

## GOVERNMENT RESPONDS TO CONSULTATION ON FURTHER EMPOWERING THE PENSIONS REGULATOR

As reported in our [July briefing](#), in June 2018 the Government consulted on plans to create a "stronger" Pensions Regulator that can intervene earlier and more quickly when defined benefit (DB) pension schemes are at risk, with serious penalties for those who have acted recklessly or failed to comply with their obligations.

Following feedback from numerous stakeholders, as well as roundtable discussions, on 11 February 2019 the [Government published its response to the consultation](#) - the response is summarised below.

Many of the proposals would have had a significant impact on business activity and while some are not being pursued at this time (e.g. the number of proposed additional notifiable events has been reduced, and the lookback period for Financial Support Directions (FSDs) has not been extended), others are. In practice, much detail remains uncertain, and we will have to wait and see the draft legislation before assessing the impact on commercial activity.

### KEY PROPOSALS TO BE IMPLEMENTED IN A NUTSHELL

- Introduction of two new employer-related notifiable events requiring the Regulator to be informed of: (i) sale of a material proportion of the business or assets of a scheme employer which has funding responsibility for at least 20% of the scheme's liabilities; and (ii) granting of security on a debt to give it priority over debt to the scheme.
- Introduction of a new 'Declaration of Intent' by any transaction corporate planners that will be shared with trustees and the Regulator. This requirement will be triggered in respect of: (i) a sale of the controlling interest in a sponsoring employer (an existing notifiable event) and (ii) the two new notifiable events set out above.
- Introduction of a new civil penalty of up to a maximum of £1 million for serious breaches (including 'knowingly or recklessly' providing false information to trustees) and two new criminal offences for (i) 'wilful or reckless' behaviour in relation to a pension scheme; and (ii) failure to comply with a Contribution Notice (CN).
- Strengthening of the Regulator's CN powers in line with the proposals in the consultation. Includes amendments to the 'reasonableness' and 'material detriment' tests for CNs, providing for an uprating mechanism to apply to the CN sum and a change to the cap calculation date of the CN sum.
- Streamlining the regime for FSDs which will be renamed Financial Support Notices and broadening the scope of FSDs to capture controlling shareholders of the sponsoring employer (who are individuals) **but not to target directors**. Replacing one of the underlying financial triggers for an FSD with a new 'scheme focussed' test.
- In order to gather further information, the Regulator to have a stand-alone interview power not dependent on a notice having been issued under Section 72 of the Pensions Act 2004, and its power to inspect premises will be expanded.

- Confirmation that the Regulator will have the power to apply fixed and escalating penalties up to a statutory maximum consistent with those already in existence in relation to the Automatic Enrolment and Master Trust regimes. Consultation on regulations expected in due course.

## TIMING

Where possible the proposals are intended to be implemented in secondary legislation and/or by expansion of existing regulatory guidance and codes. Significant changes such as the introduction of new civil and criminal sanctions however require primary legislation. The response shows that there is still a substantial amount of detail to be worked through and further consultation on certain aspects will be necessary. As such we suspect the proposals are unlikely to be implemented before the 2019-2020 parliamentary session (i.e. by Spring 2020).

## THE PROPOSALS

### (1) CORPORATE TRANSACTION OVERSIGHT

#### Additions to the Notifiable Events Regime

The following two new employer-related notifiable events will be introduced: (i) sale of a material proportion of the business or assets of a scheme employer which has funding responsibility for at least 20% of the scheme's liabilities; and (ii) granting of security on a debt to give it priority over debt to the scheme. The terms 'material' and 'funding responsibility' in this context will, it is hoped, be defined more clearly in the draft legislation in order to give certainty to sponsoring employers.

Broadly the Government has taken on board the feedback from stakeholders that several of the proposed additional notifiable events were either not practical (e.g. extending the breach of a banking covenant to include covenant deferral, amendment or waiver, which in practice could cover any number of trivial matters with no impact on the employer's financial health) or could potentially stifle legitimate business activity that could be beneficial to the pension scheme.

#### Declaration of Intent

The response confirms the introduction of a new requirement on those planning certain corporate transactions to issue a "declaration of intent".

**What do 'corporate transaction planners' have to do?** Make a statement (provided to the trustees and the Regulator) covering (i) an explanation of the transaction; (ii) confirmation that the trustee board has been consulted; and (iii) how any detriment to the scheme is to be mitigated. Requirement will be triggered in relation to (a) sale of controlling interest in a sponsoring employer (an existing notifiable event); (b) sale of a material proportion of the business or assets of a sponsoring employer which has funding responsibility for at least 20% of the scheme's liabilities (new notifiable event 1); and (c) granting of security in priority to the scheme on a debt to give it priority over a debt to the scheme (new notifiable event 2).

