Trustees: TPR wants to know who your statutory employers are

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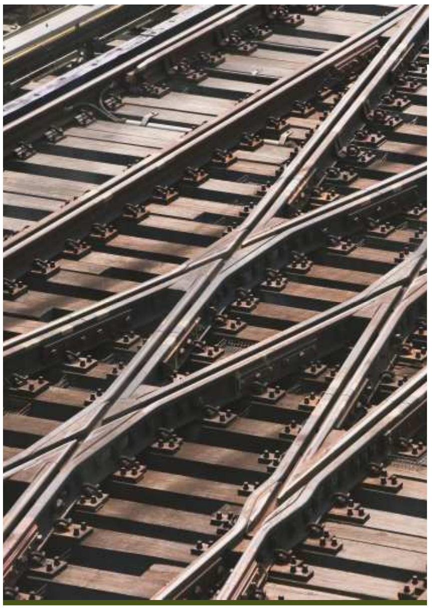
Pension briefing

HIGHLIGHTS

- The Pensions Regulator, in its recently issued statement "*Take action to identify your statutory employer*s", has announced that trustees of defined benefit pension schemes must be able to identify their statutory employers.
- Trustees need to do this so they can identify the extent of an entity's legal obligations to support the pension scheme.
- Statutory employers have the bulk of the responsibility for a pension scheme under legislation – including for section 75 debts, ongoing scheme funding and the Pension Protection Fund.
- Different obligations may apply to them (and other employers) under the scheme's trust deed and rules.
- The Pensions Regulator will expect trustees to list statutory employers in their annual scheme returns from November 2011.
- Trustees should consider an "audit" to identify current and previous statutory employers. This may also be helpful to employers who want to understand where pensions obligations and liabilities sit within their group structure.



WHAT ARE STATUTORY EMPLOYERS?

It is easy to assume that a scheme's employers are the entities that formally join the scheme by signing a legal document – such as a deed of participation, adherence or accession. But, in fact, a statutory employer is any entity that falls within one of the definitions of "employer" set out in legislation. There is no need to have signed a formal legal document. This distinction may not have been fully appreciated in the past but has been highlighted by recent court cases.

As a result, not all statutory employers in relation to a scheme will have formally signed up to it, and not all entities that have formally signed will be statutory employers: see the example below.

Example: who is the statutory employer?

- A holding company established a pension scheme and, by trust deed, became its principal employer. It has never employed anyone. It is **not** a statutory employer (but may have other obligations under the trust deed).
- Most of the group's employees and scheme members are employed through a service company. Through an oversight it never signed a deed of participation, but it is a statutory employer because of the employment relationship with scheme members.
- A small number of other members are employed by another company in the group which did sign a deed of participation. This company has obligations to the scheme both as a statutory employer and under its deed of participation.

STATUTORY EMPLOYERS: LEGAL OBLIGATIONS

Pensions legislation supports schemes by imposing a variety of legal obligations which generally only apply to statutory employers. For example:

- Insolvency or withdrawal of a statutory employer could trigger a debt to the pension scheme under section 75 of the Pensions Act 1995 (see box). A non-statutory employer cannot trigger section 75 debts.
- Trustees are required to agree (or in some cases consult) statutory employers about the schedule of contributions. This must also list contributions payable by statutory employers.
- Insolvency of a statutory employer may trigger assessment of the scheme's eligibility for the Pension Protection Fund.
- Statutory employers are required by pensions legislation to provide information the trustees reasonably require in order to run the scheme. Non-statutory employers have no automatic obligation to do so but this may be required under the trust deed and rules (or the trust deed and rules could be amended to provide this).
- The Pensions Regulator has the power to issue contribution notices or financial support directions to statutory employers or anyone connected or associated with a statutory employer.
- From November 2011 trustees will have to list statutory employers on their annual scheme returns.

A participating employer which does not qualify as a statutory employer will still owe legal obligations to the scheme. The extent of those obligations will be set out in the scheme's trust deed and rules.

Section 75 debts

Section 75 of the Pensions Act 1995 requires a statutory employer of a defined benefit pension scheme to pay an additional contribution to the scheme trustees (its section 75 debt) if:

- The employer becomes insolvent or enters voluntary winding up.
- The scheme goes into winding up.
- In a multi-employer scheme, the employer withdraws from the scheme by ceasing to employ relevant members at a time when at least one other continuing employer remains. This can happen where the employer withdrawal is because it is being sold out of a corporate group or its workforce is being transferred to another entity (by TUPE transfer or otherwise).

Currently, the debt will be based on the difference between the value of the scheme's assets and the cost of securing scheme liabilities with an insurance company. In multi-employer schemes, each employer takes a proportion of the total liabilities. Section 75 debts used to be calculated on a less costly basis but the legislation has become more stringent over time.

