

OSPS – Employer Debts

This note contains important information to help employers participating in the University of Oxford Staff Pension Scheme (“OSPS” or the “Scheme”) to manage potential debts arising upon exit from the Scheme. The applicable law is complex and imposes significant responsibilities on employers. It is therefore essential that you understand your obligations, as failure to do so could have serious adverse financial consequences.

This note is designed to provide information to employers based on the Trustee’s current understanding of the law, but is not to be taken as advice and should not be relied upon as such. Employers should obtain their own legal advice where appropriate.

The Trustee has sought to answer some of the questions that it thinks might be commonly asked below.

Key points to remember

- The amount of any exit debt (or “employer debt”) is subject to many factors.
- It is important to contact OSPS if you anticipate that your last active member will leave pensionable service (even if you anticipate employing another active member in future), or if the legal structure of the participating employer may be altered, or if there is a realistic prospect of insolvency.

Significant employer debts can arise in any of these situations although there are sometimes options to defer or assign the debt. You should consider taking advice.
- To make use of a period of grace, there is a statutory time limit of 3 months after your last active member leaves to notify the Trustee that you intend to employ another active member.

1. What is a section 75 employer debt?

Defined benefit (DB) pension arrangements are funded by contributions paid by participating employers and their employees. Each participating employer is responsible for a share of the total amount of the Scheme’s liabilities. In certain situations a participating employer must pay a share of the deficit in the Scheme’s assets against those total liabilities. It is known as a section 75 debt because it arises under section 75 of the Pensions Act 1995.

In OSPS, there is a defined benefit section in which members accrued final salary benefits and, since 2013, CARE benefits (the DB Section). There is also a defined contribution section for new members since October 2017 (the DC Section). Broadly, the Section 75 debts are calculated in relation to the benefits built up under the defined benefit section only.

2. When is a section 75 employer debt payable?

A section 75 employer debt becomes payable when a participating employer:

- ceases to have any active members in the Scheme while another participating employer continues to have active members (called an **employment cessation**)

- event**) and there is no expectation that new employees of the employer that ceases to have any active members will join the scheme in the next 12 to 36 months;
- changes its legal status (for example following a business sale/transfer of all employees to another entity or when an unincorporated organisation is reconstructed as a charitable incorporated organisation);
 - becomes insolvent; or
 - winds up.

Under each scenario, the section 75 employer debt is payable to the Scheme by the participating employer which experiences the event listed above (referred to in this note as a "departing employer").

In OSPS, the first two events are most likely to occur.

Section 75 debts for all participating employers would also be triggered in the event that the OSPS or the Defined Benefit (CARE) Section is wound up.

3. How is a section 75 employer debt calculated?

This debt is calculated on a 'buy-out' basis, which tests whether there would be sufficient assets in the Scheme to secure all the member benefits by buying annuity contracts from an insurance company.

The departing employer's share of the shortfall is based on the benefits accrued by each member whilst in their employment, plus their pro-rata share of the Scheme's benefits relating to former participating employers who have already exited the Scheme (regardless of whether they paid a section 75 employer debt), otherwise known as "orphan" liabilities.

4. What is my section 75 employer debt?

A section 75 employer debt can only be known for certain at the time the debt payment is triggered (see section 2 above). The amount of an individual employer's section 75 debt will vary depending on many factors including:

- The number of Defined Benefit Section members attributable to the departing employer, the ages of those members and the amount of pension benefits those members have built up (influenced by the size of each member's earnings and the length of their pensionable service);
- The value of the Scheme's assets on the calculation date;
- The assumptions the Scheme Actuary uses in his or her calculations (influenced by investment market conditions which change from day to day);
- The number of other participating employers in the Scheme;
- The value and appropriate share of "orphan" liabilities; and
- Whether it has agreed to the assignment of another former participating employer's liabilities (see section 6 below).

In addition, some participating employers in OSPS have guaranteed the obligations under OSPS of other (related) participating employers when they began participating in OSPS, which would include any section 75 employer debt.

