The UK Pensions Regulator’s “Moral Hazard” Provisions: Revised Legislation and Clearance Guidance

21 April 2008
Introduction

The Pensions Act 2004 (PA 2004) created two new bodies, the Pension Protection Fund (PPF) and the Pensions Regulator (TPR). The PPF (which is modelled on the US Pension Benefit Guaranty Corporation) provides a compensatory underpin of benefits to members of underfunded pension schemes on the occurrence of an insolvency event in relation to the employer. TPR is the regulatory body for employer-sponsored pension schemes in the United Kingdom. Under the PA 2004, TPR has been set a number of specific statutory objectives, which include protecting the benefits of, or in respect of, members of employer-sponsored pension schemes, and reducing the risk of situations arising which may lead to compensation being payable from the PPF.

The PA 2004 sets out a number of mechanisms to assist TPR to achieve its statutory objectives. Amongst these are anti-avoidance powers conferred on TPR, which give it regulatory teeth. The key anti-avoidance powers are the so called “moral hazard” provisions, which consist of two separate powers which can be used by TPR to provide funding for a defined benefit pension scheme by a person other than the PPF. TPR also has investigatory powers which dovetail with a notifiable events regime under which trustees and employers have duties to notify TPR of certain events.

The moral hazard provisions provide for the making of contribution notices (CNs) and financial support directions (FSDs). A CN can require the employer which sponsors the pension scheme, or a person connected with, or an associate of, the employer, to contribute up to the full buyout deficit of the scheme. An FSD requires the employer, or a person connected with, or an associate of, the employer, to effectively guarantee in full or in part the pension liabilities of the employer of the underfunded pension scheme where the employer is either a service company or is “insufficiently resourced” to meet its pension liabilities.

To bring certainty to persons who could be affected by the moral hazard provisions, TPR introduced a clearance procedure in April 2005. Those who are entering into a corporate transaction or restructuring may apply to TPR for assurance that it will not use its moral hazard powers in relation to the specified event.

THE REVISED LEGISLATION

In mid-April 2008, the UK Government Department for Work and Pensions announced amendments to the moral hazard legislative provisions of the PA 2004.

The announced amendments have two effects. They remove “hurdles” to the ability of TPR to exercise its moral hazard powers, and they broaden the circumstances in which those powers may be exercised. The new legislation under which the Government is to effect the proposals in its announcement is yet to be published, even in draft form. However, the policy intent set out in the announcement is stated as having effect from 14 April 2008 (except for one amendment which is to take retrospective effect from 27 April 2004). The announcement shall be referred to in this paper as “the new legislation”.

THE REVISED CLEARANCE GUIDANCE

The announcement of the legislative changes followed TPR’s substantial amendment of its guidance on applications for a clearance statement that TPR will not issue a CN or an FSD, which was published at the end of March 2008. The updated guidance may be found at http://www.thepensionsregulator.gov.uk/pdf/clearanceguidance2008.pdf.

The revised clearance guidance materially amends the historic guidance in a number of respects. However, the single most significant change is that the substance, rather than the form, of an event or transaction will be analysed by TPR in determining whether to exercise its moral hazard powers. This means it will no longer be possible to use a particular “structure” of transaction to sidestep pension liabilities, and this new regulations approach is supported by the amendments made by the new legislation.

This paper examines the new legislation and clearance guidance.
Key Changes and Implications – Legislation

Five key changes to the legislation were announced.

1. CNs may now be issued “where the effect of an act is materially detrimental to a scheme’s ability to pay member’s current and future benefits”. Previously, TPR had to prove “intent” on the part of a party to avoid liability for pension scheme funding.

The new legislation now closely reflects the tenor of the revised new guidance (see below) than the historic legislation did. The practical effect is the removal of a hindrance to TPR’s ability to issue a CN (by having to show intention). The legislation should now more easily facilitate a CN being issued in circumstances where an employer’s pension liabilities are either reduced or the employer’s ability to meet them is weaker than in the past.

2. Historically, a CN could only be issued to a person who had acted to prevent a liability falling due (or to compromise or reduce the amount of debt which would otherwise have become due) where that party had acted otherwise than in good faith. The Government has described the good faith “defence” as ”an unhelpful hurdle which would present the power being used in situations where parties have simply not considered impacts on pension schemes”. The good faith defence has now been removed.

