

Insight

on Employment & Benefits

New powers for the Pensions Regulator

The Government has issued a consultation paper to widen the Pensions Regulator's (TPR) anti-avoidance powers contained in the Pensions Act 2004 (PA 2004).

The proposed changes come after recent innovations in the market, led by Pension Corporation and Citigroup, involving the buyout of businesses with large and reasonably well-funded pension plans with the aim of building the surplus in the plans for profit. In some instances, the companies are sold on without the pension plan. By structuring deals in this way, companies that operate pension plans have avoided the strict solvency capital requirements imposed on insurers by the Financial Services Authority. The lower resulting costs have enabled buyout houses to undercut the bulk annuity market.

The Department for Work and Pensions (DWP) has voiced concerns about the reduced security that this new buyout model offers to beneficiaries of defined benefit pension plans and the associated risk posed to the Pension Protection Fund (PPF).

The model lacks the collaborative relationship between employers and trustees that exists in a conventional

pension plan arrangement under which an employer can stand behind the plan without having to make a capital investment.

TPR's so called "moral hazard" powers under the PA 2004 were designed to deal with situations where plan sponsors sought to avoid liabilities under their pension plans and pass these onto the PPF. The powers enable TPR to pierce the corporate veil and impose liability on individuals or companies who are associated or connected with an employer operating a pension plan. The most important of TPR's tools are the contribution notice (CN) and the financial support direction (FSD). A CN can be used where TPR considers that an employer is taking, or has taken, deliberate action to avoid its pension obligations. TPR demands the payment of a specified sum of money by the person served to the plan trustees (or to the PPF where it has assumed responsibility for the plan).



Leaders in Employment & Benefits

As a leading international law firm with full service capability, White & Case has one of the largest teams of employment and employee benefits lawyers in the world.

We understand the pressures today's employers operate under and will guide you through the complexities of employment and employee benefits law, working with you to resolve problems quickly and efficiently saving you time and money.

We believe this information will be of interest to you. However, if you do not wish to receive further similar information about events or legal issues from White & Case, then please e-mail unsubscribe@whitecase.com

White & Case consists of more than 2,300 lawyers practising in 37 offices in 25 countries around the world.

This document is prepared for the general information of our clients and other interested persons. It is not, and does not attempt to be, comprehensive in nature. Due to the general nature of its content, it should not be regarded as legal advice.

“Much of the reaction is reminiscent of that which followed the original introduction of the moral hazard powers. Companies nervously awaited the aftermath that never arrived and which led one commentator to liken the post 2004 regulator to a ‘paper tiger’..”

An FSD requires a named company or individual to put arrangements in place for the financial support of the pension plan and may include former employers who no longer participate in the plan. A CN may be used subsequently where the person served has failed to comply with the FSD.

An important difference between FSDs and CNs is that, unlike CNs, FSDs do not require fault. Whether TPR can issue an FSD depends largely upon the relative financial circumstances of the employer and any group of which it forms a member and the size of the deficit in the relevant plan. An FSD may be issued in two circumstances: where the TPR is satisfied that, at any time during the previous 12 months, an employer is a service company or that it is insufficiently resourced. The latter criterion is satisfied where the value of the company’s resources is estimated at less than 50% of the employer debt and there is an associated or connected person possessing resources at least equal to the difference between the total of the employer’s resources and 50% of the employer debt.


The amendments now proposed will lower the test for the issue of CNs. First, TPR will no longer have to show that a party intended to prevent payment of an employer debt or to stop the debt from becoming due. Focus will instead shift to the effects of a proposed transaction and whether it creates a materially detrimental risk to members’ current and future benefits. Second, a company will no longer be able to offer the defence that it acted in good faith when creating the unfunded pension deficit. Third, a party will not be able to circumvent the anti-avoidance powers by using bulk transfers between schemes.

TPR will also be able to look at resources owned by the whole group of companies when judging whether to issue an FSD.

The proposed changes will have retrospective effect from 14 April 2008. Additional changes, including the ability to issue a CN on the basis of a series of acts rather than a single act, will, if approved, come into effect from 28 April 2008. All proposals are being made subject to an eight week consultation period, which commenced on 18 April 2008, before being incorporated into legislation to be published by the end of the year.

