Corporate briefing

November 2021

Highlighting the latest developments in pensions for employers and corporate investors

Welcome

Since 1 October, the Pensions Regulator (TPR) has been armed with new criminal and civil powers in relation to certain corporate behaviour (please see "Key pensions dates" on page 5, as well as our April 2021 Corporate briefing for more details). None of the new criminal sanctions technically apply to acts which took place before 1 October 2021, although TPR may look at facts prior to that date as part of its investigations, eg when looking at someone's intention.

Scanning further ahead, in this edition we focus on the new notification requirements being introduced under the Pension Schemes Act 2021 (the PSA 2021). These new "notifiable events" are designed to alert TPR at a very early stage about certain corporate activity where a defined benefit (DB) scheme is in the mix. With penalties of up to £1 million for non-compliance, all DB sponsoring employers need to be aware of these changes.

For DB sponsoring employers considering ways to transfer risk, we take a look at some of the core buy-out ingredients. Finally, the Government's push for greater consolidation in the defined contribution (DC) market should be on sponsoring employers' radars, as should its measures to make taking pensions guidance a "normal part of the pension access journey".

New notifiable events and the declaration of intent

Sponsoring employers and trustees of DB schemes are already required to notify certain events to TPR. The purpose of the notifiable events regime is to act as an early warning system for potential calls on the pensions lifeboat, the Pension Protection Fund. Examples of existing employer-related events include breach of a banking covenant or a decision to cease trading.

Against the backdrop of the PSA 2021, draft regulations on proposed changes to the notifiable events regime are expected to come into force in April 2022. Acknowledging its ineffectiveness, given that directors are unlikely to admit to it, the draft regulations will also remove the existing requirement to notify wrongful trading.

Depending on how far any corporate activity captured by the new requirements progresses, it may trigger several notifications to TPR at different stages along the way (see "Triggering events" on page 2). In addition, the trustees may need to be informed and an accompanying statement prepared highlighting certain key information (see "Accompanying statement" on page 2).

As currently drafted, which could well change, the circumstances which will trigger the new notification requirements are:

- the sale by a DB sponsoring employer of business or assets representing more than 25% of its annual revenue or gross assets, either on its own or when combined with other disposals decided upon or completed in the previous 12 months
- the grant or extension by a DB sponsoring employer, or one or more subsidiaries of that employer comprising more than 25% of the sponsoring employer's consolidated revenue or gross assets, of a relevant security which would rank ahead of the pension scheme. A "relevant security" includes a fixed or floating charge, as well as a floating charge giving the charge-holder the right to appoint an administrator
- the intended or actual relinquishing of control of a DB sponsoring company.

New notifiable events and the declaration of intent cont.

Triggering events (based on the current drafting)

When?	Initial notification on a "decision in principle", ie prior to any negotiations or agreements being entered into	Fuller notification, including accompanying statement, when main terms proposed	Update when material change to the proposals
Who notifies?	DB sponsoring employer	DB sponsoring employer and anyone associated or connected	DB sponsoring employer and anyone associated or connected
Recipient(s)	TPR	TPR / the trustees or managers	TPR / the trustees or managers

Accompanying statement (based on the current drafting)

Where required, the accompanying statement will need to spell out some essentials, such as:

- a description of the event and the main terms proposed
- any adverse effects of the event on the DB scheme or on the sponsoring employer's ability to meet its legal obligations to support the scheme
- a description of any steps taken to mitigate those adverse effects, and
- a description of any communication with the trustees or managers about the event.

Comments

The upshot of the new requirements is that certain corporate plans will need to be divulged at a much more embryonic stage, and potentially numerous times. This will lead to additional complexity, and is likely to have both timing and confidentiality implications. Compliance with the new requirements should therefore be added to the very beginning of any transaction plan and reviewed regularly.

Whilst the drafting of the regulations could change, currently the DB sponsoring employer, and anyone associated or connected with it, will be on the hook to notify when main terms are proposed or there is a material change. Parent companies should take heed as they may be the only party in a position to notify in certain circumstances, being that much closer to the action.

The regulations will also catch activities that financial institutions undertake in the ordinary course of their business, such as granting security in relation to derivatives and stock lending.

Key action

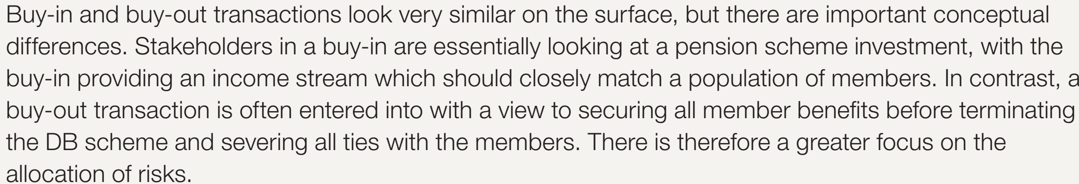
- Since 1 October 2021, failure to comply with the existing or new notifiable events framework – without a reasonable excuse – is punishable by a penalty of up to £1 million, up from £5,000 for individuals and £50,000 for corporates. TPR could also take non-compliance into account when deciding whether to bring its other new super powers into play.
- It is vital that DB sponsoring employers take pensions legal advice before embarking on corporate activity, including M&As, financing and refinancing, granting of security and/or paying dividends.

