

Plumbing & Mechanical Services (UK) Industry Pension Scheme (The "Scheme")

Employer Consultation 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. Throughout this period, the Trustee Directors have considered options to mitigate the impact of this legislation on employers and the Scheme and lobbied Government to change the legislation to make it fairer.

2. *Why haven't you previously told employers about the section 75 liability?*

The Trustee Directors (which include representatives from the trade associations, the APHC and SNIPEF) understand the concerns expressed by some employers that they should have been told about section 75 employer debts before now. However, until now, the Trustee Directors have been unable to calculate section 75 debts because the legislation is drafted with pension schemes with a small number of employers in mind and is not suitable to deal with industry-wide schemes such as the Scheme with hundreds of employers. In addition, there has always been hope that the legislation would be changed to make its application fairer and more appropriate for large non-associated multi-employer pension schemes like the Industry Scheme. Throughout, the Trustee Directors have been in regular contact with the Pensions Regulator, the Department for Work and Pensions (DWP) and their own advisers with the objective of achieving a change to the law, or failing that, to find a path through the current legislation which is reasonable to all employers, whilst ensuring that pension scheme members' interests are best served.

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 already triggered a section 75 employer debt payment. The first 'all employer' communication to explicitly mention section 75 employer debts was the Contribution Consultation Announcement issued in September 2015. See Question 7 in the employer announcement 'Why haven't you told me about employer debts before?' The communication that we sent in April 2016 went to all employers that have participated in the Scheme since the legislation changed in September 2005.

3. When was there first a buy-out shortfall? Why didn't you tell us?

The Scheme has, probably, always had a buy-out shortfall. 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 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 two to three years. The latest actuarial valuation in 2014 showed that there were enough assets to cover the Scheme's benefit promises on a technical provisions basis. However, the funding position has deteriorated since April 2014 because of lower expectations for future investment returns on the Scheme's assets, which requires more assets to be held today to meet future pension payments. The next formal valuation will be carried out as at 5 April 2017 and the results will be available during 2018.

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

No section 75 employer debts have been collected yet. However, no debts have been "compromised" or written off, which means that they remain payable, once we have calculated them. The Scheme first needs to agree how it is going to calculate section 75 employer debts. Once a method has been agreed (which may require approval from the Scottish law courts), the Scheme Actuary will calculate section 75 employer debts for any company that has triggered a debt payment in the past.

Employers are required under the legislation to pay a section 75 employer debt, other than in exceptional circumstances. However, there may be circumstances where it might be possible for the Trustee Directors to agree to stagger payment of a section 75 employer debt. There may be circumstances where it would not be a reasonable or appropriate use of Scheme resources to pursue a debt payment however any decisions not to pursue a debt would only be taken following legal advice and possibly discussions with the Pensions Regulator.

5. Will the higher contribution rates help to reduce the buy-out shortfall?

No, the extra contributions that employers and employees pay from April 2017 are needed because the cost of providing pension benefits has increased over time and the contributions being paid to the Scheme are no longer sufficient to cover the cost of future benefit accrual. As we said during the autumn 2015 contribution rate consultation, people are living longer and future expected investment returns are lower than previously assumed and these both increase the cost of providing defined benefit pensions.

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 business ceasing to participate in the Scheme. This is in accordance with the Scheme Rules and pensions law requirements.

7. What have you told members?

There is a small reference to the employer consultation on the Plumbing Pensions website but the Trustee Directors have not directly told members about section 75 employer debts because the Scheme is funded on a technical provisions basis, which is the statutory requirement. The Scheme had enough money at the latest formal actuarial valuation in 2014 to meet all its benefit promises using a prudent set of assumptions. In the normal course of events, it should therefore be possible for the Scheme to carry on and pay all the member benefits in full. In addition, the Trustee Directors felt it was important to communicate with employers first.

8. What do the politicians think about section 75 legislation?

The Government is aware this legislation is very complicated but cannot reach agreement on what changes are required.

