

PARLIAMENTARY REVIEW OF THE REGULATION OF DEFINED BENEFIT PENSION SCHEMES

BACKGROUND

The report published at the end of the recent parliamentary enquiry in relation to the [BHS Pension Scheme](#) was critical of a number of parties for their involvement in the demise of BHS. The Regulator was itself not immune from criticism and was labelled as being “reactive” and “slow moving”.

In August, the Committee commenced a wider review of the role of the Regulator and the PPF. Written submissions were invited on a variety of regulatory issues including the adequacy of existing regulatory powers, the manner in which they are currently used and whether greater emphasis should be placed on supervision and pro-active regulation.

The Regulator and the PPF are amongst a number of parties that have made submissions to the Committee. The Regulator and the PPF's submissions are of particular interest as they ask for wider powers to be granted to the Regulator in relation to corporate transactions and scheme funding.

WIDER REGULATORY POWERS

The current statutory funding regime in relation to defined benefit pension schemes was introduced by the Pensions Act 2004. The same legislation established the Regulator and the PPF and granted the Regulator wide “moral hazard” powers to protect member benefits and the PPF.

Whilst the Regulator accepts that the current regulatory regime is broadly working as Parliament had intended, in its submission to the Committee it has identified a number of areas where there is merit in exploring improvements. Key improvements suggested include:

- ◆ a requirement for employers to seek mandatory clearance where corporate action significantly weakens a scheme sponsor in circumstances where the scheme is not sufficiently funded;
- ◆ greater flexibility in relation to scheme funding including more regular valuations for higher-risk schemes; and
- ◆ more flexible information-gathering powers and enhanced investigatory powers including the ability to compel parties to submit to interview.

The PPF likewise suggests a number of improvements to the current governance framework including improvements to increase regulatory oversight of corporate transactions.

MANDATORY CLEARANCE

While there may be merit in introducing more flexibility to the scheme funding regime (after all, the funding regime is meant to be scheme specific) and possibly some benefit in revisions to the existing information gathering regime, there are concerns about making clearance compulsory.

Clearance was intended as a voluntary process to provide legal certainty to commercial parties against the risk of retrospective regulatory moral hazard action. The certainty provided by clearance was in turn intended to ensure that the Regulator's powers did not impede legitimate corporate activity.

The Regulator's approach to clearance is set out in its guidance. In practice, the Regulator has insisted that clearance is only available where there is an identifiable material detriment to the scheme which is addressed by the provision of appropriate mitigation. The Regulator's approach to clearance applications has, to a large extent, undermined the legislative intent of providing certainty to commercial parties by making clearance unavailable where there is no detriment and available but unattractive where there is a risk of detriment. Faced with the Regulator's position, commercial parties have often seen little or no merit in seeking clearance and are effectively forced to take their own view on the risks.

It is not entirely clear how a mandatory clearance framework would sit alongside the Regulator's current approach. A mandatory process would dictate that the circumstances in which clearance must be sought should be set out clearly. While an extensive list of events that require mandatory clearance is likely to reduce the risk of avoidance activity (it will not eliminate that risk entirely), it will require significant resourcing to police and will undoubtedly hinder corporate activity where a defined benefit scheme is involved.

COMMENT

Events such as BHS make it easy to forget that the Regulator already has a significant suite of powers at its disposal to further its statutory objectives.

In relation to corporate transactions, its moral hazard powers allow it in certain circumstances to extend the funding obligations in relation to defined benefit schemes beyond the sponsoring employers to wider group entities and in some cases individuals. The moral hazard powers have for many years acted as a deterrent against “dumping” pension scheme liabilities. The potency of the threat of use of these powers was

seen as recently as this October in [a report](#) published by the Regulator in relation to the Database Group Limited Retirement Benefit Scheme. There, the threat of regulatory intervention was sufficient to ensure that members' benefits were secured in full as part of a corporate transaction.

The introduction of mandatory clearance will bring the Regulator to the negotiation table. This will very likely hinder legitimate corporate activity and impact the delicate balance that was struck by the draftsman of the Pensions Act 2004 in protecting the interests of both the pension schemes and their various stakeholders. It is questionable in any event whether mandatory clearance would prevent unscrupulous employers from attempting to walk away from their pension liabilities. A moral hazard investigation is currently ongoing in relation to the BHS Pension Scheme and action may yet be taken against parties connected with BHS. Any judgement on the adequacy of the current regime ought to be delayed until the results of that investigation are known.

It is interesting to note that in practice, as with BHS, the moral hazard powers have mainly (but not entirely) been used retrospectively once the sponsoring employers have entered into an insolvency process. However, given adequate resourcing and having regard to the existing regulatory notification requirements, it is likely that the Regulator would be able to adopt a more proactive regulatory approach using its existing powers.

The Regulator, like most other public bodies, has faced significant budgeting restrictions in recent years. The inadequacy of its resources is something even the Regulator acknowledges. Perhaps the solution to minimise the risk of another BHS is to ensure that the Regulator has sufficient funding and resources to exercise its existing powers in a proactive way for the benefit of the entire regulated community and the PPF.

This may be the inconvenient truth that the Committee and the government would have to face up to at the end of the Committee's review. The resourcing of the Regulator is also something that is likely to be on the agenda for the foreseeable future given that the revised draft Institutions for Occupational Retirement Provision directive requires regulatory bodies not only to have the means but also the expertise and capacity to achieve their regulatory objectives.

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