



# Pensions briefing

## A stronger Pensions Regulator – The DWP’s consultation on increasing regulatory sanctions

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### Briefing

July 2018

### Introduction

On *June 26, 2018*, the Department for Work and Pensions (DWP) published “Protecting Defined Benefit Pension Schemes – A stronger Pensions Regulator”, a consultation on proposals outlined in the pensions White Paper, published on *March 19, 2018*. The consultation closes on *August 21, 2018*.

The White Paper included a wide range of reforms to support defined benefit (DB) pension schemes, among which were suggested measures to strengthen the powers of The Pensions Regulator (TPR), including

- Changes to the voluntary clearance regime.
- A power for TPR to issue punitive fines against targets of a contribution notice.
- A new criminal offence to punish “wilful or grossly reckless behaviour” of directors in relation to a DB scheme.
- A requirement for sponsoring employers to make a statement of intent before any relevant business transaction, to confirm that they had considered the potential impact of the transaction on their DB scheme.

### Outline of the consultation

The DWP’s current consultation paper on proposals to “strengthen” TPR outlines three main areas of change

- Improving TPR’s powers allowing it to be more proactive where changes are proposed which could affect DB schemes.
- A new system of sanctions to “deter wrongdoing and punish it when necessary”.

- Improving TPR’s existing powers to issue contribution notices (CNs) and financial support directions (FSDs).

## Oversight of corporate transactions

The consultation proposes several major changes enabling TPR to be more closely involved in transactions and restructurings that involve companies with DB pension schemes. This would be implemented by changes to the current notifiable events framework, including the introduction of a requirement to produce a “declaration of intent” prior to signing contracts on the transaction.

## New notifiable events requirements

The proposed changes affect the current notifiable events regime in respect of both the range of events that will trigger a reporting requirement, and the timing for making a notification. The new regime will only require notification where a certain “risk threshold” is exceeded, for example, where the scheme is underfunded on a pre-determined (and yet to be defined) basis, which is to be set out in regulations later.

The new events will be employer-related and include

- Sale of a “material proportion” of the business or assets of a scheme employer which has funding responsibility for at least 20 per cent of the scheme’s liabilities. The DWP sees these transactions as significant because they frequently indicate a change in covenant support for the scheme.
- Granting of security on a debt to give it priority over debt to the scheme.
- Significant restructuring of the employer’s board of directors and certain senior management appointments.

The DWP proposes removing the existing notifiable event relating to wrongful trading of the sponsoring employer and to extend the current notifiable event on the breach of a banking covenant to include covenant deferral, amendment or waiver.

The payment of dividends will not be a trigger for notification at this stage, pending the results of the Department for Business, Energy and Industrial Strategy (BEIS) consultation into corporate governance, which closed on *June 11, 2018*. This consultation sought views on new proposals to improve the governance of companies by strengthening the responsibilities of directors of companies either in or approaching insolvency, “while [maintaining] a fair balance of interests for all shareholders”. In particular, the consultation considered

- The sale of businesses in distress.
- The reversal of value extraction schemes (asset-stripping).
- Investigating the actions of directors of dissolved companies.
- Strengthening governance in pre-insolvency situations.

The timing of the notification requirement to TPR is proposed to be at an earlier stage. The current requirement for notification of relevant events “as soon as reasonably practicable” after they have occurred, has sometimes meant this takes place after the transaction has completed.

The consultation states that TPR should be made aware of the relevant transaction no later than when negotiations have led to agreement in principle of its main terms, to coincide with the point at which scheme trustees being made aware of the transaction. The DWP proposes that notification of these particular notifiable events should occur when a Heads of Terms agreement is first put in place, but the trustees are expected to be involved earlier in the negotiations.

### **Failure to comply with the new notifiable events framework**

Among the new sanctions proposed in the consultation is the introduction of a new criminal offence to punish several breaches. These include failure to comply with the notifiable events framework, although the consultation states that any criminal penalties would be reserved for “the most serious cases of wrongdoing”. Alternatively, TPR may levy a fine of up to £1 million.

### **Declaration of intent**

The consultation sets out how the DWP envisages that a “declaration of intent” will operate in conjunction with the notifiable events regime. It will be required at a stage when “there is greater certainty as to whether the transaction is going ahead, its nature and the implications for the scheme”.

### **Voluntary clearance**

The current clearance guidance was last updated in March 2010, and will be reviewed to make clearer TPR’s expectations of trustees and employers. The consultation proposes changes to the current clearance regime in three respects

- The “material detriment” definition will be reviewed and clarification will be given on how applicants and trustees should approach this test.
- A revised definition of event types will be produced, including the circumstances in which clearance is given in relation to FSDs.
- Further detail on the clearance process, including expectations around the timing of an application, expressed as “as early as possible” in the consultation.

