ASSOCIATION OF CONSULTING ACTUARIES

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18 May 2017

Employer Debt Team
Department for Work and Pensions
First floor
Caxton House
6-12 Tothill Street
London SW1H 9NA

Dear Sirs

The draft Occupational Pension Schemes (Employer Debt) (Amendment) Regulations 2017

I am writing on behalf of the Association of Consulting Actuaries in response to the above consultation.

Our comments on the specific questions raised in the consultation are set out in Appendix 1. We welcome the deferred debt arrangement, but acknowledge that there may be practical difficulties in its operation. We support your decision to keep in place the existing various means by which employer debts can be managed when an employment-cessation event occurs.

In response to your consultation *"Better Workplace Pensions: Reducing regulatory burdens, minor regulation changes, and response to consultation on the investment regulations "* dated November 2015, we raised a number of issues with the employer debt regulations one of which we see is being addressed in this latest consultation. We set out the remaining issues in Appendix 2 along with how we think they should be addressed. We ask you to look at them again as part of what we believe is necessary good house-keeping and given that you have produced draft regulations that are close to finalisation and which you intend should come into force on 1 October 2017.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. Please contact me on 020 7432 6635 (david.everett@lcp.uk.com).

Yours faithfully

David Everett
Chairman, Pension Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

Sent by e-mail to: Private.pensionspublicconsultation@dwp.gsi.gov.uk

APPENDIX 1

The draft Occupational Pension Schemes (Employer Debt) (Amendment) Regulations 2017

We responded to your call for evidence dated 12 March 2015[1] and our thoughts can be found at http://www.aca.org.uk/files/ACA_response_re_Section_75_Employer_Debt_in_Non-Associated_Multi-Employer_Defined_Benefit_Pension_Schemes_consultation-22_May_2015_-20150528094235.pdf. We were supportive of your "Amend the provisions so that ceasing to employ active members does not trigger employer debt" proposition from which it seems you have developed the deferred debt arrangement.

Chapter 2: The deferred debt arrangement

1. We would welcome your views on the deferred debt arrangement proposal. In particular, will it be helpful to employers of non-associated multi-employer schemes in managing an employer debt when they cease to employ an active member?

We can see the merits of this further option to manage employer debts, particularly when, although an employment-cessation event is triggered, the reality is that the employer is not seeking to end its responsibilities and obligations to the DB scheme in respect of its members. We foresee some practical challenges, however, as discussed further below.

Although there is a multitude of ways in which departing employers can manage their section 75 debt under the current legislation, it is clear to us that they have been constructed with associated multi-employer schemes in mind. For non-associated multi-employer schemes the various mechanisms for apportioning the liability share (ie the scheme apportionment arrangement and the two forms of withdrawal arrangement) are unlikely to be available. Furthermore, other than the grace provisions that are only temporary, the remaining mechanisms under which an employment-cessation event is not triggered, or the debt that arises under such an event is deemed not to have arisen (ie the restructuring provisions and flexible apportionment arrangement provisions) are not likely to be of assistance in the non-associated multi-employer scheme context.

Although we agree that the deferred debt arrangement will be helpful to employers of non-associated multi-employer schemes, for whom the alternative in practice is immediate payment of the liability share, it has to be remembered that the price for seeking to cut ties with the DB scheme remains an employer debt determined on a buyout basis. Contrary to what some other commentators are saying, we believe this has to continue to be the case given that it is a cornerstone of the DB regulatory regime.

We support your decision not to restrict this new option to non-associated multi-employer schemes. This is because the option may be of assistance to associated multi-employer schemes and it avoids having to distinguish in legislation between the two types of scheme – an issue that the Call for Evidence demonstrated was problematic.

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[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/410565/s75-employer-debt-call-for-evidence-march-2015.pdf.

2. Will the proposed conditions to enter into a deferred debt arrangement work in practice for the employer and the trustees and managers of the scheme?