**When do they have to do it?** Unclear at this stage, but the aim is to involve the trustees and Regulator earlier than would previously have been the case.

### (2) NEW CIVIL AND CRIMINAL SANCTIONS

The response reiterates the Government's intention to 'punish' those who have acted 'recklessly' or failed to comply with their obligations in respect of a DB pension scheme. The table from the consultation, summarising the new penalties which will exist alongside the existing penalties is appended to this briefing. Broadly:

- The Regulator will have a new power to issue civil penalties of up to a maximum of £1 million for more serious breaches (see Appendix). The Regulator will update its relevant policies for pension schemes so that expectations on businesses are clear once the proposals come into force;<sup>1</sup>

<sup>1</sup> NB following feedback from stakeholders the government is considering how to treat proceeds of fines given suggestions such as proceeds should be reinvested in pension schemes affected by the mischief.

- Both (i) 'wilful or reckless' behaviour in relation to a pension scheme; and (ii) failure to comply with a CN, will attract criminal sanctions (in both cases the possibility of unlimited fines and in the case of 'wilful or reckless' behaviour the possibility of a custodial sentence of up to 7 years). The term 'wilful or reckless' behaviour is regrettably vague, and it is hoped that further detail will be included in draft legislation. Criminal sanctions **will not be** introduced for a breach of the notifiable events requirements as initially proposed; and
- The proposed targets of these sanctions include, the sponsoring employers of pension schemes and those associated and connected with sponsoring employers, which in some circumstances would **include directors**. The proposed fines of up to £1 million could also be imposed on trustees in certain circumstances. See Appendix for further detail.

### (3) EXTENDING THE REGULATOR'S EXISTING MORAL HAZARD POWERS

Broadly the Government will be proceeding with the proposed CN measures as outlined in the initial consultation.

CN Proposals	
Current feature	Consultation Response
<ul style="list-style-type: none"> <li>• The Regulator may only issue a CN if it considers that it is reasonable to impose liability on the recipient to pay the amount specified in the CN.</li> </ul>	<ul style="list-style-type: none"> <li>• Response confirms that the 'reasonableness' test is to be amended so consideration is given to the actual or potential impact on the scheme's assets or liabilities when assessing the amount to be demanded under a CN.</li> </ul>
<ul style="list-style-type: none"> <li>• The sum specified in the CN is currently calculated by reference to the employer debt due to the scheme at the time of the act/failure to act.</li> </ul>	<p>Response confirms that:</p> <ul style="list-style-type: none"> <li>• there will be an uprating mechanism to reflect the gap in time between the date of the "act" and the determination to issue the CN. The Government is considering whether a specific uprating mechanism should be set out in legislation and exploring ways in which this could be reflected; and</li> <li>• there will be a change to the date on which the cap on the level of a CN is calculated (so that this is calculated at a date closer to the final determination, rather than calculating the cap at the date of the act).</li> </ul>
<ul style="list-style-type: none"> <li>• For a CN, either the 'material detriment' test or the 'main purpose' test must be met (among other things).</li> <li>• The material detriment test as currently formulated is concerned with an act or failure which has a materially detrimental effect on the likelihood of accrued scheme benefits being received.</li> </ul>	<ul style="list-style-type: none"> <li>• There will be two additional limbs to the 'material detriment' test. A "snapshot funding approach" is proposed to be used and the test will be met if either: (i) the amount the scheme would have recovered on a hypothetical insolvency of the employer is materially reduced as a result of the relevant act/ failure to act; or (ii) the 'value' of the employer provides materially less 'coverage' of the scheme's section 75 deficit following the relevant act/ failure to act.</li> </ul>
<ul style="list-style-type: none"> <li>• Currently, only those connected/associated with an employer in the scheme fall within scope of a CN.</li> </ul>	<ul style="list-style-type: none"> <li>• The response is ambiguous but suggests that the Government will pursue broadening the targets of CNs issued where there has been non-compliance with an FSD, which may include an extension to those who are connected and associated with the recipient of an FSD. This could significantly expand the potential range of targets for a CN.</li> </ul>

A few of the proposed changes to the FSD (FSN) regime **will not be taken forward** (at least at this time). The changes that will be pursued are set out below.

