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Submission via TPR question template

By email only Code12consultation@tpr.gov.uk

The Pensions Regulator

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Code of Practice 12 consultation

Key Points for submission email:

1. As set out in SPP's response to the separate DWP consultation, we have concerns over the proposed single definition of employer resources. Irrespective of the outcome, the Code will need to be consistent with DWP's final approach.
2. Guidance is needed on what would constitute a "material reduction" in employer resources relative to the estimated s75 deficit, and how the Regulator would go about assessing this. Clarification is needed as to when actions affecting non-employers with obligations to a scheme will result in a CN on any of the three CN grounds in any of the listed circumstances.
3. Examples are too simplistic to provide real clarity. Guidance is needed on the more nuanced cases, along with more guidance on what would constitute normal activity.

Detailed response

Question 1: Is our overall approach in the draft code and code-related guidance consistent with the policy intent behind the changes introducing the two new alternative 'act' tests to the CN power?

No

SPP commented on the recent DWP consultation on regulations in relation to the new alternative "act" tests, notably the employer resources test. We did not think that they achieved the policy aim and we hope that there will be changes. This might affect the content of this guidance. As noted below, additional content on the employer resources test will be helpful when the final detail of the regulations is known.

Whilst we hope that there will be changes to the single employer resources test, it will be important for the code to be consistent with DWP's final approach. Two of the examples given in the draft code are of actions that could trigger "any of the tests" (instances of paying a dividend or

The Society of Pension Professionals
Kemp House, 152 – 160 City Road, London EC1V 2NX T: 020 7353 1688
E: info@the-spp.co.uk www.the-spp.co.uk

a return of capital and payments favouring other creditors) which do not apply to a purely profit-based measure of employer resources, as proposed by DWP.

Also, we understand that the policy intent was to capture the deliberate acts of abandonment or covenant reduction. The tests as set out would appear to capture other potential events, many that are part of normal corporate activity. For those that are part of normal corporate activity it should not be reasonable for the Regulator to impose a CN. However, there is a danger that some Group's (particularly if there is a cautious view taken regarding the Regulator's potential intervention) may be dissuaded from investing in the employer.

Finally, an act might fail one test while offering benefit in another test. For example, a major capital expenditure investment would be likely to have an adverse impact on an insolvency outcome based on asset valuations but would enhance future profitability albeit not immediately after the expenditure.

Question 2: Is the code clear on what the tests are and the circumstances in which we will consider any of the tests to be met? If not, how could we make it clearer, without limiting the scope of the tests?

No

We are not clear as to why four of the five circumstances listed in the current code of practice have not been included in the proposed new code. Is it the intention that they are covered by broader circumstances in the new draft code (we are not sure that they are) or has there been a policy change that we should understand? Some explanation would be helpful.

The descriptions in the draft code of the employer insolvency test and employer resources test mention the valuation of liabilities and section 75 debts. There is no prescribed basis for these valuations (except by reference to section 75 Pensions Act 1995), different practitioners may arrive at materially different answers, and allocation of liabilities between employers is often not a simple exercise. Some discussion of the approach that would be taken by the Regulator to these valuations and, whether, in a multiple employer scheme, tPR would be looking at the employer's share, would help those concerned to assess when the tests may and may not be met.

The draft code provides no guidance on what would constitute a "material reduction in employer resources relative to the s75 debt". This is key for sponsors, trustees and advisers in assessing a proposed course of action. Examples of concerns in this regard include the fact that a small s75 debt would be more likely to trigger because an action is more material to the s75 debt and vice versa in respect of larger s75 debts; as currently drafted, the test could permit a significant proportional reduction in employer resources without the Regulator being able to issue a CN. For example, how would the Regulator asses a significant reduction in employer resources, where the annual ongoing resources before the action were already immaterial compared to (say less than 5% of) the S75 debt?

It would also be helpful to understand how the Regulator would allow for any reduction in the s75 debt resulting from any mitigation for the action. For example, could the Regulator include an example of how it would approach a circumstance where the proportionate reduction in employer resources is mitigated by a similar proportionate reduction in s75 debt through mitigation.

Based on the Pension Schemes Act 2021 and the draft regulations, the employer resources CN test only measures the resources of statutory employers. In contrast, the material detriment CN test measures scheme obligations of the employer or any other person, including obligations that are contingent or otherwise might fall due. The employer insolvency CN test measures the recovery of

a s75 debt from a statutory employer. The existing Code 12 included a definition of "sponsor support" (a phrase still used in the first circumstance but now left undefined) that, aligned with the legislation, clearly included support from non-employers. This reflected the fact that other entities, typically within a wider group, often do provide important support for a scheme. Is there a reason why this has been deleted? The new definition of "employer covenant" (a phrase which is not used in the Code but appears once in the Code-related guidance) is unclear as to whether or not liabilities owed to the scheme by non-employers is included. Also, we note that the phrase "scheme obligation" is defined but is not used. We suggest the Code should be amended to explain clearly when non-employer support matters and when it does not, in relation to each CN ground and each circumstance.

