



Reshaping the DB world: What to expect in 2019/20

The government is consulting on strengthening the powers of the Pensions Regulator. Greater oversight of corporate transactions is a central focus, with changes to the notifiable events framework and a new declaration of intent. A three-tier system of fines would introduce civil penalties of up to GBP1m, with criminal penalties for the worst offences. The moral hazard (anti-avoidance) regime will be strengthened to allow quicker, tougher enforcement action.

Other proposals are also on the table, including changes to the rules on funding defined benefit (DB) schemes and moves to encourage the development of DB consolidator vehicles. The key issues and points to watch are set out below.

A stronger Pensions Regulator: three key areas

Widening the notifiable events framework

- A broader range of employer-related events to be notified to the Regulator
- Earlier notification required – Heads of Terms stage, or before
- Parent companies/shareholders of sponsors also required to notify



Sale of part of business that funds
>20% of liabilities



Employer takes independent
insolvency advice



Granting of security on a debt with
priority over scheme debt



Deferral, amendment or waiver of
banking covenant



Significant restructuring of
board/senior management

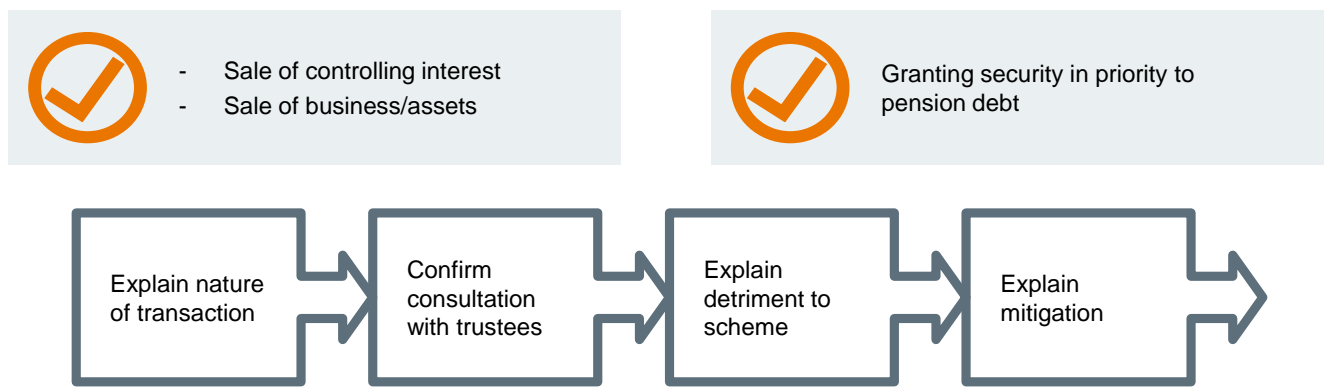
This proposal is designed to allow the Regulator to intervene earlier where necessary. Currently, information about a 'notifiable event' must be given to the Regulator as soon as reasonably practicable after the event has occurred. The idea is to bring this timing forward for transactions with the highest risk to DB schemes, such as the sale or takeover of the scheme's sponsoring employer or the granting of security in priority to scheme debt.

The list of people with a duty to report would also be extended (for example, to the directors of the sponsor's parent company).

A&O view: Favourable to trustees, but may require significant changes in commercial practice. For this to be effective and to avoid disrupting commercial activity, the Regulator must be able to respond quickly; this may require additional resourcing. Some triggers are funding-dependent, and the desire to avoid missing at-risk cases could imply that the bar for notification would be set quite low, bringing more schemes and transactions into scope than might otherwise be the case. Clear guidance as to the Regulator’s intended approach will be necessary.

A new declaration of intent

- A new statement by employers focussed on pension implications
- Agreed with trustees (or not) and provided to the Regulator
- To be provided before signing of deal



This is designed to ensure that early consideration is given to the effect that corporate decisions may have on affected pension schemes, to identify mitigation for any detrimental impact and to provide a record of the agreement reached with the scheme trustees. The proposed relevant business transactions are those which pose the highest risk to DB schemes, such as the sale or takeover of the scheme’s sponsoring employer or the granting of security in priority to scheme debt, but risk-based criteria will also apply (for example, the level of scheme funding). The declaration would be required later in the process than the associated notifiable event, after due diligence and transaction financing has been completed, but before contracts are signed.

A&O view: Favourable to trustees – this could be a powerful tool for trustees in negotiating for greater mitigation, but may not add anything in practice, given that the Regulator may already have ongoing involvement following a notifiable event. This proposal could create complex issues around timing (for example, announcements to the market) and commercial certainty. Trustees and sponsors would also need to think carefully about their confidentiality obligations and arrangements.

