

# **Defined benefit multi-employer schemes and employer departures: guidance for trustees**

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## Introduction

This is a consultation document on guidance for trustees of multi-employer schemes, produced by The Pensions Regulator ('the regulator'), the body that regulates work-based pension arrangements. This guidance replaces the 'Multi-employer withdrawal arrangements' guidance published in April 2008.

The employer debt regime for multi-employer schemes is a complex area with many factors for trustees to consider. We have produced this guidance to assist trustees in understanding their responsibilities and available options, and to highlight the areas where their attention should be focused. The guidance emphasises the importance of ensuring that the employer covenant strength is reviewed and maintained throughout the life of the scheme; not only when a particular event such as an employer departing the scheme occurs.

This reinforces the messages set out in our 'Guidance on monitoring employer support: covenant, contingent assets and other security' which was published for consultation on 15 June 2010.

## Background: legal framework

The guidance on which we are consulting relates to amendments to the employer debt regime introduced by:

- the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008 (SI 2008/731);
- the Occupational Pension Schemes (Employer Debt Apportionment Arrangements) (Amendment) Regulations 2008 (SI 2008/1068); and
- the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2010 (SI 2010/725).

In April 2008, 4 mechanisms were introduced by which an employer could modify the debt that would normally arise under section 75 of the Pensions Act 1995 ('section 75 debt') upon departing a multi-employer defined benefit (DB) scheme, as a result of either insolvency or other corporate activity.

On 6 April 2010, 2 further mechanisms were introduced which, rather than modifying the debt due, prevent it from arising.

Therefore, in addition to the option of paying the full section 75 debt, there are now 6 mechanisms by which an employer can depart from a multi-employer DB scheme and be discharged from their liability to that scheme.

## Development of guidance

Following the amendments made to the employer debt regime in 2008 under the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008 (SI 2008/731) and the Occupational Pension Schemes (Employer Debt Apportionment Arrangements) (Amendment) Regulations 2008 (SI 2008/1068), the regulator published guidance on the mechanisms introduced in the regulations. The Department for Work and Pensions (DWP) then introduced the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2010 (SI 2010/725).

Following the new regulations, the updated guidance that we have now drafted is aimed at trustees of multi-employer DB schemes, and sets out our expectations of them when they are faced with an employer departing their scheme. It highlights the fact that, in addition to the prescribed requirements that must be met in relation to each particular mechanism, trustees must consider their overall fiduciary duty to the scheme members when making decisions relating to the risks to which the scheme may be exposed.

It is not intended to be technical guidance; we expect that trustees will normally need to seek independent professional advice where the circumstances described in this guidance apply to their scheme. The guidance outlines the mechanisms that are available as an alternative to full payment of the section 75 debt and signposts the areas where the regulator may become involved.

Although the guidance is aimed at trustees, we have indicated that it may be of interest to employers, and have included a section for employers both to raise their awareness of the issues trustees have to consider in this area and to highlight the regulator's expectations of them during the process.

## Format of guidance

The final guidance will be developed primarily as a web-based product.

Whilst copies of the guidance can be printed in full or in part, users will be able to access it online and navigate using a series of hyperlinks to various sections and other resources.

The guidance does not seek to duplicate material contained in other regulatory publications; however, it does include key messages and signposts users to other resources.

## Consultation questions

The regulator would like to hear from trustees and other interested stakeholders on the areas covered in the guidance, which is divided into 4 sections. We would welcome comments on the guidance in general, but would particularly welcome comments on the following specific areas:

### Section 1: What is a multi-employer DB scheme?

This section aims to outline the characteristics of a multi-employer scheme and to highlight some of the complexities that go with it, particularly around establishing the legal structure of the group of employers and the circumstances under which an employer may depart from a scheme.

1. Are there any other particular characteristics or complexities that it would be appropriate to include in this section?

### Section 2: Considerations for employers

This section is intended to raise employers' awareness of the trustees' duty to carefully consider any proposals put by the employer and why they need to ensure that support for the scheme will remain robust. We have also included periods of grace under this section, as the employer is solely responsible for this process, with no action required from the trustees.

2. Are there any other specific considerations for employers that we should include here?

### Section 3: What do we expect of trustees?

This section sets out the areas that we expect trustees to understand and to consider closely. This section in particular highlights the importance of protecting the employer covenant.

3. Does this section clearly explain the regulator's expectations of trustees and are these expectations reasonable?

### Section 4: Important aspects of each mechanism

This section aims to outline the mechanisms that are available either to modify a section 75 debt or to prevent it from arising. As well as describing the requirements for each mechanism, it also highlights particular issues for trustees to consider. This section is not intended to be a complete technical guide to each mechanism, as this is an area where we would expect trustees to obtain professional advice.

4. Does this section give an adequate overview of each mechanism for employer departure?

## Responding to the consultation

Responses may be made in either of the following ways:

- By email to:  
[meconsultation@thepensionsregulator.gov.uk](mailto:meconsultation@thepensionsregulator.gov.uk)  
(documents should preferably be in Word format)
- By post to:  
**Louise Hallard**  
**Regulatory Policy and Programmes**  
**The Pensions Regulator**  
**Napier House**  
**Trafalgar Place**  
**Brighton**  
**BN1 4DW**

We may need to share the feedback you send us within our own organisation or with other Government bodies. We may also publish this feedback as part of our response to the consultation. If you wish your comments to remain anonymous, please state this explicitly in your response.

If you wish your response to be kept confidential, please make this known and we will take the necessary steps to meet your request. However, please be aware that, should we receive a formal request under Freedom of Information legislation, we may be required to make your response available.

When responding, please advise whether you are responding as an individual or on behalf of an organisation (and if the latter, which organisation).

### Closing date

This consultation document was published on **1 July 2010**. The closing date for responses to this consultation is **23 September 2010**.

### The Government code of practice on consultation

This consultation is being conducted in line with the 7 criteria of the Government code of practice on consultation:

1. Formal consultation should take place at a stage when there is scope to influence the outcome.
2. Consultations should normally last for at least 12 weeks, with consideration given to longer timescales where feasible and sensible.

3. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence, and the expected costs and benefits of the proposals.
4. Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is designed to reach.
5. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Officials running consultation exercises should seek guidance in how to run an effective consultation exercise, and share what they have learned from the experience.

### Feedback on this consultation exercise

We value your feedback on how well we consult. If you have any comments on the process of this consultation (as opposed to the policy issues raised) please contact our consultation co-ordinator:

- By email to:  
[laura.butler@thepensionsregulator.gov.uk](mailto:laura.butler@thepensionsregulator.gov.uk)
- By post to:  
**Laura Butler**  
**The Pensions Regulator**  
**Napier House**  
**Trafalgar Place**  
**Brighton**  
**BN1 4DW**

In particular, please tell us if you feel that the consultation does not satisfy the consultation criteria. If you have any requirements that we need to meet to enable you to respond, please let us know.

## Impact assessment statement

The DWP is responsible for conducting Impact assessments for new legislation affecting the legislative framework for pensions regulation. In some circumstances it may be appropriate for the regulator to conduct its own Impact assessment, and publish this as part of its consultation exercise, where proposals have additional costs for the regulated community above those already imposed by the legislative requirements.

In the majority of cases, our proposals will impose no significant additional costs above those already imposed by the legislation. Our 'comply or explain' approach means that where initial analysis suggests that there will be no significant cost impact on the regulated community, and an Impact assessment is unnecessary, we should explain the reasons for this opinion clearly when we consult.

This guidance seeks to clarify the responsibilities of trustees of multi-employer schemes and considerations which trustees should already observe in fulfilling their fiduciary duties to scheme members in compliance with the pre-existing legislation. Therefore, in our opinion, the guidance on which we are consulting does not introduce any new regulatory requirements of trustees or significant associated costs for pension schemes.