As an indication of the size of the Scheme's buy-out shortfall, if the Scheme had discontinued at 31 March 2019 and had to secure benefits with an insurance company, the

latest estimate provided by the Scheme Actuary is that there would have been a shortfall of approximately £500 million.

5. Is my section 75 employer debt fixed?

The figure can vary over time depending on factors listed in section 4 above.

As defined benefit (CARE) benefits continue to accrue under the OSPS, this will affect the figure, since the Scheme is funded on the expectation of it continuing to pay benefits as they fall due (with a prudent margin) rather than purchasing annuities.

6. Can I avoid paying the employer debt?

If a departing employer tries to avoid paying an employer debt, the Pensions Regulator has powers, known as anti-avoidance or moral hazard powers which it can use if it is concerned that any alternative to full payment of the departing employer's debt is being made to the Scheme. The Pensions Regulator can also use its powers if a participating employer undertakes, for example, a corporate change or restructuring which is considered to be of material detriment to the scheme, such that the employer debt recoverable was compromised or reduced.

In certain circumstances a departing employer may however be able to reassign its liabilities under the OSPS (including for a section 75 employer debt) to another participating employer in the Scheme using an apportionment arrangement, such as a Flexible Apportionment Arrangement (FAA). For this to occur, another participating employer (or employers) must be willing to take on the departing employer's liability, consent in writing to the apportionment and certain conditions must be met, including the Trustee's agreement to the FAA. A statutory funding test must also be met to ensure that the employer or employers which take on the liability are financially able to do so. If agreed, the section 75 debt is not immediately triggered.

The Trustee would normally expect a section 75 employer debt to be paid rather than "apportioned" to another employer.

There is also a statutory route available on a corporate restructuring or change of legal status to reassign liabilities under the OSPS to the replacement entity. Again, statutory conditions including a funding test must be met.

7. Deferred Debt Arrangements (DDAs)

DDAs were introduced into the legislation in April 2018 and under this arrangement the deferred employer will remain responsible for its share of the Scheme's liabilities after ceasing to employ an active member, but its liability to pay the employer debt will be deferred provided certain conditions are satisfied. The Trustee must consent.

The "funding test" does not apply, but the Trustee must be satisfied that the deferred employer's covenant is not likely to weaken materially within the period of twelve months after the DDA takes effect. The deferred employer will continue to be treated as if it is an employer of an active member of the Scheme, and as if no employment cessation event had occurred (meaning no section 75 debt will have been triggered). The deferred employer will therefore continue to be subject to the obligations of the normal funding regime. A special contribution arrangement may be arranged.

A DDA comes to an end (and so, the employer debt becomes payable) in various circumstances, including when:

- the Trustee and deferred employer agree to terminate the DDA;
- the deferred employer starts employing an active member of the Scheme;
- the Trustee serves notice on the deferred employer to terminate the DDA on the grounds that it is reasonably satisfied that:
 - the deferred employer has failed to comply materially with its duties under the funding regime;
 - the deferred employer's covenant with the Scheme is likely to weaken materially in the next 12 months; or
 - the deferred employer has materially failed to comply with its statutory duty to disclose certain information to the Trustee.
- all the participating employers become deferred employers (i.e. cease to employ any active members);
- the deferred employer undergoes a "relevant event" (i.e. an insolvency event);
- all the participating employers undergo "relevant events";
- the deferred employer is restructured; or
- the Scheme enters winding-up.

Please note that under the OSPS Trust Deed, continued participation in OSPS would also need to be agreed by the Trustee and the University.

8. Periods of Grace

There is often a gap between the last active scheme member leaving and a new one starting, particularly for small employers. The law provides a remedy called a "period of grace" which can be used to prevent a section 75 debt from arising as a result of this temporary gap. This only applies if the employer intends to employ at least one active member again before the end of the period of grace.

