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The Pensions Regulator - powers to protect pension benefits

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Summary

The Pensions Regulator (TPR) has powers to act where it believes an employer is deliberately attempting to avoid their obligations to a defined benefit (DB) pension scheme, leaving the Pension Protection Fund to pick up their pension liabilities. A DB scheme is one in which the employee builds up pension benefits based on fixed factors - salary and length of service. To protect scheme benefits and reduce the exposure of the PPF to claims for compensation, it can issue any of the following:

- **Contribution notices**. These allow TPR to direct that, where there is a deliberate attempt to avoid a statutory debt, those involved must pay an amount up to the full statutory debt either to the scheme or to the board of the Pension Protection Fund.
- **Financial support directions.** These require financial support to be put in place for an underfunded scheme where TPR concludes that the sponsoring employer is either a service company or is insufficiently resourced.
- **Restoration orders**. If there has been a transaction at an undervalue involving the scheme's assets, these allow TPR to take action to have the assets (or their equivalent value) restored to the scheme. [1]

A clearance procedure is available for anyone who wishes to confirm that they will not be subject to either a contribution notice or a financial support direction following a business transaction.

In its December 2016 report on DB schemes, the Work and Pensions Select Committee recommended that reforms should enable TPR to intervene sooner when difficulties become apparent. It recommended that the Government should consult on new rules for situations where TPR clearance of major corporate transactions would be mandatory and that TPR should be able to impose punitive fines that could treble the amount payable under TPR's existing anti-avoidance powers (press release, 21 December 2016).

In its February 2017 Green Paper, Security and Sustainability in Defined Benefit Pension Schemes, the Government said that the "overarching view of virtually all stakeholders is that the regulatory regime for DB pensions is satisfactory" but that there might be a case for "limited changes to the regulation of DB provision to help employers and trustees manage liabilities more effectively in some of the circumstances that exist" (para 139-40). It asked for views on reforms that had been suggested, including:

- Proactive compulsory clearance of certain corporate activities in limited circumstances;
- Levying substantial fines on companies for corporate transactions which have a detrimental impact on schemes; and
- Widening the criteria for Regulatory Apportionment Arrangements.

In its White Paper on 19 March 2018, the Government said it would strengthen the regulatory framework and the Regulator's powers to:

  - Give the Regulator powers to punish those who deliberately put their pension scheme at risk by introducing punitive fines;
  - Legislate to introduce a criminal offence to punish those found to have committed wilful or grossly reckless behaviour in relation to a pension scheme and, build on the existing process to support the disqualification of company directors; and

[1] The Pensions Regulator/our powers/acting against avoidance

- Work with the Regulator to strengthen the existing notifiable events framework and voluntary clearance regime so that employers have appropriate regard to pension considerations in any relevant corporate transactions. This includes improving the effectiveness and efficiency of the Regulator's existing anti-avoidance powers. We will work with relevant parties to ensure that these measures do not have an adverse effect on legitimate business activity and the wider economy.
- Legislate to have the Regulator some of the information-gathering powers already in place for automatic enrolment and Master Trusts to its Defined Benefit and Defined Contribution functions, including the power to compel any person to submit to an interview, the power to issue civil sanctions for non-compliance and an inspection power. (Cm 9591, chapter 1).

For more on the White Paper proposals more generally, see CBP-8219 Defined Benefit Pension Schemes (20 March 2018).

1. Overview

A Defined Benefit (DB) pension scheme promises to pay a pre-determined amount of pension to its members based on their salary and years of contribution.[2]

1.1 *Pensions Act 2004*

A number of high-profile cases of schemes winding up under-funded on the insolvency of the employers, led the Labour Government to introduce a number of measures in the *Pensions Act 2004*, aimed at improving the protection of pension scheme members' benefits and making provision easier for employers. One of these was the establishment of a new Pensions Regulator (TPR) to replace the previous Occupational Pensions Regulatory Authority (OPRA).[3]

The legislation previously in force had led OPRA to direct its effort towards "high volumes of relatively low value reports and breaches." In contrast, TPR would take a "risk-focused and proactive approach."[4]

It would also have a significantly wider range of powers and responsibilities.[5] While OPRA had no power to act against employers' attempts to avoid meeting their pension obligations, and no duty to do so, TPR would have a regulatory tool kit, enabling it to take a targeted approach to protecting pension scheme members.[6]

The 2004 Act also established the Pension Protection Fund (PPF) to provide compensation to members of defined benefit (DB) pension schemes which wind up underfunded on the sponsoring employer's insolvency. The Government recognised that this created 'moral hazard': i.e. that unscrupulous employers might seek to side-step their responsibilities to a scheme and off-load it onto the PPF.[7] The then Pensions Minister, the late Malcolm Wicks, explained that mitigating this risk was "one of the biggest challenges" the Government faced in introducing the PPF" but one that needed to be addressed to "safeguard the integrity and sustainability of the fund and avoid placing an unfair burden on levy payers." [8]

1.2 Regulator's powers

The Government recognised that the PPF created different forms of moral hazard. The legislation already included provision to address some of them – for example, a cap on compensation for those under normal

2 DWP, Security and Sustainability in Defined Benefit Pension Schemes, February 2017, p13
3 Library Briefing Paper RP 04/18 Pensions Bill (Feb 2004); *Pensions Act 2004,* Part 1
4 DWP, 'Simplicity, security and choice, working and saving for retirement: action on occupational pensions', June 2003, Cm 5835
5 The Pensions Regulator, 'Annual report and accounts, 2005-06', p3
6 DWP, 'Simplicity, security and choice. Working and saving for retirement. Action on occupational pensions', 2003; NAO, 'The Pensions Regulator: Progress in establishing its new regulatory approach', HC 1035, Session 2006-07, 26 October 2007
7 See Library Briefing Paper SN-03917 Pension Protection Fund (April 2016)
8 SC Deb, 27 April 2004, c768

pension age would avoid "potential perverse incentives for key decision makers to allow companies to go into insolvency."[9]

At Commons Committee Stage, Malcolm Wicks announced the introduction of powers for TPR to issue Contribution Notices and Financial Support Directions. The aim was to mitigate:

> […] the risk posed by unscrupulous employers who might seek to use company structures and business transactions as a cover for side-stepping their pension obligations in the form of the debt due from the employer under section 75 of the *Pensions Act 1995*.[10]

Mr Wicks explained that the provisions would be operated and enforced by TPR, working closely with the PPF:

> The powers will need to be exercisable by the regulator, as the very nature of the actions that they are designed to capture is such that manipulation may occur some time before the PPF would normally get involved in a scheme as a result of an employer insolvency. Moreover, the pensions regulator will have the intelligence and expertise, as a result of its day-to-day work monitoring pension schemes, to deal proactively with the risks of moral hazard.[11]

The then Shadow Pensions Minister, Nigel Waterson said that such 'anti-avoidance' provisions were "necessary, and we do not argue with the need for them."[12]

1.3 TPR's process

A decision to issue a Contribution Notice, Financial Support Direction or Restoration Order must be made by the determinations panel of the Pensions Regulator.[13]

TPR explained the process in evidence to the Work and Pensions Committee in 2016:

> We will undertake a comprehensive investigation to determine whether it is appropriate and reasonable to exercise either of these powers. These investigations are complex and can involve the review of thousands of documents and other pieces of expert and witness evidence. When we are satisfied it is appropriate to use a power we will issue a Warning Notice to the proposed targets and any other directly affected parties.
>
> The investigating team do not determine whether a power is exercised. This decision is made by our Determinations Panel, an independent committee which has no connection to the people undertaking the investigation. The Determinations Panel hears the case and representations from the proposed targets, and will determine if it is reasonable to exercise the power.
>
> We can issue a Contribution Notice in relation to acts up to 6 years prior to when we issue a Warning Notice.