Transferring risk – buy-out on the menu?

For many corporate sponsors, buy-out is the ultimate endgame when it comes to DB pension liabilities. Set against the backdrop of a pensions environment which has largely shifted to DC models, transferring DB liabilities to a reputable, highly regulated insurance provider offers a clean break.

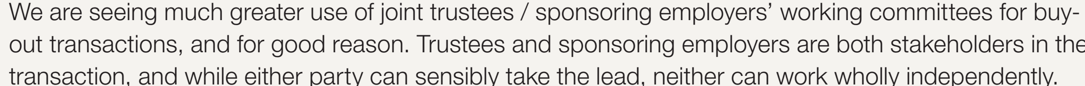
A combination of factors (including the DB funding regime, movements to derisking, and improvements in insurer pricing and transaction execution) have brought buy-out within reach of more schemes than ever. Given this and the cost implications, it is often sponsoring employers who take the lead.

Buy-in versus buy-out



Buy-in and buy-out transactions look very similar on the surface, but there are important conceptual differences. Stakeholders in a buy-in are essentially looking at a pension scheme investment, with the buy-in providing an income stream which should closely match a population of members. In contrast, a buy-out transaction is often entered into with a view to securing all member benefits before terminating the DB scheme and severing all ties with the members. There is therefore a greater focus on the allocation of risks.

Getting the governance right



We are seeing much greater use of joint trustees / sponsoring employers' working committees for buy-out transactions, and for good reason. Trustees and sponsoring employers are both stakeholders in the transaction, and while either party can sensibly take the lead, neither can work wholly independently.

There is an important commercial element to this. The risk transfer market is booming, and insurers do not want to invest material amounts of work in providing a quotation if they think there is material execution risk. Joint working arrangements demonstrate that both the trustees and sponsoring employers are committed to a transaction which could be a key factor in securing insurer engagement in a tender process.

Residual risks

When a DB scheme buys out, the legal, administrative, actuarial and governance history of that scheme is not directly inherited by the insurer. The bulk annuity provider will, instead, refer to the information recorded in a benefit specification and data set which are appended to the contract. There is, therefore, a lot of information and history to be distilled into a single contract, and if the body of scheme documentation differs in any material respect to the terms of the contract, the insurer may well not be liable for the difference. Bulk purchase annuity policies are not, therefore, a panacea.

Insurers writing billions of pounds of DB risk transfer business a year are extremely careful about what risks they take on, and those they do not. It will be important to consider what happens to the risks that fall out of scope and, in particular, the package of protections trustees might need before they will agree to proceed.

So-called "all risks", "data risks" or "residual risks" transactions go further than the standard transaction in pushing risks on to the insurer. Residual risks cover is typically only available for larger DB schemes, will involve an additional premium (typically in the region of 1 to 2% as a rule of thumb) and, sometimes, material additional work in relation to the due diligence which must be undertaken. In any event such contracts are rarely, if ever, truly "all" risks, and careful consideration of insurers' terms will be needed.

Due diligence

While residual risks are increasingly common in larger transactions, an insurer taking on extra risk will carry out additional due diligence. For example, if the insurer is to accept the risks associated with any undiscovered differences between the scheme's documentary history and the member benefits described in the policy, the insurer will need to look at those documents. This could be a very material exercise in its own right, which has implications in terms of both costs and timing. It could also bring issues to light which the insurer is simply not prepared to take on. Having identified an issue, the trustees and sponsoring employers may then be obliged to resolve it, incurring yet more cost and delay.

Key action

Once you start to dig up the drains, you must be prepared to accept the disruptions that could ensue, but there may be alternatives. Whatever approach you take, getting specialist pensions advice at the earliest possible stage is crucial.

In other news

The push for DC consolidation

While the Government has made no secret of its desire for small DC schemes to wind up and consolidate, it may soon be turning its attention to DC schemes with between £100m and £5bn in assets.

In future, small DC schemes (ie with less than £100 million assets) will generally be required to complete a "more holistic" annual value for member assessment, and to report on it in their annual chair's statement. For example, costs and charges will need to be compared with at least three other "large" schemes (ie with assets of £100 million or more) at least one of which must "have had discussions" with the smaller scheme about a potential transfer. Other factors to consider include investment returns and governance and administration, including the level of trustee knowledge, understanding and skills. Subject to exceptions, if trustees conclude that a small scheme is not delivering good overall value, it is expected to wind up.

In June 2021, the Government published a consultation with the intention of kickstarting "the next conversation" on what best value looks like in medium and large DC schemes. Our understanding is that it is pursuing greater consolidation both to ensure individuals are in well-run schemes, and to enable schemes to achieve the necessary scale for more innovative investment strategies.

