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THE EUROPEAN LEGAL ALLIANCE

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Pensions Bill Update

Moral hazard

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Pensions Bill Update - moral hazard

Pension Protection Fund

A new Pension Protection Fund (PPF) is being set up by the Pensions Bill currently in the House of Lords. This aims to ensure that occupational final salary schemes provide a minimum level of pension to members even when the sponsoring employer becomes insolvent. The likely start date of the PPF is April 2005.

The Bill also creates a new pensions regulator. This will replace the Occupational Pensions Regulatory Authority.

New “anti-dumping” provisions

The government is worried about employers "dumping" their underfunded schemes onto the new PPF. Some worrying new provisions have been inserted by government amendment into the Pensions Bill since it was first published in February 2004. These seek to prevent "dumping" but will also strain the concept of limited liability to breaking point.

The new pensions regulator will be given power to force companies within a group to give financial support to subsidiaries for pension scheme funding. So a holding or parent company (and possibly its directors or shareholders) may find itself liable to pay the pension scheme deficit of a UK subsidiary. And some of these new powers of the regulator will be retrospective to 11 June 2003 when the start date is eventually announced.

Attempts may be made to limit these new powers as the Pensions Bill goes through Parliament, but the government has just reaffirmed its commitment to the substance of the changes in the House of Lords debate. Consultation will continue over the summer and some safeguards may be inserted at a later stage of the Bill. These will need to be monitored very closely.

The political will to reduce claims on the new PPF is very strong and we expect these changes are more likely to happen than not.

Contribution notices after restructuring

One set of changes catches corporate restructurings **on or after 11 June 2003**. They will affect groups which have deliberately manipulated their corporate structure to avoid paying the full buy-out cost on the winding-up of a pension scheme of a solvent employer. (This full buy-out requirement was announced in June 2003.) They apply if any act was done:

- to reduce the recoverability of a pension scheme debt on an employer (e.g. asset stripping); or
- to reduce the actual level of debt which could be calculated "otherwise than in good faith" (this includes devices such as withdrawing most employers from a scheme to leave one company which then enters insolvency).

The pensions regulator will be able to issue a *contribution notice* against a wide range of employers in a group to fund the pensions deficit of an otherwise unrelated employer.

Financial support directions

Another set of changes further upsets the fundamental principles of separate legal personality and limited liability. *Any employer* participating in a final salary pension scheme or *any person connected to or associated with such an employer* can be made liable for that scheme's deficit and/or ongoing funding. Directors may be at risk of being found personally liable.

Any corporate group where one company in the group sponsors a defined benefit/final salary pension scheme, including a closed scheme, may be affected if the scheme is not fully funded and the sponsoring company is either a service company or is not sufficiently resourced to fund the scheme. "Fully funded" will probably be measured on the expensive insurance buy-out standard as that will be the new standard required when employers leave schemes.

The new pensions regulator can make a *financial support direction* against *any of the scheme employers* or *any person connected to or associated with an employer*. The financial support direction can require that connected person to part-fund the scheme. This is possible even if there has been no deliberate attempt to underfund the pension scheme.

It is understood that the government is confident that such financial support directions will be enforceable throughout the European Union. The fact that cross-border enforceability had been considered suggests this new power may be used to trace UK subsidiary debts through to foreign parent companies.

Multi-employer schemes

Separately from the Pensions Bill, the government also intends to block another pensions loophole. At present, a solvent employer can withdraw from a multi-employer scheme and only pay the Minimum Funding Requirement (MFR) debt instead of the full buy-out cost which would be payable on a winding-up of the whole scheme.

From a date yet to be announced, the pension debt when an employer leaves a multi-employer scheme under section 75 Pensions Act 1995 will be based on the full buy-out cost for its employees.

The only way to avoid this is for another participating employer to put appropriate "financial support" in place. Then only a "scheme specific" debt will be payable by the withdrawing employer of an amount to be agreed with the regulator.

Limited liability - under threat

Government lawyers have stated that they have checked the Human Rights Act position on these changes. They believe that the new laws are permitted as they balance the rights of scheme members not to be deprived of their accrued pension rights proportionately with the rights of those who will be forced to pay under the retrospective provisions.

But the concept of limited liability where a parent company is not responsible for the debts of its subsidiary (including the subsidiary's pension scheme) will be severely undermined by these changes. They conflict with both company law and insolvency law in ways which have not been addressed by the Pensions Bill. If enacted, we believe they could have an unforeseen detrimental effect on corporate transactions, venture capital and the ability of companies to borrow.

The pensions landscape as we know it is changing. It is changing fast and it is changing retrospectively. The government goal is to restore pension funding quickly to improve pensioner security. But the effect may be to accelerate the disappearance of final salary schemes.

Action points

- **Sale of a company** – can the purchaser afford to pay full buy-out cost to the ongoing final salary scheme of the seller?
- **Sale of a business** – could this be seen as a deliberate restructuring and trigger a contribution notice?
- Think very carefully before you buy into a group with a final salary scheme in deficit – **you could end up paying for it!**
- Await further developments in the autumn after the summer consultation.

Contacts

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