During the period of grace, the employer is treated as if it was still an employer of active members and no section 75 debt is triggered.

A period of grace lasts for 12 months automatically and with the agreement of the Trustee before the 12 months has expired this can be extended to 36 months maximum.

Please advise us if you think that you may need a 'period of grace' as soon as possible and please note the statutory time limit for notification of 3 months after the last active member leaves.

Please note that under the OSPS Trust Deed, continued participation in OSPS would also need to be agreed by the Trustee and the University.

9. What impact did the closure to new defined benefit entrants have on section 75 debts?

The changes to OSPS were devised so that employees who are active members of the DC Section count as active members. When a participating employer's last defined benefit active member leaves in future, an employment cessation event and related section 75 employer debt will not be triggered if there is at least one active member of the DC Section employed by that participating employer.

Under the DC Section, members build up rights equal to their personal accounts, so that there is no shortfall between assets and liabilities. Accordingly, their accrual of benefits will not affect the amount of the section 75 employer debt for their employer, save for the estimated expenses of winding up the DC Section.

11. What do the OSPS Trust Deed and Rules provide?

A key point about the employer debt framework is that it exists alongside any existing provisions in scheme rules.

Since 2003, the OSPS Trust Deed and Rules have included equivalent employer debt provisions, calculated on the 'buy out' basis. The Trustee is permitted to allow such payment to be made in instalments, waive or reduce the employer debt (or a proportion of it), or with the University's agreement apportion it to another employer with agreement of that employer. These discretions are subject to the statutory section 75 debt regime.

12. Do I have to recognise a potential employer debt in the Participating Employer's accounts?

There is no requirement in the employer debt regulations for organisations to disclose potential employer debts in their accounts. The main accounting standards used by UK companies to account for defined benefit pensions (IAS 19 and Section 28 of FRS 102) do not require disclosures of potential employer debts. Employers should take their own accounting advice on the circumstances that may override this.

Further information

Further information may be obtained from the Scheme secretary, Lee Spithray (lee.spithray@admin.ox.ac.uk).

March 2020

OSPS Employer Information on Section 75 Employer Debts Frequently Asked Questions (FAQs)

1. When were section 75 employer debts introduced?

The concept of a section 75 employer debt was introduced in the Pensions Act 1995, but became stronger in September 2005 when the calculation basis was changed. This now uses the 'buy-out' basis to calculate employer debts, which bases the calculation on the cost of buying annuities from an insurance company. The buy-out basis is significantly more expensive than the calculations used to determine the scheme funding level on an on-going basis. The buy-out shortfall measure was introduced into the Scheme's governing documents in 2003.

2. Have you previously told employers about the section 75 liability?

Our approach has been to tell employers about the section 75 employer debt legislation when we become aware they may be about to trigger or have few active members and so are at risk of triggering the debt. Previous versions of this note were sent to employers in 2017 and 2019.

3. When was there first a buy-out shortfall?

The Scheme has had a buy-out shortfall since the section 75 legislation changed in 2005. The Scheme reports on the buy-out funding level in the annual update.

4. Have any entities in the Scheme paid Section 75 employer debts and if so, how much money has been recovered from those institutions?

Section 75 employer debts have been collected from a small number of former participating employers and in a few instances the debt has been apportioned either to the University or to a new entity on reconstruction of an unincorporated organisation.

5. What will happen to any section 75 employer debt money paid to the Scheme?

The Scheme's assets are held in one pot and are not ring-fenced or split between employers. Any money paid into the Scheme will be used to meet the benefits for all the Scheme's members, not just employees of the employer ceasing to participate in the Scheme. This is in accordance with the Scheme Rules and pensions law requirements.

6. How can I get an estimate of my institution's section 75 employer debt?

Participating employers can be provided on request with an indication of the likely order of magnitude of their own section 75 debt based on the most recent formal actuarial valuation. Contact the Scheme secretary, Lee Spithray (lee.spithray@admin.ox.ac.uk) if you require an estimate.