The guidance encourages trustees to work constructively with employers; we believe that when trustees are fully aware of the issues that can impact a multi-employer scheme (particularly when dealing with an employer departure), and are equipped to address such issues promptly should they arise, there are potential cost savings to the scheme.

# Defined benefit multi-employer schemes and employer departures: guidance for trustees

## At a glance

- This guidance is to help trustees of multi-employer schemes understand the different mechanisms by which an employer can depart from the scheme. It will also be of interest to employers of those schemes.
- Employers participating in a scheme stand behind the scheme's ongoing liabilities (technical provisions) and the discontinuance debt (section 75 debt) should it become due.
- Security for a scheme's liabilities is usually provided by a combination of scheme assets and the employer covenant. Trustees should understand exactly which employers (and other parties) are responsible for meeting the scheme's liabilities, and for how much.
- Our code of practice on scheme funding sets out how trustees should engage with employers to ensure that the level of technical provisions is prudent and appropriately reflects the strength of the employer covenant. Any recovery plan agreed by the trustees should take into account what the employer can reasonably afford.
- Trustees should routinely review and ensure they understand the employer covenant strength. An assessment of covenant should not be a one-off exercise taking place only at the point of a corporate restructure or other corporate activity or event, or for a valuation.
- Where an employer ceases to employ active members for a temporary period, they can delay their departure from the scheme by providing the trustees with a 'period of grace' notice.
- When an employer departs from a scheme they will normally become liable to pay their share of the scheme's liabilities; this is their section 75 debt. As a starting point, trustees should always consider whether it is appropriate for the departing employer to pay their full section 75 debt. However, there are some alternatives which result in modification of that debt.
- There are 2 mechanisms which allow an employer to depart without becoming liable to pay a section 75 debt, introduced in amendments to the Employer Debt Regulations from April 2010:
  - de minimis restructuring test – applicable to one-to-one restructures where the amount of the departing employer's liabilities is minimal; and
  - restructuring test – applicable to one-to-one restructures where there is no weakening of the covenant.
- There are 4 mechanisms which allow the employer to depart from the scheme having paid a modified section 75 debt that remain unchanged by the April 2010 amendments:
  - scheme apportionment arrangement;
  - withdrawal arrangement;
  - approved withdrawal arrangement; and
  - regulated apportionment arrangement.
- Each mechanism has specific criteria and tests which must be met.
- Where a departing employer wishes to explore the use of 1 or more of the mechanisms, we would expect trustees to engage constructively to determine whether use of a mechanism is appropriate to the circumstances.

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- The trustees should consider whether, overall, this is a series of events where the ultimate aim is to abandon the scheme or where the overall effect would be of material detriment to the scheme.
- Whichever mechanism the trustees and employer may decide is appropriate, trustees must ensure that the process relating to that mechanism is followed correctly. Trustees must also decide whether the chosen mechanism is in the best interests of scheme members.
- When an employer departs from a scheme this may be an irreversible loss of an important part of the overall covenant. It is vitally important that trustees fully understand the implications of an employer's departure and any mechanism used, and seek to mitigate any loss of covenant where appropriate.
- Trustees will normally need to seek independent professional advice to understand and assess how each mechanism will impact the scheme.
- Trustees can approach the regulator if they are concerned that an employer's departure or use of a mechanism may be detrimental to the scheme. If employers have similar concerns they can apply to the regulator for clearance (see our separate clearance guidance).
- The regulator will be concerned if the use of any mechanism or any corporate activity results in material detriment to the scheme, and may consider use of its anti-avoidance powers.

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## About this guidance

1. This guidance covers the law relating to section 75 debts for multi-employer schemes as at April 2010. Accordingly, some of the content only relates to employers' departures from schemes that occur after 5 April 2010.
2. This guidance must be read in conjunction with the relevant legislation. It does not override the legislation, or provide a definitive interpretation.
3. The glossary provides explanations of the main terms used in this guidance.
4. We recognise that the legislation is complex and can apply in different ways to different schemes depending on their circumstances. We expect trustees, where appropriate, to seek independent legal advice on how the legislation applies to their scheme.
5. Where the employer is insolvent or near insolvency, or the scheme is in or near wind-up, special considerations will apply and trustees should seek advice where appropriate and consider contacting the regulator with any concerns about mechanisms proposed by the employer.
9. The regulator will be concerned if the use of any mechanism or any corporate activity results in detriment to the scheme and may consider use of its anti-avoidance powers, which have their own distinct tests. Other alternatives to the mechanisms described in this guidance (for example arrangements that prevent a section 75 debt from triggering) could also be detrimental. Employers should refer to our clearance guidance for information on circumstances in which it may be appropriate to consider applying to the regulator for a clearance statement.
10. Employers should ensure that they have an understanding of these issues, not only where they currently participate in a multi-employer scheme, but equally if they are considering participating in such a scheme in the future.

### Advisers

11. Advisers may find it useful when advising their clients if they understand what the regulator expects in these situations. Advisers should note that this is not a technical guide to employer debt legislation.

### Who is this guidance for?

6. This guidance is aimed at trustees of all multi-employer DB schemes.
7. The guidance is relevant for both open schemes (which have active members) and frozen schemes (which have ceased to have active members). The guidance may also be of interest to employers and advisers, as described in the following paragraphs.

### Employers

8. Employers stand behind the scheme funding both on an ongoing basis and on the full annuity buy-out (section 75<sup>1</sup>) basis should they depart from the scheme, whether by employment-cessation event, insolvency, or when the scheme winds up. The regulator understands that in order to run a business to its full potential it is often necessary to undergo company group restructures, to remove certain employers from a scheme, and/or to replace them with others. This may trigger section 75 debts. It is important that employers understand how trustees will approach these transactions and the mechanisms that may be used. The aim is to enable legitimate corporate activity while ensuring the proper safeguards intended for members' benefits.
12. This guidance sets out our expectations of trustees when faced with an employer departing the scheme. It sets out their responsibilities in ensuring that the support for the scheme does not deteriorate.
13. The guidance summarises the mechanisms which may be applied to modify the amount of the section 75 debt payable by an employer, or, in certain circumstances, to prevent such a debt arising, when an employer departs from a scheme.
14. This guidance also signposts throughout the areas where we become involved in an employer's departure from a multi-employer scheme. This includes the process for approval of regulated apportionment arrangements and approved withdrawal arrangements, and the use of clearance and anti-avoidance powers where an employer's departure or the use of a mechanism is detrimental to a scheme.

<sup>1</sup> Section 75 of the 1995 Act

## Section 1: What is a multi-employer defined benefit scheme?

### What is a multi-employer scheme?

15. A multi-employer scheme is a pension scheme that has more than 1 employer.
16. Schemes may be either segregated or non-segregated. In summary, segregated schemes have a specified proportion of scheme assets that can only be used to meet the liabilities of particular sections of the scheme and not others, and contributions are allocated accordingly. Non-segregated schemes may still have sections, but there will be an element of cross-subsidy between sections or employers. Each section in a segregated scheme is treated as an individual scheme for the purpose of employer debt legislation, and for this guidance. It can be complicated to assess whether or not a scheme is segregated, and legal advice may be needed.
17. The employers participating in a multi-employer scheme may be part of a group of companies or have common ownership or control, or they may be unrelated companies participating in an industry-wide scheme.
18. Each employer in a multi-employer DB scheme is responsible for a share of the total amount of scheme liabilities, which may change with changing circumstances. Trustees should continue to assess whether each participating employer will be able to meet their share of the ongoing liabilities as they fall due, and their share of the scheme's section 75 deficit should it become due as a result of an employment-cessation event, employer insolvency or scheme wind-up.
20. Employers (including former employers) are liable to pay section 75 debts when an employment-cessation event or insolvency occurs or the scheme goes into wind-up.
21. A guarantor is a party who has agreed to accept liability for the obligations of an employer (or former employer) of the scheme. They may or may not themselves be an employer (or former employer) of the scheme. In both cases they will have entered into a legally binding guarantee to the scheme. There may also be different types of support provided to schemes under enforceable agreements, further details of which are set out in our 'Guidance on monitoring employer support: covenant, contingent assets and other security'.
22. A guarantor can become so for a number of reasons, for example, through a withdrawal arrangement or through negotiations relating to a corporate transaction or other event, or during the scheme specific funding valuation process.
23. Trustees should ensure that they understand who is actually sponsoring their scheme and should be clear on who the employers, former employers and guarantors are. Trustees will need to regularly monitor the ability of those parties to meet their obligations to the scheme.
24. The employers for the various purposes of legislation may not be identical to the particular employers identified by each scheme's trust deed and rules.
25. Determining which employers, former employers and guarantors within a group are legally responsible for meeting the scheme's liabilities, both on an ongoing basis and upon wind-up or other section 75 debt triggers, can be a complex exercise for which trustees should normally seek independent legal advice.

