Pensions white paper: proposals for a clearer, quicker, tougher Regulator

Following the high-profile insolvencies of BHS and Carillion, corporate groups that sponsor UK defined benefit (DB) pension schemes face ever-increasing scrutiny of the impact that their corporate activity might have on their pension schemes.

The Pensions Regulator (the Regulator) has a new mantra to be "clearer, quicker, tougher" in its approach to protecting pension schemes, which has seen it take a more restrictive view on what mitigation might be appropriate to address the impact of corporate activity on a pension scheme. This is coupled with proposals in the government's white paper on protecting DB pension schemes, published on 19 March 2018, to extend the powers of the Regulator when dealing with corporate activity, particularly in the context of transactions.

Although the changes to the Regulator's powers are not expected to be laid before Parliament until the 2019/20 Parliamentary session, some changes could have retrospective effect from 19 March 2018 and, more broadly, the Regulator's new approach is already becoming evident. As a result, it is more important than ever for corporate groups to ensure that the impact of corporate activity on their DB pension schemes is carefully considered and appropriately mitigated.

Green paper and report

On 20 February 2017, the government published a green paper on the future regulation of DB pension schemes (*see News brief "Pensions Green Paper: the future of defined benefit schemes", www.practicallaw.com/1-640-1213*). This followed on from the House of Commons Work and Pensions Committee's report (the report) published on 19 December 2016 in relation to its inquiry into DB pension schemes (*https://publications.parliament.uk/pa/cm201617/cmselect/cmworpen/55/55.pdf*). While the report recommended some radical changes to the pensions regulatory framework, the government took a more measured approach in the green paper by recognising the need for regulatory changes to strike a balance between the interests of members and sponsoring employers.

Aim of the proposals

The white paper sets out the government's plans for reforming the regulation of DB pension schemes in a number of areas, including strengthening and clarifying the scheme funding requirements and encouraging the consolidation of smaller schemes (*see box "The key proposals"*).

Much of the focus of the white paper is on proposals to extend the Regulator's current powers and the obligations of pension scheme sponsors in the context of transactions, both in terms of increased personal liability for, among others, individual directors of sponsoring employers, and additional scrutiny and reporting requirements for corporate transactions. Many of the proposals reflect policies outlined in the Conservative Party's 2017 election manifesto and the increased attention that DB schemes have received following recent high-profile insolvencies (*see News brief "Carillion liquidation: questions to answer", www.practicallaw.com/w-012-8830*).

Punitive fines

The government intends to legislate to give the Regulator the power to impose punitive fines on the targets of a contribution notice where corporate activity has detrimentally affected a pension scheme. The Regulator will be able to exercise this power against individual company directors as well as companies connected with the scheme employer. This was one of the recommendations of the report that made its way into the government's manifesto. At the time of the report this seemed a radical recommendation, but further high-profile insolvencies and a hardening political climate make this less of a surprise to the pensions industry.

According to the white paper, the new penalty regime will be robust but penalties will be proportionate, and the government wants to ensure that no unintended consequences result from the regime's introduction. It is expected that the ability to impose the penalty will be linked to the issue of a contribution notice. The white paper does not include any further details of potential quantum but it is clear that the result is expected to be punitive in order to deter the perceived irresponsible activities that may cause a detriment to a DB scheme. The report, by contrast, was more explicit, suggesting that fines should serve as a "nuclear deterrent" and could be set at twice the amount payable to the scheme under a contribution notice, which can be the full amount of the scheme's deficit calculated under section 75 of the Pensions Act 1995.

The threat of punitive fines should serve to focus corporate attention on decisions to undertake any kind of corporate activity by groups that sponsor DB schemes, particularly as the government has said that, as part of the consultation process, it will consider whether the new penalty regime should apply

The key proposals

The key proposals in the white paper that will affect corporate activity include:

- A power for the Pensions Regulator (the Regulator) to impose punitive fines where it exercises its moral hazard powers.
- A new criminal offence to punish the wilful or grossly reckless behaviour of directors and other connected persons in relation to a defined benefit pension scheme.
- No mandatory Regulator clearance for transactions, but a new requirement for sponsoring employers or parent companies to make a declaration of impacts statement before certain material business transactions take place, such as the sale or takeover of the sponsoring employer.
- Further strengthening of the Regulator's investigatory powers, including a power to require any person to attend an interview and a power to inspect records at parties' premises, which could enable unannounced raids.
- A review of the current legal framework which requires certain events to be notified to the Regulator.

retrospectively in respect of acts or omissions after 19 March 2018. The government took a similar approach when contribution notices were first introduced, as they applied to acts or omissions from 27 April 2004, the date that the proposed legislation was announced, rather than when the Pensions Act 2004 came into force on 6 April 2005 (*www.practicallaw.com/9-200-2413; see News brief "Moral hazard provisions: pensions reforms draw closer", www.practicallaw.com/7-103-2445*).