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9 SC Deb, 27 April 2004, c768
10 Ibid
11 Ibid; Memorandum of Understanding between DWP, PPF and TPR, February 2008
12 Ibid c771
13 *Pensions Act 2004*, s9-10, Sch 2

> We can issue a Financial Support Direction where a connection/association to the scheme sponsor has been in place within 2 years prior to TPR issuing a Warning Notice. We can consider, as part of our assessment of whether or not it is reasonable to exercise the power, any acts or events which have taken place during the proposed targets' connection/ association with the scheme sponsor, and there is no time limit on how far we can look back.
>
> Generally speaking, the fact a company has moved into insolvency does not impact the use of our avoidance powers, and we have used our powers on a number of occasions in which the employer has become insolvent.
>
> The Upper Tribunal has yet to rule on a decision by the Determinations Panel to issue a Financial Support Direction or Contribution Notice, though it has been asked to rule on related procedural matters connected with those decisions, such as whether or not to strike-out TPR's case.[14]

See also Determinations Procedure on TPRs website.[15]

1.4 Does TPR have the powers it needs?

A report by the National Audit Office in 2007 found that TPR had made sparing use of its powers, preferring to concentrate on education and influence:

> 4.17 TPR was given much greater enforcement powers than those of the previous regulator. To date it has used education and enablement in preference to enforcement. It has not yet felt the need to use its enforcement powers widely considering it more proportionate to use the threat of powers to influence the desired behaviour. In particular TPR believes the threat of a Contribution Notice or a Financial Support Direction has resulted in increases in the funding of pension schemes that are part of a corporate transaction.[16]

An article by a pensions lawyer in 2014, noted that cases in which TPR's formal powers had been used remained the exception rather than the rule. TPR had shown a willingness to use its powers but had not "held corporate activity hostage".[17]

More recently, particularly in relation to the BHS Pension Scheme, questions have been asked about whether it has the powers it needs and how it has used those it has.[18] In a December 2016 report, the Work and Pensions Select Committee said several witnesses thought TPR's powers were sufficient and that extending them could hamper business. However, others were concerned that it did not use its powers

14 Written Evidence to the Work and Pensions Select Committee (PPF0004, May 2016)
15 The Pensions Regulator. Determinations panel. Procedures for cases
TPR website – determinations procedure; See 'The Pensions Regulator. Determinations Panel Procedure', (revised June 2008)
16 National Audit Office, 'The Pensions Regulator: Progress in establishing its new regulatory approach', HC 1035 Session 2006-07, 26 October 2007
17 'Comment – The regulator's powers have not held corporate activity hostage, *Pensions expert,* May 2014
18 'UK regulator urged to be 'robust' on the pensions before BHS collapse', *Financial Times,* 2 may 2016

as effectively as it could. The Committee concluded that TPR had a mixed record:

> **145. Under TPR's existing anti-avoidance powers, an employer seeking to avoid its responsibilities to a pension scheme may well take a punt on risking enforcement action. TPR has a mixed record, resolution may take several years, and the most TPR might hope to recover is the amount of support the employer should have provided to the scheme in the first place. In the meantime, the pension scheme members are left in limbo.**[19]

It recommended that the Government consult in its forthcoming Green Paper on:

- Giving TPR powers to add 'punitive fines' to Contribution Notices and Financial Support Directions; and
- Proposals to require advance clearance from TPR for certain corporate transactions that could be materially detrimental to the funding position of a DB scheme.[20]

1.5 February 2017 Green Paper

In its February 2017 Green Paper Security and Sustainability in Defined Benefit Pension Schemes, the Government said that the "overarching view of virtually all stakeholders is that the regulatory regime for DB pensions is satisfactory." However, there might be a case for "limited changes to the regulation of DB provision to help employers and trustees manage liabilities more effectively in some of the circumstances that exist."[21] It asked for views in relation to a range of changes which had been suggested, including:

- Proactive compulsory clearance of certain corporate activities in limited circumstances;
- Levy substantial fines on companies for corporate transactions which have a detrimental impact on schemes.
- Require sponsors to engage with and provide information to trustees in a timely manner.
- Require consultation with trustees before paying dividends if scheme is severely underfunded.
- Better communications with members.[22]

On 11 January 2018, Pensions Minister Guy Opperman said a White Paper would be forthcoming later this Spring.[23]

Section 2 below discusses TPR's powers, how they have been used and proposals that have been made for change.

[19] Work and Pensions Committee, Defined Benefit pension schemes, December 2016
[20] Ibid, para 141-6
[21] DWP, Security and Sustainability in Defined Benefit Pension Schemes, Cm 9412, February 2017, para 139-40
[22] DWP, Security and Sustainability in Defined Benefit Pension Schemes, Cm 9412, February 2017, para 139-40 page 73
[23] HC Deb 11 January 2018 c586

A recommendation to consider additional scheme funding powers is discussed in CBP 4877 Pension Scheme Funding requirements (October 2017).

1.6 The March 2018 White Paper

On 22 January 2018, following the collapse of Carillion, Shadow Work and Pensions Secretary Debbie Abrahams asked why the Government had not acted earlier:

> Yesterday, the Prime Minister chose to announce via the media, in part in response to the collapse of Carillion, that the Government planned to introduce tough new rules to stop private sector pension abuse.[…] Given the severity of the financial problems facing Carillion, why did the Government not act then, rather than attempting to close the stable door after the horse had bolted?[24]

Work and Pensions Secretary Esther McVey said the Government had been consulting on measures to strengthen TPR's powers and would set out proposals in its forthcoming White Paper.[25]

The White Paper published on 19 March 2018 said that for the "small number of employers evading their obligations", the Government would "put in place tougher, more proactive powers so that the Pensions Regulator can intervene more effectively to protect individuals." It would:

> Strengthen the regulatory framework and the Regulator's powers, as set out in the Government's 2019 manifesto, to:
>
> - Give the Regulator powers to punish those who deliberately put their pension scheme at risk by introducing punitive fines;
> - Legislate to introduce a criminal offence to punish those found to have committed wilful or grossly reckless behaviour in relation to a pension scheme and build on the existing process to support the disqualification of company directors; and
> - Work with the Regulator to strengthen the existing notifiable events framework and voluntary clearance so that employers have appropriate regard to pension considerations in any relevant corporate transactions. This includes improving the effectiveness and efficiency of the Regulator's existing anti-avoidance powers. We will work with the relevant parties to ensure that these measures do not have an adverse effect on legitimate business activity and the wider economy.[26]

24 HC Deb 22 January 2018 c28
25 Ibid para 25-6
26 DWP, Protecting Defined Benefit Pension Schemes, Cm 9591, March 2018

Responses

Shadow Pensions Minister Jack Dromey described the White Paper as a missed opportunity to "properly tackle the widespread problems facing DB schemes."[27]

The Work and Pensions Select Committee welcomed the fact that some of its recommendations for "nuclear deterrent" fines had been taken forward but said pension rights were still at risk while the Government consulted:

> Although the White Paper appears to leave room for the deterrent fines to be applied immediately – another very welcome move - the legislation needed to enact the new regime in full will not happen before 2019-20 at the earliest. In the meantime, with Government proposing to consult further, pension rights are still at risk from unscrupulous businesses seeking to avoid their pension obligations.[28]