### Who supports the scheme?

19. There are various parties who may stand behind the liabilities of a scheme: most commonly employers (including former employers – see Former employers and frozen schemes) and guarantors. There may also be other parties who have agreed to support the scheme under other agreements (who are also referred to as 'guarantors' for the purpose of this guidance).
26. It is important that both the trustees and these other parties have a full understanding of their legal responsibilities, in order to properly assess covenant, to identify and calculate section 75 debt triggers, and to assess the impact of any employer departure or any mechanism proposed to modify a section 75 debt.

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## When does an employer depart from a scheme?

27. For the purposes of section 75 of the 1995 Act an employer will depart from a scheme and a section 75 debt will become due if:

- it ceases to have active members when another employer (who is not a defined contribution employer<sup>2</sup>) continues to employ at least 1 active member (this is known as an 'employment-cessation event'); or
- it gives notice of an employment-cessation event to the trustees of a frozen scheme; or
- an insolvency event occurs; or
- the scheme begins winding up.

28. Before 6 April 2010, there was only 1 mechanism which prevented an employment-cessation event occurring: this was a period of grace, described in Section 2 of this guidance. Where a period of grace applies, the employment-cessation event does not occur, therefore a section 75 debt is not triggered, but the employer does not depart from the scheme.

29. Two further mechanisms have been introduced from 6 April 2010 which prevent an employment-cessation event occurring, thereby ensuring the section 75 debt is not triggered. Unlike the period of grace, these mechanisms allow an employer to depart from a multi-employer scheme without paying a section 75 debt. These are known as the 'restructuring test' and the 'de minimis restructuring test'. Further information about these mechanisms is given in Section 4 of this guidance.

30. When an employer departs from a multi-employer scheme, provided that none of these 3 mechanisms (a period of grace, the restructuring test or the de minimis restructuring test) applies, a section 75 debt may be triggered. When a section 75 debt is triggered, the trustees and scheme actuary must calculate the liability share which is payable by the departing employer.

31. In some circumstances, trustees may decide that it is appropriate to use 1 of the 4 mechanisms which result in modification of the departing employer's section 75 debt:

- a withdrawal arrangement;
- an approved withdrawal arrangement;
- a scheme apportionment arrangement; and
- a regulated apportionment arrangement

Further information about each of these mechanisms is given in Section 4 of this guidance.

## Former employers and frozen schemes

32. For the purposes of section 75, the term 'employers' includes 'former employers'. 'Former employers' include any employer who has ceased to employ relevant members. This may include employers of 'frozen schemes'<sup>3</sup> which are closed to future accrual (ie have no active members).

33. 'Former employers' remain liable for a scheme's section 75 debt when it becomes due, including on insolvency or scheme wind-up, and will continue to be so until any of various conditions are met<sup>4</sup>. These include:

- that a section 75 debt has become payable by the former employer as a result of an employment-cessation event or insolvency, and that debt has been paid in full; and
- that an employment-cessation event or insolvency occurred but no debt became due

34. An employer in a frozen scheme may undergo an employment-cessation event notwithstanding that it does not employ any active members. This is achieved by giving notice to the trustees, stating that an employment-cessation event will be treated as having occurred on a specified date that is not more than 3 months earlier or later than the date the notice is given.

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<sup>2</sup> Regulation 2(1) of the Employer Debt Regulations

<sup>3</sup> Regulations 2(1) and 9 of the Employer Debt Regulations

<sup>4</sup> Full conditions are set out in Regulation 9 of the Employer Debt Regulations

### What happens when a scheme winds up?

35. When a scheme begins winding up, the trustees are obliged to ensure that the full section 75 debt is calculated and to collect that debt from all of the employers and former employers in full.
36. Winding up is not treated as an employment-cessation event, therefore periods of grace and the restructuring easements, all of which are explained later in this guidance, do not apply.
37. Trustees should recognise that upon wind-up they may not be able to alter each employer's liability share to get the maximum return for the scheme (for example by seeking additional funding from the financially strong employers if the trustees are unable to recover the full liability share(s) owed by the weaker employers). However, there is nothing to prevent a financially strong employer paying the debt due from another employer, should it wish to do so.
38. While the scheme is still ongoing, trustees should take legal advice on whether the scheme rules (and any other documents) contain any enforceable provisions that oblige employers (including any former employers) to fund the scheme on wind-up, that are in addition to the requirements of section 75 of the 1995 Act and the Employer Debt Regulations. If no such provisions exist, trustees may consider whether a scheme apportionment arrangement could assist (see Section 4) or whether the employers or other companies would be prepared to provide guarantees or cross-guarantees, or to become jointly and severally liable, for the scheme's section 75 debts. As such measures could improve the scheme's return on insolvency they will generally improve the overall employer covenant. Our 'Guidance on monitoring employer support: covenant, contingent assets and other security' provides further information about these types of consideration.

### Key points from this section:

- Security for a scheme's liabilities is usually provided by a combination of scheme assets and the employer covenant.
- Trustees should understand the roles and responsibilities of the employer and any other parties that stand behind the scheme.
- It can be complex to determine which employers and other parties are legally responsible for meeting a scheme's liabilities, and independent legal advice may be needed.

## Section 2: Considerations for employers

39. An employer usually departs from a multi-employer scheme when it ceases to employ active members, enters insolvency, or when the scheme winds up.
40. When an employer departs in a way which triggers an employer debt under section 75 of the 1995 Act, the trustees are entitled to expect the departing employer to pay its full section 75 debt (as calculated by the scheme actuary) within a reasonable timescale, and enforce payment of that debt. However, the employer may propose that one of the alternative mechanisms is used.
41. In acting consistently with their fiduciary duties and in assessing any likely impact that an employer's departure may have on the security of members' benefits, trustees not only need to consider the statutory tests that determine whether use of a particular mechanism is possible, but also whether use of one of the alternatives to full payment of the departing employer's section 75 debt would be appropriate.
42. In order to assess whether use of one of the particular mechanisms would be appropriate, trustees will require certain information from the employer. We expect employers to comply with such requests in line with their legal obligations<sup>5</sup>, and to engage openly with trustees to ensure that the decisions made by the trustees are based on full and accurate information. Trustees should be prepared to commit to confidentiality where such information might have price sensitive implications if released into the public domain.
43. We expect employers to give trustees sufficient time to consider any proposal properly, and it may be appropriate for employers to meet the cost of any advice that trustees need for their considerations.
44. In weighing up options, employers and trustees may wish to consider whether the benefit of implementing a particular mechanism is proportionate to the time and cost involved, particularly where the section 75 debt is small relative to the overall costs involved.