FSD Proposals	
Current feature	Consultation Response
<ul style="list-style-type: none"> <li>Currently, an FSD requires the recipient to put in place financial support for the scheme, though it does not impose a specific enforceable obligation and instead the recipient has to propose a form of financial support for consideration by the Regulator.</li> </ul>	<ul style="list-style-type: none"> <li>Response confirms that a single-stage process will be developed.</li> <li>The forms of financial support will be restricted to cash and/or joint and several liability under which the targets are jointly and severally liable for the sponsoring employer's liabilities in relation to the pension scheme. However, the response states that there should still be scope for the target to agree an alternative form of support with the Regulator prior to determination, through settlement outside the formal FSD process. The Government will continue to assess flexibilities whilst working out the detail of the proposals with the Regulator.</li> </ul>
<ul style="list-style-type: none"> <li>Currently, an FSD may be issued where, at the relevant time, the scheme employer is either a service company or insufficiently resourced. The insufficiently resourced test is determined by reference to the value of its resources compared to the amount of its debt due to the scheme, as estimated by the Regulator.</li> </ul>	<ul style="list-style-type: none"> <li>Response confirms that the 'insufficiently resourced' requirements will be replaced with a new test which will be scheme-focussed and will be set out in secondary legislation.</li> <li>The Government is also going to look at amending the current service company test following feedback from stakeholders.</li> </ul>
<ul style="list-style-type: none"> <li>Currently, it is generally only corporates who are connected/associated with an employer of the scheme who are potential targets of an FSD (not individuals).</li> </ul>	<ul style="list-style-type: none"> <li>Response confirms that the scope of FSD targets will not be broadened to include directors. However, it will be extended to capture controlling shareholders of the sponsoring employer who are individuals.</li> </ul>
<ul style="list-style-type: none"> <li>Currently, the Regulator may only issue an FSD if it is satisfied that the employer was either a service company or insufficiently resourced and the target was within scope at the "relevant time". This imposes a maximum two-year lookback period during which the Regulator must issue a warning notice in relation to the FSD.</li> </ul>	<ul style="list-style-type: none"> <li>Response confirms that the lookback period will not be extended <b>at this time</b>. NB, changes to the lookback period can be made in secondary legislation and so are easier to implement than through primary legislation – the response signposts that the Government will continue to consider whether this is appropriate in light of other changes to the regime and work with the Regulator on any potential changes to the lookback period.</li> </ul>

#### (4) INFORMATION GATHERING AND INSPECTION POWERS

The Regulator will be given a standalone power to compel persons involved with a pension scheme to attend an interview, without needing to issue a formal information request under Section 72 of the Pensions Act 2004.

## APPENDIX

### *Proposed new/amended civil and criminal sanctions*

<b>New Offence</b>	<b>New Penalty</b>	<b>Target</b>
Wilful or reckless behaviour in relation to a pension scheme	Criminal offence: up to 7 years' imprisonment and/or unlimited fines  And/or  New civil penalty: up to a maximum of £1 million	Sponsoring employers and others associated or connected
Failure to comply with a Contribution Notice	Criminal offence: unlimited fines  And/or  New civil penalty: up to a maximum of £1 million	Sponsoring employers and others associated or connected
Failure to comply with a Financial Support Direction	New civil penalty: up to a maximum of £1 million	Sponsoring employers and others associated or connected (Not individuals with the exception of controlling shareholders who are individuals)
Failure to comply with the Notifiable Events Framework	New civil penalty: up to a maximum of £1 million	Sponsoring employers and trustees
Failure to comply with requirements for a Declaration of Intent	New civil penalty: up to a maximum of £1 million	Sponsoring employers and others associated or connected
Knowingly or recklessly providing false information to trustees	New civil penalty: up to a maximum of £1 million	Any person who is required to provide information to trustees as prescribed
Non-compliance with information requests (including inspections and interviews) or delays in providing information	Fixed and escalating civil fine  The Government will develop the levels of fines as part of its secondary legislation package	Any person targeted by TPR under section 72 to 75 of the Pensions Act 2004
Knowingly or recklessly providing false information to TPR	New civil penalty: up to a maximum of £1 million	Any person who is required to provide information to TPR as prescribed
Non-compliance with clearer funding standards	Strengthened section 231 (Powers of the Regulator) scheme funding power and existing powers (such as improvement notices) of the Pensions Act 2004	Trustees and sponsoring employers
Failure to provide a Chair's Statement, failure to provide on time or providing a poor quality statement	Existing civil penalty under section 10 of the Pensions Act 1995	Trustees and sponsoring employers

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