Section 75 employer debt in non-associated multi-employer defined benefit pension schemes

RESPONSE FROM ICAS TO THE DEPARTMENT OF WORK AND PENSIONS

22 May 2015
Introduction

The ICAS Charities Committee and ICAS Pensions Committee welcomes the Department of Work and Pensions (DWP) call for evidence on reform of section 75 of the Pensions Act 1995.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public and charity sectors.

Our Charter requires ICAS committees to act primarily in the public interest and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key points

We believe very strongly that reform of section 75 of the Pensions Act 1995 is needed. We have two overarching concerns about the section 75 cessation debt regime which need to be addressed in the interests of all stakeholders. First, we would recommend that the Occupational Pension Schemes (Employer Debt) Regulations 2005 are amended to enable non-associated employers, largely charities, in private sector multi-employer defined benefit schemes to cease future accrual without a cessation debt being triggered. Second, we would recommend that pension trustees are given the flexibility to enable employers, who have ceased future accrual, to pay down their debt over a longer-period.

We also support similar reforms being made to the cessation debt regime operated by the Local Government Pension Scheme (LGPS), which in Scotland is a devolved matter. It has been custom and practice for LGPS funds to adopt the employer debt regime of section 75. The implications for community admission bodies, largely charities, are similar to those of non-associated employers in private sector multi-employer schemes.

Earlier this year we responded to a consultation by the Department for Communities and Local Government (DCLG) on proposed Local Government Pension Scheme Amendment Regulations (England and Wales). As part of this consultation the DCLG asked for suggestions on how to better protect local taxpayers where there is a risk that they will have to foot the bill for employers who leave the scheme. We responded by urging a change in approach to employer debt and recommended engaging with the Scottish Government to address this issue on a UK-wide basis. However, the subsequent consultation report issued by the DCLG did not address this broader aspect of the consultation.

It is important that the UK Government works across departments to resolve these challenges and engages with the Scottish Government to arrive at a consistent UK-wide approach which addresses the risks faced by the stakeholders of multi-employer defined benefit schemes arising from employers being obliged to accrue pension liabilities they cannot afford to meet.

Any enquiries should be addressed to Christine Scott, Assistant Director, Charities and Pensions, at cscott@icas.com.
Responses to consultation questions

Employer debt in non-associated schemes

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

Answer 3.1 We believe that the employer debt regime should be reformed to address specifically the challenges faced by non-associated employers participating in multi-employer schemes.

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

Answer 3.2 We believe that it is possible to address the challenges faced by non-associated employers arising from the employer debt regime by amending secondary legislation. For example, in April 2014, the Charity Finance Group published ‘A practical approach to employer debt in multi-employer schemes’. This publication sets out suggested amendments to the Occupational Pension Schemes (Employer Debt) Regulations 2005 (The Employer Debt Regulations).

Stakeholder views

Question 4.1 Has your organisation had any experience with the section 75 employer debt regime as it applies to non-associated multi-employer defined benefit schemes?

Answer 4.1 The ICAS Charities Committee and ICAS Pensions Committee represent the views of ICAS members within their subject areas. The expertise of ICAS members on both these committees is complemented by representatives from other professions involved in the charity sector and pensions industry. Together the members of these committees have experience and knowledge of the difficulties faced by charities which are non-associated employers in both private sector multi-employer schemes and community admission bodies in the Local Government Pension Scheme.

Question 4.2 Do you think that the employer debt regime for these schemes needs to be changed, or does it work as it currently stands?

Answer 4.2 We believe that the employer debt regime for non-associated employers needs to be changed as a matter of some urgency.

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

The Charity Finance Group conducted a Defined Benefit survey amongst its membership in 2014. The results of aspects of the survey have been published in ‘Navigating the Charity Pension Maze’ (2014). While the number of charities responding to this aspect of the survey is not specified in the Pension Maze, chapter 5 highlights how those charities may respond to a change in the employer debt rules:

- 35% would definitely exit their scheme
- 25% would strongly consider exiting their scheme
- 20% would likely consider it
- 20% would not consider it

The result indicates that most non-associated charity employers have a preference for revisiting their relationship with their scheme.