### Periods of grace

45. If an employer ceases to employ any active members and an employment-cessation event occurs, but the employer is of the view that it might employ an active member within the next 12 months, it may give the trustees a notice called a 'period of grace' notice. The notice must be given to the trustees before, on, or as soon as possible (and in any event within 1 month) after the employment-cessation event. The effect of the notice is that the employer will be treated as if they were still an employer of active members during the period of grace, as though an employment-cessation event had not occurred.
46. If the period of grace notice is provided, the period of grace begins when the employer ceases to employ active members and ends 12 months later, or, if earlier, the date the employer employs an active member of the scheme. If an employer employs an active member during the period of grace, the employer will be treated as if the relevant employment-cessation event had not occurred.
47. If the employer does not provide the period of grace notice within the statutory time limit stated in paragraph 45, the section 75 debt will remain due as at the date the employment-cessation event occurred. The trustees must arrange for this to be calculated and certified.
48. If, during the period of grace, the employer
  - does not employ an active member by the last day of the period of grace;
  - no longer intends to employ an active member and notifies the trustees as required; or
  - suffers an insolvency event,then the employer will be treated as if the period of grace had not applied. This means that an employment-cessation event will be treated as having occurred when the employer ceased to employ active members, and the trustees should arrange for the employer's section 75 debt to be calculated and certified.
49. We expect employers to use this provision only for genuine cases of likely employment of active members and not as a means to delay calculation or payment of any section 75 debt that may arise.

<sup>5</sup> Including those set out in Regulation 6(1) of the Scheme Admin Regulations

## Section 3: What do we expect of trustees?

### Understand your employer covenant

50. In this section, any reference to 'employers' also includes, where relevant, guarantors or other parties with obligations to the scheme.
51. Trustees should seek to ensure that the scheme funding position and security of the employer covenant combine to offer adequate support for the scheme at all times.
52. Trustees have an ongoing responsibility to actively and regularly monitor the strength of the employer covenant supporting the scheme, as this informs decisions on all aspects of the scheme's funding and may provide an indication of whether or not an employer departure is on the horizon, and what the implications of that would be.
53. This responsibility encompasses the need to fully understand the structure of the group, which employers (or other parties) within the group have a legal obligation to support the scheme, and the financial strength of the employers (or other parties) with those obligations. Where companies with an obligation to the scheme sit within the group may be relevant to the scheme's returns in an insolvency situation. For example, if the principal employer to the scheme is merely the group's parent company then it may be structurally subordinated to other creditors and so provide reduced support to the scheme in an insolvency situation. The structure and operations of the group, and inter-company transactions, may also provide an indication of the employers' position or future.
54. When considering the impact of an employer departing the scheme, trustees should take steps to understand the short, medium and long term implications for the scheme and the wider group. In the case of industry-wide schemes, trustees may also need to attain an understanding of the covenant of the other employers.
55. In many circumstances, trustees are likely to consider that they do not have the detailed knowledge, experience, or independence needed to make an objective assessment. In these circumstances relevant independent professional advice should be sought. Where trustees decide not to seek such professional advice, they should document their reasons.

56. We expect trustees to react accordingly to changes in the covenant strength. Our 'Guidance on monitoring employer support: covenant, contingent assets and other security' sets out best practice that we expect trustees to follow in this regard, including the legal and financial aspects, and the type of information they should request from the employer in order to do this.

### Understand the scheme's liabilities and who is responsible for them

57. Trustees should ensure that they fully understand the scheme's liabilities, including any orphan liabilities, how the liabilities are shared between the employers and how they would be met if an employer departed the scheme, became insolvent, or the scheme were to wind up.
58. This is important as the employers participating in a scheme stand behind the ongoing liabilities (technical provisions) of a scheme, and the discontinuance debt (section 75 debt) should it become due.
59. The ongoing liabilities, or technical provisions, represent the level of funding that is required in order to pay the members' benefits as they fall due, until the last member or beneficiary dies or transfers out of the scheme, assuming that all of the employers continue to support the scheme.
60. Our code of practice on scheme funding sets out how trustees should engage with employers to ensure that the level of technical provisions is prudent and appropriately reflects the strength of the employer covenant. Any recovery plan agreed by trustees should be set taking into account what the employer can reasonably afford.
61. The section 75 debt is the amount, over and above the value of the scheme assets, which the scheme actuary estimates would be required to fully buy out the scheme benefits with annuities from a regulated insurer at the relevant date. In a multi-employer scheme each employer has a liability share which is calculated as a proportion of the entire section 75 deficit for the scheme. If an employer is seeking to depart from the scheme, it is the responsibility of the trustees, having consulted with the scheme actuary, to determine the share of liabilities attributable to each employer within the multi-employer scheme.

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62. Broadly<sup>6</sup>, an employer is liable for the scheme liabilities for each of its own employees as well as a proportionate share of orphan liabilities (see paragraph 64). However, it can be complex to ascertain each employer's exact share, so independent legal advice may be needed.
63. In order to ensure that the scheme liabilities can be accurately attributed to the relevant employers, trustees should ensure that employment records are kept up to date, and that the employers keep and provide trustees with the necessary information to calculate the liabilities.
64. There may be members of the scheme (whether deferred or pensioners) whose benefits have not accrued as a result of service with one of the current employers within the group. The liabilities in respect of these members are known as orphan liabilities, as they are not immediately attributable to one particular employer within the group. However, they still make up a part of the overall liabilities, in some cases a very significant part, and trustees should ensure that they understand how these liabilities will be shared amongst the employers. The method for calculating the liability share for each employer is detailed in regulation 2(1) of the Employer Debt Regulations.
65. It is important for trustees to understand how the scheme liabilities are shared between the employers in order for them to properly assess the risks in the scheme. For example, a scheme may have 1 employer with a strong covenant and several others with a weak covenant, a situation which may have arisen for historical reasons. If an employer with a strong covenant becomes responsible for only a small proportion of the total scheme liability when it departs from the scheme, the scheme is put at risk if even if it pays its full liability share. The weaker employers may be unable to meet their subsequent section 75 debts, thus causing a funding shortfall in the scheme. This situation is not unusual, and trustees should be aware of such risks and seek to bolster the financial support for the scheme wherever possible, for example by agreeing guarantees, cross-guarantees, or joint and several liability for section 75 debts.

### **Understand the options, assess the impact and mitigate the risks**

66. When an employer ceases to be responsible for supporting the scheme this may be an irreversible loss of an important part of the overall covenant. It is therefore vitally important that trustees fully understand the implications of the employer's departure and any mechanisms used, and seek mitigation where appropriate.
67. As a starting point trustees should always consider whether it is appropriate for the employer to pay its full liability share.
68. However, the trustees may decide that in the circumstances it is appropriate to use one of the alternative mechanisms detailed in Section 4 of this guidance, either in isolation, or when combined with increased security for the scheme in the form of additional mitigation, such as guarantees or contingent assets.
69. Trustees will not always be able to justify agreeing to modify a departing employer's section 75 debt. For example, where the departure of an employer has the effect of weakening the overall covenant and there is little prospect of obtaining appropriate mitigation from other employers or a third party, or where the remaining employers are at risk of insolvency, we would generally expect trustees to pursue payment of the departing employer's liability share. If the liability share is not sufficient to mitigate for the loss of covenant then trustees may also need to seek additional mitigation (for example in the situation described in paragraph 65).
70. A significant deterioration in the covenant strength indicates that there may be a need to revise any recovery plan that is in place, and in some cases it may also be appropriate for the trustees to call a new valuation and revise the technical provisions.
71. Where the departing employer is willing to pay its liability share in full, we would normally expect trustees to accept payment without considering any of the alternatives. Whether the departing employer can afford to pay its liability share is likely to be a relevant factor for trustees to consider for most employer departures.

