



Institute
and Faculty
of Actuaries

Protecting Defined Benefit Pension Schemes - A Stronger Pensions Regulator

IFoA response to Department for Work and
Pensions

21 August 2018

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Submitted online

21 August 2018

IFoA draft response to DWP consultation: Protecting Defined Benefit Pension Schemes - A Stronger Pensions Regulator.

8. We have set out a number of proposed changes to the existing notifiable events framework. Do these proposals strike the right balance between improved regulations on business and protecting pensions?

We welcome the proposal to bring the timing of reporting of notifiable events forward. However a reassessment of the appropriate risk indicators is needed, rather than simply adding more events, as noted in our response to Question 14. It is also worth noting that the number of notifiable events has been reduced in the past because too much information was being provided that the Regulator was not able to effectively deal with.

The right balance will only be achieved if notifiable events are at a level such that TPR can reasonably identify where action is needed and take the appropriate action, whilst not being overloaded with unnecessary information.

9. Alternatively, are there any other significant business events which you think should be captured?

We note the focus on sales and the difficulty of capturing every possible business event, but we support the rationale behind the suggested new events.

However, a reference to 'sales' alone in the legislation will not be sufficient. A clearer definition of 'sale' is therefore necessary, particularly in the case of corporate restructures and the transfer of assets between subsidiaries. The IFoA expects other respondents will comment further on the detail of the events that need to be captured.

We note that the issues of paying dividends and executive remuneration/reward packages are being covered separately, but would expect something in this area, and other ways of diluting a covenant, to be included in the notifiable events regime in due course.

10. Have we captured the right criteria for a significant change in the make-up of a board of directors?

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No comment.

11. We are proposing to bring forward or specify more clearly the timing of reporting notification of certain events, for instance to the point at which Heads of Terms are agreed for some transactions. Is this appropriate or is there a better time/ event to pin the reporting notification to?

We support earlier notification of employer-related events, provided the requirements are clear.

We also support efforts to engage trustees earlier, although we assume that requiring earlier notification of business-related events by employers will not also require them to inform the trustees and therefore won't necessarily achieve earlier engagement.

There should be no compulsion to notify transfer values or the payment of other member benefits earlier as this would be impractical, particularly where members have an entitlement to benefits under the scheme rules and payment of them is 'business as usual'.

12. What is the likely impact (either direct or indirect) on business of sponsoring employers being required to report earlier?

The direct impact will largely depend on TPR's reaction to notifications, and it could be significant if TPR cannot act swiftly. We also expect sponsoring employers to require confidentiality agreements to be in place before sharing market and business-sensitive information at an earlier stage than may have been the case previously.

13. How could the framework be modified to ensure that any adverse impact is mitigated?

Firstly, we believe that Government should not refer to the proposal as a 'framework' as it will be a set of regulations and non-compliance will be sanctioned. 'Regime' might be a more appropriate term.

Secondly, there is also a considerable lack of clarity in the current notifiable events regime and therefore it needs to be clarified so it is not open to interpretation, so as to limit as far as possible the risk of uncertainty as to whether it applies. We also comment on this under the next question.

Finally, we would suggest ensuring that the reporting process is streamlined into a one-step process through Exchange. For example, it is not efficient for TPR to follow up every notification with a further standard set of questions via email (as is current practice for FAA notifications). Follow-ups (other than confirmation that no action is being taken) should only occur where TPR has concerns.

14. Are there any additional changes that could further improve the design of the framework for sponsoring employers, trustees and the Regulator?

As we commented earlier, the right balance will only be achieved if notifiable events are at a level such that TPR can reasonably identify where action is needed and take the appropriate action, whilst not being overloaded with unnecessary information. We believe this means some of the existing scheme-related events need to be reviewed and ideally removed.

For example, existing scheme-related events regarding transfers and the granting of benefits where these are in line with scheme rules are not good risk indicators and reporting them is not a good use of resources for trustees or TPR.

We would therefore suggest stripping these out and replacing them with a new focus on TPR's existing guidance to trustees on the impact of transfers, cash flow issues and mature schemes.

However, if these scheme-related events remain in place, TPR will need to provide more clarification on how to interpret them, as there is a general lack of clarity and this is not acceptable if trustees could be fined (or even potentially be subject to criminal sanctions) for non-compliance.

