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alert

CLEARANCE – MORE OBSTACLES IN THE WAY?

1 INTRODUCTION

Clearance was introduced in April 2005 as a voluntary process to meet concerns about how the Pensions Regulator was going to use its anti-avoidance powers. The original clearance guidance was understandably focused on process. But reflecting three years of experience, the revised guidance now looks at when clearance may be available. The guidance is structured on a set of "guiding principles" which ask the parties to look at the true effect of an event on the pension scheme.

The draft guidance was published for consultation in September 2007[1]. The 6 month wait before the final guidance was published on 20 March[2] shows the industry concern caused by the Regulator's increasing confidence in this area.

2 KEY POINTS

- There are new guiding principles for making clearance applications – and even for the Regulator (section 4)
- The Regulator plans to publish stand-alone guidance on assessing the employer covenant later in the year (section 5)
- The interaction of the new employer debt requirements and the clearance guidance suggest a lack of joined up thinking (section 6)
- Parties to clearance applications will welcome additional guidance on what may amount to appropriate mitigation (section 7)

[1] See our Sackers Extra Alert "Clearance – the Present Danger?" dated 13 September 2007

[2] http://www.thepensionsregulator.gov.uk/pdf/clearanceGuidance2008.pdf

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3 PRINCIPLE-BASED APPROACH

Despite criticism during consultation that its principle-based approach "brings less certainty" than a prescriptive approach, the Regulator has stuck to this approach in the final version. There are guiding principles listed for both trustees and employers and, surprisingly, for the Regulator itself when considering whether to grant clearance (see section 4 for the guiding principles).

With these principles in mind the Regulator has removed case examples as it believes that including case examples "could undermine the successful reinforcement of a principle-based approach as there is a risk that these could be interpreted restrictively".

Professional Advice

Reliance on guiding principles means that trustees and applicants for clearance will need professional advice in order to interpret the guidance. Indeed, the Regulator acknowledges that the guidance is aimed primarily at professional advisers to both clearance applicants and trustees.

4 THE GUIDING PRINCIPLES

Trustees should:

- recognise and understand their powers and duties and act appropriately; and
- consider taking professional advice where appropriate.

Trustees and Employers should:

- recognise that a scheme in deficit should be treated in the same way as "any other material creditor";
- work together in relation to events which "may be detrimental to the ability of the scheme to meet its liabilities or the benefits of scheme

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members" (including communicating and sharing appropriate information);

- understand the nature and the impact of a potentially detrimental event and the appropriate mitigation for the event; and
- recognise that the Regulator will "wish to know about all events that have a materially detrimental effect on the ability of the scheme to meet its liabilities".

The Regulator will:

- deploy its resources in a risk based manner; and
- seek to protect members' benefits and reduce the risk of calls on the PPF "while at the same time recognising commercial activity and business needs".

Ultimately, the Regulator's preferred outcome is "an appropriately funded scheme with a solvent employer".

5 "TYPE A" EVENTS

As indicated in the draft guidance, the Regulator has kept its designation of "type A" events. These are either employer-related or scheme-related events which are materially detrimental to the ability of the scheme to meet its liabilities. The Regulator expects clearance will be sought for type A events, except where appropriate mitigation is on the table (section 6).

Employer-related events

As expected, the focus is on the assessment of the employer covenant before and after the event in order to decide whether the event is materially detrimental to the scheme. But the Regulator has removed the detailed content on monitoring employer covenant from the clearance guidance as it believes this is a "general governance issue" rather than specific to clearance. (We should expect

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general guidance on this topic "later in the year".)

An employer-related event is not a type A event unless there is a "relevant deficit". Despite criticism during consultation that the calculation of the relevant deficit was overly complex, the Regulator is sticking to its guns. The relevant deficit will therefore generally be the highest of the following three bases – the PPF deficit (section 179), FRS 17/IAS 19 or the scheme's technical provisions.

6 SCHEME-RELATED EVENTS

The biggest change to scheme-related events is the interaction between the clearance guidance and the new rules on employer debt. Rising deficits have meant that the ability to shift responsibility of an employer debt is critical to the smooth running of schemes. Recent amendments made to the employer debt legislation[3] rely on increased scrutiny of these arrangements by trustees, but it seems that the Regulator still wants parties to seek clearance.

Scheme Apportionment Arrangement (SAA)

An SAA will be a type A event except where:

- the SAA increases the employer debt payable by an employer who can afford the increased employer debt;
- it is a practical option because of the cost and complexity of other alternatives (for example, where the apportionment results in an employer debt which is the actuary's best estimate of the debt, because of lack of records); or
- the employer debt arises in circumstances where there is no net reduction of the employer covenant (for example, on a group reorganisation).

[3] See our Sackers Extra Alert "Whose debt is it Anyway?" dated 17 March 2008

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Withdrawal Arrangements

- Approved Withdrawal Arrangements (AWAs) are required to be approved by the Regulator, but nevertheless the Regulator may expect clearance to be sought as well if the guarantee provides insufficient mitigation. The guidance does not go into what might happen if the Regulator approved the AWA but refused clearance!

- Trustee-sanctioned withdrawal arrangements (TWAs) may need clearance if they are detrimental to the ability of the scheme to meet its liabilities – for example, because of the choice of guarantor, the agreed payment event for the guaranteed debt or because the TWA does not meet the statutory requirements.

7 MITIGATION

Clearance is often only available if the trustees receive a quid pro quo (called mitigation in the guidance) which reflects that once clearance has been granted the Regulator has given up its right to use its anti-avoidance powers.

Mitigation is perhaps the most difficult element of the clearance package to assess. The type of mitigation appropriate will be dependent on the relevant circumstances, but trustees will no doubt welcome the expanded section on mitigation (including a number of helpful examples).

Examples given include standard options such as additional cash contributions, guarantees or escrow accounts as well as more creative solutions like negative pledges or performance thresholds agreed by the employer.

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