9. Can you send me a template email to send to my MP?

We encourage you to lobby Government for change in the legislation to make it fairer:

- a. We suggest you consider contacting your local MP:
www.parliament.uk/get-involved/contact-your-mp
- b. You may also wish to write to: Richard Harrington MP, Minister for Pensions, Caxton House, Tothill Street, London, SW1H 9DA
- c. You could also write to the Federation of Small Businesses

We feel your voice is more likely to be heard if you use your own words to lobby for change rather than a standard template.

10. What should I say to my MP?

There are certain aspects of the section 75 employer debt legislation that are viewed as particularly unfair for employers in the Scheme:

- There are unincorporated employers in the Scheme where the business owners' personal wealth is at risk (which the legislation can never have intended);
- The shared responsibility to cover the cost of benefits for employees from businesses that an employer has absolutely no connection with (the treatment of 'orphan liabilities'). The Scheme has suggested that the Pension Protection Fund (PPF) be considered as a Guarantor of Last Resort for the Scheme's orphan liabilities, which would allow employers that leave the Scheme to pay a section 75 employer debt solely in respect of their employees' pension liabilities.

- The retrospective aspect and inter-generational unfairness of the legislation, because employers who left the Scheme before September 2005 were not required to pay anything.

The Scheme has been and will continue to lobby for change but we feel the Government is more likely to take note of “real life” employers.

11. How can I get an estimate of my company’s section 75 employer debt?

We understand this is a difficult and worrying time for you but unfortunately we cannot provide you with an estimate of your company’s section 75 employer debt at the current time. An employer’s debt can only be known at the date of the employer’s cessation event and when the Scottish Law Courts have delivered their view on the proposed calculation method. Question 5 in the April 2016 consultation communication sets out further details behind this.

It would not be cost effective to estimate possible section 75 employer debt amounts for every single employer until a calculation method has been agreed and approved by the Scottish Law Courts. If we did calculate estimates using a particular method which the Scottish courts did not agree with, then we would have wasted a significant amount of Scheme resources.

To help employers understand the possible financial impact of this legislation, three simplified employer examples, each assumed to have two employees, have been included in the consultation documentation. Please note, for the reasons explained on the back of the consultation communication dated April 2016, the actual debt for an individual employer may be very different to the examples and could be significantly higher.

12. I don’t understand what I am being consulted on.

The consultation aim is to seek the views of employers on the Trustee’s proposals for calculating section 75 employer debts. Strict interpretation of the law would result in significant costs to the Scheme. The Trustee wishes to follow a practical and cost effective approach. Details of the Trustee proposals can be found on page two of the consultation communication dated April 2016. Further technical information is noted below.

To calculate an employer’s debt, the Regulations state this should be based on the employer’s share of the shortfall in the Scheme on a ‘buy-out’ basis as at the date of the trigger event. The Trustee is proposing to calculate employer debts once a year, at the date of the most recent audited Scheme accounts (5 April).

The Regulations have different requirements for calculating employer debts depending on whether the departing employer becomes insolvent, winds up or has an employer cessation event (for example, by ceasing to have any active employees). One of the differences relates to whether the asset value used in determining the employer’s share of the ‘buy-out’ shortfall should be taken from the recent audited accounts or alternatively if an ‘updated asset assessment’ can be assumed. The Trustee is proposing to calculate all employer debts in the same way regardless of the event which triggers the debt, unless the Trustee decides that a more up-to-date assessment is required (expected to be in exceptional circumstances).

As part of the latest formal actuarial valuation on 5 April 2014, the Trustee determined the share of the 'buy-out' shortfall for employers who remained in the Scheme at that time. Under the Trustee proposals, these employer shares will be the starting position when determining an employer debt with an approximate update of the assets and liabilities for the relevant employers on an annual basis until the next formal actuarial valuation to derive the updated employer share for the employer debt calculation.