Chair of the Committee Frank Field said there had to be a credible threat of TPR's powers being "deployed in full and at speed."[29]

The Pensions Regulator welcomed new proposals to improve its ability to intervene to protect pension savers:

> We called on government for more effective powers and so we welcome the proposals.
>
> Planned improvements to our scheme funding, information-gathering and anti-avoidance powers will enable us to be clearer about what we expect from employers in relation to scheme funding and tougher where a scheme is not getting the funding it needs.
>
> Furthermore, strengthening the notifiable events framework will improve our regulatory grip and will ensure we are sighted sooner on planned transactions that could pose a risk to scheme members.
>
> We will now work closely with government to develop the White Paper's proposals, including fines and criminal sanctions, to ensure they are proportionate, act as an effective deterrent and work in practice.
>
> The best support for a DB scheme is a strong employer and we believe the current flexible funding framework, which allows employers to balance growth with meeting pension benefits, remains the right approach and we will aim to retain this flexibility in any new approach.[30]

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27 'Shadow Minister: The White Paper has been a long time coming and is a missed opportunity', *Professional Pensions,* 26 October 2017

28 Pensions still at risk while Government continues to consult, Work and Pensions Select Committee, 19 March 2018

29 Ibid

30 TPR welcomes proposed new powers to protect pension savers, the Pensions Regulator, 19 March 2018

2. Powers to protect benefits

This section looks at how current policy developed, how TPR has used its powers and what proposals have been made for change.

2.1 Contribution Notices

Section 75 of the *Pensions Act 1995* provides for the calculation of the employer debt to a pension scheme in certain circumstances: insolvency, the scheme being wound up or an employer withdrawing from a multi-employer scheme.[31]

When the *Pensions Act 2004* was before Parliament, the Government announced that it had decided to give TPR power to issue a Contribution Notice where there was an "act or deliberate failure, a main purpose of which is to prevent the recovery of the whole or part of the section 75 debt."[32] The maximum contribution required would be calculated with reference to the section 75 debt that might otherwise have been recoverable from the employer.[33]

In April 2008, the Government proposed amendments to address concerns about new business models which might "sever the link between the employer and the pension scheme in order to operate well-funded occupational pension schemes for profit."[34] It proposed:

- Enabling TPR to issue a Contribution Notice where "the effect of an act is materially detrimental to a scheme's ability to pay members' current and future benefits" (i.e. it would no longer be necessary to prove intent to avoid funding the scheme);
- Removing the provision preventing a Contribution Notice being issued where a party has "acted in good faith, but their actions have had the effect of preventing a debt becoming due." This had proved to be "an unhelpful hurdle which would prevent the powers being used in situations where parties [had] simply not considered the impacts on pension schemes"; and
- Providing that a Contribution Notice could be triggered by a series of acts, not just a single act aimed at avoiding a debt to the pension scheme. [35]

The proposals had a mixed response, with the CBI giving a "cautious welcome" and arguing that it was important not to "ratchet up the regulatory burden" and the TUC saying the changes would "help protect pension schemes against smash-and-grab raids."[36]

Contribution Notice can be issued…

Where TPR believes there has been an attempt to avoid supporting a pension scheme, their actions have weakened the sponsor's ability to support the scheme, or where a sponsor that is part of a corporate group is insufficiently resourced to support the scheme. It requires those responsible to make a payment into the scheme of an amount which could equate to the cost of securing member benefits in full with a third party insurer.

In relation to acts up to 6 years prior to TPR issuing a warning notice.
(PPF004-May 2016)

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31 And *Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008* (SI 2008 No. 731)
32 SC Deb, 27 April 2004, c768
33 Ibid
34 DWP Press Release, '14 April 2008 - Increasing protection for pension scheme members – O'Brien'; DWP, 'The powers of the Pensions Regulator. Amendments to the anti-avoidance measures in the Pensions Act 2004,' April 2008, para 2
35 'Statement on planned DWP consultation on the powers of the Pensions Regulator', 14 April 2008
36 'Regulator will be able to force buy-out firms to fund pensions, *Guardian,* 15 April 2008; TUC Press Release, 18 June 2008, 'TUC calls for full review of buyouts model

Following consultation, the Government announced three filters to the new power:

- TPR would issue a statutory Code of Practice for the circumstances in which it expected to use its power;
- The legislation would include a non-exhaustive list of factors that TPR would be required to consider when determining whether an act or failure to act was "materially detrimental";
- It would not be possible to issue a Contribution Notice where a party had "undertaken due diligence before the act and considered and, where appropriate, mitigated the detriment, and could reasonably conclude that the act would not be materially detrimental."[37]

The amendments to the existing powers were made in the *Pensions Act 2008* s126 and Sch 9 and are now in the *Pensions Act 2004,* ss38-42, as amended.[38]

For the debates on the provisions, see Library Briefing Paper SN-02141 Pensions Bill 2007-08 – debates in Parliament (August 2008) (s 7.9).

Code of Practice No. 12 - Circumstances in relation to the material detriment test - was published in June 2009.

In practice…

In June 2010, the Pensions Regulator issued its first Contribution Notice, for £5 million, in respect of the Bonas Group Pension Scheme.[39] In June 2011, it announced that it had agreed to settle for £60,000 but commented that this did not signal any change in its approach and that it would not hesitate to use its powers where appropriate to improve the outcome.[40] *Occupational Pensions* commented that the case would have dented companies' respect for the regulator's powers.[41]

In March 2012, TPR set out the action it had taken in relation to the Desmond and Sons Pension Scheme.[42] In May 2015, in advance of an appeal hearing, TPR said the trustees had reached an agreement for contributions to the scheme.[43]

An issue in the *Storm Funding* case, considered by the High Court in 2014, was whether - in circumstances where two or more companies in

to safeguard members' interests'; 'Pension regulator gains new powers', *Financial Times*, 15 April 2008

37 DWP, The powers of the Pensions Regulator. Amendment to anti-avoidance measures in the Pensions Act 2004', April 2008; HL Deb, 27 October 2008, c1432; DWP, 'The powers of the Pensions Regulator. Amendments to the anti-avoidance measures in the Pensions Act 2004', October 2008

38 Section 126 and Schedule 9

39 TPR press release, Regulator confirms Contribution Notice , June 2011

40 Ibid; Report on Bonas case under s89, June 2011

41 Occupational Pensions, 'Regulator in climb-down over its first contribution notice', July 2011

42 TPR Press Release, Regulator publishes details of Contribution Notice case, March 2012

43 Report under s89 in relation to Desmond and Sons, May 2015

a group were the subject of contribution notices - the aggregate maximum was limited to the 'shortfall sum' (or section 75 debt).[44]

In 2017, the High Court refused an application for judicial review against TPR's decision to issue a second warning notice in relation to the Silentnight Group DB Scheme, in part because there was a procedure for challenging decisions through TPR's Determinations Panel.[45]

2.2 Financial Support Directions

TPR also has the power to issue a Financial Support Direction (FSD), requiring strong employers within a group to support the pension schemes of weak employers in the group. An FSD may be issued where the regulator concludes that the sponsoring employer is a "service company or is insufficiently resourced, and it is reasonable to do so."[46]

When the legislation was before Parliament, the then Pensions Minister, the late Malcolm Wicks, explained:

