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ANTI-AVOIDANCE POWERS - UPDATE

1 INTRODUCTION

On 14 April 2008, the Government announced sweeping changes to the Pension Regulator's anti-avoidance powers. These were designed to tackle "new business models" in pensions which, in severing the link between sponsor and scheme, might have the effect of reducing security for members and increase the risk of schemes going into the Pension Protection Fund.

Following consultation by the Department for Work and Pensions, the Government has set out the detail of the proposed amendments in clauses tabled to the Pensions Bill on 20 October 2008.¹ The primary legislation will be backed by a code of practice on the material detriment test (a draft of which was published by the Regulator on the same day).

The most significant change to the anti-avoidance powers is the introduction of a new test for the imposition of a Contribution Notice (CN), which we focus on in this Alert.²

2 KEY POINTS

- Amendments to the anti-avoidance powers will be made in primary legislation rather than by regulations, as previously proposed.
- Proposed changes to the test for the imposition of a CN remain focused on the effect of an act rather than the intention of the parties (the "material detriment test") (section 3).
- There is a defence to the material detriment test (section 4).
- The Regulator will publish a code of practice on the material detriment test (section 5).

¹ These amendments are still subject to parliamentary scrutiny – they will be debated by the House of Lords later this month

² There are a number of other amendments proposed - please see our earlier Sackers Extra Alert "Proposed Extension of Anti-Avoidance Powers" dated 16 April 2008

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3 THE “MATERIAL DETRIMENT TEST”

Currently, a CN can only be imposed where an employer’s intention is to avoid or prevent a debt becoming due. In future, it is proposed that the Regulator will be able to issue a CN to require a contribution to a scheme where an act or failure to act has detrimentally affected, in a material way, the likelihood of a scheme being able to pay members’ benefits (the material detriment test). The aim of this provision is to permit the Regulator to look at the effect of an act, rather than the intention of the parties.

Safety measures

Unsurprisingly, concerns were raised during the consultation process that “normal business” had the potential to come within the scope of the test. As a result, the Government has put forward the following three key safety measures to ensure that the test is adequately targeted:

- Legislation will include a list of factors the Regulator should consider when deciding whether the material detriment test has been met. This list includes, for example, the value of the assets and liabilities of the scheme, the effect of the act or failure to act on those assets or liabilities and the scheme obligations of any of the parties. Although the aim of the list is to give certainty, the list itself is non-exhaustive and is not set in stone - there is specific provision for it to be amended by regulations.
- There will be a statutory defence (see section 4 below).
- The Regulator will be required to set out, in a statutory code of practice, the circumstances in which it expects to use this power (see section 5).

4 DEFENCE TO THE “MATERIAL DETRIMENT TEST”

Any person in receipt of a “warning notice” from the Regulator that it is going to issue a CN will be entitled to rely upon a statutory defence, provided three conditions are met.

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These are:

- the party in receipt of that warning notice gave consideration to the extent to which the act or failure to act may be materially detrimental to the scheme;
- if there may have been a materially detrimental effect, that party took “all reasonable steps to eliminate or minimise the potential detrimental effects that the act or failure might have on the likelihood of accrued scheme benefits being received”; and
- it must have been reasonable for that party to conclude that the act or failure to act was not materially detrimental to the members’ benefits.

5 REGULATOR’S CODE OF PRACTICE

The new code of practice will set out the circumstances in which the Regulator expects to use its power in connection with the material detriment test. The Regulator is expected to consult formally on its new code this year. In the meantime, it has issued a draft list of circumstances in which it expects to use the new power (referred to as “an early pre-consultation draft”).

Those circumstances include:

- a transfer (of the scheme or the sponsoring employer) out of the jurisdictions of the UK;
- 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 risks to members.

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Any party applying for clearance from the anti-avoidance powers will still need to rely on the Regulator applying the provisions as it says it will do under the code. Like other codes, it is not legally binding but is admissible in evidence in any proceedings before a court or tribunal.

6 DETERRENT EFFECT?

It is still proposed that the changes to the anti-avoidance powers, including the new material detriment test, will take effect from the date of the initial announcement (14 April). This retrospective effect is, the Government says, an important part of their “deterrent effect”.

Indeed, the whole package of changes can be seen in this light. Concerns were raised on consultation that there would be an increase in the number of clearance applications. Whilst it remains to be seen whether this is correct, it is likely that, together with amendments to the clearance guidance earlier in the year³, trustees may see the changes bolster their negotiating positions whenever there is a potentially materially detrimental event in relation to a pension scheme.

³ See our Sackers Extra Alert “Clearance - More Obstacles in the Way?” dated 27 March 2008