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<sup>6</sup> Full details of an employer's liabilities are set out in Regulation 5 of the Employer Debt Regulations

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72. Where a departing employer wishes to explore the use of one or more of the alternatives to paying its section 75 debt in full, we would expect trustees to engage constructively to determine whether use of an alternative is appropriate to the circumstances, without placing the scheme at risk of a material weakening of covenant or scheme abandonment.
73. We will expect trustees to obtain appropriate independent professional advice when deciding whether to agree to the use of one of the alternatives. Should trustees decide not to seek professional advice, they should document their decision not to do so, by reference to the possible consequential risks to the scheme.
74. Trustees should also bear in mind that when an employer departs from a non-segregated scheme and pays their liability share in full or implements one of the alternative mechanisms, then unless the scheme is sectionalised or partially winds up in accordance with the scheme rules, any payment made by the departing employer is likely to go towards funding across the whole scheme, not in respect of the departing employer's liabilities alone. We would expect trustees in this situation to consider taking independent legal advice on how to manage the section 75 debt paid by the departing employer.
75. All of the 4 available mechanisms which result in modification of the section 75 debt require the trustees (and in some cases also the regulator) to agree to the arrangement.
76. Trustees should be cautious about consenting to the use of any of the alternatives far in advance of the time of an employer departing the scheme. It reduces the likelihood that the full effect and/or impact can be properly assessed, or that the statutory tests that determine whether any of the alternatives are possible can be properly considered or conducted. It is also less likely that any additional (non-statutory) conditions that the trustees decide would be appropriate can be properly assessed and included. If agreeing to an arrangement in advance, trustees should consider negotiating additional provisions to protect the scheme against events or changes in circumstances which may happen before an employer actually departs from the scheme.
77. In discussions with the departing employer, remaining employers and advisers, trustees should ensure that all relevant matters in relation to each alternative have been properly explored and all facts accurately established and documented. In many cases the options open to the trustees and the departing employer will be limited by the circumstances. The feasible options should be thoroughly explored to ensure proper understanding of their implications.
78. We expect trustees to negotiate the type and terms of the arrangement with the departing employer, remaining employers and any guarantor(s) or other relevant parties, as appropriate, to ensure that the arrangement entered into is in the best interests of scheme members. Where appropriate, trustees should seek to negotiate the inclusion of additional conditions for any of the mechanisms, over and above those specified in the legislation, and the provision of additional security, should this be needed to support the scheme.
79. Specific statutory tests must be met for each of the mechanisms. If these tests are met they will, to some extent, safeguard against detriment to the scheme as a result of an employer departing the scheme without paying its liability share in full. In addition to ensuring that the statutory tests are met, we expect trustees to act in accordance with their fiduciary duties and to fully consider the scheme's ongoing needs and financial support requirements in all circumstances.
80. Trustees should consider the impact on the scheme's funding position in terms of how the strength of the employer covenant may be affected, in relation to the ability to meet the scheme's funding needs both now and in the future (taking into account, for example, the risk of insolvency and any future plans of the employer).

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81. We expect trustees to understand the reasons for an employer's departure from the scheme, or for the use of a mechanism proposed by the employer. Trustees should seek to understand all relevant circumstances, including any related disposals or substitutions of employers, or changes to the wider group of companies. The departure or mechanism may be part of a series of events that may affect the strength of the overall covenant and financial support for the scheme. We expect trustees to seek information from those associated with the scheme to establish whether the employer departure in question is a one-off event or part of a larger transaction or a wider change in strategy. Some information in relation to employer departures and restructuring may be sensitive and therefore trustees and employers may want to consider the use of confidentiality agreements.
82. If an employer's departure or the use of a mechanism is part of a series of events, then as well as assessing the overall effect of all events, trustees (and employers) should assess each event separately to establish its impact on the scheme and members' benefits in terms of both its immediate and possible future effects.
83. The trustees should consider whether, overall, this is a series of events where the ultimate aim is to abandon the scheme or where the overall effect would be of material detriment to the scheme.
84. The regulator will be concerned if any corporate activity results in scheme abandonment or material detriment to the scheme. It is possible for the requirements of the tests for each available alternative to be fulfilled but for there still to be a detriment to the scheme; this is why it is important for trustees to consider the widest aspects of each test and seek mitigation where appropriate.
85. If trustees have concerns about the possibility of material detriment or scheme abandonment they should approach the regulator.
86. If employers have similar concerns they can apply to the regulator for clearance. Please refer to our clearance guidance for further information on what this involves.
87. We may consider use of our anti-avoidance powers (which have their own distinct tests) if we are concerned that any alternative to full payment of the departing employer's liability share is being abused in order to abandon the scheme or is likely to be of material detriment to the scheme.
88. We will also be concerned about any other arrangement which has the result of preventing a section 75 debt from triggering and which is likely to be of material detriment to the scheme.

### Understand the process

89. Trustees should ensure that they understand how a section 75 debt is triggered, how an employer's section 75 debt is determined and how each of the alternatives to payment of the employer's liability share would operate.
90. Failure to properly carry out each stage can potentially result in the departing employer's liabilities not being discharged as intended or the strength of the employer covenant being eroded. Trustees need to understand the roles of the various parties involved, and establish who is responsible for completing each part of the process. Good communication between the trustees, employers and each party's advisers is likely to aid this.
91. Prior to and during discussions about an employer departing the scheme, trustees should ensure that all scheme documentation is accurate and up to date and, as stated in paragraph 63, that they have adequate information about scheme members' current and previous employment. The regulator has published guidance on record-keeping, because we recognise that keeping these details up to date will ensure that any decisions are based on accurate information. The guidance includes targets for the quality of core scheme data which will underpin good decision making.
92. Trustees should also ensure that their consideration of the key issues in relation to a departing employer is properly minuted and their decision making is accurately documented.

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## Understand and manage conflicts

93. Trustees should understand the importance of identifying and managing or avoiding any conflicts on the trustee board when considering the options for dealing with a departing employer. This is particularly important with regard to the assessment of whether the covenant strength of the employer will change as a result of the employer's departure, any mechanism proposed, and when considering any appropriate mitigation. Independent legal advice may need to be sought in relation to any possible conflicts.
94. Where the trustees themselves have sufficient experience and expertise to carry out this assessment, and therefore do not seek professional advice, the possibility of conflicts of interest should also be considered.
95. We have issued separate conflicts of interest guidance on how we expect trustees to assess and address conflicts.

## Key points from this section:

- Trustees should regularly review and ensure they understand the employer covenant strength. An assessment of covenant should not be a one-off exercise taking place only at the point of a corporate restructure or other corporate activity or events, or for a valuation.
- It is important that trustees fully understand the implications of an employer's departure and seek appropriate mitigation for any loss of covenant.
- As a starting point trustees should consider whether it is appropriate for the departing employer to pay their full liability share. However, there are some alternatives which result in modification of the section 75 debt.
- Trustees must ensure any chosen mechanism is in the best interests of scheme members, and that the process relating to that mechanism is followed correctly.
- We will be concerned if the use of any mechanism or any corporate activity results in material detriment to the scheme, and may consider use of our anti-avoidance powers.
- We expect that trustees will normally need to seek independent professional advice when they encounter many of the circumstances described in this guidance.

## Section 4: Important aspects of each mechanism

96. From 6 April 2010, there are, in total, 6 ways in which an employer departing a multi-employer scheme can remove or modify its section 75 debt.
97. When considering these options it is important that trustees take independent professional advice on their appropriateness in the circumstances in which the employer is departing the scheme.
98. Our 'Guidance on monitoring employer support: covenant, contingent assets and other security' contains further information about how trustees can assess the impact of such activity on the security of members' benefits.