Relevant parties, and in particular employers supervising defined benefit schemes, will now need to consider the impact on the pension scheme of any material event in order to determine whether an “unintended consequence” could expose them to the risk of a CN.

3. The Government has now confirmed that a CN can be triggered by a series of acts or events and not just a single act or event aimed at avoiding a debt to a pension scheme. This amendment is introduced retrospectively to 27 April 2004.

Whilst TPR’s revised guidance indicates that a CN will be considered in relation to a series of acts or events, the legislative basis for this was less clear. The new legislation removes the doubt and will be retrospective to 27 April 2004. No details have, however, been made available. There is no indication, for example, as to what the maximum time period is between each act for them to form a series of acts. Equally, there is no indication as to whether the six year time limit within which a CN can be issued will be measured from the first or last act in the series. An ongoing review of the effects of corporate activity or a pension scheme may be necessary to manage the moral hazard risk with the review extending back to April 2004 where appropriate.

4. In relation to FSDs, the new legislation is amended so that in determining “insufficiently resourced”, the resources of the whole group of companies (rather than just the company sponsoring the scheme) may be considered when judging whether to issue one. This will increase the number of circumstances in which it would be possible for TPR to issue an FSD. A more detailed analysis of the financial circumstances of a greater number of group companies will need to be undertaken in relation to any risk assessment.

5. Finally, the new legislation introduces measures to ensure that bulk transfers of members between schemes are not used as a means to frustrate the ability of TPR to use its anti-avoidance powers, which closes off a potential route to circumventing the “spirit” of the new legislation (and guidance). There is no indication of law this will be achieved by the legislation.

The new legislation under which the Government is to effect the proposals in its announcement is yet to be published, even in draft form. However, the amendments are stated as being introduced with effect from 14 April 2008 (with the exception of point 3 above which is retrospectively introduced from 27 April 2004).
Key Changes and Implications – Clearance Guidance

There are five key changes to the clearance guidance:

1. The application process: although documentation supporting an application under the 2005 guidance was required, it typically did not relate to the “heart” of the employer’s business. TPR now expects, as a matter of course, high-level and potentially sensitive business information to be made available to it, for example management accounts, details of debt, intra-group balances and guarantees, and summaries of related party transactions not disclosed in the statutory accounts. The disclosure requirement clearly becomes more onerous.

Employers will also need to consider confidentiality issues more closely than previously. Whilst there is no requirement that the above documentation is disclosed to the scheme trustees, their ability to comment on the application and negotiate appropriate mitigation (which TPR expects) will be limited without sight of it, which can be expected to be taken into account by TPR in deciding whether to grant clearance.

2. New definition of “type A” event: clearance remains only appropriate for what are defined as type A events. However, type A events are now (more widely) defined as all events that are materially detrimental to the ability of the scheme to meet its pension liabilities. In addition, certain events will now be type A events regardless of the funding position of the scheme.

This represents a material shift in determining whether an event is type A, from analysing the nature of the event or transaction, to analysing the effects of the event or transaction. This may mean that a transaction that was not type A for the purposes of the old guidance (for example a business sale carried out at arm’s length) may now be a type A event. Applying for clearance may now be appropriate in circumstances where it was not previously, and more complex and detailed consideration of pensions issues will be required in relation to transactions than previously.

3. Funding triggers: historically a scheme had to be underfunded on an FRS17/IAS19 basis in order for an event to be type A. The funding trigger will now be calculated as the higher of (i) FRS17/IAS19, (ii) Section 179 Pensions Act 2004 (Pensions Protection Fund), (iii) Section 222 Pensions Act 2004 (Scheme’s technical provisions), and (iv) the scheme’s ongoing valuation basis (where provisions are not available). However, where the relevant event is “significantly materially detrimental” (for example there are “going-concern” issues) the relevant deficit will be measured on the higher Section 75 Pensions Act 1995 (buyout) basis.

While the funding benchmark has been finessed, what is more material is that under the new guidance, certain (scheme-related) events will be type A events regardless of the funding position of the scheme. The new funding trigger, however, remains relevant for “employer-related” events, for example corporate restructuring and mergers and acquisitions.