Questions 19, 20, 21 and 24 provide further information on the calculation proposals and technical details of the approximations to calculate the figures.

13. What does the Pensions Regulator have to say about all this?

The Pensions Regulator is aware that the Scheme has not been able to calculate and collect any section 75 employer debts in the past. Although the Regulator has not been involved directly in the current consultation process, based on previous discussions we have no reason to believe that they would have any concerns about the way the Scheme is proceeding.

14. What are other schemes doing?

We believe that other schemes like ours have had similar issues with historical data. We have spoken with a number of schemes about section 75 debts over the last few years, and it is clear that there are substantial differences between schemes which mean that a solution that is appropriate for one may not be sensible or practical for another. However, the QC (senior lawyer) who has reviewed our proposed approach has experience of this issue and how it has been handled by other multi-employer schemes. Taking this experience into account, he seemed comfortable that our approach was appropriate, subject to the views of employers and of the courts.

15. Why is court approval required?

The Trustee of the Scheme believes that its proposal works with the legislation as closely as possible, taking into account the special circumstances of the Scheme. However, because the legislation does not fit well with the provisions of our Scheme, we will need to make certain assumptions and decisions on measurement points for employer data and asset and liability values (as set out in the consultation document on page 2) to enable us to be able to certify debts, and to do that without prohibitive cost. Because these assumptions and decisions aren't specifically permitted (or indeed prohibited) in the legislation, we have been advised to obtain Court approval to ensure that once we begin to calculate debts, those debts can be pursued with authority and with less risk of costly litigation and delay.

16. Are any more changes to the Scheme planned?

The Trustee has no current plans to change the benefit structure of the Scheme, although a new benefit scale will be available from April 2017 (more information is at www.plumbingpensions.co.uk). The Trustee will keep the position under review.

17. Does this issue affect the payment of pensions?

No.

18. Have any employer groups been set up to discuss this?

We are not aware of any employer groups arising from this consultation. However, we know that the two plumbing trade associations (APHC and SNIPEF) are both taking an interest and may be able to assist you.

19. Are there any approximations in your calculation of an employer's share of buy-out shortfall as at 5 April 2014?

Until now, the Trustee has been unable to calculate section 75 employer debts because of the complexities of applying the legislation to the Scheme and the significant costs to obtain all of the data needed to carry out the calculations.

In particular, the data is held separately for each member of the Scheme and the information to allocate pension credits to different employers is not readily available. As part of the work to find a suitable calculation method member records had to be reconstructed based on historic employment data and certain approximations have been made, for example:

- Where employment history is incomplete we have attributed pension credits between that individual's known employers in a reasonable manner (for non-pensioners we have attributed pension credits to the next known employer, for pensioners we have attributed pension credits across all known employers because commutation and early retirement adjustments make the calculation more complex);
- Transferred in pension credits have been attributed between an individual's known employers;
- Adjustments, for example when a member chooses to retire early with a reduced pension or exchanges pension for cash on retirement, have been applied equally to all periods of service within a pension tranche (eg service before April 1997).

20. How will you calculate employer debt amounts for companies that left the Scheme before April 2014?

Legislation has changed over time. Whether or not a company needs to pay a section 75 employer debt depends on the date the company ceased to participate in the Scheme.

Date company ceased to participate in the Scheme	Is a section 75 employer debt due?
Before 6 April 1997	No, the employer debt legislation did not exist before 6 April 1997
Between 6 April 1997 & 2 September 2005	No, all section 75 employer debts triggered during this period were £nil
From 2 September 2005	Yes, the legislation requires section 75 employer debts to be calculated using the buy-out basis

In line with the proposed approach for section 75 employer debts triggered on or after 5 April 2014 (see answer to FAQ 12), the Trustee intends to have one calculation date each year. This will be the 5 April before the date a company ceased to participate in the Scheme. The section 75 employer debt will be based on the Company's share of the buy-out shortfall calculated at 5 April 2014, approximately adjusted to reflect the position at the

5 April immediately before the date the company ceased to participate in the Scheme. This adjustment would allow for any pensions paid but not individual member movements such as transfers out of the Scheme or members exchanging pension for cash. The calculations would allow for new benefit accrual when looking at other companies with active members. The allowance for pensions paid and new benefit accrual will be based on membership data from the 2014 valuation.

