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Opra Update 10 – guidance on avoiding pension liabilities

1 BACKGROUND

Opra (the Occupational Pensions Regulatory Authority) has published a new update on "avoiding pension liabilities - implications of the Pensions Act 2004".

Update 10 is primarily aimed at sponsoring employers and trustees of defined benefit (DB) schemes. But it is especially important for anyone considering compromising a scheme debt and for all parties involved in corporate transactions (and restructurings). The underlying theme is avoiding the risk that statutory debts can pose to members and the Pension Protection Fund (PPF), with the focus on particular actions (or inactions) which may heighten such risk.

2 COMPROMISING DEBTS – PPF UPDATE

In May of this year, Opra published Update 7 providing guidance to trustees of DB schemes contemplating compromising an employer debt. With the 2004 Act finalised, regulations are now in the offing which will further clarify the eligibility criteria for the PPF. Update 10 therefore forewarns trustees that, from April 2005, a scheme is likely to be ineligible for the PPF if a debt is compromised below the PPF level of benefits (unless, say, compromised by the PPF Board during a PPF assessment period).

From April 2005, compromise agreements will also need to be notified by trustees and employers to the Pensions Regulator (TPR)[1].

3 DEALING WITH CERTAIN CAUSES OF UNDERFUNDING

Under the so-called "moral hazard" sections of the 2004 Act, from April 2005 TPR can:

[1] See our Alert dated 14 December 2004 "Protecting the PPF - draft code on notifiable events"

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- issue contribution notices against a person involved in an act or deliberate failure to act (at any time since 27 April 2004) which had as one of its main purposes the avoidance of pension liabilities;
- direct other companies within a group to provide financial support if the sponsoring employer is, for example, insufficiently resourced;
- undo transactions at an undervalue (retrospective to 27 April 2004).

TPR can only use these powers where it is reasonable to do so and, according to Update 10, is only likely to "when absolutely necessary".

4 GUIDANCE FOR EMPLOYERS

Set against the backdrop of the moral hazard provisions, sponsoring employers and other companies involved in corporate transactions are advised to take into account:

- the possible effect of a corporate transaction on the ability to fund both past and future service liabilities in DB schemes;
- whether TPR may use its moral hazard powers.

Sponsoring employers are encouraged to enter into an early dialogue with trustees if the transaction is likely to have a detrimental effect on the sponsoring employer's ability to fund the scheme. They can also discuss concerns with Opra in advance of a transaction to help assess TPR's likely approach. (From April 2005, TPR will be able to issue formal clearance statements confirming that it will not use certain moral hazard powers in a particular case.)

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5 GUIDANCE FOR TRUSTEES

In a similar vein to the advice given to trustees in Update 7 on compromising debts[2], trustees who become aware of corporate transactions should:

- Raise concerns with the sponsoring employer (and possibly other group companies);
- Avoid conflicts of interest (trustees who are also senior employees are warned not simply to disregard information of corporate activity that is likely to affect beneficiaries' interests);
- Consider all options (including the possibility of bank guarantees to shore up a scheme debt in the event of winding-up);
- Monitor corporate activity;
- Take appropriate advice;
- Comply with their obligations under pensions legislation.

6 PASSING INFORMATION TO OPRA

Opra has established a special team to look into cases where employer-related risks are generated by corporate activity. In the transitional period between now and the emergence of TPR (April 2005), the message for trustees is to think about informing Opra if:

- the scheme is underfunded or is likely to become so following the employer's proposed action; and

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[2] See our Alert dated 19 May 2004 "Opra Update 7 – compromising employer debts"

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- there is "the likelihood of a significant impact on the security of members' benefits because actions have been taken since 27 April 2004 or are being taken or contemplated, that would put [the statutory debt] at risk" if the scheme were to start winding-up.

In deciding whether to take action, Opra will consider all relevant factors "including the survival of the employer and the job security of employees".