### The de minimis restructuring test<sup>7</sup>

99. If an employer departs from a scheme using this mechanism the departure will not be classed as an employment-cessation event and no section 75 debt is triggered.
100. Where a corporate restructuring is due to take place which involves 1 departing employer and 1 receiving employer, the employer who intends to depart from the scheme can write to the trustees to ask them to assess whether 4 conditions are met:
  - the scheme is funded to at least Pension Protection Fund (s179) levels;
  - the number of 'relevant members' (who had accrued DBs as a result of pensionable service with the departing employer) being transferred does not exceed the greater of 2 individuals or 3% of the total number of scheme members who have accrued DBs in the scheme;
  - the total accrued annual pensions of relevant members, including pensions in payment and pensions not in payment, does not exceed £20,000 (this amount will increase by £500 every 6 April, ie on 6 April 2011 it increases to £20,500); and
  - any restructurings under the de minimis restructuring test that have taken place in the last 3 years involve in total, together with the current proposed restructuring, no more than the greater of 5 relevant members or 7.5% of the total scheme membership, and no more than £50,000 of accrued annual pension.
101. For the purpose of this guidance this assessment is known as the 'de minimis restructuring test'.
102. Both the departing employer and receiving employer must employ at least 1 active member accruing defined benefits in the scheme.
103. If the trustees, having taken appropriate professional advice, are satisfied that the de minimis restructuring test has been met, they must confirm this in writing to the relevant employers.
104. Trustees may decide that any costs incurred by them as a result of an employer departure using the de minimis restructuring test are to be met by the departing employer or the receiving employer, or both.<sup>8</sup>
105. If the departing employer transfers all of its assets, employees, scheme members and liabilities in relation to the pension scheme to the receiving employer within the timescales set out in the Employer Debt Regulations, and the employers provide written confirmation to the trustees of the date when this transfer is carried out, then the departure will not be an employment-cessation event and no section 75 debt will be triggered.
106. When this has occurred and all relevant conditions are met, the departing employer will cease to be an 'employer' for the purposes of section 75.

### Key considerations

107. This mechanism is only available in relation to employer departures that would otherwise be employment-cessation events, and for 'one-to-one' restructures involving a transfer of assets, employees, scheme members and pension liabilities between 1 departing employer and 1 receiving employer, neither of whom have had an insolvency event. However, it can also apply to a single employer that seeks to change its legal status (for example a charity becoming incorporated), in which case the receiving employer is the new entity.
108. The de minimis restructuring test is different from the other mechanisms in that it merely requires the trustees to confirm that the number of members and monetary amounts involved fall within the prescribed parameters. If the trustees decide that the test is met they have no further discretion to refuse the arrangement.

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<sup>7</sup> Regulation 6ZC of the Employer Debt Regulations

<sup>8</sup> Regulation 6ZD of the Employer Debt Regulations

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109. However, it is important that all of the steps set out in the legislation are properly followed and completed. If, within 6 years of the restructuring transfer, it becomes apparent that key steps were not completed properly or on time, the de minimis restructuring will not be effective. This means that a section 75 debt will be triggered when the departing employer ceases to employ any active members, and the departing employer will remain an 'employer' for the purposes of section 75 unless other conditions are met (as described in paragraph 33).
110. The de minimis restructuring test does not require the section 75 liabilities to be calculated. Therefore, unlike the other mechanisms for scheme departure, the test does not take into account the amount of any orphan liabilities for which the departing employer might otherwise have been liable. These may form a significant part of overall liabilities, which would otherwise have been payable by the departing employer, and trustees should therefore assess any impact of the arrangement on the security of members' benefits. If they believe the use of the de minimis mechanism will have adverse effects on the scheme overall, they should consider whether it would be appropriate to negotiate with the employers involved for an appropriate level of mitigation to be provided to the scheme (such as additional contributions or contingent assets – see our 'Guidance on monitoring employer support; covenant, contingent assets and other security').
111. In addition, unlike the other mechanisms, the de minimis restructuring test does not consider the financial strength of the departing employer and any consequential reduction in the overall employer covenant. The scheme may be left at risk if significant orphan liabilities are left behind, or where the departing employer was financially strong but departed the scheme without adequate mitigation being provided.

### The restructuring test<sup>9</sup>

112. If an employer departs from a scheme using this mechanism it will not be classed as an employment-cessation event and no section 75 debt is triggered.
113. Where a corporate restructuring is due to take place, which involves 1 departing employer and 1 associated receiving employer, the employer who intends to depart from the scheme can write to the trustees to ask them to assess whether they are satisfied that, after the proposed restructuring has taken place, the receiving employer will be:
- at least as likely as the departing employer to meet all of the liabilities in relation to the scheme for which the departing employer was responsible; and
  - likely to meet the receiving employer's own liabilities in relation to the scheme which existed immediately prior to the transaction.
114. Both the departing employer and receiving employer must employ at least 1 active member accruing defined benefits in the scheme.
115. One of the factors that trustees must take into account when making this assessment is whether the arrangement will result in any material change that would justify revision of the methods or assumptions used in the last calculation of the scheme's technical provisions; a change in the trustees' assessment of the employer covenant strength may justify a change in relevant assumptions. The relevant assumptions are described in the Scheme Funding Regulations.<sup>10</sup>
116. For the purpose of this guidance this assessment is known as the 'restructuring test'.
117. The trustees may request any information from the departing employer or receiving employer which the trustees are satisfied is necessary to assess the restructuring test, and the employers must provide it. The trustees should consult the employers about their decision.

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<sup>9</sup> Regulation 6ZB of the Employer Debt Regulations

<sup>10</sup> Regulation 5(4)(d)

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118. If the trustees, having received the necessary information from the departing employer and receiving employer, and having taken independent professional advice as appropriate, are satisfied that the restructuring test has been met, they must confirm this in writing, with reasons, to those employers.
119. Trustees may decide that any costs incurred by them as a result of an employer departure using the restructuring test are to be met by the departing employer or the receiving employer, or both.<sup>11</sup>
120. If the departing employer transfers all of its assets, employees, scheme members and liabilities in relation to the pension scheme to the receiving employer, within the timescales set out in the Employer Debt Regulations, and the employers provide written confirmation to the trustees of the date when this transfer is carried out, then the departure will not be an employment-cessation event and no section 75 debt will be triggered.
121. When this has occurred and all relevant conditions are met, the departing employer will cease to be an 'employer' for the purposes of section 75.
- Key considerations**
122. This mechanism is only available in relation to employer departures that would otherwise be employment-cessation events, and for 'one-to-one' restructures involving a transfer of assets, employers, scheme members and pension liabilities between 1 departing employer and 1 receiving employer, neither of whom have had an insolvency event. However, it can also apply to a single employer that seeks to change its legal status (for example a charity becoming incorporated), in which case the receiving employer is the new entity.
123. Although this mechanism only applies to restructurings involving transfers of assets and liabilities from one employer to another, trustees should be aware that such corporate activity rarely occurs in isolation. Such arrangements are usually part of a more complex restructuring plan for a group of companies which may also involve group businesses being divided up and/or sold. Restructuring may also involve the group purchasing other companies, businesses and/or assets from third parties in order to integrate them into existing operations. Trustees therefore need to be fully alert to the wider context in which the restructuring is taking place and the implications of this for the scheme.
124. The receiving employer may be either a new employer created for the purpose of the restructuring, or an existing company, which may or may not have participated in the scheme before the restructuring.
125. If the receiving employer was already a participating employer before the restructure, it may already have its own scheme liabilities in addition to those of the departing employer. It is important that trustees take this into account when considering whether the restructuring test is met.
126. In order to carry out the restructuring test the trustees will have to compare the current overall employer covenant with the employer covenant after the restructuring. The trustees should establish the strength of the receiving employer's covenant and the financial support it will offer the scheme after the restructuring. The trustees should consider how any existing assets and liabilities will be integrated with those it assumes from the departing employer, how any security or charges are likely to affect assets in the receiving employer, the receiving employer's position in the group structure, and what advantages the restructuring actually offers. Understanding this and the business rationale for the restructuring should assist the trustees in reaching a view on the restructuring test and the short, medium and long term implications for the scheme.