21. How will you calculate employer debt amounts for companies that leave the Scheme after April 2014?

Under the proposed calculation method, a section 75 employer debt would be calculated using assets and approximate liabilities at the date of the latest audited accounts (ie 5 April) before the debt was triggered. This means that a company's section 75 employer debt could change substantially over time as market conditions change.

In practice, at each formal actuarial valuation (usually carried out every three years), the Trustee will recalculate each participating employer's share of the 'buy-out' shortfall. For years where a formal actuarial valuation is not carried out, liabilities will be estimated. This would allow for new benefits built up from an extra year of pensionable service (based on the cost for the average member in the Scheme) and transfer values (see question 24) but not other individual member movements (such as members taking lump sums upon retirement) after the previous formal valuation date.

22. Can you recommend an advisor that I can use?

Plumbing Pensions (UK) Ltd regrets that it is not in a position to recommend particular advisers from whom participating employers can seek advice on their responsibilities under the section 75 employer debt regulations. We suggest that firms which are members of one of the trade associations (APHC and SNIPEF) should contact these organisations. Other possible sources of assistance could be accountants, a firm's legal advisers and small business representative organisations.

23. Has the Trustee carried out an independent review of all the advice they have received on section 75 employer debts?

Although the Trustee has taken advice on section 75 employer debts from a number of different professional advisers, it has not, to date, considered commissioning an independent review of that advice.

24. Will the Trustee change the employer debt calculation method to allow for transfers out of the Scheme?

Yes, as a result of responses received from a number of employers during the consultation process, the Trustee has reviewed the proposed calculation method and agreed that allowing for transfers in and out of the Scheme would make the original proposal fairer. Please note that, as the position is assessed at the 5 April before the date a debt is triggered, the proposed method will not allow for any transfers that occur after that 5 April.

25. Will the Trustee facilitate the setting up of an employer web-forum?

The Trustee has no plans to establish an employer web-forum although it has referred the suggestion to the two trade associations, APHC and SNIPEF, for their consideration.

26. If the Trustee previously could not calculate section 75 debts, what has changed?

Until now, the Trustee has been unable to calculate section 75 debts because of the complexity of applying the legislation to large multi-employer pension schemes such as the Plumbing Industry Pension Scheme and the significant costs involved both in obtaining complex professional advice and to obtain all of the data needed to carry out the calculations. These costs had previously been considered 'disproportionate' compared to the likely level of debt recovery from departing employers. The Trustee now recognises that the legislation is unlikely to change.

A particular challenge has been that for historical reasons, data is held separately for each member of the Scheme and the information to allocate pensionable service to different employers is not readily available. This is because the Scheme was setup for an itinerant workforce expected to work for a large number of different employers during their working life.

As part of the work to establish a calculation method, member records have had to be reconstructed based on historic employment data and certain approximations have been made due to limited information available, for example:

- Where employment history is incomplete we have attributed pension credits between that individual's known employers in a reasonable manner (for non-pensioners we have attributed pension credits to the next known employer, for pensioners we have attributed pension credits across all known employers because commutation and early retirement adjustments make the calculation more complex).
- Transferred in credits have been attributed between an individual's known employers.
- Adjustments such as commutation and early retirement reductions have been applied equally to all periods of service within a pension tranche (eg pre 1997, 1997-2004 and post 2004 service periods).