4. Mitigation: considerable detailed guidance has now been provided in relation to forms of mitigation that may be provided, as an alternative to a cash contribution to fund the scheme up to the level of the funding trigger.

When the clearance regime was first introduced, mitigation most usually constituted ensuring the scheme was fully funded on an FRS17/IAS19 basis. As TPR became more comfortable with analysing transactions or events, so it became more comfortable with agreeing to alternative forms of mitigation, but exploring possible forms with TPR was time consuming. The expanded list of example forms of mitigation that may be acceptable is to be welcomed as being practical and extensive.

5. Focus on “principles-based” regulatory approach: the historic “prescriptive-test” based approach to clearance applications has been replaced by guidance overlaid by guiding principles to be applied by trustees and employers, and separate guiding principles to be applied by TPR.

This new approach removes some of the certainty as to which transactions or events may be type A and put the relevant parties at risk of receipt of a CN or an FSD. Additionally, since no transaction, however structured, is automatically excluded from being a type A event, all transactions or events should potentially be analysed to determine their effect on the defined benefit pension scheme creditor.
The New Moral Hazard Legislation in Detail

The moral hazard provisions are designed to prevent the use by companies of corporate structures to avoid pension liabilities. A clearance statement is an assurance from TPR that it will not use its powers to invoke the moral hazard provisions.

The amendments to the historic legislation have been introduced in an unconventional manner. A ministerial statement has been issued which sets out the principle of the new legislation. The statement confirms that the UK Government Department for Work and Pensions will consult with the appropriate industry bodies prior to issuing the final forum legislation. It is therefore likely that the actual “text” of the legislation will not be available for some months.

The principles contained in the statement have been developed in reaction to “the launch of business models that look to sever the link between employer and scheme, and operate well-funded occupational pensions schemes for profit but to the possible detriment of scheme members”. The Government believes that deviation from the trust law based model of governance, retaining the employer-scheme relationship, is acceptable but only where those business models contain “adequate protection for members and the PPF”. TPR’s moral hazard powers have been supplemented to allow it to take appropriate steps to protect the security of members’ benefits where it considers the “business model” does not provide adequate protection. It is clear that the “business model” the Government is referring to is a certain type of pension scheme buyout model under which employers are able to “sell” their pension schemes to a special purpose buyout vehicle which is not adequately capitalised to provide “adequate security”.

The following is a summary of the historic legislation as “amended” by the principles set out in the ministerial statement. Although not expected to, it is possible that the actual text of the new legislation may not exactly reflect the principles set out in the statement. Equally, further as yet unannounced amendments may appear in the final legislation, and it is possible that the following summary will need updating in due course.

The new legislation is stated to have been introduced with effect from 14 April 2008, except for the “series of acts” amendments which will be retrospectively effective back to 27 April 2004.

CONTRIBUTION NOTICES

TPR may issue a CN to a person if that person is or was a party to an act (or series of acts) or a deliberate failure (or series of failures) to act, the effect of which is materially detrimental to a defined benefit pension scheme’s ability to pay members’ current and future benefits. The Government has recognised that greater clarity will be required in the detail of the actual legislation. However, it also wishes TPR to be able to utilise this power “without undue burden”. It can therefore be expected that the powers will be focussed on actions (or inaction) which pose risks to pension schemes. One example is given in the statement, that “it may be appropriate to limit the use of the power to situations in which the prospective recipient of an Contribution Notice is unable to demonstrate that the likely consequences of their actions could not reasonably have been foreseen.”

In relation to acts (or failures to act) which prevented a Section 75 debt becoming due, compromising or otherwise settling such a debt, or reducing the amount of such a debt which would otherwise have become due, TPR was not able to issue a CN where the relevant party had acted in good faith. The good faith “get out” is being removed. No such get out was available if the act or failure prevented the recovery of all or a part of a Section 75 debt which was, or might become, due from the employer to the scheme and this remains the case.

Under certain structures, it could have been possible to bulk transfer members between pension schemes to avoid the effects of TPR, moral hazard provisions. The new legislation will specifically prevent such action being taken.

