

**The Actuarial Profession**  
making financial sense of the future

Current issues in pensions (CIP)  
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## FSDs, CNs and other legal issues

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### Overview of this session

- Regulator activity – latest developments
  - contribution notices & financial support directions
  - Nortel, Lehmans & Bonas
- Other (recent) legal issues
  - actuarial factors and the ECJ
  - CPI v RPI
  - latest Regulator guidance

## Regulator activity – a sudden run of cases

- Sea Containers (2007) – FSD
- Bonas (2010) – CN
- Nortel (2010) – FSD
- Lehmans (2010) – FSD

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## Why the sudden run of cases?

### Professional Pensions

REGULATOR'S JUNE MULROY PREDICTS 'BOW WAVE' EFFECT AS COMPANIES ACCEPT TPR'S WILLINGNESS TO USE POWERS

## TPR dealing with 'gruesome' aftermath of credit crunch

### Professional Pensions

REGULATOR DETERMINATION PANEL SAYS US PARENT WAS SOURCE OF CONTRIBUTIONS

## US Lehman parent link to UK sponsoring employer

### Professional Pensions

## Contribution notice first sign of regulator clampdown

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### Professional Pensions

## Regulator issues FSD to Nortel

By Tom Selby

The Pensions Regulator has issued a Financial Support Direction against companies in the Nortel group requiring them to provide support for the UK scheme, which had a £2.1bn shortfall on a buyout basis.

The Pensions Regulator's Determinations Panel found that it would be reasonable to impose the requirements of a Financial Support Direction on the target companies after the employer of the Nortel Networks UK Pension Plan was found to be "insufficiently resourced" (PP Online, July 29).

The FSD will require those companies within the group to provide financial support for the scheme.

The employer, Nortel Networks UK Limited, entered administration in January 2009 together with several other entities worldwide.

Under UK pension law, the FSD requires the target companies to provide financial support of up to £2.1bn – the shortfall on the section 75 buyout basis.

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## What is a contribution notice?

- A demand to pay immediately into the scheme an amount up to the full actual or contingent buy-out debt
- Can be issued against any person who is **associated with or connected to** the employer - wide definition:
  - non-participating employers
  - overseas companies
  - individuals as well as corporates
  - private equity houses

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## When can a contribution notice be issued?

- Act or failure to act - within previous 6 years:-
  - “material detriment test” is met, or
  - the main purpose or one of the main purposes of the act/failure to act was to prevent the recovery of all or part of the section 75 debt or to prevent it becoming due or to compromise, settle or reduce that debt;
- Must be reasonable for the Regulator to issue a CN

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## Material detriment test

*“.....the material detriment test is met in relation to an act or failure if the Regulator is of the opinion that the act or failure has detrimentally affected in a material way the likelihood of accrued scheme benefits being received (whether the benefits are to be received as benefits under the scheme or otherwise).”*

(section 38A(1) Pensions Act 2004)

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## Defence to material detriment test

Person being targeted by the Regulator must show:

- gave due prior consideration to extent to which act/failure to act might have material detrimental effect;
- (where appropriate) then took reasonable steps to eliminate or minimise any potential detriment identified; and
- in all the circumstances prevailing at the time it was reasonable to conclude that the act/failure to act would not result in accrued benefits being detrimentally affected in a material way.

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## Reasonableness

Regulator must consider:-

- involvement in the act or failure to act
- relationship with the employer – especially control
- involvement with the scheme – especially influence
- failure to comply with statutory duty to notify to the Regulator about the act or failure.....

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## Reasonableness (continued)

- the purpose of the act or failure (eg was the aim of the transaction to save jobs?)
- the value of benefits received directly or indirectly from the scheme or the employer
- likelihood and extent to which creditors will be paid
- financial circumstances

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## Financial Support Directions (FSDs)

- State of affairs – no need to show fault
- Requirement to put in place financial support where the employer is either a service company or “insufficiently resourced”
- Can be issued against associated or connected persons ... (but not individuals)
- Two stage test

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## FSD – stage one test

Employer must be either **a service company ....**

- employer must be a member of a group; and
- turnover (latest accounts) solely or principally derived from amounts charged for the provision of services of its employees to other members of the group

**OR...**

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## FSD – stage one

....it must be “**insufficiently resourced**” (rich man/poor man test)

- Value of employer's resources < 50% of the buy-out debt; and
- Value of resources of one or more of other members of the group not less than the difference between employer's resources and the 50% amount
- Easy concept, complicated in practice!

