PENSIONS IN 30 PODCASTS

09 ONGOING SCHEME FUNDING - contribution obligation when employer departs from scheme

Key points

- Ceasing to employ active members in a defined benefit pension scheme at a time when another employer continues to employ active members into that scheme can trigger a potentially crippling debt.
- There are various mechanisms which can be deployed to avoid the effects of this lawfully. These should be considered before the debt is triggered.

Main sources

- Pensions Act 1995
- Occupational Pension Schemes (Employer Debt) Regulations 2005

NOTE: the legislation is simple in theory but in practice it is extremely complicated, not least because it keeps changing and being reinterpreted by case law. This fact card is a considerable simplification and omits points of detail that might be relevant in practice.

When is an employer debt triggered?

A section 75 statutory debt is triggered, owed by an employer to the trustees of that scheme, in relation to a pension scheme which includes salary-related benefits, in the following situations:

a) the employer becomes insolvent;
b) the pension scheme is wound up; or
c) if the scheme has more than one employer, the employer ceases to employ active members at a time when at least one other employer (not counting an employer responsible only for money purchase benefits) continues to do so.

All current employers of active members count as "employers" for this purpose, and so do former employers, unless they have already paid such a statutory debt or are released from the obligation for one of the other specified reasons.

How much is the debt?

The debt is calculated by reference to the scheme's funding deficit on a buy-out basis. This is the shortfall between: (i) the value of the scheme's assets; and (ii) the amount of its liabilities (assuming the liabilities are secured by purchasing policies with an insurance company).

If there is more than one employer, the employer's debt is not the full deficit but the employer's share of it. The employer's share will cover the liabilities of the scheme that are attributable to the employer plus a proportionate share of the liabilities that cannot be attributed to any other employer.

Lawful ways to avoid the debt

The debt trigger that causes the most issues is (c) above, as this can be inadvertently triggered by normal activity. However the legislation does contain several mechanisms to prevent a debt being triggered in such circumstances. These include:

- a grace period of up to three years in which the employer can employ another active member without triggering a debt;
- the debt or the liabilities can be "apportioned" to a different employer, so the employer pays less or no debt and the other employer takes over responsibility for the rest; or
- the employer can pay only part of the debt, with the rest being backed by guarantors.

More information

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You can also stay up to date with the latest pension developments at **gowlingwlg.com/en/united-kingdom/insights-resources**.

Bad ways to avoid the debt

In normal circumstances, trustees should avoid allowing a section 75 debt to be compromised (except by one of the mechanisms set out above). This is because such a compromise would put at risk the scheme's eligibility for the Pension Protection Fund if its sponsoring employer(s) became insolvent.

There are occasions when a compromise is appropriate – usually as a part of a scheme abandonment with the support of The Pensions Regulator and the Pension Protection Fund – but these need careful handling.

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