buyers under existing agreements and agreements currently being negotiated.

Our earlier briefing on the Pensions Bill 2004 (no 107, April 2004) gave an overview of the provisions of the version of the Bill published on 11 February 2004, as amended in the early Standing Committee debates. Those debates continued to run and, on 27 April 2004, the pensions minister Malcolm Wicks announced a number of significant changes to the Bill.

- Contribution notices: the new Pensions Regulator will have significant powers to require contributions to schemes (other than money purchase schemes and schemes of a prescribed description) not only from participating employers but, in appropriate circumstances, from other connected and associated persons.
- Financial support notices: the Regulator will have significant power to require financial support to be put in place where a participating employer is a 'service company' or is 'insufficiently resourced'.
- A new funding requirement on ceasing to participate: the debt arising under section 75 of the Pensions Act 1995 (see box) will increase when an employer ceases to participate in a multi-employer scheme. Currently the statutory funding obligation is based on the MFR level (see box). This will increase to the buyout level. This will be a very significant change that will have a major impact on corporate transactions and internal restructurings.

No details were given in the press release about whether this proposed amendment to section 75 will be retrospective. However, the Department for Work and Pensions (DWP) told us by telephone that it is not envisaged as being retrospective (the minister also confirmed this in a recent debate). It may well apply only from 6 April 2005.

Amendments reflecting these changes have now been agreed and incorporated into the Bill. The Bill is due to complete its stages in the House of Commons shortly. It will then pass to the House of Lords for consideration. It is likely only to receive Royal Assent in the Autumn and to come into force during 2005.

Some terms

Buy-out debt

The cost of securing all benefits by purchasing matching policies with an insurance company. Usually a far greater amount than applicable on other funding bases (eg the MFR or FRS17).

Minimum funding requirement (MFR)

The minimum funding requirement under the Pensions Act 1995. Occupational pension schemes which are not money purchase schemes or of a prescribed description are subject to a funding requirement based on the value of their assets compared to the amount of the liabilities of the scheme calculated on the prescribed basis. The MFR will be abolished by the Pensions Bill (if enacted) and replaced by a 'scheme-specific funding requirement', to be agreed between the employer and the trustees (or fixed by the new Pensions Regulator in default).

Section 75 Pensions Act 1995 – deficiencies in the assets

Where the value of the assets of an occupational scheme which is not a money purchase scheme or a scheme of a prescribed description is less than the amount of the liabilities, section 75 imposes a statutory funding debt on employers in various situations. In particular, it is imposed if the scheme winds up; the employer becomes insolvent (currently only 'goes into liquidation', but the Pensions Bill will extend this to other insolvencies); or (in a multi-employer scheme) the employer ceases to participate in the scheme (eg is sold or ceases to have any employees who are (or are eligible to become) active members).

Contribution notices

The power

The Pensions Regulator will be able to issue a contribution notice to a person stating that the person is under a liability to pay a specified amount. The notice may be issued to an employer or a person who is 'connected with' or 'an associate of' an employer (see box) where:

- there has been an act or deliberate omission on or after 11 June 2003 (the date of the White Paper announcing the changes to be included in the Pensions Bill) which reduces the recovery of a debt under section 75 of the Pensions Act 1995 or reduces the amount of the debt;
- that person was a party to (or 'knowingly assisted' in) that act or omission;
- the Regulator is of the opinion that reducing the section 75 recovery/debt was the main purpose or one of the main purposes of the act or omission; and
- the Regulator thinks it is reasonable to impose the debt on that person.

The contribution notice will require payment of the full amount payable under section 75, assuming for these purposes that the scheme winds up (ie the full buyout debt in most cases).

Practical effect

The 'main purpose' requirement should limit the impact of this power on corporate transactions.

However, any internal restructuring should be considered carefully, as should any changes to the principal or participating employers. The purpose of undertaking such transactions should be documented in order to rebut any later suggestion that the main purpose was to avoid section 75 liabilities.

Connected persons and associates

The categories of 'connected person or associate' are widely defined (using the definition in the Insolvency Act). The expression includes both other group companies and directors of the employer. It could include persons with a very tenuous connection (eg grandchild of the ex-wife of the chief executive of the employer). A 33.3 per cent shareholder is also connected, as is a company with a director who is also a director of the employer.

Financial support directions

The power

The Regulator will be able to issue a financial support direction where, at the relevant time (any time determined by the Regulator which falls within a prescribed period), the employer is or was:

- a service company (ie a company with accounts showing its turnover principally derived from providing services to other group companies); or
- insufficiently resourced (did not have sufficient assets to meet a prescribed percentage of the section 75 debt in relation to the scheme and at that time there was a connected or associated person who did have sufficient resources).

A financial support direction requires the person to whom it is issued to ensure that financial support (broadly, funding) for the scheme is put in place within a specified period and maintained throughout the life of the scheme.