> There may be circumstances in which, as a result of actions that may well have been perfectly legitimate and not aimed at avoiding pension liabilities, schemes end up with a participating employer who is financially weak and unable to meet its pension liabilities. In particular, that may apply in the case of the debt on the employer imposed under section 75 of the 1995 Act in the event of the scheme winding up or the sponsoring employer becoming insolvent. An example of that is the use of service companies, often as part of entirely legitimate group arrangements. Such entities frequently have no material assets and their sole revenue comes from amounts charged to other group companies for the service of the employees, pursuant to inter-company agreements. If the parent company wishes to dump its pension liabilities, it can simply terminate its agreement with the company and wind both it and the scheme up. The service company will have no assets with which to pay any section 75 debt due. Similarly, the participating employer may, by chance, be a weak member of the group, equally unable to meet any debt and suitable to be sacrificed by the parent in order to reduce the group's pension liabilities. I am sure that hon. Members will agree that, in general terms, sponsoring employers of pension schemes should be genuine entities carrying on a material trading activity or holding material assets, so that the employer guarantee of the scheme is meaningful.[47]

In response to concerns, the Government provided that the majority of individuals (directors or shareholders) would be excluded from the scope of financial support directions.[48]

In practice…

TPR issued its first Financial Support Directions (FSDs) in relation to Sea Containers Limited (SCL) directing it to provide "financial support for

Financial Support Directions

Where the scheme sponsor is under-resourced or a service company, to require ongoing financial support to be provided from elsewhere in the corporate group. Often used to ensure parent companies in corporate groups support the schemes of subsidiaries that cannot provide support on their own. Financial support can be provided in a number of ways, including by a lump sum payment, a parent company guarantee or other additional financial resources.

Where a connection to the scheme sponsor has been in place within 2 years prior to TPR issuing a warning notice.PPF004-May 2016

44 'Pensions again – 'just when you through it was save to go into administration', Professor Ian Fletcher, Gary Squires, *Insolvency intelligence,* 2014

45 The Pensions Regulator is successful in legal challenge concerning the Silentnight Group DB scheme, PN 17-02, 12 January 2017

46 TPR issues FSD on Sea Containers Ltd, 6 February 2008

47 SC Deb, 27 April 2004, cc 780-781

48 DWP Press Release, 'Results of industry consultation on moral hazard clauses in Pensions Bill' 25 October 2004; See also, HL Deb, 1 November 2004, c25-29

the two pension schemes of its London-based UK subsidiary Sea Containers Services Ltd."[49] On 6 February 2008, following the withdrawal of an appeal to the Pensions Regulator Tribunal, TPR confirmed that SCL would be compelled to provide a form of financial support for the pension schemes within 30 days.[50]

In 2010, TPR issued FSDs against companies in the Nortel and Lehman Brothers groups. The companies challenged these directions in the Courts. In July 2013, the Supreme Court delivered a judgment to the effect that "liabilities under a financial support direction (FSD) issued against an insolvent company would rank as a provable debt." TPR commented that:

> The judgment therefore confirms that the FSD is effective in an insolvency, but overrules the findings of the High Court and the Court of Appeal that the costs of complying with an FSD issued against an insolvent target company following insolvency would rank as an expense of the administration or liquidation.[51]

An article in *Insolvency Intelligence* argued that had the Court of Appeal decision not been reversed, the need to take account of pension fund deficiencies elsewhere in the group might have deprived "otherwise-viable members of a corporate group…of any reasonable prospect of survival."[52]

In January 2012, TPR explained its decision to issue Financial Support Directions against ITV in relation to the Box Clever Group Pension Scheme, on the basis that Box Clever Technology Ltd had been set up as part of a "highly leveraged transaction" and that the burden of servicing the resulting debt had been a major factor in its insolvency:

> […] the scheme's principal employer, Box Clever Technology Ltd ('BCT'), was set up by the Granada and Thorn groups as part of a highly leveraged transaction that effectively extracted value from the consumer rentals businesses of those groups, whilst leaving the possibility for Granada and Thorn to share in any future profit of BCT. A requirement of the transaction was that a pension scheme was set up for transferring employees. The ITV group received cash proceeds of approximately £500m as a result of the Box Clever transaction, which was paid from total debt of £860m raised by the BCT group. That borrowing was secured on all the assets of BCT and the other sponsoring employers of the scheme, but not the Granada or Thorn group companies, thereby insulating them from any downside. The burden of servicing this debt was a major factor in the insolvency of BCT group, including the sponsoring employers of the scheme, in 2003. The Panel did not find any misconduct on the part of the target companies, but

[49] TPR, 'Regulator uses anti-avoidance powers on Sea Containers', (PN 07-10), 18 June 2007; TPR, 'Regulator issues Financial Support Directions on Sea Containers', (PN 08/02, 6 February 2008); TPR, 'Reasons of the Determinations Panel of the Pensions Regulator in relation to the Determination Notices issued on 15 June 2007 re. The Sea Containers 1983 Pension Scheme and the Sea Containers 1990 Pension Scheme; NAO, 'The Pensions Regulator: Progress in establishing its new regulatory approach', HC 1035, 26 October 2007, p24

[50] TPR Press Release, 'Regulator issues Financial Support Directions on Sea Containers' 6 Feb 2008

[51] 'Nortel-Lehman' Supreme Court judgement – regulator statement, 24 July 2013

[52] 'Pensions again – 'just when you thought it was safe to go into administration', Professor Ian Fletcher and Gary Squires, AlixPartners, Insolvency intelligence, 2014

> considered FSDs to be an appropriate and reasonable response to these events.[53]

ITV appealed through various stages and in March 2015, the Court of Appeal allowed its appeal against the decision of the Upper Tribunal to refuse its application to strike out certain parts of the cases advanced by TPR and the scheme trustees. It remitted the matter back to the Upper Tribunal. ITV's Lawyers commented that legal action had help clarify the extent of TPR's powers.[54] Legal firm Eversheds commented that there was "ample scope in the appeals process for a reluctant target of regulatory attention to drag the process out for many years."[55] The Work and Pensions Committee commented that such cases could be "extraordinarily protracted":

> A final hearing in the case of the Box Clever pension scheme is due before the Upper Tribunal in early 2018. The Determinations Panel ruled in December 2011 that a FSD should be issued to ITV, which has repeatedly appealed that decision. Box Clever itself, which was a joint venture between ITV and another television company, went insolvent in 2003.[56]

In November 2016, TPR issued Warning Notices in respect of the BHS Pension Scheme – to Sir Philip Green, Taveta Investments Limited, Taveta Investments (No. 2) Limited, Dominic Chappell, Retail Acquisitions Limited., setting out evidence to support the use of its Contribution Notice and Financial Support Direction powers.[57] In February 2017, TPR it announced the terms of a settlement as a result of which enforcement action against Sir Philip Green, Taveta Investments Limited, Taveta Investments (No. 2) Limited would cease.[58]

In December 2016, TPR said it had secured a settlement with Coats for two of its schemes, covering approximately 90% of the total membership, following the issue of Warnings Notices.[59]

2.3 Punitive fines

In its December 2016 report on DB schemes, the Work and Pensions Select Committee recommended that the Government consult on giving TPR powers to impose punitive fines. It thought these fines could "treble the original demand" in a Contribution Notice or Financial Support Direction from TPR:

> **Punitive fines as a nuclear deterrent**
>
> 142. A compulsory clearance system risks being either so broad as to act as a brake on business activity, or so narrow as to miss the very transactions it intends to prevent. Employers do not have incentives to seek clearance voluntarily, however, because the risk of later enforcement activity may be preferable to an up-front arrangement which is not materially detrimental to the pension scheme. This effect is reinforced by the nature of TPR's anti-avoidance regime. Alan