## FSD – stage two test

Regulator must act **reasonably** - has a statutory duty to take account of the following factors:-

- relationship with the scheme employer - especially control
- the value of any benefits received directly or indirectly from the scheme employer
- involvement with the scheme – especially influence
- financial circumstances

## The FSD process

- Can take many months of evidence gathering and investigations
- Actuarial involvement?
  - scheme actuary providing analysis
  - use of independent actuarial expert witness
- Warning notice

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## The Determinations Panel

- Independent arm of the Regulator
- Panel hearing
- Two year time limit (Lehmans)
- Referral to the Upper Tribunal

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## International considerations - Nortel

- Filing claims by the "bar date"
- Dealing with "the stay"
  - US Chapter 11 proceedings, *Sea Containers*
  - Canadian CCAA proceedings
  - watch this space!

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## Nortel & Lehmans in the UK – a provable debt....

Meanwhile, in the UK:-

- Decision to issue FSD referred to the Upper Tribunal
- Joint application to the High Court by the administrators for determination as to how FSDs rank in an insolvency:-
  - provable debt?
  - expense of administration?
  - non-provable debt?

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## .... or something else?

High Court decision:-

- *Toshoku* principle – “necessary disbursement”
- FSD = expense of administration unless it has been issued before the insolvency event (in which case it is a provable debt)
- FSD therefore given super priority status
- “a legislative mess” (Briggs J)

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## Consequences?

- Subject to appeal but in the meantime..
- Issues for banks, corporate groups, insolvency practitioners, etc
- Trustees may feel they now have real leverage
- FSD issued after insolvency is better than one issued before insolvency!
- Watch this space!

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## Bonas, first contribution notice

- Background:-
  - Van de Wiele N.V. acquired Bonas in 1998 – loss making with pension scheme deficit
  - In 2006 Bonas put into administration – assets and liabilities transferred to new company within VdW group on a pre-pack for £40,000
- Regulator issued CN for £5m against VdW. Reasons?
  - Pre-pack had been aimed at avoiding the pension liability
  - Failure by VdW to engage openly with the trustees or the Regulator

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## Bonas (continued)

- VdW referred the DP decision to the Upper Tribunal (UT)  
October 2010 – application to strike out
- UT expressed surprise at the quantum of the CN demand
- UT decided to send the case back down to the DP to reconsider various issues
- Could now result in a much lower CN being awarded

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## What do we take from these cases?

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- Regulator alive and kicking – but checks and balances
- N American insolvency proceedings – issues remain
- Unfinished business in the UK – will there be legislative change?
- Greater role for actuaries and covenant reviews in the evidence gathering for CNs and FSDs.

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## Other legal issues (overview)

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- Actuarial factors and the ECJ
- CPI v RPI
- Latest Regulator guidance

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## Actuarial factors and the ECJ

- *Association Belge des Consommateurs Test-Achats ASBL*
- ECJ decision following referral by Advocate-General
- Gender Directive – derogation permitting sex-specific factors
- Is the derogation incompatible with EU law on equal treatment?

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## Actuarial factors and the ECJ (continued)

- ECJ issued decision on 1 March 2011
- Follows Advocate-General's opinion
- Insurance companies can no longer price annuities based on gender from 21 December 2012
- Impact on occupational pension schemes?

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## CPI v RPI

- Automatic switch will depend on precise wording of scheme rules
- Not much assistance from the legislation
- Vagaries of scheme rules drafting will make a difference – odd results
- Need to check the historic versions of scheme rules
- Don't forget the scheme booklet!

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## Regulator Guidance – covenant reviews

- Covenant reviews
- Guidance now finalised
- Recognises a more proportionate approach
- But most trustees will still need to get external advice

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## Regulator guidance – transfer incentives

- Guidance now finalised
- 5 principles
  - clear, fair and not misleading offer
  - open and transparent
  - manage conflicts of interest
  - engage and consult with trustees
  - members to be provided with access to fully independent and impartial advice.

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## Any questions?



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