New criminal offence

Another commitment from the government's manifesto, now confirmed in the white paper, is a proposal to introduce a new criminal offence that will apply to directors and other connected persons to punish wilful or grossly reckless behaviour in relation to a DB pension scheme.

The white paper lacks any detail as to how this offence would be framed, including how it would relate to the Regulator's existing moral hazard powers or to the proposed punitive fines, or what the penalties would be if a director were found guilty of this new offence. Again, however, this should serve to focus corporate attention on the impact of corporate activity on pension schemes.

Declaration of impacts statement

There has been a lot of speculation as to whether the government would introduce a mandatory clearance regime following the report's recommendation to do so, and many industry professionals were concerned about how such a regime would operate in practice. However, the government is not proposing to introduce a mandatory clearance regime.

Instead, the white paper proposes legislation to introduce a requirement for companies to make a statement confirming that they have appropriately considered the impact of a relevant business transaction on their DB pension scheme. The purpose of a declaration of impacts statement would be to enable scheme trustees to better engage with the Regulator if the scheme is put at risk by transactions. These statements will need to: be made before the transaction takes place; be prepared in consultation with the scheme trustees; and set out what mitigation action is proposed to address any detrimental impact on the scheme. The requirement will only be triggered by transactions that pose the highest potential risk to the pension scheme, such as the sale or takeover of the sponsoring employer. It is not clear whether material distributions or financings will be included, but it seems probable that they will be. In effect, this new proposal would give the Regulator the same information as it would receive on a voluntary clearance application; giving it a clear opportunity to raise concerns before a relevant transaction takes place. It remains to be seen whether these measures amount in practice to mandatory clearance by the back door.

Corporate activity

Examples of corporate activity that could affect the employer covenant include:

- Reductions of capital.
- Dividend payments to shareholders.
- Restructurings and reorganisations.
- New debt or security to creditors.
- Sales and acquisitions (and related financing and restructuring).
- Switching to having a service company, rather than a trading entity, as principal employer.

Notifiable events

There will also be a review of the current notifiable events framework to consider whether more transactions should require mandatory notification to the Regulator and whether notification should be required in advance of decisions being taken. This would be a significant change from the current position, which requires some key events, such as the sale of a participating employer in a pension scheme or compromise of a debt to the scheme, to be notified to the Regulator only when the decision is made to take that step.

Strengthening investigatory powers

Under section 72 of the Pensions Act 2004, the Regulator has a broad range of powers to require trustees, employers and other persons to disclose information. The government will legislate to widen those powers and to introduce new civil penalties in addition to the existing criminal sanctions for failure to comply with the disclosure requirements.

The Regulator will have a new power to inspect records, documents and electronic devices at relevant parties' premises. There would be advance notice of an inspection, unless that would work against the purpose of the inspection, which means that unannounced raids will be possible. There will also be a new standalone power to require any relevant person to attend an interview with the Regulator to explain any facts, events or circumstances relevant to an investigation by the Regulator. This will extend to professional advisers.

Actions for employers

Employers need to ensure that the impact of corporate activity on their DB pension schemes is carefully considered and appropriately mitigated if necessary, and that these steps are properly documented (*see box "Corporate activity"*). This is with the dual aims of reducing the risk of future regulatory action being instigated, while also putting them in the best possible position to defend any action if it arises.

Dividend payments, although not specifically mentioned in the white paper, are likely to be scrutinised where there is a significant deficit in the scheme. The Regulator's annual funding statement published in April 2018 sets out the Regulator's expectation that scheme liabilities are prioritised over payments to shareholders where the employer covenant is constrained and that companies should retain cash to address the deficit (*see "Defined benefit funding: Pensions Regulator statement", Bulletin, Pensions, this issue*).

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The white paper is available at www.gov.uk/government/publications/protecting-defined-benefit-pension-schemes.