53 TPR Press Release, FSD determination in Box Clever case, 31 January 2012
54 'Court of Appeal allows ITV's appeal in the Box Clever FSD litigation', *Pensions World*, 25 March 2015
55 Box Clever Financial Support Direction – Court of Appeal Decision, 27 March 2015
56 Work and Pensions Committee, Defined Benefit Pension Schemes, December 2016
57 BHS TPR launches enforcement action, November 2016
58 TPR, A quick guide to the BHS pension settlement, February 2017
59 TPR reaches £255m settlement in Coats anti-avoidance case, December 2016

> Rubenstein told us that it "essentially replaces the money that is missing": after a lengthy and complex process the most TPR might hope to extract from an employer is the amount it ought to have contributed to the pension scheme in the first place.
>
> 143. Alan Rubenstein suggested TPR be able to add a punitive fine element to a CN or FSD. This, he said, would encourage employers to seek clearance where they might otherwise be subject to anti-avoidance powers:
>
>> good companies, as ever, would do the right thing. It is just to encourage those who are getting close to the line or are perhaps inclined to try to transgress upon it, to nudge them in the direction of seeking clearance before they go ahead.
>
> This, he said, was "a better approach than one that would require pretty much every single transaction to have to go to the Regulator". If in doubt, employers would seek clearance.
>
> 144. Lesley Titcomb said the fine "would have to be quite large in order to constitute a deterrent". Alan Rubenstein suggested that the fine element:
>
>> should either be up to the same amount as the contribution notice or warning notice, effectively doubling it, or possibly up to twice the amount.
>
> While this may appear draconian, he said the "intention would be that one would not really need it". The size of the potential fine would deter employers from avoiding their pension responsibilities.
>
> 145. Under TPR's existing anti-avoidance powers, an employer seeking to avoid its responsibilities to a pension scheme may well take a punt on risking enforcement action. TPR has a mixed record, resolution may take several years, and the most TPR might hope to recover is the amount of support the employer should have provided to the scheme in the first place. In the meantime, the pension scheme members are left in limbo.
>
> 146. ***We recommend that in its forthcoming Green Paper the Government consult on giving TPR powers to add punitive fines to Contribution Notices and Financial Support Directions. These fines would have to be set at a high level to ensure they incentivised sponsors to properly fund pension schemes and seek clearance for corporate transactions which may be to a scheme's detriment. We recommend that fines that could treble the original demand be considered. The intention would be that such fines would not need to be imposed: they would act as a nuclear deterrent to avoidance.***[60]

In its Defined Benefit Pension Scheme Green Paper, the Government asked for views on whether the Pensions Regulator (TPR) "should be able to impose punitive fines for corporate transactions that are detrimental to schemes" and if so, in what circumstances.[61]

In its manifesto for the 2017 general election, the Conservative Party said it would give TPR "new powers to issue punitive fines for those found to have left a pension scheme under-resourced."[62]

60 Work and Pensions Select Committee, Defined Benefit Pension Schemes, December 2016

61 DWP, Security and sustainability in Defined Benefit pension schemes, Cm 9412, February 2017, p73

62 Conservative Party, General Election Manifesto 2017

In *the Observer* on 21 January 2018, following the collapse of Carillion, Prime Minister, Theresa May said:

> In the spring, we will set out new tough new rules for executives who try to line their own pockets by putting their workers' pensions at risk – an unacceptable abuse that we will end.[63]

In the March 2018 White Paper, the Government said it would legislate to give TPR powers "to punish those who deliberately put their pension scheme at risk by introducing punitive fines."

> 14. We will legislate to introduce a proportionate and robust penalty regime to tackle irresponsible activities that may cause a material detriment to a pension scheme and may compromise the scheme's funding position.
>
> 15. This will strengthen the Regulator's existing anti-avoidance framework, and will give the Regulator an express power to penalise the targets of a contribution notice. This power will extend to individual company Directors.
>
> 16. The parameters of this new approach will be enacted in primary legislation.
>
> 17. To ensure members of Defined Benefit schemes are protected as far as possible and to deter activity that puts the security of members' benefits at risk, we will examine the feasibility of the penalty regime applying in respect of acts or omissions prior to enactment, in particular, after the date this document is published.
>
> 18. We will continue to work on the design of the new regime including the penalty levels, to ensure it remains proportionate and there are no unintended consequences. Although the details are still being developed, it is expected that the penalty will be linked to the contribution notice, effectively creating the possibility of a highly punitive fine being issued by the Regulator.
>
> 19. Through its operation of the regime over the last ten years, the Regulator has identified other ways in which its anti-avoidance powers could be enhanced. We will take this opportunity to review these powers more generally and, if needed, legislate to improve the Regulator's contribution notice and financial support directions powers, further strengthening the regime.[64]

It would also legislate to introduce a criminal offence to "punish those found to have committed wilful or grossly reckless behaviour in relation to a pension scheme and build on the existing process to support the disqualification of company directors."[65]

2.4 Restoration Orders

While the *Pensions Act 2004* was before Parliament (at Report Stage in the Commons) the Government introduced a further power, allowing TPR to impose a Restoration Order directing that the position of a scheme be "restored where the scheme has entered into a 'transaction

63 'Boardroom excesses can no longer be tolerated: the economy has to work for all', Theresa May, The Observer, 21 January 2018
64 DWP, Protecting Defined Benefit Pension Schemes, Cm 9591, March 2018
65 Ibid p6

at an undervalue' within a two-year period leading up to an insolvency event." Malcolm Wicks explained:

> A transaction at an undervalue is exactly what it says—a transaction involving scheme assets that results in the scheme receiving no consideration, or consideration that is less than the market value, in return. That could include, for example, trustees being persuaded to purchase a property on the basis of planning permission for a development that does not actually exist, or a director of a company persuading trustees to offer him a transfer on a very generous basis to prevent his benefits being reduced by the compensation cap should the scheme enter the PPF. There is currently provision in insolvency legislation retrospectively to undo "transactions at an undervalue" involving company assets, which occur in the run-up to insolvency. New clauses 12 to 16 introduce similar provision in respect of transactions involving scheme assets, in order both to protect scheme members from having the assets of their scheme unfairly depleted and to guard against the possibility of the PPF having to assume responsibility for such schemes where it otherwise would not have done so.[66]

2.5 Regulated Apportionment Arrangements

Section 75 of the *Pensions Act 1995* provides that a debt is due from a sponsoring employer if they become insolvent or their scheme starts to wind up underfunded, or an application is made to the PPF for it to take responsibility for the scheme.[67]

When these rules came into force in 2005, the rules included detailed provisions for dealing with the employer debt when an employer exited a multi-employer scheme:

- The employer debt was calculated on a 'full buy-out' basis,[68] but with provision for 'withdrawal arrangements' - allowing a lower amount to be paid on provision of a guarantee.
- The employer debt to be apportioned among the remaining employers.[69]

The Government made changes to the rules in 2008 to provide more flexibility while at the same time aiming to prevent mis-use of the apportionment rule, with the aim of preventing a debt from being apportioned to weak employers or shell employers.[70]

They also introduced the new option of Regulated Apportionment Arrangement (RAA), whereby debt could be apportioned outside the usual parameters, with the involvement of TPR. This could only take place where a scheme:

