

STATEMENT ON PLANNED DWP CONSULTATION ON THE POWERS OF THE PENSIONS REGULATOR

The Government will shortly be issuing a consultation document on proposed changes to the powers of the Pensions Regulator. This consultation will set out why the Government considers change is needed, and ask for views on the Government's proposed way to achieve those changes. To ensure that these changes treat all parties fairly, the Government intends that the core amendments should be effective from the date of this announcement 14 April 2008; one minor amendment would be effective from 27 April 2004.

The regulatory regime for defined benefit occupational pensions is designed to enable employers to provide good quality pensions for employees. On the understanding that the employer will stand behind the scheme risks related to investment, longevity and other issues, sponsoring employers are not required to ensure that the scheme has capital against unexpected events, as would an insurance company.

In the main the system works well, with good relationships evident between pension scheme trustees and their sponsoring employers. The vast majority of schemes are well run and regulatory intervention is rare. We have seen some very welcome innovation which helps employers manage their pension scheme liabilities without jeopardising the security of members' benefits. But we need to stay alive to changes which might undermine the traditional employer/trustee relationship in a way that is damaging to the system as a whole.

However, developments in this area have included 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. Sponsors of such models are attracted to operating in the occupational pensions regime (as regulated by the Pensions Regulator) rather than the Financial Services Authority regime, in which they would be required to hold greater capital against liabilities.

Such business models have significant implications for the nature of the relationship between sponsor and scheme. Changes in this relationship may, in some circumstances, place the trust model of governance under some strain.

The Government believes that the trust model is the most appropriate governance structure for defined benefit occupational pension schemes to balance the interests of scheme sponsor and beneficiaries. The Pensions Regulator's powers are designed to complement and bolster the role of trustees, who have the primary responsibility for the protection of member benefits. The Government is committed to ensuring that the Regulator has the powers it needs

to continue to support trustees, and to mitigate risks to members and to the Pension Protection Fund (PPF).

In particular, the Government is concerned to achieve fairness between pension scheme beneficiaries and others who may seek a return from scheme assets. There would be an asymmetry if any surplus could be returned to shareholders whilst any risk of underfunding could be offloaded onto members and the Pension Protection Fund – which could lead to additional costs to other employers through the PPF levy. The pensions regulatory regime was designed to assist employers with pension provision, and the Government remains committed to ensuring that employers who wish to retain defined benefit pension schemes can do so in a cost effective way. However, these new developments require the Government to consider whether changes are needed to ensure that the regime treats new business models appropriately.

The Government believes that in order to retain the current system of occupational pension provision, while ensuring that new business models contain adequate protection for members and the PPF, it should enhance the Regulator's power to require contributions to pension schemes when sponsor actions materially reduce the security of member benefits.

In 2004, the Government identified that the introduction of the PPF created new risks that unscrupulous scheme sponsors could seek to offload liabilities onto the PPF. It therefore legislated to introduce 'anti-avoidance' powers that allowed the Pensions Regulator to act where corporate transactions were aimed at avoiding debts to pension schemes. The principal of these powers are the **Contribution Notice**, which can be issued to require a contribution to a pension scheme if there is behaviour aimed at avoiding a debt to a pension scheme or preventing such a debt becoming due, and the **Financial Support Direction**, which requires a parent company or other person connected or associated with the employer to put support in place for a pension scheme whose sponsor is either under-resourced or a service company.

Experience since 2005 has shown that these powers are effective deterrents, and the Regulator has successfully deployed the Financial Support Direction to protect two pension schemes associated with one organisation. However, the Government considers that in the light of recent developments there are a number of areas in which amendments to these powers would be helpful, and one area in which it is desirable to extend the Regulator's powers.

At present, a Contribution Notice may be issued if there is behaviour which is intended to prevent the recovery of a debt from an employer to a pension scheme, or at preventing a debt becoming due. While this is a key power for the Regulator, experience has shown that there are acts that present risks for member benefits which may not trigger the issue of a Contribution Notice. For

example, the disposal of significant company assets may seriously undermine the ability of the company to meet the pension promises it has made.

The Government therefore proposes that Contribution Notices may be issued where the **effect of an act is materially detrimental to a scheme's ability to pay members' current and future benefits** in order to cover situations such as this. This change would mean that the Regulator would no longer need to prove **intent** on the part of a party to avoid funding the scheme, but rather that the **effect** of an act or course of conduct posed a materially detrimental risk to members' benefits.

The Government recognises that a new power such as this must be defined carefully to give clarity to pension schemes and their sponsors, and to ensure that it may be deployed by the Pensions Regulator where necessary without undue burden. It will therefore consult on the best approach to draft such a power. The Government will ensure that new powers are appropriately targeted on actions which pose risks to pension schemes. For example, it may be appropriate to limit the use of the power to situations in which the prospective recipient of a Contribution Notice is unable to demonstrate that the likely consequences of their actions could not reasonably have been foreseen.

The Government also proposes to remove the existing provision that states that a Contribution Notice may not be issued where a party has acted in **good faith**, but their actions have had the effect of preventing a debt becoming due. Operational experience has shown that this is an unhelpful hurdle which would prevent the power being used in situations where parties have simply not considered impacts on pension schemes.

These approaches have precedent in tax legislation – but we are consulting widely to avoid legislation with unforeseen side-effects.

The Government also intends to ensure that the use of the Regulator's moral hazard powers is not frustrated by **'bulk transfers'** of members between pension schemes, and will ensure that its planned amendments to the Regulator's power to issue Contribution Notices achieve this.

The Government intends to amend the Regulator's powers to clarify the policy intention in two areas:

- First, to clarify that the issue of a Contribution Notice can be triggered by a **series of acts**, and not just a single act aimed at avoiding a debt to a pension scheme;
- Second, to ensure that the resources of the **whole group** of companies may be considered when judging whether to issue a Financial Support Direction when there is an under-resourced employer – rather than requiring the Regulator to identify one single 'person' which is sufficiently resourced to enable the issue of a direction.

These amendments will be introduced with effect from 14 April 2008, except for the 'series of acts' amendment which will be effective back to 27 April 2004 as it is a clarification of an existing provision whose effect dates back to this date.

The overwhelming majority of pension schemes will not be affected by these changes. The Regulator has demonstrated that it takes a proportionate approach to regulating pension schemes, and only uses its powers where it is reasonable to do so.

This consultation approach will ensure that everyone gets a chance to influence the way these changes are made. Following consultation we will seek to bring forward any legislative changes at the earliest opportunity.

These proposals will ensure that pensions are secure, and that promises are kept. They will also ensure that pensions liabilities cannot be off-loaded to the PPF, which would impose new costs on continuing schemes and their sponsoring employers.