A key aspect of the Regulator's powers is its opinion as to reasonableness. Those concerned can read and understand the legislation but, in cases that are not clear cut, they cannot know the Regulator's opinion. It would be helpful if the code, or at least the guidance, could discuss this, including factors that will and will not be taken into account when the Regulator is forming its opinion as to whether or not it is reasonable to issue a contribution notice. In any event, we expect that the Regulator will be updating the 2010 clearance guidance to reflect the new contribution notice grounds and perhaps also to reflect experience since 2010: as an alternative, that guidance could also discuss this, and indeed should do if not covered in Code of Practice 12 and its associated guidance.

It would also be helpful to understand how the Regulator would propose to address a series of acts that in isolation are not material under the tests, but in aggregate would be material.

Question 3: Are the examples provided in the code-related guidance useful in illustrating the circumstances in which we might consider the new 'act' tests to be met? Are there any other examples you would consider helpful?

Yes

Whilst we welcome the intention to publish guidance, unfortunately we believe that some of the examples could cause confusion.

There is a tendency to use (or at least seek to use) examples where there are crystal clear grounds for issuing a contribution notice. We understand that the Regulator does not wish to give room for argument that it has fettered its powers. Where guidance is needed in practice, however, is in more complicated situations where some stakeholders might consider there to be no issue and others might consider that there is. The Regulator has plenty of expertise in analysing complex situations and weighing up different considerations. The inclusion of more complex case studies, including suitable caveats to keep the Regulator's powers unfettered, would be more helpful. We also note the Regulator's proposed linking of the new criminal offences to circumstances in which contribution notices are considered. This makes clear and practical guidance even more important.

Turning to the specific examples, we find that many of them may cause confusion. We also query whether in some of the examples there are better options available, including apportionment arrangements or application of the Regulator's financial support direction powers rather than its contribution notice powers, and this could usefully be discussed. For example:

- Substitution of sponsor – sponsor support becomes nominal: We are not clear how the substitution is being achieved, and how the parent company is involved. It would appear that it would trigger a section 75 debt, in which case there may be no need for a contribution notice or there could be an apportionment arrangement to more easily

address the Regulator's concerns. In the absence of that, this looks like a case where a financial support direction might in practice be preferred by the Regulator over a contribution notice since it would be easier to secure.

- Disposal – sponsor support is reduced: We do not understand this example: how would a payment to the parent company constitute consideration passing from the other group company to Employer G? Again, since assets remain in the group, would a financial support direction in practice be the preferred option?

- Restructuring – sponsor support is reduced: Again, since assets remain in the group, would a financial support direction in practice be pursued rather than a contribution notice?

- Transfer of scheme liabilities – sponsor support is reduced: We do not quite understand what is happening here or how, so our ability to comment is limited. For example, is Company I in the same group or not? If it is then might a financial support direction be preferred? It would also appear that there could again be a section 75 debt and a possible apportionment arrangement. If it is not in the same group, the analysis is very different, so this needs to be clarified.

- Manufactured insolvency – sponsor support is removed: This looks like criminal activity. Would the Regulator tend to use its contribution notice powers rather than, for example, prosecuting and/or encouraging the trustees to threaten, and if necessary pursue, litigation for damages over the apparent fraud?

- Increase in debt/prior-ranking security – weakening of scheme's creditor position: There may be unspoken nuances behind this example that affect the analysis. We are not clear why the group's survival would not benefit Employer N. Is there actually benefit in that the group needs the refinancing and the lender has insisted on greater/broader security?

- Leveraged acquisition – weakening of scheme's creditor position: At the end of this there is a reference to "the fund". We assume that “the fund” refers to the new owners but it would be helpful to clarify this.

The examples of where the Regulator would not consider issuing a contribution notice are few in number (and reduced to three from five in the current version of the guidance). A much longer list would be welcome as the tests would seem to capture certain “normal corporate activity” and the list as presented is unlikely to provide much help to those involved in running schemes. In particular, we note the investment strategy example has been removed, which might suggest to some that a contribution notice could be considered even where the strategy had otherwise been properly agreed under legislation.

The guidance could also usefully discuss the areas of overlap between the two new contribution notice grounds. It would also be helpful if indication could be given of which test(s) each example relates to. This would aid understanding of their scope.

We have mentioned above that it would be helpful if the code, or at least the guidance, could discuss the reasonableness test, including factors that will and will not be taken into account when the Regulator is forming its opinion as to whether or not it is reasonable to issue a contribution notice.

As mentioned above, there is also a question of materiality in relation to the employer resources test, under section 38E(1)(b). This is determined by the Regulator's opinion. Guidance is needed here on how the Regulator will define and assess materiality, in order for those concerned to be able to assess their position with regard to the legislation.

There may also be scope (depending on the final DWP regulations) for differing approaches to the calculation of the "resources of the employer": guidance on the approach the Regulator will take is likely to be needed for the same reason. The draft regulations base the employer resources test on “normalised profits” but none of the examples explicitly make reference to this metric – as this is a new area, further examples on this point would be welcome. We would also note that we have made a number of comments to the DWP on our concerns around using this metric in isolation, so it is important to understand how the Regulator will make use of it in practice.

Question 4: Do you have any other feedback?

No

Response ends