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<sup>11</sup> Regulation 6ZD of the Employer Debt Regulations

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127. The trustees should establish whether the receiving employer will receive only the assets and liabilities of the departing employer, or whether there are plans for it to acquire other assets or liabilities (either from within the group or purchased from a third party) and how that might affect the strength of the covenant.
128. The pension liabilities which must be transferred to the receiving employer from the departing employer are wide-ranging and include the departing employer's share of the scheme's orphan liabilities (its 'liability share').
129. The restructuring test involves a strict process and it is important that all of the steps set out in the legislation are properly followed and completed. If, within 6 years of the restructuring transfer, it becomes apparent that key steps were not completed properly or on time, or that the employers failed to provide complete and correct information to the trustees, the restructuring will not be effective. This means that a section 75 debt will be triggered when the departing employer ceases to employ any active members, and the departing employer will remain an 'employer' for the purposes of section 75 unless other conditions are met (as described in paragraph 33).
130. The restructuring transfer must be completed within 18 weeks of the trustees' written decision that the restructuring test is met, unless the trustees decide that a longer period (up to 36 weeks) is appropriate.
131. Trustees should consider whether relevant circumstances might alter in a material way during the period, especially if they are asked to agree a longer period. It would not be uncommon for the employer covenant to change over an 18-week period. The trustees should satisfy themselves that by the time the transfer actually takes place there has been no change that would alter their opinion that the restructuring test has been met. Trustees should decide early in the process how they will satisfy themselves of this, and whether it would be appropriate to agree any additional conditions with the employers. It will generally be in the interests of all parties to complete the process as quickly as reasonably possible, rather than treating the maximum permissible timescale as the default.

## **Scheme apportionment arrangements<sup>12</sup>**

132. A scheme apportionment arrangement takes effect when an employment-cessation event occurs or, if later, when the arrangement is agreed.
133. A scheme apportionment arrangement modifies the amount of the departing employer's section 75 debt so that it is greater or less than the liability share. If it is less, then all or part of the difference is apportioned to one or more of the remaining employers.
134. A scheme apportionment arrangement must be agreed by the trustees as well as by any employers whose liabilities increase as a result of the arrangement.
135. The trustees must be satisfied that the funding test for scheme apportionment arrangements is met.
136. In order to undertake a scheme apportionment arrangement the scheme's rules must provide for the departing employer's share of the deficit to be modified by apportionment. The scheme apportionment arrangement must:
  - allow the departing employer to pay a specified amount that is different from their liability share;
  - where this is less than the departing employer's liability share, apportion all or part of the difference to one or more of the remaining employers (it may also specify when the apportioned amount is to be paid).
137. A scheme apportionment arrangement can be entered into before, on or after the triggering of the section 75 debt. However, parties should note that:
  - any retrospective apportionment (taking place after the event which has triggered the section 75 debt) is similar to a compromise, for which clearance is an appropriate consideration (see our clearance guidance for further information); and
  - the decision to enter into a retrospective scheme apportionment arrangement is a notifiable event (refer to our code of practice on notifiable events).

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### Funding test – scheme apportionment arrangement

138. If a scheme apportionment arrangement reduces the departing employer's section 75 debt (or increases it, as agreed by the departing employer, to a level that the trustee is not satisfied the departing employer can afford), then the trustees must be reasonably satisfied that both parts of the funding test are met:

- When the arrangement takes effect the remaining employers will be reasonably likely to be able to fund the scheme, so that it will have sufficient and appropriate assets to cover its technical provisions (taking into account any changes to the technical provisions that may need to be made as a result of the scheme apportionment arrangement, for example because of a consequential reduction in covenant strength).
- The effect of the arrangement will not adversely affect the security of members' benefits as a result of any:
- material change in legal, demographic or economic circumstances, as described in the Scheme Funding Regulations<sup>13</sup>, that would justify a change in the methods or assumptions used in the last calculation of the scheme's technical provisions (a change in the trustees' assessment of the employer covenant strength may justify a change in relevant assumptions); or
- material revision to any existing recovery plan (for example a longer recovery period).

139. If the trustees have not received the scheme's first actuarial valuation under the 2004 Act<sup>14</sup>, then the second part (ii, above) of the funding test differs.

140. When assessing the funding test we would expect trustees to assess the effect of the scheme apportionment arrangement on the scheme's technical provisions, taking into account those factors set out in our code of practice on scheme funding.

141. There are 2 circumstances where the trustees are not required to consider whether the funding test is satisfied:

- where the amount paid by the departing employer is greater than its section 75 debt and the trustees are satisfied that the departing employer can make this payment; or
- when the scheme has commenced winding-up, but is not in a Pension Protection Fund (PPF) assessment period and is unlikely to enter one in the next 12 months, and the trustees are satisfied that:
  - the departing employer is not able to pay its liability share but can pay the scheme apportionment arrangement share; and
  - it is likely that the remaining employers will be able to pay the difference.

### Consents required

142. In order to enter into a scheme apportionment arrangement, the following consents must be obtained:

- the consent of the trustees;
- where the departing employer is paying less than its section 75 debt, the consent of the remaining employers to whom the remainder of the liability share is being apportioned; and
- the consent of the departing employer if it is not paying less than its liability share.

### Key considerations

143. Before agreeing to a scheme apportionment arrangement, the trustees must be satisfied that the arrangement is consistent with the interests of the scheme members. Even if a scheme apportionment arrangement is possible, it might still be inappropriate to proceed if trustees are not satisfied that, in the circumstances, it is in the members' best interests. If this is the case trustees should consider whether any other mitigation can be put in place (such as contingent assets).

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<sup>13</sup> Regulation 5(4)(d)

<sup>14</sup> Sections 221–233

## Withdrawal arrangements<sup>15</sup>

144. A withdrawal arrangement is an arrangement by which the departing employer can pay an amount that is less than its liability share, but at least as much as its share of the technical provisions. The amount paid by the departing employer is known as the 'withdrawal arrangement share'. One or more guarantors guarantee to pay the difference between that amount and the departing employer's liability share. The amount guaranteed by the guarantor is known as 'amount B'.
145. Amount B is payable by the guarantors on scheme wind-up, the insolvency of the last remaining employer, or when agreed by the guarantors and the trustees.
146. Trustees must only agree to a withdrawal arrangement if they are satisfied that:
- at the date of the agreement the guarantors have sufficient financial resources to be likely to be able to pay amount B that would arise on that date, or the likely amount B; and
  - the funding test for withdrawal arrangements is met (see paragraphs 151–152).
147. The arrangement can be entered into before, on or after an employment-cessation event.
148. Withdrawal arrangements which do not require regulatory approval must contain a number of statutory conditions. Care should be taken by all parties (supported by relevant independent professional advice) to ensure that the statutory conditions are fully included. Failure to do so will mean that the withdrawal arrangement does not comply with legislation, and as such the departing employer may retain liability for its full section 75 debt.
149. Trustees may negotiate the inclusion of additional conditions, over and above the statutory conditions, where appropriate.
150. The employer requirements in relation to notifiable events are extended to guarantors where a withdrawal arrangement is in place.

## Funding test – withdrawal arrangement

151. The funding test will be met if the trustees are reasonably satisfied that, when the arrangement takes effect, the remaining employers will be reasonably likely to be able to fund the scheme so that it will have sufficient and appropriate assets to cover its technical provisions (taking into account any changes to the technical provisions that may need to be made as a result of the withdrawal arrangement, for example because of a consequential reduction in employer covenant).
152. When assessing the funding test we would expect trustees to assess the effect of the withdrawal arrangement on the scheme's technical provisions, taking into account those factors set out in our code of practice on scheme funding.