Stronger Regulator powers

The Regulator will review and clarify its guidance on the voluntary clearance process (which provides assurance that the Regulator will not use its anti-avoidance powers in relation to the transaction for which clearance is given). Changes are proposed to both contribution notices and financial support directions to strengthen the anti-avoidance regime.

A new three-tier penalty system is proposed. The existing civil penalties will remain in place, but a new second tier would allow the Regulator to impose a fine of up to GBP1m for more serious non-compliance, with a third tier comprising criminal sanctions (possibly unlimited fines and/or custodial sentences) for the most serious offences.

The framework will target anyone with a responsibility to the pension scheme (directors, sponsoring employers, any associated or connected persons and, in some circumstances, trustees). The consultation also proposes a range of new potential offences including:

Potential new offence	Suggested penalty	Proposed targets
Wilful/reckless behaviour in relation to scheme	Crime/max GBP1m fine	Employers and connected/associated parties
Failure to comply with notifiable events rules	Crime/max GBP1m fine	Employers/trustees
Non-compliance with declaration of intent	Max GBP1m fine	Employers and connected/associated parties
Providing false/insufficient information to trustees	Max GBP1m fine	Person providing/required to provide information
Non-compliance with DB funding code	Max GBP1m fine	Trustees, employers and connected/associated parties

A&O view: Penalties and offences will only have a deterrent effect if they can be delivered effectively: for such severe penalties, there must be transparency about how penalties are applied and clear objective definitions of the offences involved – what does non-compliance mean in the context of a scheme-specific DB funding regime? What does ‘insufficiency’ mean in the context of information provided to trustees?

Improving scheme funding

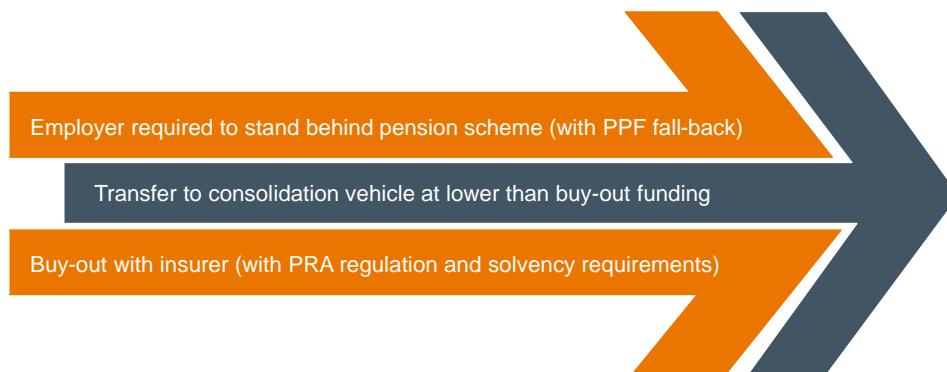
“The flexibility of a scheme-specific funding regime works well on the whole and enables trustees and sponsoring employers to balance affordability and considerations of employer growth with the need to meet the employer’s pension promise to members” – Government’s DB White Paper

Despite this confident overview, the White Paper identified three areas of concern:

- Decision-making and risk management – do schemes set technical provisions at a ‘prudent’ level and set recovery plans ‘appropriately’? Do those terms need to be clarified, and should there be greater enforceability around scheme funding decisions?
- Too much focus on the three years to the next valuation, and not enough on long-term strategic aims.
- Lack of accountability in cases where the funding strategy fails. A proposed new DB Chair’s statement would cover objectives, risks and mitigation, and would be provided to the Regulator alongside the valuation.

A&O view: A consultation on a revised DB Funding Code of Practice is expected in 2019. There is clearly a tension between the scheme-specific funding regime set out in the Pensions Act 2004 and binding, enforceable funding standards that all trustees are expected to deliver.

Driving DB consolidation



Following on from concern about governance standards in small DC schemes, the focus of attention has shifted to the outlook for small (fewer than 100 members) DB schemes and concern about higher costs/perceived lower governance in those schemes. A new legislative framework and authorisation regime for consolidation vehicles will be developed, potentially as a middle way between ongoing funding and buy out.

A&O view: *With early consolidator vehicles already on the market, clarity is needed in short order on key issues such as funding/solvency requirements, PPF eligibility and appropriate business models. Realistically, primary legislation is unlikely before 2020, but DB consolidation is potentially the greatest market change of the proposals currently under consideration.*

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