

The Actuarial Profession
making financial sense of the future

Actuaries and the Law Seminar
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FSDs and CNs in Practice Some Revelations

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Agenda

- Moral hazard powers – recap
- Experience to date
 - CN
 - FSD
- Process and dynamics
- Managing risk
- Key messages

Moral Hazard Powers - History

- 27 April 2004 - Malcolm Wicks:
 - “...*unscrupulous employers might find ways to circumvent the provisions. The regulator must be able to adapt to deal with that if the provisions are to be workable and if they are to represent a real deterrent...*”
- tPR initial approach
 - 6 years until Bonas
 - tPR as an educator
 - Difficult test to meet for a CN:
 - Main purpose of act/omission was to:
 - prevent recovery of an employer debt; or
 - compromise debt in bad faith.

Moral Hazard Powers (cont.) - CN

- What?
 - tPR can require the person to whom it is issued to pay a specified sum of money to the pension scheme
- How?
 - Act or failure to act and either:
 - Pre 2009: main purpose to prevent recovery of employer debt or otherwise than in good faith
 - Post 2009: Main purpose to prevent recovery of employer debt or material detriment test met

Moral Hazard Powers (cont.) – CN Material Detriment

- “the act or failure to act has detrimentally affected in a material way the likelihood of the accrued scheme benefits being received”
- Relevant Factors:
 - Value of assets and liabilities
 - Scheme obligations of any person
 - Likelihood of discharge of scheme obligations
 - Extent to which likelihood has been acted upon
- Defence: that it was reasonable to conclude (having considered the point and taken required action) that the act was not materially detrimental

Moral Hazard Powers (cont.) – CN Limitation

- Limitation:
- (i) must be after 27 April 2004
- (ii) **AND** within six years ending with the determination by tPR to exercise the power to issue the CN, or
- (ii) for multiple acts/multiple failures the six years begins with the last act/failure to act
- End date prone to exploitation
- Pensions Bill proposal to change

Moral Hazard Powers (cont.) – FSD Tests

- What?
 - tPR can require the employer (and those associated and connected) to put in place financial support for the scheme
- When?
 - 2 x tests:
 - Service Company
 - Insufficiently Resourced

Moral Hazard Powers (cont.) – FSD Test

- Scheme Test – DB OPS?
- Target Test – Scheme Employer or ‘connected with or associated with’
- Insufficiently Resourced Test:
 - (1) poor employer (Assets < 50% of buy out debt)
 - (2) rich friend (to ‘make up the difference’)

Moral Hazard Powers (cont.) - FSD

- Reasonableness Test – Relevant Factors:
 - Relationships between Targets
 - Value of benefits flowing from PE to Targets and circumstances of any benefit extraction
 - Involvement of Targets with Scheme
 - Financial Circumstances of PE and Targets
 - Discussions for a Recovery Plan

Moral Hazard Powers (cont.) – FSD Target Test

- Many companies may be associated
- Significance is ‘control’: director or 1/3 voting rights

Our experience

- CNs
- FSDs

Regulatory proceedings: Process

- Warning Notice: served on Target and Interested Parties
- tPR teams: Prosecution team and Determination Panel
- Directions
- Response: Target – defence+, Interested Parties... ?
- Hearing
- Determination: end of the matter or not?
- Costs: each party bears its own

Determination Panel: potential drawbacks

- Not a court: no formal disclosure, no power to compel attendance of witnesses, no cross examination
- Response: open to wide interpretation by Targets
- Timetabling: beware longstop date
- Hearings: can be inadequate length
- DP decision: right to refer to Upper Tribunal
- UT referrals: appeal by way of re-hearing

Regulatory Proceedings: Considerations

- Sometimes long gestation:
 - Impact for trustees
 - consideration for employers?
- FSD settlement discussions:
 - Trustees in driving seat with tPR in the background
 - Additional pressure for employers?
 - tPR's role in negotiations
- Upper Tribunal duplication

Process – Dynamics (cont.)

Information use

- Beware confidential information.
- S72 - Provision of information
 - tPR may, by notice in writing, require [someone] to produce any document, or provide any other information, which is relevant to the exercise of the Regulator's functions.
 - [Someone]:
 - Trustees, Employer, Professional Advisors
 - Anyone else who tPR thinks holds relevant info!

Process – Dynamics (cont.)

Information use

- But – Legal Professional Advice Privilege
- S311 PA 2004: A person need not disclose “protected items”:
 - (broadly) legal advice communications between a lawyer and his client (/’s advisors) or legal advice communications in contemplation of legal proceedings.
 - Note: actuarial reports, other sensitive data

Process – Dynamics (cont.)

Layers of Reasonableness

- tPR as a reasonable public body
 - Reasonable to pursue a sufficiently resourced company for an FSD?
- Reasonableness Test (4th test) to issue an FSD
- Reasonableness within test of a materially detrimental act for a CN
- tPR to consider reasonableness of company's actions
 - Is it reasonable to pursue company for more money than what is needed to meet 'insufficiently resourced' test?

Managing tPR risk

1. Being sufficiently resourced (FSD)

- Insufficiently Resourced:
 - (1) poor employer (Assets < 50% of buy out debt)
 - (i) take net assets, deduct pension liabilities
 - (ii) adjust for fair value differences (in value of assets)
 - (iii) add on difference between entity value as at calculation date and net assets used by tPR
 - (2) rich friend (to 'make up the difference')

Managing tPR risk

1. Being sufficiently resourced

- sufficient assets to cover at least half of the buy-out debt
- Monitoring of companies seeking to up their entity values (stage iii)
 - Eg. by contending inter-company receivables are recoverable
- Consider approach to tPR?

Managing tPR risk

2. Where is business placed?

- Consider where business is placed
 - Inform tPR?
 - Covenant assessment – quarterly review?

Managing tPR risk

3. Preventative Clearance

- Consider pensions liabilities in corporate restructurings
- Early clearance an option
 - trustees and ‘supra-creditor’ status
 - Mitigation to trustees

Managing tPR risk

4. Reaching agreement

- Agreement one way forward
 - (extensions to deadlines etc)
 - trustees not restricted to cash options (as tPR is)
 - Interesting options:
 - Security (amortisation)
 - Recovery plan payments
 - Loans
 - Negative Pledges

Points to takeaway

- 1. Recognise tPR's powers:
 - Company: practical steps
 - Trustees: consider company's actions and time starting to run
- 2. Clearance can help plan for the future
- 3. Trustees need to be proactive
- 4. Consider your associates and to whom you are connected
- 5. Being sufficiently resourced

Any questions?
