19 December 2008

alert

sackers extra

RISKY BUSINESS? MATERIAL DETRIMENT CODE PUBLISHED

1 INTRODUCTION

Responding to the emergence of new business models which may "reduce the security provided by the pension scheme's sponsoring employer", the Pensions Act 2008 (the Act) makes provision to enhance the Pensions Regulator's anti-avoidance powers.[1]

The most significant change is the introduction of a power to impose contribution notices, based on a test of "material detriment", under which the Regulator will look at whether a sponsor's actions or failures to act have had a materially detrimental effect on the likelihood of members receiving their benefits.

The Act provides a number of safeguards on the use of this new power, one of which is the requirement for the Regulator to set out, in a statutory code of practice, the circumstances in which it expects to use its power. In this Alert, we take a brief look at the draft code (the Code), which was published for consultation on 15 December 2008.[2] The consultation (which Sackers will be responding to) closes on 6 February 2009.

2 KEY POINTS

- The Regulator will be able to look at the effect of an act or failure to act on the pension scheme, as opposed to the intention of the parties (the "material detriment test") (see section 3).
- The test and the Code will have retrospective effect to 14 April 2008 (section 3).
- The Code lists the circumstances in which the test is intended to apply (section 4).

[1] For a summary of the Regulator's new powers, please see our Alerts: "Pensions Act 2008 - The Road to 2012" (dated 5 December 2008) and "Anti-Avoidance Powers - Update" (dated 22 October 2008)

[2] http://www.thepensionsregulator.gov.uk/pdf/MaterialDetrimentCOPConDoc.pdf

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3 THE MATERIAL DETRIMENT TEST

The Regulator already has the power to impose a contribution notice on an employer whose intention is to avoid or prevent a debt becoming due to a defined benefit scheme. The Act extends this power to enable the Regulator to require a contribution to a scheme where an act or failure to act has had a materially detrimental effect on the likelihood of members' benefits being received.

As the Regulator's power under the new test is potentially very wide, three safeguards have been introduced (referred to as "legislative filters"), which are designed to ensure that the material detriment test is appropriately targeted. These protective measures include:

- a requirement for the Regulator to publish a code of practice on the circumstances in which it expects to issue a contribution notice based on the new material detriment test; and
- the exercise of the Regulator's new power is subject to a statutory defence.

The Regulator will be able to apply its new powers retrospectively to 14 April 2008 (the date on which the extended powers were announced). However, the relevant provisions of the Act will formally be brought into force by a commencement order, with the Code intended to come into force on the same date.[3] Until this happens, the Regulator's statement of 25 April 2008[4] "will apply in relation to the application of the new test" (although this broadly mirrors the wording in the Code).

4 THE CODE OF PRACTICE

The Code is designed to help trustees, employers and other related parties understand the practical application of the material detriment test by setting out the circumstances in which the Regulator expects to use its new power.

[3] The Code has to be laid before Parliament for a period of 40 days after the consultation period ends (on 6 February 2009)
[4] http://www.thepensionsregulator.gov.uk/pdf/StatementOnPowers.pdf

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In the Regulator's view, each of these circumstances (which are unchanged from the draft list of circumstances published by the Regulator on 20 October 2008) potentially poses significant risks to members' benefits or to the Pension Protection Fund. They include:

- a transfer of the scheme out of the jurisdictions of the UK;
- the transfer of the sponsoring employer out of the jurisdictions of the UK, if by doing so there is a material reduction in the level of employer support (defined in the Code) or legal and regulatory protection for scheme members;
- the severing of employer support for the scheme to the extent that it is removed, becomes substantially reduced or becomes nominal; and
- the operation of the scheme in such a way that is designed to create a financial benefit for the employer or some other person from the scheme where inadequate account has been taken of the interests of the members of the scheme, including increased risk to members.

Having received negative feedback from some corners of the industry when the enhanced powers were first announced, the Regulator attempts to allay industry concerns by stating in the draft Code that "it is not the Regulator's intention that the material detriment test…must be considered for all corporate transactions". However, trustees and employers will want to tread carefully, as it is likely to be some time before the full extent of the material detriment test is examined in practice.

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