WHY IS IT IMPORTANT TO IDENTIFY STATUTORY EMPLOYERS?

The extent and basis of an employer's legal obligations are fundamental parts of the scheme's employer covenant. Unless the trustees are able accurately to identify their statutory employers and assess the employer covenant, it will be difficult to complete important scheme tasks such as levying section 75 debts against the correct entities and preparing the schedule of contributions. Changes in the legislation and case law over time have made this a difficult task (see below).

There are similar issues for employers themselves. Pension risk may sit in different (and potentially more) entities within a corporate structure. Potential connections to a pension scheme should always be considered carefully when changing employment arrangements or corporate structures, to avoid unintended pensions consequences such as triggering section 75 debts. Understanding who the statutory employers are also reveals their connected and associated entities for the purposes of the Pensions Regulator's "moral hazard" powers.

Legal definition of statutory employer

Definitions of statutory employer vary slightly across different pieces of pensions legislation and should be checked carefully if uncertainties arise. In broad terms, a statutory employer will be any entity that has a legal employment relationship with either current members of the pension scheme or other employees who are eligible to join the scheme.

HOW TO IDENTIFY STATUTORY EMPLOYERS

Simple cases and current employers

The Pensions Regulator anticipates that identifying the current statutory employers should be a relatively routine task for many schemes.

Some trustees may already have "working lists" of employers based on the entities that signed deeds of participation or on their last scheme return. These are a useful starting point but should be reviewed for accuracy. Trustees and employers can then work together to identify the entities that qualify as statutory employers. The following information may be of assistance:

- Employment records (payroll information; National Insurance records; employment contracts).
- Scheme records showing employer information, departures and locations of active members.
- Past scheme accounts and other records of previous payments into the scheme.
- Previous announcements about eligibility of employees to join the pension scheme.

Historic and more complex cases

Employers who have left the scheme in the past could still be statutory employers if they qualify as "former employers" under the various legal definitions. The legislation has been amended several times and been interpreted by the courts, meaning a former employer's ongoing connection to a pension scheme may have gone unnoticed.

Employer withdrawals

The most complex cases arise where a previously unknown statutory employer stopped employing relevant members at some time in the past. Depending on the legislation this may or may not have triggered a section 75 debt (which could still be owed to the scheme). In broad terms, the legislation applies as follows:

Period	Debt triggered when ...
6 April 1997 – 5 April 2008	Stop employing all active member employees ("actives) AND any other employees eligible for scheme ("eligibles"); OR if no actives, when stop employing eligibles.
6 April 2008 – date	Stop employing actives UNLESS ceased to employ actives before 6 April 2008 and continue to employ eligibles, in which case debt triggered when cease to employ eligibles.

If a debt was triggered, trustees need to consider how to deal with it and whether further obligations should apply to the entity that owes the debt. The employer will remain a statutory employer (and could therefore trigger further section 75 debts) until the debt is paid or one of the limited exceptions in legislation applies to it. Transitional provisions mean in some cases it may be necessary to look back to December 1996.

Following the decision in *PNPF Trust Co v Taylor & others* (June 2010), an employer may be released from its section 75 debts but technically remain liable for ongoing scheme funding if it continues to have other employees who are eligible to join the scheme. This is because the definition of statutory employer is different in these two pieces of legislation.

Both trustees and employers will want to understand where this risk exists in relation to current or previous scheme employers. This involves looking back at past employers and identifying whether they have fully withdrawn from the scheme or owe one or more uncollected section 75 debts.

If an outstanding debt is revealed then, as a matter of trust law, trustees should consider what to do about collecting it in order to improve scheme funding. They also need to consider whether it is appropriate to require further funding from that entity on an ongoing basis and what its presence means for the employer covenant.

If there has been a major corporate restructuring or benefit redesign (such as a closure to new members or future accrual), both trustees and companies may wish to review the steps taken for reassurance they have correctly identified the statutory employers in relation to their scheme and any section 75 issues, and to make sure any departing employers have satisfied their obligations.

PRACTICAL STEPS

Many of these difficulties can only be resolved if the trustees and company "audit" their current and former employer lists and trace the pattern of previous employer adherence and departures. Because of the way the legislation developed this can mean looking as far back as the early 1990s.

The Pensions Regulator's statement warns that legal advice may be needed. A full audit will involve:

- Extensive fact-gathering and co-operation between trustees and employers to identify previous employers and departures and employment and membership eligibility issues.
- Complex legal analysis of the actual course of events and the legislation at the time.
- Legal identification of historic issues and current statutory employers.
- Developing an action plan to deal with any issues revealed such as uncollected section 75 debts or changes in assessment of the employer covenant.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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