This provision is potentially retrospective. In practice, the Regulator will not be concerned if the current employer is of sufficient substance. Presumably the Regulator may look to the past if the current employer is not particularly strong yet does not currently satisfy the definitions of 'service company' or 'insufficiently resourced'.

The notice can be directed at the employer or person 'connected' with the employer. It can require arrangements to be put in place where all group companies are jointly liable or a suitable holding company is liable.

Companies will be required to notify the Regulator (afterwards) if anything happens that has an impact on the financial support.

Practical effect

Depending on how 'insufficiently resourced' is defined, a large number of employers could actually fall within this test.

Past restructurings which have resulted in the employer being a service company or insufficiently resourced will be situations in which the Regulator can exercise this power.

Where a corporate transaction involves sales by participating employers which could put them in a position of being a service company or insufficiently resourced, they could trigger this provision.

Malcolm Wicks commented in the Standing Committee debate on this clause that it could apply 'even where the company structures have been set up for perfectly legitimate reasons'.

Companies that are served with such a notice will have to consider carefully the most appropriate type of financial support to provide. Agreeing that all group companies will be jointly and severally liable could cause problems with later transactions. Certainly, a notification requirement will be triggered.

Funding on ceasing to participate (section 75)

Proposal

As noted above, when an employer stops participating in a multi-employer scheme, eg because it has been sold, or has no active members (and no employees in a waiting period), a funding check is required. The outgoing employer may incur a statutory debt under section 75 Pensions Act 1995.

Currently, this statutory funding obligation is based on the MFR level (currently a buyout debt arises only if the scheme is wound up). The government now envisages changing the regulations so that this debt will increase to the buyout level (ie the cost of securing benefits based on purchasing annuity policies from an insurer).

The notes to the DWP press release issued on 27 April stated:

'Malcolm Wicks also announced that the Government plans further reform regulations governing the position in relation to the application of debt on withdrawal from associated multi-employer schemes (associated multi-employer schemes usually consist of several subsidiaries of one company). In the future, when a participating employer withdraws from a multi-employer scheme with associated employers, a full buyout debt should be triggered unless appropriate financial support is put in place (in which case a 'scheme-specific' debt will be payable). This will ensure that there is comprehensive protection for scheme members and the PPF (Pension Protection Fund) against employers who would seek to rid themselves of their pension liabilities.'

An amendment was passed on 19 May to insert a new section 75A into the Pensions Act 1995. This will enable regulations to be made which could provide for the section 75 debt to be triggered in circumstances additional to those currently specified by section 75 and prescribe alternative methods of determining, calculating and verifying the assets and liabilities of the scheme. These may depend on whether the Regulator is satisfied that prescribed requirements have been met, including the putting in place of a 'prescribed arrangement' approved by the Regulator and the identification of one or more persons to whom the Regulator may issue a contribution notice. It is expressly stated that any amount specified in a contribution notice is to be treated as a debt due from the person to whom the notice is issued.

The 'prescribed arrangement' is presumably the 'appropriate financial support' referred to in the press release, upon which a 'scheme-specific' debt will be payable instead of the full debt. This is presumably a reference to the new scheme-specific funding requirement envisaged by the Pensions Bill as replacing the MFR.

This will be a very significant change that will have a major impact on corporate transactions and internal restructurings.

No details were given in the press release about whether this amendment to section 75 will be retrospective. However, the Department for Work and Pensions (DWP) told us by telephone that it is not envisaged as being retrospective (the minister also confirmed this in a recent debate). It may well apply only from 6 April 2005.

Practical effect

Corporate transactions currently in progress

These should be assessed immediately to consider the impact of the above changes.

In the case of sales/acquisitions, purchasers of businesses will want to check whether they get an indemnity from the vendor for any such debt. Similarly, vendors will want to consider carefully whether they are prepared to give an indemnity (and if so whether it should apply if there is a change in the law).

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Existing agreements

These should be reviewed to ascertain whether they could be affected. The date on which the section 75 debt is fixed is when a company ceases to participate in the pension scheme (or ceases to have any employees in the description or category of employment to which the scheme relates). This could be after 5 April 2005 under many existing agreements (eg those with a delayed completion or where an interim period of participation in the existing pension scheme is allowed).

Client seminar: pensions and corporate transactions – the new reality

Friday 25 June, 9-10am at our London office, 65 Fleet Street, EC4. This seminar will consider issues in corporate transactions regarding pensions, including:

- recent changes affecting business transfers (Tupe and ECJ cases);
- dealing with defaults (FRS 17, Pensions Act and Pensions Bill liabilities);
- dealing with funding and contractual issues;
- new banking covenants (negative pledge, pension funding, etc); and
- implications of the Pensions Bill for corporate transactions.

If you are interested in attending, please contact Val d'Souza (val.dsouza@freshfields.com or T +44 20 7427 3281) or register by visiting our website at www.freshfields.com/practice/epb/seminars

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