In our view the proposed conditions are appropriate as well as being consistent with certain other ways in which employer debts can be managed. However, it does place an extra burden on trustees. We envisage that trustees may well have difficulties in agreeing to the arrangement taking place because of the ongoing obligations it places on them. At the very least there will need to be some guidance, which we suggest is provided by the Pensions Regulator, in order to "educate and enable" trustees to look favourably on this new arrangement. In particular, such guidance will need to assist the trustees in reaching a decision as to whether to impose a buyout debt now against continuation of the status quo with the potential to impose a buyout debt later. In many cases reaching such a decision will not be straightforward.

3. Do you envisage any difficulties in the practical operation of the deferred debt arrangement?

Yes, in both the initial decision making process and in the subsequent monitoring that the trustees will need to undertake given certain situations in which the arrangement comes to an end. We expand on this below.

4. Do you agree with the list of circumstances in which the deferred debt arrangement would end, and can you identify any other circumstances in which it will end?

We are not sure about all of them. It is not clear to us why a freezing event (Regulation 6F(5)(e)) should cause the arrangement to end, still less why it should then be regarded as an employment-cessation event for all those in a deferred debt arrangement given that those not in a deferred debt arrangement will not have a section 75 debt crystallised at that point.

We have some concerns over Regulation 6F(5)(f). Whilst aspect (i) may be black or white, aspect (ii) (the deferred employer's covenant to the scheme is likely to weaken in any other way in the next 12 months) is essentially subjective and implies the need for continuous monitoring. Although we appreciate the logic for its inclusion and are not asking for it to be removed, this could make deferred debt arrangements impractical in the context of a non-associated multi-employer scheme, especially if it contains numerous employers. It is also not entirely clear to us how Regulation 6F(5)(f) is intended to operate. If the conditions are met are the trustees <u>obliged</u> to bring the arrangement to an end or are they merely <u>empowered</u> to do so? From paragraphs 2.13-2.14 of the consultation paper it seems that the policy intention is the latter.

A further point is that there is a moral hazard aspect of Regulation 6F(5)(f)(ii). If the employer has reason to believe that this condition will be satisfied it can avoid an immediate debt being triggered by the trustees through the expedient of employing an active member.

We also note that this may well be the first time that the term "covenant" has been used in pension legislation. As such it may need to be defined.

We think that the Regulation 6F(5)(f)(ii) trigger should also apply if the weakening in the covenant has already taken place. Otherwise by the time the trustees become "reasonably satisfied" they may not be able to bring the arrangement to an end.

It appears that the deferred employer restructuring (Regulation 6F(5)(d)) is not defined. As it is an event which will be treated as an employment-cessation event (and thus trigger an employer debt) it does need to be defined. Separately, in paragraph 3.33d of the consultation paper, you say that restructuring is likely to weaken the covenant to the scheme. It is not clear to us why this should be so in all cases. We therefore disagree that a restructuring should necessarily bring a deferred debt arrangement to an end and trigger an employment-cessation event.

5. The deferred debt arrangement is available to employers who have entered into a period of grace. Should the deferred debt arrangement be available to employers who have already used one of the other arrangements for managing their employer debt?

We do not see the need to make provision in other arrangements that have been entered into, for them to cease. However, we note that the regulations as drafted appear to enable a liability share that has not yet been paid to be unwound. They certainly enable situations where the employment-cessation event has happened (potentially many years ago), but no liability share has been certified and served, to be replaced by deferred debt arrangements.

Chapter 3: Commentary on the draft Regulations

6. Changes to the restructuring provisions

i. Will this amendment work in practice where an organisation's restructuring is limited to changing its status and are there any further situations it should cover?

We will leave it to others to comment on whether the amendment to this part of the definition of "receiving employer" is legally effective. From our layman's reading, the proposed amendment appears to provide useful clarity for the unchanged policy intention. We also note how under the new terminology the restructuring provisions could be used in a situation where an employer that is unincorporated changes its status, primarily in order to end personal liability of the directors. We think it right that an employer debt should not be triggered in this situation. We would hope that those currently participating in non-associated multi-employer schemes, who are at risk of triggering a personal liability, could make use of this if they are willing to incorporate.

ii. Are any changes needed to regulations 6ZA and 6ZB of the Employer Debt Regulations to provide for a restructuring where the receiving employer is the new legal status of the exiting employer?

