



## Pensions Regulator grows more teeth

Back in April, the Government announced what some rather dramatically referred to as "emergency legislation" to strengthen the Pension Regulator's powers to go after employers connected or associated with pension schemes that have dodged their pension obligations.

On 20 October 2008, the Government tabled amendments to the Pensions Bill and published their response to consultation, bringing these new powers (effective from 14 April 2008) one step closer.

The Government still claims that their actions are in response to some of the innovative new products in the market which look to sever the link between employer and scheme. However, it does seem that the new powers could be far wider reaching than this.

### Changes to Contribution Notice power

The Contribution Notice 'test' will be amended such that the Pensions Regulator (the Regulator) no longer needs to be able to prove that there has been a deliberate act or failure to act, only that the effect of an act or failure "has detrimentally affected in a material way the likelihood of accrued scheme benefits being received".

The Regulator will be required to set out in a statutory code of practice the circumstances in which it expects to use this power. The Regulator's draft list of circumstances is as follows:

- Scheme transferring outside the UK;
- Sponsoring employer transferring outside the UK;
- Severing of employer support for the scheme;
- Transfer of liabilities to another scheme with insufficient employer support or is not sufficiently well funded; and
- Business model/operation of the scheme in a way designed to create a financial benefit of the employer, but where inadequate account has been taken of the interests of the members of the scheme.

The final circumstance is potentially very wide ranging indeed and could conceivably be extended to numerous aspects of running a scheme, including setting its investment strategy or offering enhanced transfer values. Furthermore, this list is not exhaustive and does not rule out the use of this new power in other circumstances.

This new power would not apply in cases where a party can demonstrate that they have a 'statutory defence'. In particular, if the party has undertaken due diligence before the act, mitigated the material detriment and can reasonably conclude that the act will not be materially detrimental, the power would not apply. Importantly, the Regulator will not be able to operate with the benefit of hindsight.

In addition, the Government is introducing some additional protections. In particular, the Regulator will have to consider:

- the reasonableness of the party's actions;
- whether there was a transfer of value to the party (bringing it into line with the existing requirement for a Financial Support Direction); and
- the effect on other creditors.

The other proposed changes to the Contribution Notice power will also be made such that:

- parties will no longer have the excuse that they acted in good faith in taking actions which had the effect of preventing a debt becoming due; and
- Contribution Notices can be triggered by a series of acts, and not just a single act aimed at avoiding a debt or causing material detriment to a pension scheme.

### Changes to Financial Support Direction power

The Financial Support Direction power will be changed so that the resources of the whole group of companies may be considered when judging whether to issue a Financial Support Direction when there is an under-resourced employer rather than requiring the Regulator to identify one single 'person' who is sufficiently resourced to enable the issue of a direction.

In its response to consultation, the Government gave some reassurance to the private equity industry, stating that "It is unlikely that an otherwise unrelated company in another venture-capital portfolio who is, strictly, connected and associated with an employer but is remote from the employer and its scheme, would find itself liable under a direction for another group's pension deficits."

## Regulation of 'new business models'

The Government has blamed the need to extend the Regulator's powers on the advent of new business models which allow scheme sponsors to circumvent the existing powers. To address this, the powers will be extended to allow the Regulator to:

- redirect support (i.e. a Contribution Notice or Financial Support Direction) following a bulk transfer if it would have been possible for the Regulator to act before the bulk transfer; and
- issue a Contribution Notice if the bulk transfer itself was detrimental.

## Other proposed changes

The Government is considering extending the timeframe over which a Financial Support Direction can be applied from the current position of 12 months of ceasing to be a connected party. The Government's initial view is that a gradual increase to 24 months may be appropriate. The Government says that it will consult on this matter as soon as practicable.

The Regulator has proposed a number of changes to the Notifiable Events framework. In particular, the Regulator proposes that the following requirements to notify are removed:

- two or more changes in the holders of any key scheme posts within the previous 12 months;
- any change in the employer's credit rating; and
- two or more changes in the holders of any key employer posts within the previous 12 months.

The Regulator also proposes that full funding on the technical provisions basis is used for deciding whether an event is notifiable, rather than the current s179 test (or the higher of s179 and FRS 17 where an SFO valuation has yet to be completed).

## Implications for corporate activity

The changes to the Regulator's powers will have little or no effect on any properly advised party that is connected or associated with a defined benefit pension scheme.

In particular:

- the material detriment test aligns the scope of the Contribution Notice power with the clearance regime;
- a properly advised party would be well aware of the risk of a Contribution Notice and would never have been able to claim ignorance when acting to the detriment of the pension scheme;

- the Regulator could always have argued that a Contribution Notice was possible in response to a series of acts; and
- the change to the Financial Support Direction power seems sensible and prevents abuse through the dividing up of a business into a number of operating businesses, none of which, in isolation, would be sufficiently resourced.

Importantly, the reasonableness test is retained and indeed made explicit in the case of a Contribution Notice which means that the Regulator will not be able to take action against parties that have not benefited from their association with a business which sponsors a defined benefit pension scheme.

The Pensions Regulator will amend clearance guidance on using the statutory defence to the new material detriment test in due course. In the meantime, the Clearance regime will remain unaltered and hence those parties concerned about the new powers and seeking certainty can continue to use the Clearance process to obtain that certainty, which as always will come at a price!

## Conclusion

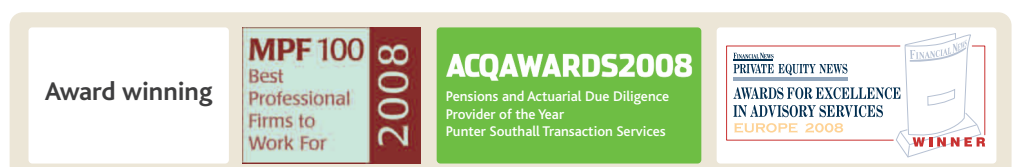
We remain of the view that the strengthening of the Regulator's powers by the Government will not significantly alter the pensions landscape. It will mean that private equity and other entities connected or associated with defined benefit pension schemes will have to think that little bit harder about whether the Regulator could reasonably take action against them as a result of any corporate activity being considered.

The Regulator's teeth do look razor sharp and clearly market participants will want to ensure they don't get bitten. However, it is reassuring to see that a number of protections are in place so the Regulator will have to swim through a number of hoops before it can take a chunk out of anyone.

### Where can I get further information?

If you would like further information on this topic or have a specific query please contact **Richard Jones 020 7533 6967** or **Chris Parlour 020 7533 1815**.

For further information, visit our website at [www.pstransactions.co.uk](http://www.pstransactions.co.uk)



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