OSPS - Cessation Events

This note contains important information to help employers participating in the University of Oxford Staff Pension Scheme (OSPS) to manage potential liabilities 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.

Given the changes to OSPS benefits, we have sought to answer some of the questions that we think might be commonly asked below.

Key points to remember

- The introduction of the defined contribution (DC) Section from 1 October 2017 will not affect the likelihood or otherwise of an employer debt arising. The amount of any particular employer debt is subject to many factors;
- It is important that you contact OSPS if it is anticipated 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. You should also consider taking advice; and
- To make use of a period of grace, there is a statutory time limit of 2 months (proposed to be extended to 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 schemes are funded by contributions paid by participating employers and their employees. Under current legislation, each participating employer that participates in a multi-employer defined benefit occupational pension scheme such as OSPS is responsible for a share of the total amount of the scheme's liabilities. This wasn't the case when the Scheme was established in 1978 — the current position has primarily arisen as a result of the Pensions Act 1995 and subsequent regulations, as well as changes to the Scheme over the years.

Under section 75 of the Pensions Act 1995, participating employers can in certain circumstances become liable for what is known as a section 75 employer debt.

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.

2. When is a section 75 employer debt payable?

Currently, legislation specifies that a section 75 employer debt becomes payable when a participating employer either:

- 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 a new entity or when an unincorporated organisation is reconstructed as a charitable incorporated organisation) or;
- becomes insolvent;
- winds up.

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

In OSPS, the first two events are most common.

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

3. How is a section 75 employer debt calculated?

A section 75 employer debt is equal to the departing employer's share of the shortfall in the scheme on a 'buy-out' basis. This includes an allowance for the estimated expenses that would be incurred in the hypothetical situation that the scheme decided to wind up and buy annuities for all the members, to secure the members' retirement income. 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. The shortfall is calculated by comparing the scheme's assets (including section 75 debts received in the past) against the scheme Actuary's estimate of the cost of securing all the scheme's benefits with an insurance company. This has been the method of calculation since 2005, although previously a lower measure was used.

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. As outlined above, under the current employer debt regime, this occurs when a participating employer changes its legal status, ceases to have any active members in the scheme, becomes insolvent or winds up while another participating employer continues to have some active members. The amount of an individual employer's section 75 debt will vary depending on many factors including:

- The number of pension Scheme 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 5 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 2016 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 in excess of £500 million.

5. Is my section 75 employer debt fixed?

A section 75 employer debt is equal to a departing employer's share of the shortfall in the Scheme on a 'buy-out' basis at the time of calculation. This shortfall will vary over time, depending on the value of the Scheme's assets and the Scheme Actuary's 'buyout' estimate.

An employer's share of the 'buy out' shortfall can vary over time depending on the number of its employees and their earnings and length of pensionable service in the Scheme, compared to those of other participating employers. Exits of other participating employers can also affect an employer's the share of the overall shortfall.

As defined benefit (CARE) benefits continue to accrue under the OSPS, this will affect the total 'buy out' shortfall, since it is funded on the expectation of it continuing to pay benefits as they fall due (with a prudent margin) rather than purchasing annuities. The changes to indexation had the effect of reducing the shortfall, and it may be further mitigated to a limited extent due to the closure of defined membership to new members from 1 October 2017, though as described above there are many factors affecting the size of the shortfall.

6. Can I avoid paying the employer debt?

An employer debt only becomes payable when a participating employer changes legal status, winds up, becomes insolvent or ceases to have active members and there is no expectation that the employer will put new employees into the scheme in the next 12 to 36 months.

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. Periods of Grace

Pensions law recognises that, particularly for small employers, there is often a gap between the last active scheme member leaving and a new one starting. The law provides a remedy called a “period of grace” which can be used to prevent an employer 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 last 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 2 months after the last active member leaves (this is subject to a Government proposal for extension to 3 months, not yet in force).

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. What impact does closure to new defined benefit entrants have on section 75 debts?

The changes to OSPS have been devised so that employees who are active members of the new DC Section from 1 October 2017 onwards will 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.

9. When did these employer debt provisions come into force?

The relevant regulations, which deal with employer departures and section 75 employer debts, have been in force since 1995. The legislation has changed several times since 1995. In particular, since 2005 the current legislative requirements link section 75 employer debts to the 'buyout' shortfall (based on the cost of buying annuities from an insurance company for all the members to match the scheme's benefits), which is much more expensive than under the previous regime.

10. 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.

11. 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, Jan Killick (jan.killick@admin.ox.ac.uk).

August 2017

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

1. When were you first aware of the section 75 liability?

The concept of a section 75 employer debt was introduced in the Pensions Act 1995, which became effective on 6 April 1997. At that time the statutory funding requirement (called the 'Minimum Funding Requirement') which is used to calculate the funding level of UK defined benefit schemes and determine whether additional funding was required, was considerably weaker than it is now. Employers were able to join and leave the Scheme without any payment being required. The Government changed the legislation in September 2005 and brought in the Statutory Funding Objective' (or scheme specific funding) regime. This 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 legislation governing the scheme specific funding regime has changed a number of times since it was first brought in. 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 recently 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.

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 buy-out basis looks at how much money a pension scheme would need to buy annuities from an insurance company, and secure benefits, for all the Scheme's members. This is a very expensive way to measure the value of the Scheme's liabilities because insurance companies are heavily regulated and can only invest in low risk assets, which means annuities can be expensive to buy. Very few DB pension schemes in the UK have sufficient assets to buy annuities for all its members, nor is the scheme required to hold enough money to do so, so the buy-out basis as a measure of valuing section 75 debts is a hypothetical basis. The Scheme reports on the buy-out funding level in the annual update.

The principal method for measuring whether the Scheme has enough money to cover its benefit promises is the ongoing Technical Provisions' funding level. The annual update that we prepare each autumn shows the Scheme's funding position on this basis. The Scheme Actuary carries out a formal review of the Scheme funding level every three years. The latest actuarial valuation in 2016 showed that there was a deficit on an ongoing basis of £133m.

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 two small former participating employers and in two instances the debt has been apportioned to the University.

5. Will the benefit changes help to manage the buy-out shortfall?

The closure to new defined benefit entrants, the change to the final salary link, increase in member contributions and changes to inflation increases are likely between them have an impact on the buy-out shortfall, especially as to how it develops in future. However, many other factors are also important including the performance of the assets, economic conditions affecting liabilities, and the future level of contributions by employers and defined benefit members.

In common with the vast majority of pension schemes, the Scheme is funded on the basis that it will continue to pay pensions as they fall due and not purchase annuities to cover them. Although a prudent margin is included, it is expected that a buy-out shortfall will remain, since this is by law calculated on the basis of purchasing insurance policies.

6. 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.

7. 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 actuarial valuation. Contact the Scheme secretary, Jan Killick (jan.killick@admin.ox.ac.uk) if you require an estimate.