A CN is an order to pay a specified sum up to the full amount of the scheme’s Section 75 Pensions Act 1995 employer or buyout debt (Section 75 debt). It may only be issued against an employer, a person “connected” with, or an “associate” of, an employer (as in the Insolvency Act 1986), or a person who otherwise knowingly assisted in the act or failure. There is some protection for insolvency practitioners; a CN may only be issued if the insolvency practitioner, in being a party to the act or failure, was not acting in accordance with his or her functions in relation to another person.
There is no such protection for receivers or chief restructuring officers. Accordingly, where such persons accept appointments where an underfunded defined benefit scheme is involved, they may wish to review their insurance policies to check coverage.

It must, in TPR’s opinion, be reasonable to impose a CN (judging “reasonable” against specified statutory criteria). If the above conditions are met, a CN may be issued up to six years after the relevant act or failure.

FINANCIAL SUPPORT DIRECTIONS
TPR may issue an FSD where, in its opinion, the employer is either a service company or is insufficiently resourced.

Historically, an employer was, broadly, insufficiently resourced if both the value of its resources was less than 50 per cent of the scheme’s Section 75 debt and the value of the resources of a connected or associated person (broadly, group companies) when added to the employer’s resources would be 50 per cent or more of the Section 75 debt. TPR will now be able to consider the resources of the whole group of companies when judging whether or not to issue an FSD rather than just single entities. Potentially, this will broaden the circumstances in which an FSD can be issued.

An FSD is an order to put in place financial support, such as an arrangement which makes other group companies jointly and severally liable for an employer’s potential Section 75 debt or a guarantee of that debt, where the employer is a service company or is insufficiently resourced. An FSD can be issued against an employer, an associate of such an employer (but not where association is only by reason of employment) or a person, other than an individual, who is connected with, or an associate of, the employer.

TPR can only issue an FSD when it is reasonable to do so and within one year of the criteria being met.

CONNECTED OR ASSOCIATED WITH AN EMPLOYER/KNOWINGLY ASSISTED
A person is connected with an employer where he or she is a director (or shadow director) or an associate of such a director, or where he or she is an associate of the employer.

A person can be an associate of another person in a wide variety of circumstances. The legislative provision is complex and drafted to encompass a wide range of relationships. For example, companies are associated where the same person(s) has “control” of them or where different persons who are themselves associates of each other control the companies (broadly, this is group companies), but also relatives, business partners, and employees and employers can be associated with each other.

A person has “control” of a company where its directors are accustomed to act in accordance with his or her instructions, or he or she can exercise one-third or more of the voting power at a shareholders’ general meeting.

“Knowingly assisted” is a catch-all provision designed to sweep up persons who are not employers or persons connected with or associates of them. The clearance guidance offers no insight as to how TPR might apply its moral hazard powers in relation to such third parties, except that it is arguable that purchasers of businesses may be caught.

Parent companies are therefore potentially liable under the moral hazard provisions in a wide range of circumstances, including, for example, even if they omit to prevent the steps taken by a participating employer (in the pension scheme) that lead to a weakening of that participating employer’s covenant. Similarly, substantial (more than 33 per cent) shareholders in an employer may also be potentially liable.

No distinction is made in the legislation between UK and non-UK companies (or individuals), and it is therefore possible for a CN (or an FSD) to be issued against an overseas company. However, the extent to which a CN or an FSD will be enforced in the courts of an overseas jurisdiction in the event of non-compliance is yet to be tested.
REASONABLENESS TEST

A CN or FSD can only be imposed if TPR is of the opinion that it is reasonable to do so. In forming its opinion, TPR must have regard to certain prescribed factors.