Key action

DC sponsoring employers whose schemes are caught by the new requirements should be prepared for discussions with their trustees about whether their scheme is currently offering good value, or whether consolidation may ultimately be on the cards.

Stronger nudge to guidance

Earlier this year, the DWP and the FCA consulted on measures which would "nudge" members of both DB and DC occupational and contract-based schemes to take guidance from Pension Wise (now MoneyHelper) when they apply to take or to transfer their benefits. We look at the key aspects of the DWP proposals below.

How will it work?

Trustees / managers will be required to ensure that individuals have either received or opted out of receiving appropriate pensions guidance before proceeding with their application. In contrast to the current signposting requirement, members will have to actively choose not to take guidance.

Key challenges

When to nudge – the nudge will be triggered by an application to transfer or to start receiving benefits. The question of what counts as an "application" is due to be set out in the final regulations, but it may be tricky to fit this within the context of existing administration processes.

Booking the appointment – the draft regulations require trustees or managers to offer to book a pensions guidance appointment "at a time and of a kind suitable" for the beneficiary. It is hoped that the final regulations will clarify whether trustees or managers will be expected to make the appointment or to simply facilitate it.

Requirement for the opt-out to be in a "separate communication" – this is intended to provide the individual with enough time to consider their decision and to ensure opting-out isn't too easy. Our concern is that it could render the process frustrating for members. Scheme administration processes will need sufficient flexibility to achieve the policy intent in a practical, appropriate way.

Exemptions – as currently drafted, only those who have received guidance or regulated advice in the last 12 months, or who are applying for a serious ill-health lump sum, will not have to be nudged. We have suggested that those who have received targeted guidance via either their sponsoring employer or scheme should also be excluded.

Timing – the regulations are due to come into force in April 2022, leaving schemes with very little time to prepare.

Key action

As highlighted in our April 2021 Corporate briefing, a growing number of DC sponsoring employers are either considering, or have already put in place, some form of financial education programme in the workplace, going beyond the guidance available through not-for-profit organisations like MoneyHelper. Such programmes should aim to be compatible with the new requirements.

Key pensions dates

1 September 2021

The PPF announced that schemes and sponsoring employers can apply for a payment extension of up to 90 days to pay their 2021/22 levy bill without interest being charged

1 October 2021

The following new criminal offences form part of TPR's armoury:

- avoidance of a statutory employer debt – punishable by an unlimited fine and/or up to seven years in prison
- conduct risking accrued DB scheme benefits – punishable by an unlimited fine and/or up to seven years in prison
- failure to comply with a contribution notice – punishable by an unlimited fine
- failure to attend or respond to an interview (see below) – punishable by a fine

1 October 2021

The following new civil powers form part of TPR's armoury:

- the ability to impose a new civil penalty of up to £1 million:
  - as an alternative to the above criminal sanctions
  - where a person knowingly or recklessly provides false or misleading information to the trustees or to TPR (the latter already being a criminal offence punishable by an unlimited fine and/or up to two years in prison)
  - for breach of the notifiable events regime
- extended information gathering and interview powers, and new fixed and escalating penalty rates for non-compliance with information-gathering requests
- two new snapshot tests for imposing a contribution notice, the "employer insolvency" and the "employer resources" tests

1 October 2021

New climate change risk governance and reporting requirements apply to authorised master trusts and occupational pension schemes whose net assets are £5 billion or more

Q1 2022?

- Draft regulations expected outlining the detail of the new requirement for DB trustees to determine, with sponsoring employer agreement, a strategy for ensuring that scheme benefits can be provided over the long term. Known as the "funding and investment strategy", it is being introduced as part of the PSA 2021 changes
- Second consultation on TPR's revised DB funding code of practice, complementing the new funding and investment strategy but also introducing a "Fast Track" or "Bespoke" approach to scheme funding valuations

6 April 2022

New employer notification requirements due into force (see pages 1 and 2)

1 October 2022

New climate change risk requirements (see above) apply to occupational pension schemes with £1 billion or more of assets

Q4 2022

Earliest date from which the new funding and investment strategy and TPR's new DB funding code of practice (see above) are likely to come into force

Contact

Sackers is the leading law firm for pension scheme employers, trustees and providers. Over 60 lawyers advise employers on all aspects of their pension arrangements. This includes getting automatic enrolment right, moving to a master trust, advising on corporate pensions strategy, advice relating to DB schemes such as DB risk and funding solutions, and advising on the pensions aspects of M&A activity and corporate group restructuring. For more information or to arrange training, please get in touch with David Saunders, Philippa Connaughton, Faith Dickson, Fuat Sami, Tom Jackman or Ferdy Lovett, or your usual Sackers contact.

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Upcoming webinars

10/02/2022 (12:30pm-1:30pm)
Quarterly legal update – this webinar will provide an essential overview of significant developments affecting occupational pension provision in the UK for employers and trustees.

29/03/2022 (10:00am-4:00pm)
PLSA Trustee Training Programme – Part 2: the practice – with support and guidance from independent experts, trustees with some experience will take part in boardroom simulations to learn how to approach the issues you will face in your role.

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