- Was in a PPF assessment period; or
- An assessment period was likely to commence in future; and

66 HC Deb, 18 May 2004, c899-900
67 As amended by *Pensions Act 2004,* s271; explanatory notes, para 1065; *Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678)*
68 The amount that would need to be paid to secure buy out of the pension's full liabilities with an insurance company
69 Explanatory Memorandum to SI 2008/731
70 Ibid para 7.4-8

- The PPF Board agreed to the arrangement (usually because it would result in a higher level of funding for the scheme than if the employer became insolvent).[71]

RAAs were intended to be extremely uncommon. In deciding whether to allow one, TPR considers:

> - whether insolvency of the employer would be otherwise inevitable or whether there could be other solutions (including funding options for the scheme) which would avoid insolvency;
> - whether the scheme might receive more from an insolvency;
> - whether a better outcome might otherwise be attained for the scheme by other means (including through the use of the regulator's powers where relevant);
> - the position of the rest of the employer group; and
> - the outcome of the proposals for other creditors.[72]

In an August 2016 paper setting out its Approach to Employer Restructuring, the PPF explained that its aim was to "make sure that the pension scheme is in a much better position than it would have been if we had done nothing."

In practice…

TPR gave approval for an RAA in the case of the Uniq pension. This provided for an insurance arrangement to 'buy out' scheme benefits at a level that would at least equal PPF compensation but would be less than full scheme benefits. TPR said this was a good example of what close and positive co-operation could achieve:

> The funding challenges had appeared intractable and threatened the solvency of the business. No recovery plan was possible without taking inappropriate investment risk. But, unusually, there were no senior creditors ahead of the pension scheme. The scheme was in the uncommon position of being the dominant creditor and effectively owner of the company. This paved the way for an innovative solution that enabled the scheme to maximise the value of its interest in the employer and for the company to be sold as a going concern - achieving benefit levels at least equal to PPF compensation and protecting PPF levy payers.[73]

TPR also approved an RAA in relation to the BMI Pension Scheme, allowing for its controlled entry into the PPF. It decided not to grant clearance to a proposal that would have involved keeping the scheme open. This was because the proposed voluntary contributions from Lufthansa (which had no statutory obligation to fund the scheme) were "insufficient in isolation to prevent a deterioration in the Scheme's funding position, leaving the proposal almost wholly reliant on investment outperformance. TPR considered that this posed

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71 Explanatory Memorandum to SI 2008/731
72 TPR, RAAs and employer insolvency, August 2010
73 Pensions Regulator press release, 2 March 2012, Regulator publishes report on Uniq plc Pension Scheme

unacceptable risks to members' benefits and PPF levy payers and therefore worked to explore alternatives:

> Following further discussions, the regulator issued a clearance statement for a second proposal which involved a controlled entry to the PPF via a rarely used mechanism called a Regulated Apportionment Arrangement (RAA). Under the arrangement, the Scheme (and therefore PPF) received £16 million, significantly more than would have been received from the insolvency of British Midland Airways Limited (BMAL), the Scheme's statutory employer. In addition, Lufthansa provided a further voluntary contribution of £84 million to top up members' benefits outside the PPF.[74]

An RAA was also approved in the case of the Kodak Pension Plan. TPR explained that members were given the option to transfer to a new scheme that would offer benefits better than PPF compensation levels but those that would have been provided through the scheme:

> In January 2012, the Kodak group's US parent, Eastman Kodak Company, entered Chapter 11 bankruptcy proceedings. This meant that the Kodak Pension Plan was at risk of losing both existing support from the wider Kodak group and ongoing contributions from its sponsoring employer.
>
> In order to maximise the value available to the Kodak Pension Plan, a deal was agreed under which the trustees acquired Kodak's cash generative 'personalised imaging' and 'document imaging' businesses. In exchange, the Kodak group was released from its liabilities to the Kodak Pension Plan.
>
> Despite the acquisition, there remained serious doubts as to whether the assets could provide adequate support for the scheme's existing liabilities. Therefore members were given the option to transfer to a new scheme which would offer benefits better than the Pension Protection Fund, but lower than in the Kodak Pension Plan. Members representing in excess of 94% of liabilities have decided to transfer.
>
> The regulator and the trustees have agreed a governance framework to limit risks to member benefits and the PPF, including monitoring the performance of the acquired businesses and imposing restrictions on discretionary pension benefit awards and investments.[75]

In November 2013, it issued a report regarding its role in the restructuring of UK Coal's operations following a "catastrophic fire" earlier that year. It said:

> Our role in this new situation was to work with the parties concerned to reach the best available outcome for pension scheme members and the PPF. With greatly increased business challenges and risks, the regulator's view was that balancing the needs of the company and the scheme was no longer possible."
>
> The regulator notes that subsequent to the completion of the 2013 restructuring, UK Coal has been obliged to participate in a

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74 Regulator publishes report on BMI pension scheme, PN12-15, 31 May 2012

75 'Kodak and UK Coal case reports published,' TPR press release, Monday 3 November 2014; Report in relation to the Kodak Pension Plan (November 2014)

> further restructuring, which is expected to result in a managed closure of the business.
>
> In July 2014 the PPF took on the assets and liabilities of the UKCOL Sections of the Industry Wide Coal Staff Superannuation Scheme and the Industry Wide Mineworkers' Pension Scheme, and will provide compensation for their 7,000 members.[76]

The Halcrow Pension Scheme was in deficit and its sponsoring employer unable to afford the necessary contributions to repair it. In this case, TPR, the PPF, Halcrow Group Limited (HGL) and its parent company CH2M Ltd negotiated a proposal that would involve offering members the chance to transfer to a new scheme or remain in the existing one and transfer to the PPF. CH2M would make a cash payment to the scheme, together with an equity stake in HGL in view of the loss of employer support through an RAA.[77]

In May 2017, TPR announced that it had reached agreement in principle on the key commercial terms of an RAA in relation to the British Steel Pension Scheme.[78]

In June 2017, TPR announced an RAA in relation to the Hoover Pension Scheme, which would "receive £60 million from Hoover and is expected to transfer into the Pension Protection Fund (PPF). "[79]

In September 2017, TPR granted formal approval to a proposal from Tata Steel UK (TSUK) to separate itself from the British Steel Pension Scheme (BSPS), through an RAA. The BSPS would receive £550 from the Tata Steel Group and a 33% equity stake in TSUK. Scheme members would be given the opportunity to transfer to a new BSPS (which would provide indexation that was less generous than the current scheme but higher than the PPF).[80] This is discussed in more detail in Library Briefing Paper CBP-05656 Occupational pension increases (September 2017) (section 3).

Proposals for reform

The Work and Pensions Select Committee said it thought TPR should become involved at an earlier stage and take a more iterative approach:

> **92. The Regulated Apportionment Arrangement (RAA) is a means of negotiating an outcome for scheme members that is better than the PPF in instances where a sponsoring employer is in mortal danger. When agreed, it can produce results that are better for pensioners, better for employers and better for the PPF than insolvency. It is, however, very rarely used, and the process includes potentially harmful delays. It is an emergency measure, but it does not operate at an emergency pace.**

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76 Ibid; Report in relation to UK Coal Operations Ltd (November 2014)

77 TPR, Regulatory Intervention Report issued under s89 of the Pensions Act 2004 in relation to Halcrow Pension Scheme, July 2016

78 TPR Statement on British Steel Pension Scheme, PN 17/25, 17 May 2017; For more detail, see Library Briefing Paper SN-05656 Occupational pension increases (June 2017), section 3.