FACTORS TPR MUST TAKE INTO ACCOUNT IN DETERMINING REASONABLENESS

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<th>Contribution Notice</th>
<th>Financial Support Direction</th>
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<td>The extent of the person’s involvement in the act or failure</td>
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<td>The person’s relationship with the employer</td>
<td>The value of benefits received by the person from the scheme</td>
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<td>The degree of connection or involvement of the person with the scheme</td>
<td>The degree of connection or involvement of the person with the scheme</td>
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<tr>
<td>Whether the act or failure was a notifiable event, and any failure to notify TPR</td>
<td>The financial circumstances of the person</td>
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<td>All the purposes of the act or failure (e.g., to prevent or limit loss of employment)</td>
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<td>The financial circumstances of the person</td>
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Clearance

“Clearance” is the term used to describe the process of obtaining a “clearance statement” from TPR. A clearance statement is a statement from TPR that, in its opinion, in the circumstances described in the application: (i) the applicant would not be a party to an act or a deliberate failure to act, or (ii) it would not be reasonable to impose any liability on the applicant, in respect of CNs; and (iii) the employer is not a service company, (iv) the employer is not insufficiently resourced, or (v) it would not be reasonable to impose liability on the applicant, in respect of FSDs.

Making an application for clearance is voluntary. The application may be made by those parties who could be or may become (e.g., a purchaser) subject to a CN or FSD. TPR ordinarily expects to issue clearance on the basis that it would not be responsible to impose liability on the applicant.

Although voluntary on the part of employers and current or future connected or associated persons, TPR states that where an application is not being considered and the scheme trustees are concerned that no or insufficient mitigation is being offered to the scheme, they should consider notifying TPR, which may use its investigatory powers to assess the effect of the event or circumstances that have arisen. Although used sparingly, TPR has power to require any person to produce any document or provide any other information which is relevant to the exercise of TPR’s functions.

There is some anecdotal evidence that as employers have become better informed of the clearance process and better able to assess the risks of not obtaining clearance, increasingly fewer applications have been made. TPR is therefore attempting to reverse this trend by effectively making it a “best practice” for trustees to notify it of key commercial transactions.

PRINCIPLES-BASED REGULATORY APPROVAL

TPR has moved away from the “prescriptive” approach to clearance applications, which characterised its historic 2005 guidance, to a “principles-based” approach.

The guiding principles that trustees and employers should apply when dealing with events that may affect a scheme are set out below.

GUIDING PRINCIPLES – TRUSTEES AND EMPLOYERS

- Trustees and employers should recognise and understand that a scheme in deficit on any basis should be treated in the same way as any other material creditor.
- Trustees should recognise and understand their powers and duties, and act appropriately, including managing any conflicts.
- Trustees should consider taking independent professional advice where appropriate.
- Trustees and employers should work together in relation to events that may be detrimental to the ability of the scheme to meet its liabilities or the benefits of the scheme members, communicating and sharing appropriate information.
- Trustees and employers should understand the nature and the impact of the potentially detrimental event and the appropriate mitigation for the event.
- Trustees and employers should recognise that TPR will wish to know about all events that may have a materially detrimental effect on the ability of a scheme to meet its liabilities.
TPR has stated that it will apply the following principles in considering whether to issue a clearance statement.

**GUIDING PRINCIPLES – TPR**

- TPR's preferred outcome is an appropriately funded scheme with a solvent employer.
- TPR will deploy its resources in a risk-based manner, targeting risk in a proportionate, responsive, flexible, pragmatic, consistent, transparent and reasonable way.
- TPR will seek to protect members' benefits and reduce the risk of calls on the PPF, while at the same time recognising commercial activity and business needs.

**ASSESSING WHETHER CLEARANCE IS APPROPRIATE**

One of TPR’s principal premises is that trustees of a defined benefit pension scheme in deficit should act as a bank would act if it were an unsecured creditor of the employer. However, TPR recognises that while many events may be detrimental to the scheme’s ability to meet its liabilities, not all will be materially detrimental. TPR expects a clearance statement to be sought only in relation to type A events.
OVERVIEW OF ASSESSMENT PROCESS

EVENT

Is the event materially detrimental to the ability of the scheme to meet its liabilities?

Yes

No

The event is not a type A event and clearance need not be considered.

Is the event employer-related or scheme-related?

Scheme-related

Employer-related

Is there a relevant deficit?

Yes

No

The event is not a type A event and clearance need not be considered.

The event is a type A event.

Trustees and employer consider/negotiate appropriate mitigation.

Consider clearance application.
ANALYSING THE EVENT

1. Type A events “are all events that are materially detrimental to the ability of the scheme to meet its pension liabilities”.