Further, the burden of the existing notifiable events can already be significant, particularly for small schemes, where a large proportion of scheme-related events can currently be notifiable. If the events must remain notifiable, we would at least encourage the Government to review the thresholds, which have been unchanged for many years and to consider a de minimis number of events, below which scheme-related events would not need to be reported (so that only a significant block of members taking benefits or transfers would be reportable).

15. We have set out a number of proposed transactions which would trigger a Declaration of Intent. Do these proposals strike the right balance between improved regulations on business and protecting pensions?

We support the policy intention of a Declaration of Intent; however it should be clear in: what it contains; how far it needs to go in terms of agreement with trustees; and who it should be circulated to (if not TPR alone).

Clarity is particularly needed, as failure to comply with the Declaration of Intent requirements will be a fineable penalty under the new regime. This includes the criteria under which schemes/situations will trigger the requirement (unlike the current Directions for Notifiable Events, which do not resolve all uncertainties and therefore do not provide the necessary clarity).

Depending on what the Declaration of Intent entails, it is likely to be a time and resource-consuming task for the employer, in circumstances where both may be in very short supply. We would therefore expect the legislation to set criteria for when a Declaration is required to ensure that these are not needed too regularly or for more minor activities.

In terms of striking the right balance, this will depend on TPR's reaction to receipt of a Declaration of Intent.

16. Alternatively, are there any other significant business transactions which you think should be captured?

See answer to Question 9. We expect the business-related issues which ultimately become notifiable events will largely also be reflected in the new regulations covering Declarations of Intent.

17. Is there any further information which could be included in a Declaration of Intent to improve understanding of the proposals to strengthen the position of the pension scheme?

We expect the Declaration of Intent to have to state that the trustees have been consulted and whether they agree with the proposals.

18. At which point in the transaction process should sponsoring employers a) engage with trustees and b) issue a Declaration of Intent to them?

Trustees should be engaged as early as possible in the process. However we recognise the potential for confidentiality issues to arise, given the need for balance between employers' needs for confidentiality early in process and trustees needing to be engaged. If engagement is early but the information provided is too sparse to be useful this will create difficulties in itself.

We expect the Declaration of Intent, unlike the initial notification to TPR, to be a working document which ultimately formalises the practice that TPR would recommend for discussions between trustees and sponsor about the impact of the transaction and the necessary mitigation.

19. What would be the impact (both direct and indirect) of our proposals on businesses, for example on transactions or administration costs of notification?

As per our answer to Question 13, we would suggest that the process is streamlined as far as possible.

We would expect the Declaration of Intent would be submitted through Exchange and also expect there to be some guidance about TPR's expectations for the content and perhaps also the format, to avoid protracted correspondence while it gathers the information it requires. As per our answer to the previous question, we would recognise the potential tension around disclosure and confidentiality, which will require further consideration.

However, we would also expect TPR's initial information requirements to be balanced and not excessive. Generally, the costs and disruption for businesses (and, potentially, trustees and their advisers) are likely to increase as the duration and extent of TPR's involvement increases.

20. What more could we do to increase trustees' involvement in negotiations to ensure there is due consideration of the potential transactional risks to pension schemes?

TPR should try to publicise and use its current powers more (or report consideration of them through a Section 89 report). Having greater confidence that TPR will react should encourage sponsors to engage with trustees at an earlier stage.

21. Are these the right areas for the Pensions Regulator to focus on in relation to improvements to their existing guidance?

We support the first two suggestions, however we note the quandary of clearance, given that it is seldom used because it is voluntary (and rightly so). Our experience suggests that the principles underlying the clearance regime tend to be built into corporate transactions to satisfy trustees and sponsors without the additional costs and delays of obtaining clearance. In other words, the impact of the clearance guidance is felt without the need to follow the full clearance process.

That said, the guidance is outdated and therefore needs refreshing. To encourage use, it could be repackaged as possible approaches for sponsors and trustees considering corporate transactions and other notifiable events, rather than guidance on something which is optional.

Based on experience to date, we do not expect refreshed guidance to increase the use of clearance given the cost, unless sponsors going through the significant additional steps needed to produce a robust Declaration of Intent feel they deserve some protection (through clearance) as a result. However, if the impact of refreshed guidance is to improve outcomes for pension schemes, it should not matter whether or not actual clearance applications increase.