79 TPR finalises pensions deal with Hoover, 2 June 2017

80 TPR, Tata Steel UK's proposal to restructure the British Steel Pension Scheme agreed by TPR, PN 17-48, 11 August 2017; BSPS Trustees, British Steel Pension Scheme Separated from Tata Steel UK Limited, 11 September 2017

93.*We recommend that in its forthcoming Green Paper the Government consult on:*

- **reducing the interval, currently 28 days, between TPR issuing a warning notice of an impending RAA and issuing a final notice; and**
- **relaxing the requirement for insolvency to be inevitable within 12 months for an RAA to be approved.**

We further recommend that TPR guidance be amended to encourage its involvement at an earlier stage in the formulation of RAA proposals in order to facilitate a more iterative approach.[81]

In its February 2017 DB Green Paper, the Government asked for views on proposals to allow struggling businesses to separate from scheme sponsors more easily, including by widening the criteria for RAAs. It commented that:

> 227. Our analysis highlights that there appears to be a group of employers who are likely but not certain to become insolvent before the completion of the recovery plan or members benefits are paid in full. However, many of these employers may not be able to access an RAA as it is not clear that they will become insolvent in the next 12 months. For the schemes sponsored by these employers, the current system does not offer any alternative. Their only option is to aim for investment returns to enable them to reach full funding or for the business to improve and generate more cash. But the burden of the pension scheme may itself be compromising the ability of the business to invest and recover, or to restructure. This also creates a risk for PPF members and levy payers because there is a risk that the PPF deficit could grow very substantially in the run up to a likely future insolvency.[82]

It said there could be a considerable prize – giving struggling employers the chance to emerge as a sustainable business and generate more value for the pension scheme – but that it would also require a "different trade-off" between sponsors, members and the PPF levy payers and would raise moral hazard issues:

> 229. It is also important to recognise that the options that involve a 'transfer of wealth' from the members to the sponsor would raise moral hazard issues and there would need to be appropriate quid pro quo provisions in place. For example similar provisions to the condition for RAAs where the scheme would need to receive more than it would otherwise on insolvency, to ensure that the scheme is being treated fairly compared to other creditors to the employer.[83]

Respondents to the Green Paper recognised the tensions. The TUC said trade unions should be involved in the consultation but that there was a case for considering whether "a special measures process could be put in place at an earlier stage than available under the current regime as a means of securing a better deal than would be available at the point of

81 Work and Pensions Select Committee, Defined benefit pension schemes, December 2016
82 Cm 9412, Feb 2017
83 Ibid

insolvency."[84] The PPF thought the requirement that insolvency must be inevitable in the next 12 months was overly restrictive and might limit the restructuring action that can take place whilst value remains in the employer. However, any amendments would need to retain strong safeguards to protect against "pension dumping", including ensuring that the outcome was better for the scheme than the alternative and that the employer would otherwise be expected to become insolvent.[85] The PLSA said it "should be easier to separate schemes from struggling employers."[86] The Association of Consulting Actuaries said the test for allowing an RAA should be based on the members' best interests rather than explicitly requiring insolvency in the near future.[87]

In the White Paper, the Government said it would look further at whether changes could be made to the RAA process without increasing the risks to scheme members:

> 207. We discussed the idea of making changes to the RAA process in the Green Paper. Around half of the respondents suggested that the current process is too complex, and that this complexity can prevent employers from making use of an RAA even where it would be in both the employer and the scheme's interest. They argued that making the process simpler could enable more businesses who would otherwise fail due to loss of investment or restructuring to benefit from RAAs, leading to better outcomes for current and future employees.
>
> 208. However, the other half of respondents were opposed the idea of any changes to the RAA process. Respondents argued that making it easier for employers to go through an RAA increased the risk that unscrupulous employers could seek to manipulate their circumstances in order to be able to separate themselves from their scheme.
>
> 209. We have given careful thought to whether, and how, we should make any changes to simplify the RAA process. We believe that an RAA can be helpful for both employers and schemes in some circumstances. We want to ensure that RAAs can be accessed by the right employers at the right time where an objective assessment suggests that they are at risk of insolvency and are not likely to be able to continue to support their Defined Benefit scheme.
>
> 210. However, we recognise that there is a risk in allowing more employers to go through an RAA process. It is important that we do not increase the risk to members by making changes.
>
> 211. We are therefore committing to working closely with the Regulator, PPF, stakeholders and the pensions industry to look at whether it is possible, without increasing risk to scheme members, to make improvements to the RAA process, thereby increasing the potential for positive outcomes for businesses which might otherwise fail.[88]

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[84] TUC, Response to Green Paper, May 2017
[85] PPF Response to Green Paper, May 2017
[86] PLSA, Response to Green Paper, May 2017
[87] ACA, Response to Green Paper, May 2017
[88] DWP, Protecting Defined Benefit Pension Schemes, Cm 9591, March 2018

2.6 Clearance statements

The clearance procedure was introduced to enable companies undergoing restructuring to gain assurance that TPR's anti-avoidance powers would not be used in relation to the transaction. The guidance states:

> 'Clearance' is the term used to describe the voluntary process of obtaining a clearance statement from the regulator. A clearance statement gives assurance that, based on the information provided, the regulator will not use its anti-avoidance powers to issue to the applicants either contribution notices or financial support directions in relation to a defined benefit occupational pension scheme and a particular event. 'Events' include transactions, agreements, decisions, other acts and failures to act.[89]

TPR seeks to balance different factors in reaching a decision:

- The regulator's preferred outcome is an appropriately funded scheme with a solvent employer.
- The regulator will deploy its resources in a risk-based manner, targeting risk in a proportionate, responsive, flexible, pragmatic, consistent, transparent and reasonable way.
- The regulator will seek to protect members' benefits and reduce the risk of calls on the PPF, while at the same time recognising commercial activity and business needs.[90]

It cannot stop a corporate transaction from proceeding but can issue an assurance that its powers will not be used after the event. It strongly advises seeking clearance where " there is an event that may be materially detrimental to the ability of the scheme to meet pensions liabilities – such as a change of ownership."[91]

TPR published guidance on clearance in June 2009.

The Green Paper

The Work and Pensions Select Committee noted that clearance applications had declined substantially, falling from 263 in 2005-06 to nine in 2015-16. It recommended that the Government consult on new rules for situations where clearance was mandatory:

> **140. Clearance has the clear benefit of enabling TPR to tackle potential moral hazard implications of corporate transactions head-on rather than after the event, while providing comfort and certainty to the scheme members and sponsoring firm. Clearance is far preferable to the drawn-out—and resource-intensive—legal process of enforcement action. It is, however, voluntary and**

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89 TPR, Clearance Guidance, June 2009 - introduction

90 TPR, Clearance Guidance, June 2009; An earlier version of the guidance, as at March 2008, is here: http://collections.europarchive.org/tna/20100210154308/http://www.thepensionsregulator.gov.uk/pdf/clearanceGuidance2008.pdf (UK Govt Web Archive)

91 Article by Tony Hobman, Chief Executive of the Pensions Regulator in HR Director, issue 38, June 2007, http://bit.ly/cnOiOc (UK Govt Web Archive)

employers are increasingly skipping it: there were 263 applications in 2005–06 but just nine in 2015–16. The incentives to seek clearance are currently weak. Some unscrupulous sponsors may well be calculating that they are better off risking a protracted anti-avoidance battle than coming to an immediate pension settlement.