2. Type A events fall into one of two sub-categories: employer-related events and scheme-related events.

3. An employer-related event will only be a type A event if the scheme has a “relevant deficit”.

4. A scheme-related event will always be a type A event regardless of the scheme’s funding position.

The last two examples of employer-related events (set out in the box below) demonstrate in practical terms the widening of the definition of type A event from the 2005 guidance definition. Historically, commercial transactions undertaken at arm’s length involving the sale and purchase of assets were classified as type B events, which were not considered financially detrimental to the ability of a scheme to meet its pension liabilities and in respect of which a clearance application was not appropriate. Under the new guidance, if such a transaction was to have a negative effect on the employer’s covenant, then it could be a type A event.

ASSESSING WHETHER THE EVENT IS MATERIALLY DETRIMENTAL

A detrimental event will have one or more of the following effects:

1. Diminishing the amount of the employer’s Section 75 debt in any way, compared to the “pre-event” amount of Section 75 debt that could have arisen

2. Weakening the employer covenant, either because it negatively affects the employer’s ability to meet its ongoing funding commitments to the scheme (or because it reduces the level of those commitments) or it reduces the dividend that would be available to the scheme in the event of employer insolvency

The assessment of “materiality” is left as a matter of judgment for the applicants, applying the guiding principles above. However, certain factors may assist in forming this judgement, for example, considering the extent to which the employer’s covenant is weakened, the size of the employer group after the event compared with before, the size of the scheme (the assets and members) and the amount of the scheme’s relevant deficit.

EMPLOYER-RELATED TYPE A EVENTS

An employer-related event is one which affects the employer, in the first instance, in isolation to the pension scheme. Whilst an employer-related event may materially detrimentally affect the scheme, it does so generally by reference to the strength of the employer’s covenant in relation to the scheme rather than being directly detrimental to members’ benefits.

The (non-exhaustive) list of examples of employer-related events provided by TPR is as follows.
EXAMPLES OF EMPLOYER-RELATED TYPE A EVENTS INCLUDE THE FOLLOWING:

- A change in the level of security given to creditors
- A return of capital
- A change to the employer’s group structure (including a change of control)
- A change to the employer
- A sale and leaseback transaction
- The granting or repayment of inter-company loans
- A phoenix event (i.e., the re-emergence of an employer as substantially the same entity following an insolvency event)
- A business and asset sale from the employer or the wider employer group
- A corporate event which would reduce sustainable cash flow for the wider employer group’s funding commitment to the scheme

ASSESSING WHETHER AN EMPLOYER-RELATED EVENT IS A TYPE A EVENT

This is a three stage process:

1. Comparing and contrasting the pre- and post-event employer covenant. The employer covenant consists of the employer’s legal obligations to the scheme and its financial strength or ability to meet those obligations.

2. Assessing whether there has been or will be a material weakening of the covenant. This will involve an analysis of any changes to it that have or will occur because of the event. An example is assessing where the pension creditor sits in the allocation of proceeds in the event of the insolvency or the impact of the event on the employer’s ability to meet its ongoing funding liability to the scheme, because of the effect of the event on the employer’s cash flow or balance sheet.

TPR encourages trustees to obtain independent professional advice in carrying out such an assessment (and expects that responsible employers will wish to pay for the advice). Where trustees do not obtain such advice, they should record their reasons for this decision and provide their own assessment on the event.

The judgement as to whether any weakening in the covenant is material is a complex matter and may involve reference to a number of factors, not just the amount of the scheme’s relevant deficit (which was the yardstick that characterised the historic 2005 guidance). This is reflected in the greatly extended examples given of potentially acceptable forms of mitigation which may be adopted by employers (see below).

3. Determining whether there is a relevant scheme deficit. An employer-related event will only be a type A event if there is a relevant deficit. Whether the scheme has a relevant deficit will usually be assessed by determining whether the scheme has a deficit calculated on one of the following bases:

   i) FRS17/IAS19
   ii) Section 179 PA 2004 (PPF)
   iii) Section 222 PA 2004 (scheme technical provision)
   iv) Ongoing (but only where technical provision are not available)
Where the scheme is in deficit on more than one basis, the amount of the relevant deficit will be the highest of the deficit amounts calculated as above.