22. Should anything else be considered?

No comment.

23. What are the likely effects and impacts on business and trustees of the introduction of this proposed new system of penalties?

The Government has already acknowledged that the current system works well for the majority of schemes, so it is important that changes catch offenders, but do not impose a significant burden on sponsors and trustees who are already managing their schemes well and 'doing the right thing' for members.

We are supportive of not having mandatory penalties. In theory, more penalties should mean greater compliance, however more professional advice will be needed on how to comply so some balance is needed. In particular, we note that there is currently no concession for smaller schemes under the proposals. We therefore have concerns about the impact on these schemes and the subsequent pressure on trustees, although we recognise that members of small schemes equally require protection.

Whilst most of the attention in this section is on reckless behaviour towards a pension scheme and an employer trying to avoid its responsibilities to a scheme, the table of offences and penalties includes proposed civil fines for “others associated and connected” in relation to failures to comply with elements of the DB funding code. It is not currently clear whether this could extend to professional advisers, nor indeed what the new funding code will contain. We do not believe it is appropriate to consider imposing penalties on anyone for failure to comply with rules which have yet to be written and strongly urge the Government to consult on penalties for non-compliance as part of the consultation on the funding code itself.

The table of offences under the heading ‘Who will be penalised’ in the consultation document is not clear as to whether it refers to the proposed new DB Chair’s Statements as well as the existing DC Chair’s Statements. If DB Statements are also intended to be included in the proposals, again we do not believe it is appropriate to consult on penalties for non-compliance before the requirements for these Statements have been established.

Criminal penalties for failure to comply with the notifiable events regime may be harsh, especially in relation to the existing notifiable events requirements and the current lack of clarity. Moreover, it will be very difficult to succeed with criminal penalties on the notifiable events regime given the higher standard of proof and the lack of clarity.

24. Are there other behaviours that should attract sanctions? If so, what are they?

No comment.

25. We have proposed a new civil penalty (up to a maximum £1m) for example to take action for non-compliance with providing a declaration of intent. Will this deter wrongdoing? If not, what would be a suitable deterrent?

To some extent, the discussions and actions documented in the Declaration of Intent, and the mitigation promised by it, are more important than the document itself. Therefore the expected content needs to be clarified so that failure to produce a *compliant* Declaration of Intent can also be penalised. Similarly, there should be sanctions for failure to follow through with the promised mitigation.

26. We have proposed a new criminal offence for wilful or reckless behaviour in relation to a pension scheme, and for failures to comply with Contribution Notices and the Notifiable Events Framework. Do you agree with these proposals? Will they deter wrongdoing? If not, what would be a suitable deterrent?

We agree it could be useful to be able to penalise wilful or reckless behaviour, although we note that such behaviour could be difficult to define and the burden of proof will be high, making it difficult to impose sanctions in practice. Further, if an individual is not deterred by a contribution notice requiring payment from him or her personally it is unlikely that the risk of a criminal charge will make a major difference to behaviour. Nevertheless, TPR’s ability to

publicise the consideration of the use of such powers in a Section 89 report should be a useful deterrent.

As previously mentioned, a criminal offence is perhaps harsh for the notifiable events framework, particularly if it continues to be referred to as a 'framework'.

It should be remembered that the behaviour the sanctions seek to deter is rare. Therefore it seems reasonable to be able to impose criminal penalties for failures to comply with a contribution notice – but again, more information is required for us to make an appropriate judgement.

27. If yes, should the maximum penalty for these offences be: Unlimited fines? Custodial sentence and/or fine for the worst offenders – do you have views on the appropriate maximum term?

We have no view on a maximum term. To some extent the aim should be to never have to use these penalties. We therefore support there being more focus on encouraging good behaviour than on punishing poor behaviour.

28. What more can we do to support the Pensions Regulator in enforcing legal requirements in an effective and proportionate way?

We would suggest that more resource be made available to the Regulator for DB activities, particularly when it is being obliged to prioritise DC supervision and auto-enrolment.

29. We have set out a number of proposed changes to the way Contribution Notices function. Do these proposals strike the right balance between improved regulations on business and protecting pensions?

We note the proposal to create an additional limb to the 'material detriment' test, assessed by reference to the weakening of the employer. We await further detail on how this would work as again if this is to be a statutory test on which financial (or other) penalties hang, it is vital that there is clarity on how the test would operate.

