THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

19 November 2009

Our ref: ICAEW Rep 118/09

Your ref:

Mike Rochford
Department for Work and Pensions
7th Floor
Caxton House
Tothill Street
London
SW1H 9NA

Dear Mr Rochford

Employer Debt (Section 75 of the Pensions Act 1995) Consultation on draft regulations – draft ICAEW response

The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on *Employer Debt (Section 75 of the Pensions Act 1995) Consultation draft regulations.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Liz Cole
Manager, Company Law, Insolvency & Pensions
T +44(0)20 7920 8746
F +44(0)20 7920 8400
E liz.cole@icaew.com

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW REPRESENTATION

ICAEW REP 118/09

EMPLOYER DEBT (SECTION 75 OF THE PENSIONS ACT 1995) CONSULTATION ON DRAFT REGULATIONS – DRAFT ICAEW RESPONSE

Memorandum of comment submitted in November by The Institute of Chartered Accountants in England and Wales, in response to the Department for Work and Pensions consultation paper Employer Debt (Section 75 of the Pensions Act 1995) Consultation on draft regulations published in September 2009.

Contents

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the consultation paper *Employer Debt (Section 75 of the Pensions Act 1995) Consultation draft regulations.*published by Department for Work and Pensions.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

GENERAL COMMENTS

4. We support the DWP's initiative to introduce greater flexibility around the triggering of section 75 debts in corporate transactions and reorganisations, as the current regime causes issues in practice and can inhibit corporate activity, with the potential for triggering the debt attracting a disproportionate amount of attention (and fees) in such transactions.

5. As we stated in our response (ICAEW Rep 144/08[1]) to the DWP's previous consultation in 2008, we believe that section 75 should be reviewed in light of the current regulatory framework, in particular, tPR's new powers in circumstances where there has been 'material detriment', which were not in existence when s75 was first enacted. We also maintain that the 'material detriment' and Contribution Notice model already in existence may provide a relevant and widely understood framework for developing changes to the Employer Debt regulations.

6. We continue to support a '*before and after*' covenant test, and we support the DWP's proposal that the easement should apply only to one-to-one unilateral transfers to reduce complexity. However, on further reflection, we believe that such covenant test should be conducted by the relevant employing companies, rather than by the scheme trustees. This is because we fear that trustees would not be able to approve a transaction unless they have conducted a full '*before and after*' covenant review in respect of both employers, and thus incurred all the associated costs and fees. We doubt that those advising the trustees would ever recommend that they approve the proposed reorganisation in the absence of such evidence and associated cost. Moreover, even after such review, we wonder whether the trustees would be in a position to confirm (or be advised to confirm) their "satisfaction". This is because even a thorough '*before and after*' covenant review, incurring potentially significant associated costs and fees, would conclude with a subjective assessment with no incentive for trustees to take anything other than a extremely prudent view. Given the inherent uncertainties in making such an assessment, and the fact that the trustees surrender certain rights by expressing their "satisfaction", it would be difficult to challenge any level of prudence as unreasonable, even if an appeal framework for employers was provided. We are therefore concerned that employers with commercially justifiable intentions will regard the process as relatively expensive with a very low likelihood of success, resulting in the easement being very rarely utilised.

[1] www.icaew.com/index.cfm/route/163406/

7. The directors of the companies are already responsible for making commercial decisions and maintaining the employer covenant, and the assessments to be made in these cases are not in essence different to other transactions which might give rise to a Type A event. Additionally, the directors of the employing companies (who will be more familiar with their trading or business activities) would be best placed to make a comparison of their respective financial resources and legal obligations, and could choose whether to take third party advice. For instance, they could choose not to incur such expense in cases where it is clear that the covenant is not weakened, and so would not necessarily incur these costs in every case.

8. We also believe that the test should be more 'output' rather than 'process' driven, with the directors satisfying themselves that there is no material detriment to the overall covenants before and after the transaction (ie comparing the strength of the combined covenant before with that of the receiving employer covenant after the transaction), leaving it to the directors to determine what steps to take (rather than having such prescriptive steps in the regulations). See our comment regarding Reg 6ZB(7) at Q3 below regarding why we consider that this should look at the combined covenant. In practice, the exiting and receiving employers would need to exchange information with each other regarding their respective covenants, and the directors of both companies would need to make a statement that they considered the transaction would not give rise to material detriment. In order to make this assertion, the directors of one company may consider it necessary to obtain warranties or indemnities from the other company in respect of the information provided to it. The statement would be filed with the Pensions Regulator and, to prevent abuse, and the regulator should be given the power to issue FSDs or CNs where such statements are improperly given, for instance, knowingly or recklessly false. This could be achieved by making appropriate amendments to the moral hazard regime.

9. This approach would also remove the issue of 'to whom' it would become apparent under 6ZA(3)(b) that the insolvency declarations or transaction have not been executed in accordance with the regulations, thus triggering the anti-avoidance automatic crystallisation of the s75 debt.

10. Under this approach, the trustees would not be given the right to object to the reorganisation, otherwise they would need professional advice in order to determine whether to do so, which would defeat the object of requiring the directors to make the statement (to reduce such costs). This would also avoid the trustees having a veto, which would render the easement impractical, and avoid the Pensions Regulator being required to act as arbiter. The trustees would however have the ability to seek redress for any material detriment by petitioning the Pensions Regulator to issue a CN or FSD within the existing cut-off periods where it can be proven the company statements were made improperly.

11. We believe the approach we suggest above would remove much of the procedural prescription from the general easement, and such an 'outcome' rather than 'process' driven test would sit better within the moral hazards regime. The moral hazard powers have proven to be effective in directing corporate behaviours and we consider that this would be the case here also.

