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What does the new deferred debt arrangement mean for charities?

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Alison Paines
PARTNER | UK

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The government has published new regulations designed to offer an alternative way of dealing with debts triggered by employers under a defined benefit pension scheme. The new regulations came into force on 6 April 2018. Pension scheme arrangements can be tricky for charities – particularly in the case of charity mergers. The new regulations may bring potential benefits to charitable and not-for-profit organisations.

Pension debt – the background

Defined benefit pension scheme participation is not uncommon in the charity sector; a lot of organisations having previously offered defined benefit pensions as a means of enhancing a reward package that may not otherwise have been as attractive to employees as working in the private sector.

The cost of providing these accrued pension promises has, however, far exceeded most employers' expectations, and many now find themselves in the situation whereby their pension liabilities exceed the pension scheme's assets. In an analysis last year of the 40 largest charities by income, the pensions consultancy firm Hymans Robertson found that those charities alone have defined benefit pension liabilities totalling £7bn!

Pension debt – the law

There is an array of protections built into the legislation designed to safeguard the pension benefits that individuals build up during employment. One such protection is the concept of a *'section 75 debt'.* If a section 75 debt is triggered, the employer responsible for the debt will be liable, broadly, to pay adequate funds into the scheme to make good any shortfall in the that employer's share of the assets available to meet the cost of paying benefits in full.

Liability to pay a section 75 debt can put an employer under huge financial strain, particularly charities who often do not have access to substantial liquid assets or the ability to raise large funds at short notice.

A section 75 debt will be triggered upon the occurrence of a number of events, including on the insolvency of an employer in the pension scheme, and on an employer ceasing to employ active members at a time when another employer in the same scheme continues to employ active defined benefit members.

This means that an employer who participates in a multi-employer pension scheme could be subject to a debt simply by virtue of the last of its defined benefit employees retiring from employment. Similarly, a debt will be triggered if an employer merges with another entity and the original employing entity ceases to exist.

Dealing with debts

There are a number of ways of dealing with a section 75 debt that mean it does not become immediately payable by the triggering employer, such as transferring the liability for the debt to another employer within the scheme under an apportionment arrangement. However, these existing arrangements tend not to be available to employers who participate in multi-employer schemes with non-associated employers, which is very often the case for charities.

Deferred debt arrangements

The government has recognised that there is a gap in the tools available for dealing with section 75 debts, and as a result has introduced a new easement known as a *'deferred debt arrangement'* with effect from 6 April 2018. This will allow employers to essentially defer payment of a section 75 debt that would otherwise be due for immediate payment.

The deferred debt arrangement is specifically designed to assist employers in non-associated multi-employer schemes, such as charities and employers in industry-wide schemes, although it is not limited to such employers. An employer making use of a deferred debt arrangement will remain an employer in relation to the scheme for funding and administrative purposes. This means that although the employer will not have any employees accruing further benefits in the scheme, it will still be liable for deficit repair contributions under any recovery plan in place in relation to the scheme.

The deferred debt arrangement will therefore be attractive only to those employers who are willing to continue their relationship with the scheme.

Conditions for a deferred debt arrangement

A deferred debt arrangement will only be available if the following conditions are met:
• The pension scheme trustees consent to the arrangement;
• The employer has triggered a section 75 debt;
• The scheme is not in, nor likely to enter within 12 months, a PPF assessment period; and
• The trustees are satisfied that the deferred employer's covenant is not likely to weaken materially within the next 12 months

The arrangement will automatically come to an end on the occurrence of certain events (such as the insolvency of the employer). In some situations the end of the arrangement will trigger the debt, in other situations it will not.

Commentary

The deferred debt arrangement has received widespread support from the pensions industry and the charity sector. These arrangements will be valuable to charities seeking to manage their pension liabilities. For example, those employers who are presently continuing defined benefit membership solely because they cannot afford to trigger the debt, will be able to bring an end to potentially unaffordable defined benefit accrual and use a deferred debt arrangement to continue to make regular contributions to the scheme in respect of their share of the scheme's liabilities, crucially avoiding immediate payment of the debt.

The deferred debt arrangement will also be very useful to charities looking to merge who may previously have been reluctant to do so because of the likelihood that at least one of the charities would trigger an unmanageable pension scheme debt.

The conditions to be met are stringent, and the requirement for trustees to consider the likely future strength of the employer will limit the availability of the arrangement. In our view, however, it is appropriate that the needs of employers are appropriately balanced against the needs of pension scheme members, and that the protection of scheme funding remains of paramount importance. We expect the arrangement to prove a popular way for small and non-associated employers to manage their pension liabilities.

We very much look forward to helping our clients take advantage of the new deferred debt arrangement. If you have any questions, please do not hesitate to contact your usual Withers contact, or Estella Bogira, our pensions law specialist.

Authors

Alison Paines

PARTNER | LONDON

Charities

+44 20 7597 6057

alison.paines@withersworldwide.com