### Key considerations

153. Trustees should take care to satisfy themselves of the strength of the guarantee. Relevant factors may include:
- the choice of guarantor including its financial strength, and (for example) whether it is an existing employer in relation to the scheme or has provided other guarantees, in which case the advantages of the guarantee may be reduced;
  - whether amount B is a fixed amount or a floating liability<sup>16</sup>;
  - the agreed payment dates for amount B (for example earlier payment may be appropriate if amount B is fixed, to address the risk that the fixed amount will not cover the relevant liabilities);
  - any payments on account of amount B;
  - whether the guarantee is properly enforceable; and
  - whether there should be more than 1 guarantor, and if so whether they are jointly and/or severally liable for amount B.

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154. Trustees should be cautious about agreeing to the departing employer's withdrawal arrangement share being paid in instalments rather than immediately, as this is a risk to the scheme. The regulator would expect trustees to consider whether payment by instalments is appropriate or necessary. The trustees need to assess this risk including, among other things, the ongoing viability of the departing employer and whether it would be able to meet the payments as they fall due. Trustees should consider whether a guarantee or security should be provided for the instalment plan and whether interest should be an additional feature of a plan.
155. It is important that trustees routinely monitor the strength of the guarantor, as they would any sponsoring employer. Should the trustees become aware that the strength of the guarantor has weakened since the withdrawal arrangement was put in place, they should take steps to address the impact of this, just as they would if another sponsoring employer showed a weakening covenant.

#### **Approved withdrawal arrangements<sup>17</sup>**

156. An approved withdrawal arrangement is a withdrawal arrangement where the departing employer pays less than its share of the technical provisions on departing the scheme.
157. Where trustees consider that an approved withdrawal arrangement is appropriate, the employer must submit an application to the regulator for us to approve the arrangement. The application form to be completed can be downloaded from the regulator's website.
158. The trustees must be satisfied that the funding test (see paragraphs 151–152) is met.

#### **Key considerations**

159. The regulator can impose conditions over and above those set out in legislation, including where the result would be to arrive at an appropriate level of mitigation for the scheme.

#### **Regulated apportionment arrangements<sup>18</sup>**

160. A regulated apportionment arrangement modifies the departing employer's section 75 debt so that it is greater or less than its liability share. If it is less, then all or part of the difference is apportioned to one or more of the remaining employers.
161. A regulated apportionment arrangement is only available where the scheme is in a PPF assessment period, or the trustees are of the opinion that the scheme is likely to enter a PPF assessment period within the next 12 months.
162. The regulator must approve a regulated apportionment arrangement and the PPF must not object to it.
163. We expect that the use of regulated apportionment arrangements will be very rare and only appropriate in exceptional circumstances.
164. As this mechanism is only available in unusual circumstances, some of the general statements in this guidance may not apply to this mechanism.
165. We expect that an application for approval of a regulated apportionment arrangement will be accompanied by a clearance application.

<sup>17</sup> Regulation 7 of the Employer Debt Regulations

<sup>18</sup> Regulation 7A of the Employer Debt Regulations

## Glossary of terms

**Covenant** – an employer's and other relevant parties' legal obligations to fund the scheme now and in the future. The strength of the covenant depends upon the robustness of the legal agreements in place and the likelihood that the employers and any other obligors (for example guarantors) can afford to meet them. As scheme sponsor, the employer underwrites the risks to which the scheme is exposed including underfunding, longevity, investment and inflation. The covenant needs to be adequate to offset a variety of different contingencies from short term (for example insolvency or employer departure) to long term (for example increasing longevity).

**Departing employer** – an employer who is withdrawing from a scheme, including by way of employment-cessation event, an insolvency event, a de minimis restructuring arrangement or a restructuring arrangement. The term is used in this guidance to include 'cessation employer' and 'departing employer' as defined in Regulation 2(1) of the Employer Debt Regulations and 'exiting employer' as defined in Regulation 2(3A) of the Employer Debt Regulations.

**Departure** – the act of an employer withdrawing from a scheme, including by way of employment-cessation event, an insolvency event, a de minimis restructuring arrangement or a restructuring arrangement.

**Employer** – is, as the context requires, as defined in section 124(1) of the 1995 Act and as may be extended under section 125(3), including by regulations 9 and 13 of the Employer Debt Regulations in relation to former employers.

**Employment-cessation event** – as defined in Regulation 6ZA(1) of the Employer Debt Regulations and extended by regulation 9(4) in relation to frozen schemes.

**Liability proportion** –  $K / L$ , where:

- K equals the amount of a scheme's liabilities attributable to an employer in accordance with Regulation 6(4) of the Employer Debt Regulations; and
- L equals the total amount of the scheme's liabilities attributable to employment with the employers as defined in Regulation 2(1) of the Employer Debt Regulations.

**Liability share** – an amount equal to the liability proportion of the total difference between the value of the assets and the amount of the liabilities of the scheme, as defined in Regulation 2(1) of the Employer Debt Regulations.

**Orphan liabilities** – the total amount of a scheme's liabilities which are not attributable to employment with any of the employers.

**Period of grace notice** – a notice in writing that an employer intends during the period of grace to employ at least 1 person who will be an active member of the scheme as defined in Regulation 6A(3) of the Employer Debt Regulations.

**PPF assessment period** – the period after a qualifying insolvency event has occurred in relation to an employer of an eligible scheme, during which the PPF will assess whether or not it must assume responsibility for the scheme. See section 132 of the 2004 Act.

**Receiving employer** – as defined in Regulation 2(3A) of the Employer Debt Regulations.

**Relevant members** – those members who accrued DBs in the scheme as a result of pensionable service with the departing employer, as defined in regulation 6ZC(13) of the Employer Debt Regulations.

**Section 75 debt** – the debt owed by an employer to the trustees of the scheme, calculated in accordance with section 75 of the 1995 Act.

**Section 75 deficit** – the total amount by which a scheme's liabilities on an annuity buy-out basis (annuities purchased from a regulated insurance company to secure the scheme's liabilities in full) exceed the value of the scheme's assets.

**Segregated scheme** – as defined in regulation 8(2) of the Employer Debt Regulations.

**Technical provisions** – a calculation, set out in Part 3 of the 2004 Act and based on methods and assumptions usually agreed by the trustees and employer, of the amount needed at a particular time to make provision for the scheme's liabilities.

## Relevant legislation

- The Occupational Pension Schemes (Employer Debt) Regulations 2005, as amended, referred to in this guidance as 'Employer Debt Regulations'.

This guidance relates to amendments to the employer debt regime introduced by the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008 (SI 2008/731) from 6 April 2008 and then as subsequently amended by the Occupational Pension Schemes (Employer Debt – Apportionment Arrangements) (Amendment) Regulations 2008 from 15 April 2008 and the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2010 from 6 April 2010.

- The Pensions Act 2004, referred to in this guidance as 'the 2004 Act'.
- The Pensions Act 1995, referred to in this guidance as 'the 1995 Act'.
- The Occupational Pension Schemes (Scheme Funding) Regulations 2005, referred to in this guidance as the 'Scheme Funding Regulations'.
- The Occupational Pension Schemes (Scheme Administration) Regulations 1996, referred to in this guidance as the 'Scheme Admin Regulations'.

All legislation referred to in this guidance can be viewed at [www.opsi.gov.uk](http://www.opsi.gov.uk).

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[www.trusteetoolkit.com](http://www.trusteetoolkit.com)

Consultation document

**Defined benefit multi-employer schemes and employer departures:  
guidance for trustees**

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