ALLEN & OVERY

When to approach the Pensions Regulator

In some circumstances those involved in operating or advising occupational pension schemes are required to provide information to the Regulator to help it carry out its regulatory responsibilities, particularly its objectives of protecting members' benefits and reducing the risk of calls on the Pension Protection Fund.

We look below at when it may be necessary for trustees, sponsors, advisers or service providers to approach the Regulator – from routine reports on scheme compliance to more urgent matters, for example, a breach of the law or a material payment failure.

Routine compliance with pensions obligations

The Regulator has a broad general power to require information from anyone who it believes is likely to hold information relevant to the exercise of its regulatory functions, including trustees, employers and professional advisers. The Regulator has recently announced a new regulatory approach under which schemes can expect more supervisory interaction, including one-to-one supervision for the biggest schemes in the UK. Click here to read more about the Regulator's change of approach.

There are also regular occasions when those involved in occupational pension schemes are expected to provide specific information to the Regulator.

Trustees

Trustee boards are required to provide certain information to the Regulator, and to ensure that this information is kept up to date. This includes scheme contact details and information about the pension scheme's status and membership profile. Click here for a full list. Where there is a change to any of this information, trustees must tell the Regulator as soon as reasonably practicable via its online scheme maintenance system, Exchange.

Trustees of defined benefit schemes must send the Regulator copies of various scheme funding-related documents, including the schedule of contributions and any recovery plan. If agreement can't be reached between the trustees and employer on the methods and assumptions for calculating the technical provisions, or on the contents of the statement of funding principles, the recovery plan or schedule of contributions, then trustees must notify the Regulator of this fact as soon as reasonably practicable, otherwise they may face a fine.

Most schemes receive an annual scheme return notice from the Regulator, and must then complete and submit the return using Exchange within 30 working days. The online form cannot be adjusted after the deadline, and so trustees should keep a hard copy for future reference. The scheme return asks for basic scheme information such as contact details for the scheme's trustees and any associated employers, details on the type of scheme and its membership; DB specific information, such as valuation information; and DC specific information, such as details on the default strategy. The information in the scheme return allows the Regulator to monitor regulatory requirements, such as the requirement for DC schemes or sections to produce a chair's statement within seven months of the end of each scheme year.

The information in the scheme return is also used for Pension Protection Fund (**PPF**) levy purposes. Scheme information for levy purposes can be updated on Exchange at any time up to the PPF's deadline, which is normally midnight on 31 March of each year.

Employers

Employers are required to automatically enrol eligible workers into a workplace pension arrangement, and to pay mandatory minimum contributions. The Regulator is charged with ensuring employers comply with their auto-enrolment obligations. An employer must complete an online declaration of compliance to let the Regulator know how it has met its legal duty for automatic enrolment within five months of the employer's staging date. Employers are obliged to re-register every three years by providing the Regulator with a fresh declaration of compliance. Click here to read more about auto-enrolment.

Breaches of the law

The scope of the duty to report a breach of law

Trustees, scheme employers, pension scheme administrators and advisers may all be required to report breaches of the law to the Regulator so as to enable the Regulator to fulfil its responsibilities and achieve its objectives effectively. This duty is commonly referred to as 'whistle-blowing'. Not every breach needs to be reported.

The duty arises where a reporter has **reasonable cause to believe** that:

– a duty imposed by law (including legislation, trust law and the scheme's rules) which is relevant to the administration of the scheme has not been, or is not being, complied with; **and**
– this failure to comply is **likely to be of material significance** to the Regulator.

Having 'reasonable cause to believe' means more than merely having a suspicion: for example, a reporter may need to check what has happened against the law and the Regulator's relevant Code of Practice in order to form an initial view.

It is not necessary to search for breaches, but those involved in operating and advising occupational pension schemes should have an effective procedure in place to identify and evaluate breaches when they do occur. It is worth noting that the Regulator interprets 'administration' widely in the context of breaches of the law. This is not limited to the scheme administrative function, but also extends to such matters as scheme funding, investment policy and management, the custody of invested assets, and anything which could potentially affect the ability of members to access their benefits or information to which they are entitled.

When deciding if a breach is likely to be of material significance, the reporter should consider:

– **the cause of the breach** – for example, breaches caused by dishonesty, poor governance or inaccurate advice are more serious than inadvertent errors;
– **the effect of the breach** – for example, does it affect funding, the security of assets or the allocation of members' contributions?
– **the reaction to the breach** – has prompt and effective action been taken to remedy the breach and its causes and, where appropriate, to notify members whose benefits are affected?
– **the wider implications of the breach** – does it highlight a broader issue such as system failure that may affect other schemes, or a lack by the trustees or administrators of adequate knowledge and understanding to fulfil their responsibilities?

The Regulator's whistle-blowing guidance groups events in accordance with a traffic light system to help potential reporters decide if a report needs to be made.

The timeframe for reporting a breach of law

A report to the Regulator about a breach of the law must be made as soon as reasonably practicable. The urgency will depend on the circumstances, but should reflect the seriousness of the suspected breach. Where there is an immediate risk to scheme assets, the payment of members' benefits, or any suggestion of dishonesty, the Regulator should be contacted by telephone, followed up by a written report via Exchange.

What about the duty of confidentiality?

The duty to whistle-blow overrides other duties, such as confidentiality. The exception to this rule is that legal advisers only have a duty to report breaches when this would not infringe legal professional privilege. Seeking legal advice about a potential breach will not give rise to a duty to whistle-blow by the lawyer, although he or she may need to advise the client of their duty to do so. The Employment Rights Act 1996 protects employees who make a whistle-blowing disclosure to the Regulator. The Regulator will normally protect the reporter's identity, although this is not guaranteed as the identity may become apparent during the course of the Regulator's investigation.