141. ***We recommend that in its forthcoming Green Paper the Government consult on proposals to require advance clearance from TPR for certain corporate transactions that could be materially detrimental to the funding position of a DB scheme. The circumstances in which clearance was compulsory would have to be narrow to prevent a disproportionate effect on normal economic activity. They might include the sale or merger of a scheme sponsor where the pension deficit is higher than a fixed proportion of the value of the company. It is also reasonable to expect any prospective purchaser to have a credible plan for tackling a substantial pension deficit.***[92]

In its DB Green Paper, DWP said "very significant difficulties" would need to be overcome before clearance could be required in certain specified circumstances:

> 314. Making clearance a compulsory procedure even in very limited circumstances has the potential to make turnarounds more difficult and lead to more businesses being placed into insolvency. With turnarounds, there is often limited time available in which to conclude a deal. Businesses with an attached DB scheme could find themselves as unattractive investment targets. That could put more schemes into the PPF with consequences for the members and the PPF itself.
>
> 315. Giving the Regulator this power could also reduce the attractiveness of UK companies with DB pension schemes to investors, especially if investors believe this could restrict the ability of these companies to speedily restructure their operations should they fall into difficulty in the future.
>
> 316. The current regime seeks to balance the tension between the aim of protecting the pension scheme and the future prospects of the employees who also have an interest in the outcome of any deal. Any revised regime would also need to manage this difficult balance as it is inevitable that there will be circumstances where the business restructuring should proceed to ensure that jobs are saved even when the risks to the scheme have not been fully mitigated.
>
> 317. Some stakeholders have also pointed out that there are business decisions which are less recognisable as corporate transactions, but are likely to affect the ability of the sponsor to fund their DB scheme. For example, moving assets from the sponsor to another part of the corporate group cannot be effectively managed/controlled through a prospective clearance regime, and can only be addressed retrospectively. [93]

It said that another, less stringent approach – which could encourage employers to engage with TPR earlier - would be to give it power to levy a significant fine (in addition to pursuing the employer for any support)

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92 Ibid

93 DWP, Security and Sustainability in Defined Benefit Pension Schemes, Cm 9412, Feb 2017, p 7

where activity was shown to be detrimental without appropriate mitigation. Criteria would need to be very clear to prevent TPR being overwhelmed with clearance applications and corporate activity being held up.[94]

The Government asked for views on whether it would be possible to "design a system of compulsory proactive clearance by the Regulator of certain corporate transactions without significant detriment to legitimate business activity."[95]

In response, TPR said it did not think mandatory clearance would be a proportionate approach. Instead it advocated strengthening the position of trustees and incentivising employers to submit clearance applications, perhaps by enabling the imposition of substantive fines where employers are found to have avoided pension liabilities.[96] The trade union, Prospect, agreed, arguing that the focus should be on ensuring that trustees and trade unions have "access to sufficient corporate information to enable an informed decision to be made on whether such any transaction should be approved or not."[97]

The White Paper

In its March 2018 White Paper, the Government said that the majority of respondents to the Green Paper were concerned that proposals for targeted mandatory clearance could "stifle legitimate business activity such as corporate restructuring and could adversely impact on employment prospects." The Government would:

> […] strengthen the clearance regime so that sponsoring employers give sufficient regard to their pension scheme during corporate transactions, by building on existing processes and considering what new measures might be necessary. We will continue to work with the Regulator, industry and other relevant parties to understand how any new proposals might be introduced without inhibiting legitimate business activities.[98]

2.7 Trustees

The vast majority of private sector DB schemes are set up under trust.[99] This means that they are legally separate from the sponsoring employer and trustees are responsible for running the scheme – including decisions around scheme funding, recovery plans, investment choices and the assumptions used to calculate scheme liabilities. The February 2017 DB Green Paper describes them as "very much the 'first line of defence' for scheme members."[100]

TPR provides guidance and support to trustees to help them understand their duties and had "a range of powers to intervene" where it has

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94 Ibid, para 320
95 Ibid, p 73
96 TPR Green Paper response, May 2017
97 Prospect Green Paper response, May 2017)
98 DWP, Protecting Defined Benefit Pension Schemes, Cm 9591, December 2018
99 Ibid. The exception are those – usually in the public sector - set up under statute
100 Ibid, p15

"concerns about a funding plan or where an employer is seeking to walk away from its pension promises."[101]

It also has power to appoint independent trustees where it is satisfied that this is necessary:

- to secure that the trustees as a whole have, or exercise the necessary knowledge and skill for the proper administration of the scheme;
- to secure that the number of trustees is sufficient for the proper administration of the scheme
- to secure the proper use or application of the scheme's assets.[102]

Between 2010 and May 2015, TPR appointed an independent trustee in respect of 184 appointments.[103] For example, in 2007, it used these powers in relation to the Telent Pension Scheme, due to concerns about potential conflicts of interest.[104]

In its December 2016 report, the Work and Pensions Committee recommended that the Government consult on "proposals to give trustees powers to demand timely information from sponsors." This was to prevent trustees being "kept in the dark about information crucial to them carrying out their duties effectively."[105]

The February 2017 Green Paper asked:

- Should trustees be given extra powers such as powers to demand timely information from sponsors, to strengthen their position? If so, what extra powers might be helpful?
- Should trustees be consulted when the employer plans to pay dividends if the scheme is underfunded – and if so, what level of funding?[106]

The notifiable events framework

There is a notifiable events framework, which is designed to give TPR early warning of a possible call on the Pension Protection Fund. Schemes that are eligible for the PPF, and their employer, are required to notify TPR of certain types of event. Examples are an employer ceasing to carry on business in the United Kingdom, or a decision by a controlling company to relinquish control of the employer company.[107]

The February 2017 Green Paper acknowledged some concern that this was not working as well as it should:

> 310. Duties to notify the Regulator of certain corporate transactions already exist within pension legislation. The duty falls

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101 Ibid
102 Section 7, Pensions Act 1995
103 TPR FOI response, May 2015
104 TPR Press Release, PN07-18, 'Regulator confirms use of powers on Telent pension scheme', 9 November 2007; TPR Press Release, PN 08-08, 11 April 2008, Telent pension scheme undertaking received,
105 Defined Benefit pension schemes, Work and Pensions Committee, December 2016, para 13
106 DWP, Security and Sustainability in Defined Benefit Pension Schemes, Cm 9410, December 2016, p73
107 TPR Code of Practice 02, Notifiable Events, April 2005; Pensions Act 2004, s69; SI 2005/900

> on the trustees and employer through the notifiable events framework, with penalties for non-compliance. However, notification often occurs very close to the completion of the transaction, and trustees are sometimes not informed at all, which means that the Regulator is unable to act to prevent the transaction. There is some concern, shared by the Regulator, that the current regime is not working as well as it could.[108]

The March 2018 White Paper proposed improvements to:

> - coverage of the notifiable events framework – we will review whether it covers all relevant transactions and widen these to include anything that is currently missing; and
> - timing of the notifiable events framework – the framework currently requires businesses to inform the Regulator as soon as reasonably practical but without further definition. In practice, in some cases, this has meant not until (or after) the events actually occur. We think that this timing needs clarifying so that the Regulator is made aware at an earlier stage in consideration and can engage in discussions sooner.[109]

[108] Cm 9412, Feb 2017, para 69 and 310
[109] DWP, Protecting Defined Benefit Pension Schemes, Cm 9591, March 2018, para 37

BRIEFING PAPER
Number CBP-04368, 28 March 2018