pensions and transactions focus
SEPTEMBER 2008

Beware - proposed extension of the Pensions Regulator's anti-avoidance powers

Sacker & Partners is the UK's largest specialist pensions law practice. The firm has considerable experience in all aspects of commercial transactions, with a team dedicated to advising and working extensively with other law firms on deals.

New concerns for corporate transactions

On 14 April 2008, the Department for Work and Pensions (DWP) announced its intention to enhance the Pensions Regulator's powers "to require contributions to pension schemes when sponsor actions materially reduce the security of member benefits".

The announcement, which has since been followed up by a consultation paper, is primarily a response to the Government's concern over the introduction of new "business models that look to sever the link between employer and scheme". However, the Regulator's extended powers would also apply to certain corporate transactions such as dividend payments, the reallocation of debt or mergers and acquisitions which have the effect of reducing the security of members' benefits.

Background

The Pensions Act 2004 introduced a number of "anti-avoidance" powers to enable the Regulator to act where members' benefits are placed at risk or where employers otherwise try to sidestep their pensions liabilities by seeking to offload them onto the new Pension Protection Fund (PPF). The Regulator was given two key anti-avoidance powers which may affect corporate transactions:

- Contribution Notices (CNs) which can require a contribution to a pension scheme from an employer or related parties (including individuals) where there is behaviour aimed at avoiding a debt to a pension scheme or preventing such a debt becoming due; and
- Financial Support Directions (FSDs) which can require a parent company or other person connected or associated with the employer to put support in place for a pension scheme whose sponsor is either under-resourced or a service company.

"New business models"

The focus of the DWP's attention in introducing the proposals are what the consultation paper calls "new business models". These are characterised by one or more of the following features:

- moving the employer or pension scheme to another jurisdiction;
- splitting the operating company (or the assets of that company) from the pension scheme without appropriate mitigation for the pension scheme;
- transferring scheme assets and liabilities to another scheme which does not have adequate support from an employer; or
- running a scheme for profit without adequate account being taken of member interests or where the risk is predominantly borne by scheme members, but high investment returns would benefit investors.

Proposed changes

The DWP has made the following proposals in the consultation paper:

Contribution Notices

- CNs may be issued where the effect of an act is materially detrimental to a pension scheme's ability to pay members' current and future benefits. The Regulator would no longer need to prove **intent** on the part of a party to avoid funding the scheme, but instead, it would need to prove that the **effect** of an act or course of conduct "posed a materially detrimental risk to members' benefits" (in practice a far easier test);

- removing the "good faith escape clause". The Regulator is currently prevented from issuing a CN where, even though the actions of a party have had the effect of preventing a debt becoming due to the scheme, that party has acted in good faith. The removal of this provision would bring arm's length commercial transactions within the Regulator's remit, even though the parties may not have appreciated the effect of the transaction on pension scheme members' benefits;
- amendments to ensure that the use of CNs will not be frustrated by bulk transfers of members between pension schemes; and

Financial Support Directions

- that the resources of a whole group of companies can be considered when judging whether to issue an FSD when there is an under-resourced employer. Previously, having identified an "insufficiently resourced" employer, the Regulator was unable to act unless any single party had sufficient resources to meet the pension scheme debt.

What does this mean for transactions?

The Regulator has welcomed the proposed changes. It has also confirmed that between 14 April 2008 and the date on which the new provisions come into force, it will not apply the following amendments to its powers:

- the new alternative test that could trigger the issue of an FSD;
- the new alternative test that could trigger the issue of a CN;
- the removal of the "good faith escape clause";

unless one of the "new business models" is the subject of the proposed use of the power. However, once in force, it is unclear whether the Regulator will nonetheless seek to use its powers retrospectively (to 14 April 2008).

The Regulator has also made it clear that the proposals will not change the Regulator's established clearance process. Indeed the Regulator's revised clearance guidance, which was published earlier this year, already recommends that parties consider applying for clearance of a transaction which may have a materially detrimental effect on the security of members' benefits.

We therefore expect to see an increase in the number of clearance applications made to the Regulator.

Watch this space

The DWP's consultation closed on 20 June 2008. Most of the changes proposed will require amendment to primary legislation, so we await developments in the Pensions Bill currently before Parliament. That said, it is possible that some of the proposals will not be introduced.

We work closely with our law firm clients to deliver a first class service. If you have any questions regarding this newsletter, or pensions law aspects of transactions in general, please contact a member of the unit, using the details below:

Chris Close
Partner
chris.close@sackers.com

Ian Cormican
Partner
ian.cormican@sackers.com

Nicholas Couldrey
Partner
nicholas.couldrey@sackers.com

Faith Dickson
Partner
faith.dickson@sackers.com

Peter Lester
Partner
peter.lester@sackers.com

David Saunders
Partner
david.saunders@sackers.com

Sacker & Partners LLP

Solicitors specialising in pensions law

29 Ludgate Hill
London EC4M 7NX
Tel 020 7329 6699
Fax 020 7248 0552
www.sackers.com