What are the consequences of failing to report?

A failure to comply with the requirement to report without a reasonable excuse is a civil offence, and could result in a fine of up to GBP5,000 for an individual and up to GBP50,000 in the case of a corporate breach. The Regulator would consider the facts of a particular case on an objective basis to determine if it believes a potential reporter had a reasonable excuse for not making a report.

DB schemes - notifiable events

Trustees and employers of PPF-eligible pension schemes (that is, not purely defined contribution schemes, nor some very small schemes) are required to provide written notice to the Regulator of certain 'notifiable events'. These give the Regulator early warning of a risk to the security of members' benefits and a possible call on the PPF. Click here to read more about notifiable events.

DB schemes - moral hazard

'Moral hazard' is, broadly, a threat to the security of scheme members' benefits or an increased risk of reliance on the PPF. It includes events or transactions which cause the employer's commitment to its pension obligations to be reduced, whether deliberately or as the result of some other activity. The Regulator has powers to issue notices requiring financial support for the scheme.

There is an optional clearance procedure by which a company can obtain assurance that the Regulator will not seek to exercise these powers in relation to a specific transaction or event. That event could be either:

- **employer-related** – affecting the employer itself, or its group, and as a result affecting the scheme's future funding prospects – for example, a change in the level of security given to creditors, or a change in the group structure. Clearance may be relevant where the scheme is less than fully-funded (generally tested on the same basis used for the PPF levy, but in extreme cases on a buy-out basis); or
- **scheme-related** – for example, an agreement to compromise a debt owed to the scheme (which the Regulator will always want to hear about).

Normally, the employer would open a dialogue with the Regulator about such an event and applying for clearance. However, for employer-related events, if trustees believe (having assessed the strength of the employer covenant) that the event is detrimental to the scheme, then they should negotiate for additional security or funding to alleviate the detriment (this is referred to as 'mitigation'). If trustees are not satisfied with what's on offer, and if the company has not sought clearance from the Regulator in relation to this event, then trustees should consider contacting the Regulator themselves. The Regulator expects scheme trustees to be involved in a clearance application, and to comment on whether they support the application and why. Where a proposed transaction might result in an employer abandoning the scheme without fully meeting its obligations to members, the Regulator expects trustees to apply a particularly high level of scrutiny and to involve the Regulator at an early stage. The Regulator is able to provide guidance where there is uncertainty if an action is an event for which clearance might be appropriate.

DB schemes - the treatment of employer debt

Where an employer leaves a multi-employer scheme which is in deficit, it may become immediately liable for its share of the deficit. This becomes a debt from the departing employer to the trustees (under section 75A of the Pensions Act 1995). There are various ways in which this debt can be handled, including redistributing it among other employers via a scheme apportionment arrangement, transferring the liabilities under a flexible apportionment arrangement, or entering a withdrawal arrangement whereby guarantors guarantee any shortfall that is not paid by the departing employer.

Trustees must give notice to the Regulator in writing preferably via Exchange of any decision to take action which will, or is intended to, result either in a flexible apportionment arrangement taking effect, or the employer entering into a scheme apportionment arrangement retrospectively (that is, if an employer debt has already been triggered).

Where a withdrawal arrangement or approved withdrawal arrangement is in force, then each of the guarantors is required to notify the Regulator of any notifiable events (as set out above), or any insolvency event, that occurs in relation to the guarantor.

DC schemes - material payment failures

Trustees of defined contribution occupational pension schemes have a duty to check that contributions due to the scheme are paid and must report any material payment failures to the Regulator and members within a reasonable period. A material payment failure is where:

- contribution payments and other amounts under the payment schedule are **not paid to the scheme** by the due dates; **and**
- there is **reasonable cause to believe** that this failure is likely to be **of material significance to the Regulator** in the exercise of its functions.

Examples of circumstances that are material to the Regulator include the sponser being unwilling to pay; possible dishonesty or misuse of assets; and repetitive failures due to inadequate systems and procedures.

A "reasonable cause to believe" is more than a suspicion. Trustees are encouraged to make enquiries of the employer and use their judgement to determine if a report to the Regulator is appropriate. The trustees would be expected to enquire about the circumstances of the payment failure, what action has been taken by the sponsor as a result, and any wider implications.

Trustees are expected to report a material payment failure to the Regulator in writing within ten working days, and then to members within 30 days of making the report to the Regulator. However, where trustees are concerned about a current or imminent danger to members' and/or employer's payments unless immediate action is taken, they should report the failure to the Regulator as soon as they become aware that this could be the case.

Trustees should have risk-based processes in place to check and reconcile scheme contributions that are appropriate to the size and complexity of their scheme. Employers are expected to provide trustees with payment information so as to enable trustees to monitor the payments. Where trustees have requested payment information but this is not provided within 14 days of the request, the trustees should report this to the Regulator.

Key contacts

Jason Shaw
Counsel
Tel +44 203 088 2241
jason.shaw@allenovery.com

Maria Stimpson
Partner
Tel +44 20 3088 3665
maria.stimpson@allenovery.com

Neil Bowden
Partner
Tel +44 20 3088 3431
neil.bowden@allenovery.com

Jane Higgins
Partner
Tel +44 20 3088 3161
jane.higgins@allenovery.com

Andrew Cork
Partner
Tel +44 20 3088 4623
andy.cork@allenovery.com