If, however, the effect of the event is “significantly materially detrimental” to the scheme’s ability to meet its liabilities (for example, if there are “going-concern” issues or there is a scheme abandonment) the relevant deficit will be measured on the higher Section 75 Pensions Act 1995 basis.

SCHEME-RELATED EVENTS

In contrast to an employer-related event, which is assessed by reference to the employer covenant, a scheme-related event will generally have either a direct impact on the employer’s legal obligations to the scheme (reducing them) or will be directly detrimental to members’ benefits.

TPR has provided the following (non-exhaustive) list of examples of scheme-related events.

- Any compromise agreement entered into by the trustees to reduce the employer’s Section 75 debt
- The use, amendment or insertion of an apportionment rule or scheme apportionment arrangement will be a type A event except in limited circumstances. Some schemes contain an apportionment rule which modifies the amount of an employer’s Section 75 debt that would otherwise become due.
- The non-payment of part or all of a Section 75 debt for an unreasonable period, e.g., 12 months
- An arrangement that has the result of preventing a Section 75 debt from triggering

The assessment of the effect of a scheme-related event is generally easier to quantify. However it should be noted that there may be employer and scheme-related components to an event or series of events, for example, on the sale of a group company participating in a scheme and a subsequent apportionment of any Section 75 debt.

Each component will need to be assessed separately to determine whether it is a type A event, and appropriate mitigation should be considered in relation to each component.

MITIGATION

Under the historic 2005 guidance, TPR expected any FRS 17/IAS 19 deficit in the scheme to be removed as a condition of granting a clearance statement. This prescription was gradually relaxed. The revised new guidance demonstrates TPR’s willingness to move away from a one size fits all approach.

TPR provides an extensive list of possible forms of mitigation that it (and the trustees) might find appropriate in the relevant circumstances, as follows:
Which type or combination of types of mitigation will be appropriate will depend on the circumstances. It should be noted that some forms of mitigation (e.g., guarantees put in place under standardised PPF documentation) may also reduce PPF levy bills.

**CONSIDER APPLICATION FOR CLEARANCE**

Applying for clearance is optional, but a clearance statement provides a valuable degree of certainty for the applicants.

Before completing an application, it can be beneficial for the applicants to make early contact with TPR on a no-names basis, particularly in relation to more complicated or contentious circumstances. This will allow the applicants to advance any negotiations with the trustees with a better understanding of TPR’s views on the particular matter. It should also mean that a swifter decision is made by TPR as to whether to issue a clearance statement.

TPR has made it clear that the prime responsibility for safeguarding members’ interests lies with the trustees, and that TPR expects them to be involved in any application as soon as possible. It also expects trustees to negotiate assertively with the employer on behalf of the scheme.

In exceptional cases, the employer may have a concern regarding confidentiality and on this basis be reluctant to involve the trustees (many or all of whom may be employees). Such concerns should be raised with TPR, which may consider an alternative to involving the scheme trustees.

**THE APPLICATION PROCESS**

The application process remains largely unchanged, composed of the completion of a form and submission of supporting documentation. In practical terms, the parties to a transaction or an “event” (and potential applicants for a clearance statement) may wish to analyse whether the transaction exposes them to a risk of a CN or an FSD being issued under the legislation and then consider whether they wish to make an application for clearance.

If they determine to make a clearance application, the parties will need to open a dialogue with the scheme trustees. Although there is no requirement to reach agreement with the trustees, the views of the trustees and whether they support the application will be taken into account by TPR. The trustees will need to take their own advice, and
appropriate time (including that necessary for a review of the employer covenant) should be built into the transaction timetable.

In addition to factual information, the application form for a clearance statement requires details of (i) the transaction or event, (ii) the effect the transaction or event will have on the pension scheme, (iii) the basis on which the applicants believe clearance should be granted, (iv) the mitigation that will be put in place and (v) the regulations between the employer and trustees. In addition, the relevant supporting documentation should be appended to the application.

TPR does not set out a timeframe within which it aims to decide whether or not to issue a clearance statement. However, providing full information with the initial application and being available to respond to any questions may reduce the timescale of TPRs decision making process.

For more information, please contact your regular McDermott lawyer, or:

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