The proposals have attracted strong reaction from private equity leaders who see them as jeopardising corporate activity at least in the short term. The British Private Equity and Venture Capital Association (BVCA) has announced that more than one major deal has already been put on hold following the changes. It is thought that the increased risks and associated costs introduced may also lead companies to sell existing defined benefit plans to insurers who are better placed to meet future liabilities that may arise. Since the announcement, companies are being advised that any corporate restructuring, refinancing, share buybacks and dividend payments will be exposed to scrutiny. Consequently, the tightening of regulations could result in a flurry of applications to TPR for clearance of transactions in a bid for greater certainty.

Much of the reaction is reminiscent of that which followed the original introduction of the moral hazard powers. Companies nervously awaited the aftermath that never arrived and which led one commentator to liken the post 2004 regulator to a ‘paper tiger’. The pensions minister, Mike O’Brien QC, is adamant that current fears are misplaced. He points out that the powers are specifically designed to target those ‘risky situations’ which expose the PPF to potentially heavy losses.



The Government's consultation paper focuses the new powers and identifies key features of the types of arrangements that would be caught. These involve moving the employer or pension scheme to another jurisdiction; splitting the operating company from the pension plan without appropriate mitigation for the pension plan; splitting the assets from the operating company without appropriate mitigation for the pension plan; transferring plan assets and liabilities to another plan which did not have adequate support from an employer; running a plan for profit without adequate account being taken of member interests; and business models in which risk is predominantly borne by plan members but high investment returns would benefit investors.

TPR also issued a statement on 25 April 2008, in response to the DWP's consultation document published on the same day, stating that the changes would have very limited application and would not influence its fundamental risk based approach. It also emphasised that protection against excessive use of the new powers is provided in the form of safeguards built into the proposals. Consequently, no changes need be made to the circumstances in which clearance statements are required. These will be limited to the clearly defined 'type A events' in the TPR's clearance guidance. Furthermore, the DWP confirmed that in relation to a 'series of acts', it will not withdraw clearance that has already been provided in respect to an individual transaction. This means that the transaction will not form part of a course of conduct triggering the issue of a CN under the powers unless facts prove materially different subsequent to issue. It is yet to be seen whether this statement will be incorporated into regulations or regulatory guidance.

Investors should be comforted by the sparing use that has thus far been made of the TPR powers – to date no CNs have been issued. However, it is likely that company anxiety about increased exposure to liability, particularly because of the 12 month risk period in the case of FDS, will reveal itself in the transaction of wide indemnities from seller to buyer.

The real impact of these proposed powers will likely be felt in their deterrent effect which is again evidenced by experience of the existing framework. The view is also borne out by the DWP's detailed and focused consultation document which addresses very specific sets of circumstances and, it is anticipated, will succeed in steering discussions on the proposals. Investors would be further reassured by restrictions on the exercise of powers to circumstances where there is a clear risk to the relevant pension plans. The Government has proposed that this could be achieved by limiting CNs to those situations where the recipient fails to demonstrate it could not have reasonably foreseen the likely consequences of the transaction. This is a positive sign and we expect that the consultation period will further alleviate concerns and encourage the DWP to address comments made by interested parties.

“The real impact of these proposed powers will likely be felt in their deterrent effect which is again evidenced by experience of the existing framework.”

London



Oliver Brettle
+44 (0)20 7532 2103
obrettle@whitecase.com



Nicholas Greenacre
+44 (0)20 7532 2141
ngreenacre@whitecase.com



David Evans
+44 (0)20 7532 2120
devans@whitecase.com



Euan Fergusson
+44 (0)20 7532 2122
efergusson@whitecase.com



Afshan Mallik
+44 (0)20 7532 2518
amallik@whitecase.com



Nicola O'Neill
+44 (0)20 7532 2517
noneill@whitecase.com



Fahim Rahman
+44 (0)20 7532 2161
frahman@whitecase.com



Chris Weaver
+44 (0)20 7532 2174
cweaver@whitecase.com



Simon Burlinson
+44 (0)20 7532 2174
sburlinson@whitecase.com

ABU DHABI ALMATY ANKARA BANGKOK BEIJING BERLIN BRATISLAVA BRUSSELS BUCHAREST BUDAPEST DRESDEN DÜSSELDORF
FRANKFURT HAMBURG HELSINKI HONG KONG ISTANBUL JOHANNESBURG LONDON LOS ANGELES MEXICO CITY MIAMI MILAN MOSCOW
MUNICH NEW YORK PALO ALTO PARIS PRAGUE RIYADH SÃO PAULO SHANGHAI SINGAPORE STOCKHOLM TOKYO WARSAW WASHINGTON, DC

Worldwide. For Our Clients.