We are not aware of any further changes that will be necessary, but we leave it to others to look at this point in detail.

7. The funding test

i. Is the funding test appropriate for the deferred debt arrangement?

Yes.

ii. Are any further changes needed to the test to ensure it works in practice?

Not in relation to the deferred debt arrangement, but see our comments in the Appendix in relation to scheme apportionment arrangements. The funding test should be the same for all the arrangements to which it applies.

iii. Are there any circumstances in which it would be unnecessary?

Yes. We see no reason why the same exemption that applies in relation to the flexible apportionment arrangement (ie where there are multiple arrangements taking effect at the same time – see Regulation 6E(4)) could not also apply to the deferred debt arrangement.

8. Employment-cessation events

We raised this issue with you in our response to your consultation "Better Workplace Pensions: Reducing regulatory burdens, minor regulation changes, and response to consultation on the investment regulations. We are pleased that you are putting forward a potential solution.

i. Does this provision adequately address the problems schemes have faced in calculating an employer debt in relation to more than one employment-cessation event?

It is certainly a practical approach to the issue. However, we do have a concern.

If Employer B paid the employer debt in relation to Event 1 it would ordinarily expect not to have any further liability towards its scheme members at that time (ie at the time of Event 1) at any future point. This is because it had paid an appropriate exit price to settle its liabilities towards them.

But, as constructed, the proposed regulation would result in Employer B potentially picking up some cost for such individuals when Event 3 occurred, through their being treated as orphans at that point, and also if the overall deficit has increased between Event 1 and Event 3. On the other hand it could pick up some upside too which wouldn't have been available if the orphans it created after paying the first debt were actually bought out with an insurance company.

We believe that the current regulations in force would mean that the departing employer's aggregate liability to the scheme would be:

- The debt calculated in relation to Event 1 (based on financial conditions at the date of Event 1); plus
- The debt calculated in relation to Event 3 (based on financial conditions at the date of Event 3, allowing for all service in relation to that employer, including the service before the date of Event 1).

The amending regulations need to be drafted carefully bearing in mind the intended aggregate liability, which to avoid double counting is either the second bullet point above (this seems to be the intent of the draft regulations), or the Event 1 debt plus the Event 3 debt based solely on service after Event 1.

We suggest the regulations also need to cater for situations where the employer has or has not paid its Event 1 debt.

We are not sure why you need to limit this provision to situations where Employer B employs an active scheme member for the second time before 1 April 2017. By so doing you seem to be only partially addressing the issue. Could the regulations cater for circumstances where an employer has already had more than one cessation event, for example?

The provision is also limited to situations where the second employment-cessation event occurs after the Regulations come into force. It is not clear why you need to do this.

ii. Is this provision a fair way to attribute liabilities to an employer who has undergone two sequential employment-cessation events?

It is certainly a practical approach to the issue.

iii. Does there need to be any related assessment of the scheme's funding position in relation to it?

No.

iv. Does this provision pose any risk to the funding of pension schemes and members pensions?

No.

9. Will a three month period allow sufficient time for both employers and trustees to process a period of grace application?

We leave it to others to comment on whether the three month period is sufficient, but we welcome this simple easement. In passing, our understanding is that the period is simply from the employment-cessation event to the employer sending the notification. The period does not include any processing of the application and in fact there is no such thing – the trustees merely need to note that they have received it.

10. Deferred debt arrangements following on from period of grace

i. Will the arrangements enabling a deferred debt arrangement to follow on from a period of grace arrangement work in practice?

They would appear to do so.

ii. Are any further changes needed to facilitate this?

Not that we are aware.