Existing easements designed to help employers manage employer debt

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

Answer 5.1 We are not aware of withdrawal and apportionment arrangements being commonly used. Grace periods are used more often than other forms of easement.
Question 5.2 How effective are the easements for schemes and for employers?

Answer 5.2 We do not believe that easements are very effective and often do not deal with the primary issue which is the ability to cease future accrual without triggering a cessation debt.

The Employer Debt Regulations were amended in 2010 to extend the scope of available easements, both general and de minimis, to deal with corporate restructuring. The amendments did not alter the basic principles of the employer debt regime or the way of dealing with section 75 debt. In summary, this means that the employer debt regime is not a barrier to corporate restructures if pension trustees can satisfy themselves that the receiving employer is “at least as likely” as the exiting employer to meet the scheme liabilities it is acquiring.

However, we are aware that the employer debt regime has nevertheless been a barrier to corporate restructuring in the charity sector and we are also aware of charities triggering a section 75 debt inadvertently by changing legal form. It is not uncommon for charities to change legal form, for example for an unincorporated association to convert to another form of charity in order to limit the liability of the charity’s trustees or for a charitable company to convert to a charitable incorporated organisation (or Scottish charitable incorporated organisation) to reduce the dual burden of regulation under both company law and charity law. While the extension in the scope of easements is welcome, the employer debt regime can make corporate restructuring, which would be in the interests of charities’ beneficiaries, more challenging.

The spectre of employer debt, as illustrated above can also act as a disincentive to people becoming charity trustees. This is a particular concern to the trustees of charities which do not have legal personality such as unincorporated associations and trusts. While in practice, the trustees of such charities are not normally pursued as individuals for a charity’s debts when it becomes insolvent, it is a risk and a risk that understandably prospective trustees would be wary of taking on. If a charity cannot maintain a trustee body sufficient to govern it, that in itself creates a going concern problem which is not in the interests of any of the charity’s stakeholders.

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

Answer 5.3 We do not believe that the easements available enable non-associated employers to address the challenges posed by the current employer debt regime.

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

Answer 5.4 Please refer to our response to question 5.3.

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

Answer 5.5 The infrequent use of easements demonstrates that reform in this area would not enable non-associated employers to address the pensions challenges they face.

Other easements suggested

Question 6.1 Do the current employer debt provisions for multi-employer schemes need to be amended, or could better use be made of existing easements to manage any problems employers or schemes may face?

Answer 6.1 We believe that changes are needed to deal with the automatic section 75 trigger and the lack of flexibility trustees have to enable non-associated employers to pay down cessation debt over the long-term.

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

Answer 6.2 The Charity Finance Group 2014 DB survey results indicate that charities are remaining within schemes due to the section 75 trigger when most would either leave the scheme or would consider leaving the scheme, if the employer debt regime was reformed.
Question 6.3 Should DWP support and encourage greater flexibility regarding debt repayment plans?

Answer 6.3 Yes, the combination of the section 75 trigger and the lack of flexibility available to trustees to agree a longer repayment period mean that non-associated employers in last man standing schemes do not have the flexibilities available to employers in standalone or segmented schemes.

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

Answer 6.4 A more flexible repayment plan would balance the needs of employers and the needs of the scheme: we fully agree that such a balance is essential. Greater flexibility could actually protect the scheme and therefore members’ benefits and the Pension Protection Fund by reducing the risk that non-associated employers would be unable to afford debt repayments, leading to insolvency.

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

Answer 6.5 In some cases the longer the timescale the greater the risk of default, as it is not possible to anticipate the financial sustainability of employers over a period of potentially decades. However, this needs to be balanced with the risks posed by the current arrangements.

With non-associated employers obliged to keep active members within the scheme to avoid the section 75 debt trigger and thus continue to accrue liabilities and therefore debt, the financial health of employers who wish to leave the scheme and the scheme itself is further damaged. This situation is merely building up additional liabilities and debt rather than addressing the primary issue.

The section 75 trigger and the lack of flexibility over the repayment period can place non-associated employers in a position where they have a debt that they cannot repay. If a non-associated employer becomes insolvent, that employer’s debt will be shared across the remaining employers.

Enabling debt to be repaid more flexibly (and reforming the debt trigger) is likely to mean that ultimately more of the debt will be settled.