27. Has the Trustee failed in its duty to members by not collecting any section 75 debts since September 2005?

Whilst the Trustee has not attempted to calculate or claim any statutory debts as yet, it has taken other action in relation to the section 75 debts, including regular contact with the Pensions Regulator and the DWP. Given the failure of legislation or policy to deal with this issue, the Trustee is now in the position of attempting to find a path through legislation in a way which is reasonable to all employers whilst ensuring that members' interests are best served. The Trustee believes it has complied with its duty to members. The Trustee undertook the consultation process precisely to enable it to collect section 75 debts that have and will fall due to ensure it remains compliant with its primary duty to Scheme members.

28. What reassurance will the Trustee give about the quality of the Scheme's data?

The Trustee is comfortable that the individual member data is of a suitable quality to pay members' benefits and for the actuary to assess the overall funding position of the Scheme. The data issues relate solely to allocating tranches of individual member benefits between their various employers in a cost effective and fair way.

29. Is the Trustee satisfied that the Scheme remains eligible for entry to the Pensions Protection Fund (PPF)?

The Trustee has never made a decision not to pursue a section 75 debt. The Trustee intends to pursue all section 75 debts once they are able to be calculated and certified. The Trustee will only agree to write off a section 75 employer debt if it cannot be recovered without disproportionate cost. The Trustee is therefore satisfied that the Scheme remains eligible for entry to the PPF.

30. Why were contribution rates not increased to reduce the buy-out deficit?

There was no requirement to do this. Section 75 employer debt calculations are prescribed by legislation and are calculated on a much more prudent (expensive) basis than is required for the ongoing Scheme funding. The vast majority of pension schemes in the UK have a shortfall on the basis used for Section 75 employer debt calculations, and there is no requirement for pension trustees to ask employers to fund to this level.

The Scheme has always been well funded on an ongoing funding basis and has not had a funding shortfall on a formal valuation date, which probably would have required additional contributions from employers. The Trustee monitors the Scheme's funding position between formal valuation dates. The Scheme currently has a shortfall on an ongoing basis which may require additional contributions following the next formal actuarial valuation due as at 5 April 2017 (the results of which will be available in spring 2018).

[Questions about the Trustee's proposed calculation method](#)

31. How will the Trustee decide whether to use the most recently audited Scheme accounts or more recent figures?

The Trustee is proposing to use the date of the latest audited accounts before the trigger event to calculate the assets and liabilities, regardless of whether an employer has triggered its section 75 debt by ceasing to employ active members (an employment cessation event) or by insolvency. This is permitted by pension legislation. For example, if an employer left the Scheme on 5 November 2010, their employer debt would be calculated as at 5 April 2010. In the case of an employment cessation event, legislation permits the assets and liabilities to be calculated at the date of the employment cessation event. There will be "good reason" to use the date of the employment cessation event rather than the date of the last audited accounts where the Trustee and/or the actuary is of the view that there has been a material event that would significantly alter the calculation. Given the process being proposed by the Trustee is intended to streamline and simplify the debt calculation method, the alternative calculation is likely only to be used in exceptional circumstances.

32. Once the calculation method has been agreed will employers receive regular updates of their potential section 75 liability?

This has not yet been discussed by the Trustee,. The Trustee understands that employers need to know the size of their potential debt obligation and will endeavour to provide employers with periodic updates (the exact frequency will be decided in due course).

Questions about the 'orphan liabilities' and irrecoverable section 75 debts

33. What proportion of the Scheme's liability relates to 'orphan liabilities'?

As at 5 April 2014, 35% of the Scheme liabilities was in respect of employers who left the Scheme prior to 2005. These employers left during a period when no employer debt was due, given the legislation in force at that time. 15% of the Scheme liabilities as at 5 April 2014 was in respect of employers who left the Scheme between 2005 and 2014, where no debt has yet been calculated. It is not possible to assess how much of this debt will be recovered, which will improve the solvency position and reduce the orphan liability shared among the remaining employers.