Whilst we agree it is easier for the business community to recognise a weakening of the employer than a reduction in the likelihood of benefits becoming payable, the former would not necessarily affect the likelihood of benefits becoming payable, for example if sufficient alternative mitigation is provided or if the scheme is already sufficiently well-funded.

Overall, if the issue is that the current test is insufficiently clear, we think it would be better to clarify the wording in the current test which correctly identifies the issue that the Contribution Notice is designed to remedy, rather than introducing the proposed additional limb.

We would note that the detail of the statutory test and the application of penalties needs to be set out in legislation (and subsequently consulted on), rather than just in the voluntary clearance guidance.

30. Alternatively, what else could we do to improve the way Contribution Notices work?

No comment.

31. What would be the most appropriate way of protecting the value of the Contribution Notice through uprating? What are the likely impacts of this?

We note that a Section 89 notice is arguably a more powerful deterrent. Having said this, we recognise that, if a Contribution Notice is to be issued, the value of this would ideally keep pace with the deficit in the scheme to avoid a resulting worsening in the scheme's funding level due to the delay in payment. However the suggestion of using "a prescribed notional asset allocation, by reference to publically available inflation indices" would lead to uneven outcomes across schemes and would require regular calibration to ensure the mechanism does not become out of step with the average scheme.

One possible alternative would be to uprate the amount by preserving the proportion of the Scheme's total Section 75 debt that is covered by the contribution notice. So, if the amount of debt and appropriate amount for the Contribution Notice (CN) are determined at the date of the act, the proportion that the CN bears to the total Section 75 debt at that date could then be applied to the Section 75 debt at the date of the CN, to get the uprated amount. It should be noted though that this could lead to lower as well as higher amounts payable at the later date, depending on how the scheme's funding has progressed over the intervening period.

32. What could be the impacts of changing the date at which the cap was calculated to a date closer to the final determination?

The contribution notice process can take years if subject to challenge in the courts and it is likely that a deficit in the associated scheme could change materially over this period, particularly given the strength of the covenant of the target. We therefore welcome this change which will allow the contribution notice to be more flexible in response to changing circumstances.

Not knowing the amount until later in the process could make it more difficult for employers to pay, but we believe this will add to the power of the contribution notice as a deterrent.

33. What would be the likely impacts on business of a more streamlined Financial Support Direction regime?

A streamlined process is sensible to minimise the impact on business and TPR's resources.

34. How could we best amend the 'insufficiently resourced' test to make it simpler and clearer?

We assume TPR has examples where the definition fettered its actions. Such examples would be a useful guide to possible improvements.

35. We propose to tighten up the forms of financial support the target is required to make to the scheme to include cash payments or statutory guarantees. What would the impact of this approach be on business?

See answer to next question.

36. Are there other forms of support we should take into consideration?

While we are supportive of the change to a one step process, we think that the suggestion of only cash or a parent company guarantee is too inflexible. There should be a mechanism in the process, once the amount of the FSD has been determined, for the target and TPR to agree an alternative form of redress, for example a suitably secure contingent asset in place of cash.

37. What would be the impact on business of a longer lookback period?

No comment

38. The proposals in this consultation are suggested as ways in which the Pensions Regulator's powers could be increased or improved in order to clamp down on corporate wrongdoing and ensure improved compliance with all legal responsibilities by sponsoring employers. Do these proposals strike the right balance between improved regulations on business and protecting pensions?

Whilst we are supportive of the underlying principles of the proposals, they are wide-ranging and comprehensive and there is a therefore a risk that they overlook the basic premise that the current regime already works well for most schemes as stated by the Government itself.

Given the existing challenges for trustees in running schemes for the benefit of members, we believe it is important not to over-burden them with new legislative and regulatory requirements intended to penalise the few who are reckless or irresponsible, particularly if the costs are high (at the expense of members) and focus is lost. This is particularly pertinent for smaller schemes.

39. Alternatively, do you think there are other areas where the Pensions Regulator's powers could be increased or improved to achieve our intended outcomes?

TPR already has relatively strong powers, so more use of these would be a first step (and we see this happening already). Greater publicity around the use of TPR's powers is also increasing and is equally useful as a deterrent.