### **New civil and criminal penalties**

One of the biggest changes to the current regulatory regime, which permits a civil fine of up to £5,000 for individuals and £50,000 for corporate entities for non-compliance, is the proposal for an extension of the civil and criminal sanctions that TPR may impose. In addition to the existing civil penalty regime, there is to be a new layer of civil fines up to £1 million for “serious breaches” in order to “deter behaviours which ... have resulted in actual harm to the pension scheme or have the potential to do so if left unchallenged”.

In addition, new criminal offences are included to punish “wilful or grossly reckless behaviour” in relation to DB schemes, non-compliance with a CN and failure to comply with the notifiable events framework. It will also give the criminal courts the power to impose further penalties.

The possible targets of these sanctions will depend on the offence in question, but could include directors, sponsoring employers, any associated or connected persons and, in some circumstances, trustees.

## Changes to the moral hazard regime

The consultation outlines changes to the current CN and FSD regime to strengthen both procedures with proposals.

For CNs proposals include

- Changing the “reasonableness” test to focus more closely on the loss or risk caused to a scheme by the “act” when assessing the amount to be demanded under a CN. Scope would also be given for the employer’s justification for the “act” as a determining factor.
- Introducing a means to reflect the impact of the delay in payment in the amount of the CN.
- Changing the date on which the cap on the level of a CN is calculated to a date closer to the final determination.
- Creating an additional limb to the “material detriment” test, assessed by reference to the weakening of the employer.

For FSDs proposals, several features of the CN process are incorporated including

- Creating a single-stage process, under which the FSD would create a specific and enforceable obligation on the target (rather than this occurring at some later stage as in the current regime).
- Tightening up the forms of financial support the target is required to make to the scheme, so that FSDs will either require a cash payment or impose a form of statutory guarantee in relation to some or all of the sponsoring employer’s liabilities.
- Reviewing whether the “insufficiently resourced” requirements should be amended or replaced to make the criteria for imposing a FSD clearer and more certain.
- Allowing FSDs to be issued to a broader range of individuals, where they are associated with or connected to the sponsoring employer.
- Amending the reasonableness test to make clear that the actions of a target in creating or increasing risk are a relevant (but not necessary) factor.
- Providing TPR with a power to impose a CN on any person associated or connected with the recipient of the FSD.
- Exploring whether the FSD “lookback” period could be increased beyond two years.
- Allowing TPR to issue an FSD after the scheme has entered the Pension Protection Fund (PPF).

## Next steps

The consultation closes on *August 21, 2018*. Further proposals in the DB White Paper will be addressed over the coming months, and TPR intends to engage with interested stakeholders on the design of clearer funding standards, culminating in a formal consultation on a revised Defined Benefits Funding Code of Practice in 2019.

The DWP will also be consulting on the design of the legislative framework and authorisation regime for the commercial consolidation of DB pension schemes “later this year”.

## Comment

There are some major changes proposed here but it is doubtful whether any of them would have prevented the recent failures of BHS and Carillion. However, the consultation offers scant detail, so it is difficult to comment at this stage in any depth.

The next Queen’s Speech will be in 2020 and the fines and criminal proceedings changes will require primary legislation. Therefore, it may not be until late in that year that new legislation comes into force. Even the provisions that require clarifying regulations and TPR guidance are unlikely to be finalised in the near future.

Of particular concern are the proposals to make failure to report a notifiable event a criminal offence and the extension of the look-back period – is this to be retrospective? If so, current transactions could be under scrutiny before the final shape of the reforms is known.

The new notification requirements will require detailed guidance on what TPR requires, from whom and at what stage of the planned transaction. One of the new notifiable events that centres on a “significant restructuring of the employer’s board of directors and certain senior management appointments” will need clear guidance on the test that should be applied when such new appointments are made.

If the new disclosure regime proves to be highly prescriptive, corporate restructures may become unattractive and corporate activity may be stifled. Key to the sanction proposals outlined in the consultation will be the interaction with the proposed revision of the DB funding regime and the question of whether dividend payments are to be included among the new notifiable events.

Further questions arise in relation to TPR’s resources and how this new regime is to be overseen. TPR’s annual report and accounts and its quarterly compliance reports indicate that a significant proportion of its current spending allocation is dedicated to ensuring compliance with the auto-enrolment regime. It is unclear whether TPR envisages increasing its staff and budget (and therefore potentially scheme levies?) to supervise the extended notification proposals and related new sanctions.

Our September 2018 client seminar will focus on the consultation and any further information issued by the DWP, and we look forward to discussing then the various issues arising from the DWP’s proposals.

View the [consultation paper](#).

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