12. We support the inclusion of a *de minimis* threshold, below which the debt will not be triggered, with tests that are based on available information (rather than requiring new professional work, eg a specific review by the actuary) because, in these circumstances, the costs associated with such a full review are disproportionately high. However, in our view, the financial limit suggested in the consultation paper is too low, and further research and statistical analysis is needed in respect of multi-employer schemes, their liabilities and to assess the practical use of a *de minimis* test.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

General easement

Q1 We would welcome your views on the overall General Easement proposal.

13. See our general comments above.

Q2 At present we envisage the easement applying to one-to-one transactions. This is intended to protect scheme members. The expectation is that if a recipient employer receives the business assets of the exiting employer it should be in a position to provide the equivalent level of support for the pensions liabilities it is also receiving. We would welcome your views on this protection measure, in particular, whether you think the costs/risks outweigh the benefits by adding too much complexity?

14. We support the DWP's proposal that the easement should apply only to one-to-one unilateral transfers because, whilst this will limit the application of the easement, it reduces complexity for those reorganisations that it does cover, and we think the need for simplicity outweighs the potential benefit of introducing an easement that would permit more complex reorganisations, eg those involving transfers of assets and scheme liabilities to two or more employers (with the associated need to value and compare relevant proportions of assets and liabilities).

15. However, we consider that the drafting should refer to all "material" assets – 'immaterial' assets (eg any IP associated with the exiting employer or its company name (as it will be ceasing to trade), and eg branded notepaper, as this will be of no relevance or use to the receiving employer) should be permitted to remain with (probably to be disposed of by) the exiting employer. Guidance on "material" in this context could be provided in Codes of Practice or supporting guidance, to allow for refinement based on experiences of application in practice.

16. We also note that paragraph 6ZB(7) of the regulations as currently drafted does not appear to be workable because 6ZB(7)(b) effectively requires the covenant of the receiving company to be in no way weakened as a result of the transaction (ie as a result of taking on the employees, assets and liabilities of the exiting employer). However, under 6ZB(7)(a), the covenant in respect of the transferring employees must also not weakened. In effect, the regulations as drafted would only ever apply to transfers between companies with identical strength of covenant, which will never be the case in practice. We therefore think that the covenant test should look at the combined covenants of the exiting and receiving employers before and after the transaction.

17. Also, we consider it is unhelpful and cumbersome for "deregulatory" legislation to have such convoluted numbering to the Regulations.

Question 3 – Because we envisage the easement applying to one-to-one transactions, we envisaged the trustees considering the financial resources and legal obligations (i.e. the covenant) of the exiting and receiving employers only. However, we would welcome your views on whether the covenant offered by all employers (including the exiting employer) should be compared with the covenant offered by all remaining employers after the exiting employer has withdrawn. Would you, for example, expect the covenant assessment of all employers to be more complicated than looking at two employers in isolation?

18. See our comments at Q2 above regarding the benefit of considering the combined covenant of the exiting employer and receiving employer.

19. We consider that the "before and after" approach should allow analysis to focus on moving parts only and that covenant from other companies that are not party to the transaction should be excluded from the scope.

.

Q4 – Our current thinking is that, without a significant amount of prescription, it would not be possible to provide the same level of member protection for multiple transactions (e.g. where assets of one employer go to several employers; or where several employers are merged into one) as in a one-to-one transaction. However, we would welcome your views on whether multiple transactions (e.g. one-to-many) in a group of associated companies should not trigger a debt where all the assets remain within the same group, and what safeguards might be appropriate to recognise the complexity and increased risk to members of such transactions. (See also paragraphs 1.5 and 1.6.)

20. We support the DWP's proposal that (at least initially) the easement should apply only to one-to-one unilateral transfers (rather than more complex reorganisations) because, whilst this limits the application of the easement, it reduces complexity for those reorganisations that it does cover. As we mention above, we believe that the directors should conduct the covenant tests and, if such a regime is implemented, it should be reviewed after a period of time to establish whether it should be widened to allow transactions (and covenant tests) in respect of more than one receiving employer (in respect of one-to-many transactions).

Question 5 – Changes in economic and business conditions could mean that if there were a long gap between the date the Restructuring Test was satisfied and the date the assets etc were actually transferred, the receiving employer might no longer be capable of taking on and supporting new pensions obligations. To protect members' interests we therefore envisage setting a 12 week time limit. We would welcome your views on whether this timescale is appropriate.

21. This 12 week limit seems reasonable. Under the employer-based assessment we have outlined above, we would expect the 12 weeks to apply from the date the employers made their statement.

De minimis easement

Question 6 – We would welcome your views on the overall de minimis proposal.

22. As stated in our general comments above, we support the inclusion of a *de minimis* threshold, below which the debt will not be triggered. This is because the costs of the professional work needed for a covenant review would be disproportionately high, and it is more appropriate in these circumstances to have a test based on information already available. However, in our view, the financial limit suggested in the consultation paper is too low, and further research and statistical analysis is needed in respect of multi-employer schemes and the quantum of their liabilities. We believe that a rough ballpark figure for the level below which the *de minimis* test should apply should be where the outstanding debt is lower than around £5million (as we suggested in our previous response).

23. We would expect however that an employer-based assessment would entail lower inherent costs, and that the general easement that we recommend could be economically applied for smaller transactions than would be the case if the trustees are required to make the assessment.

Question 7 - The *de minimis* easement is intended to apply where small scale corporate restructurings are being undertaken. As such we propose a monetary limit of £100,000. We would welcome your views on the level of limit.

See our comments above.

Technical amendments to regulations, Minor technical amendments and Other technical issues

24. We do not have any comments on these sections.

E liz.cole@icaew.com