APPENDIX 2

Other technical issues regarding the employer debt regulations with suggested solutions[2]

Technical issue	Suggested solution
Precisely what constitutes an "active member" is not clear and yet this determines whether or not an employment-cessation event occurs. An informal view had previously been expressed by the DWP that life cover only members and those that have ceased to accrue benefits but retain a link to final salary are not active members.	Ideally adjust the regulations, but guidance could suffice
There appears to be a regulatory gap where a scheme ceases accrual for all members at the same time. This event does not in itself trigger a debt. Should the employer subsequently be sold off, its withdrawal from participation in the scheme would also not trigger a debt (since it could not be an employment-cessation event). Contrast this with a similar sell off before a scheme ceases accrual which is likely to constitute an employment-cessation event, hence triggering a debt.	Adjust regulations so that a debt is triggered as a result of the employer's withdrawal of participation from the scheme
The definition of "relevant accounts" implies that the effective date has to coincide with the scheme year end. This means that where the updated asset assessment cannot be used (because the section 75 debt trigger was not an employment-cessation event), the scheme year end needs to be moved. This in turn triggers other requirements such as the preparation of the scheme annual report and setting the date around which certain disclosure requirements operate.	Adjust the definition of "relevant accounts" so that this issue is resolved

[2] All of these, other than the last one, are taken from our response to "Better Workplace Pensions: Reducing regulatory burdens, minor regulation changes, and response to consultation on the investment regulations" which can be found at http://www.aca.org.uk/files/Response_to_DWP_consultation_on_reducing_burdens-11_December_2015-20151211095753.pdf

Technical issue	Suggested solution
In relation to scheme apportionment arrangements, the regulations are not clear whether the amount to be apportioned to remaining employers should be a fixed or floating amount or whether it is the liabilities or the debt that should be apportioned. This makes scheme apportionment arrangements very difficult to implement in practice, with legal advisers insisting on complex documents to attempt to overcome the deficiencies in the regulations. The DWP has stated that the policy intention is not to apportion the departing employer's liabilities (which instead become orphan liabilities), but this is not necessarily consistent with the regulations.	Adjust the regulations
In relation to withdrawal and approved withdrawal arrangements it does seem odd for Schedule 1C of the regulations to require the actuary to certify the withdrawal / approved withdrawal arrangement share since this is not an actuarial liability, but a sum of money agreed between two parties. It would be more logical for the actuary to be required to certify that the approved withdrawal arrangement share was less than Amount A.	A simple adjustment to the regulations
The meaning of "relevant transfer deduction" is hard to determine in the context of withdrawal and approved withdrawal arrangements. Paragraph 4(2) of Schedule 1A seems to be implying a buy-out calculation, but Paragraph 4(4) appears to be implying the use of the scheme funding requirements. Scheme funding would be consistent with the pre 6 April 2008 regulations and we understand that this is the policy intention, but it has not been reflected in the regulations.	Adjust the regulations so that it is clear that a scheme funding approach should be used
The calculation of Amount B in a withdrawal and approved withdrawal arrangement is subject to some difficulties. Under the fixed approach the regulations also provide that in the case of a withdrawal arrangement, if the amount that the withdrawal arrangement provides for the cessation employer to pay exceeds the withdrawal arrangement share, an amount equal to that excess should be paid. However, this appears to be faulty and redundant wording in the Regulations. This appears to have been accepted, but it has not yet been reflected in the regulations.	Adjust the regulations to remove the erroneous wording

Technical issue	Suggested solution
There are difficulties in understanding what the second leg of the funding test, set out in Regulation 2(4A)(b) involves in relation to a scheme apportionment arrangement. This provides that the effect of the arrangement will not be to 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, that would justify a change to the method or assumptions used on the last occasion on which the scheme's technical provisions were calculated; or • material revision to any existing recovery plan. The Pensions Regulator's clearance guidance suggests that many scheme apportionment arrangements will be regarded by it as type A events. Given this, it is not clear how the second leg can be met for such arrangements.	Adjust the Regulator's guidance

We would be pleased to work with you to make the changes we believe are necessary.

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