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

Our observations are based on the experience of members of both the ICAS Charities Committee and ICAS Pensions Committee.

We believe that charity employers are committed to meeting their financial obligations and that pension trustees understand the challenges that charity employers face. However, the regulatory arrangements are a barrier to addressing the primary issue.

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

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

Answer 6.7 We believe that the greatest risk to all stakeholders is keeping employers within the scheme, building up debt, when they wish to leave. Section 75 reform could benefit all parties by providing the opportunity for employers to focus on meeting past service costs.

We understand that employees who would no longer be able to accrue DB benefits would face a change in the terms and conditions of their employment. However, charity employers must operate in a financially sustainable way if they are to continue to employ staff and to deliver their charitable purposes.

Question 6.8 How could the relationship between a scheme and its non-active employers be best managed?
Answer 6.8 We believe that enabling employers to cease future accrual without triggering a cessation debt would have the potential to improve relationships between both parties, who could then focus specifically on a funding plan to pay down past service obligations.

The scheme should continue to have the option to trigger a cessation debt should an employer fail to meet its obligations under an agreed funding plan.

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

Answer 6.9 We would expect schemes to be able to tailor their investment strategies to their own particular circumstances whether they are closed to future accrual or remain open to future accrual, including schemes where the number of new joiners is in decline.

A change to the section 75 regime could encourage schemes to tailor their approach further to reflect better the covenant strengths of non-associated employers.

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

Both the Scottish Housing Association Scheme and the Social Housing Pension Scheme offer a defined contribution option under the Trust to allow employers to cease future accrual. The Pensions Trust CARE schemes and Growth Plan provide a similar arrangement. The trustees of these schemes have adjusted their investment profile to reflect the number of employers continuing to accrue defined benefits.

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

Ultimately we believe the cessation basis under section 75 for non-associated multi-employer schemes is the appropriate basis, provided that there is an intention or ultimate requirement to secure benefits on a buy-out basis. However, it is the journey to that point which we believe needs to be reconsidered. If we take the position of a standalone scheme, it could take 15 to 20 years for the employer to fund a technical provisions deficit and another 10 years to fund a section 75 cessation debt. If this approach could be mirrored for employers in non-associated multi-employer schemes, we believe that this would be the optimal approach.

With regard to covenant assessment, there is some flexibility in the approach adopted by The Pensions Regulator (TPR) in designing a score-card for charities which takes account of the differences between assessing the financial strength of a charity compared to a profit-distributing entity.

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

Answer 6.12 Schemes will benefit through employers with weak covenants ceasing to accrue further debts and from a reduction in the risk that those employers will become insolvent and therefore cease to contribute funds to the scheme. Schemes would also retain the power to trigger a cessation debt if an employer did not comply with the terms of an agreed deficit recovery plan.

We believe that, if employers who wish to cease future accrual were able to do so, these employers would remain committed to paying down their existing deficit. They would benefit from a greater degree of certainty about the magnitude of the debt and about how long it may take to pay it down. Greater certainty around pensions would also help to reduce the risk of insolvency and therefore the risk of disruption to the services that the respective charities provide.

Other employers would benefit from employers who cannot afford to accrue additional liabilities ceasing to do so, as the scheme as a whole would become more secure.
The benefits for scheme members would be better protected through these changes and the PPF would benefit similarly as a result of the scheme being more secure.

Question 6.13 What data do you have that might support your answer to questions 6.11 and 6.12?

Our responses to question 6.11 and 6.12 are based on the experience of our committee members across their different charity sector and pensions’ industry roles.

TPR has also made progress, in respect of covenant assessments, towards dealing with the differences in the financial assessment of charities compared to profit-distributing entities through designing a specific score-card.

Question 6.14 Are there any other approaches not listed here that we should consider that might improve the employer debt regime for employers, schemes and members?

Answer 6.14 We would like to emphasise the importance of giving pension trustees the flexibility to reach compromises with employers should they consider them to be in the interests of the scheme as a whole. At present such compromises would remove a scheme from the protection of the PPF.

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

Answer 6.15 ‘The Spirit of Enniskillen Trust’ and ‘People Can’ are examples of the above.