34. Are 'orphan liabilities' included in the consultation document examples?

Yes. The examples given are based on the total solvency debt being allocated between all the remaining active employers at 5 April 2014. The orphan liabilities for employers who left prior to 2005 have been allowed for in the examples. No allowance has been made for any debt payments which may be recovered in future for employers who left the Scheme between 2005 and 2014.

Questions about debt payment

35. What will happen if an employer cannot pay the whole section 75 debt?

Will the Trustee consider staged payment of debt?

The Trustee cannot compromise (ie reduce or settle) any debt. If an employer cannot afford to pay their debt immediately, it may be possible to make staged payments with the Trustee's agreement, in which case interest may be applied from the date the debt is certified. It may also be possible for an employer to apportion the debt to another employer provided all of the relevant tests are met and the Trustee agree to the apportionment.

36. How will the Trustee decide whether a debt should be written off?

In order to determine that there is no reasonable prospect of recovery, the Trustee will have to comply with the relevant legislation and ensure that the debt is "unlikely to be recovered without disproportionate cost or within a reasonable time." In order to do this, the Trustee will, rely on their professional advisors for support and advice.

37. Will the Trustee provide formal discharge to employers when a section 75 debt has been paid in full?

The Trustee cannot say at this time what its practice regarding formal discharges will be.

Questions about the Court process

38. What court process will the Trustee use?

The Trustee has considered a number of Court processes and is of the view that a 'Petition for Directions' to the Court of Session is likely to be the most appropriate Court route. The Trustee is currently taking further advice on how it can proceed with this type of action and will update employers in a future communication.

39. How long might the court process take?

Court action in Scotland for matters such as this one is unusual and therefore it is difficult to determine with any certainty the likely timescales. Broadly speaking, the Trustee has been advised that the Court process may take around 6 months.

40. Will member and employer representatives be involved in the Court process and who will cover the cost?

Scheme members are protected under the Scheme rules, under pensions law and, in the worst case scenario, by the Pension Protection Fund (PPF). Whilst this consultation affects employers, the methodology for calculating section 75 debts does not directly affect members. The Trustee still needs to consider the Court process, but at this stage and for the reasons outlined above, it is not anticipated that a representative beneficiary from the membership will be required. An employer representative will be required in the Court process. The Trustee will need to agree with the Court Reporter how employers will be represented. The costs of that employer representative will be a matter for discussion with the chosen representative.

Questions about Flexible Apportionment Arrangements (FAAs)**41. What is the process for requesting an FAA?**

The Trustee has recently agreed a new two stage process to consider FAAs for businesses considering incorporation.

- Stage 1 will involve the completion of a questionnaire for assessment by the Trustee's covenant advisor, KPMG. The questionnaire would allow KPMG to help an employer understand whether the Trustee would be likely to be able to consent to an FAA in their case. This stage would take place before the new incorporated business was in place. No guarantees would be given at this stage.
- Stage 2 would be the formal application for an FAA. This stage would only be completed once the new incorporated business entity was in place.

In assessing whether or not to agree to an FAA the Trustee takes advice from their professional advisors who take many factors into account. Legislation sets out the required considerations and funding test which the Trustee must consider when determining whether to accept a request for an FAA.

42. Will an employer wishing to set up an FAA have to meet any of the cost?

The professional costs incurred by the Trustee in setting up an FAA will need to be met by the employer requesting the FAA. The Trustee believes this is a fair approach taking into account other employers in the Scheme. The Trustee has agreed a low cost two-stage FAA process for small unincorporated employers wishing to incorporate.

43. How many FAAs has the Trustee agreed?

As at 30 September 2016, four Flexible Apportionment Arrangements (FAAs) have been approved to date: 3 relate to unincorporated businesses and 1 to a company restructuring.

Important Note

The information contained in this Frequently Asked Questions document is provided to help employers and their advisors understand the Trustee's proposal on how to calculate section 75 employer debts. It is not intended as a substitute for specific advice. The application of section 75 employer debt legislation is a complex area. You may need to seek independent professional advice to understand how the Trustee's proposal might impact your business.