



**PROTECTING DEFINED BENEFIT PENSION SCHEMES –
A STRONGER PENSIONS REGULATOR**

**RESPONSE FROM ICAS TO
THE DEPARTMENT OF WORK AND PENSIONS**

21 August 2018

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Background

ICAS is a professional body for more than 21,000 world class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business and in the not for profit sector; many leading some of the UK's and the world's great organisations. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

Introduction

The ICAS Pensions Panel welcomes the opportunity to comment on the Department for Work and Pensions (DWP) consultation on 'Protecting defined benefit pension schemes – A stronger pensions regulator'.

The broader context

The DWP sets this consultation in the context of the UK Government's reform agenda for defined benefit pensions as set out in the White Paper 'Protecting defined benefit pension schemes' (March 2018) and a consultation by the Department for Business, Energy and Industrial Strategy (BEIS) on corporate governance which "Dividend payments are a part of...., and will be explored by BEIS as part of their consultation response".

The reform agenda for defined benefit pension schemes, therefore, must be viewed in the context of wider developments which are intended to strengthen corporate governance in the listed and non-listed sectors and to improve the performance of regulators and the regulated.

In July 2018, the Financial Reporting Council (FRC) published an updated 'UK Corporate governance code' (the Code), which applies from 1 January 2019, and accompanying 'Guidance on board effectiveness'. The revised Code is the product of extensive stakeholder engagement by the FRC and BEIS.

The accompanying guidance sets out questions for boards to consider in relation to the viability statement which companies, applying the Code, include in their annual report; one of these questions is "Are the prospects of the company set out in the viability statement consistent with any statements made on financial covenant and commitments given to pension fund trustees?" The inclusion of this question is a new development but the accompanying guidance falls short of encouraging boards to consider the level of dividend payments relative to the support given to pension schemes.

In June 2018, an independent review of the FRC was launched by Sir John Kingman (the Kingman Review), and closed to public consultation on 6 August. The Kingman Review's objectives are to:

- Put the FRC in a position to stand as a beacon for the best in governance, transparency and independence; strengthening its position and reputation.
- Ensure that its structures, culture and processes; oversight, accountability, and powers; and its impact, resources, and capacity are fit for the future.

The FRC has oversight of both the audit and actuarial professions and we anticipate that the review report will include findings and recommendations in respect of the FRC's functions in relation to both professions.

We recommend that the DWP takes into consideration wider developments including those we refer to above in making any changes to the powers of The Pensions Regulator (TPR) arising from this consultation.

Overall comments on new TPR powers

We agree that a stronger TPR is needed and that greater oversight of corporate transactions and additional powers may be part of what is required. However, we do not believe that these measures alone will be sufficient and that other steps need to be taken in advance of any new measures arising from this consultation being implemented. We are also concerned that these proposals may not strike an appropriate balance between protecting defined benefit pension schemes and sponsoring employers being able to engage in legitimate economic activity in a timely fashion. It is vital that any new powers should be proportionate and should not unnecessarily stifle corporate activity in the UK.

However, the consultation does not address specifically whether the new measures proposed in the consultation would have prevented or mitigated the difficulties faced by pension schemes and pension scheme members arising from recent high profile corporate failures. A case study approach would have been useful evidence in support of the consultation proposals.

We believe that TPR's statutory objectives mean that it has conflicting priorities and that one consequence of this is that TPR focuses its resources on engagement with schemes and employers where there is a weak employer covenant. We understand that this is driven by its statutory objective to reduce the risk of pension schemes ending up in the Pension Protection Fund (PPF).

We recently raised concerns about TPR's conflicting statutory objectives and the extent of its responsibilities in [our response to the proposed joint strategy](#) of the Financial Conduct Authority (FCA) and TPR.

Earlier and deeper engagement by TPR with schemes and employers is needed more generally to head off crises. Therefore, we would prefer to see an approach from TPR where the focus is on improving the funding position of schemes generally and reducing the reliance of schemes on their sponsoring employer by moving them towards self-sufficiency and, where appropriate, to buy out. This more collaborative approach towards engagement with sponsoring employers could improve the way TPR is perceived and would make it a more 'open door' regulator.

If each scheme had a formally agreed funding plan for achieving self-sufficiency and accompanying timescale, the extent of progress towards achieving that plan could then be a factor in where and how TPR deploys its resources. Such an approach would recognise that schemes sponsored by employers with a strong covenant may not have a strong covenant tomorrow.

We recognise that what we are proposing could only be achieved with a more fundamental review of TPR's statutory objectives, operations, funding, staffing and skills needs. Any change of approach should be embedded across TPR's operations.

Our response to the consultation focuses on proposed new requirements in relation to corporate transactions. We would like to emphasise the following key points in this regard:

- TPR needs to be resourced sufficiently and with the right level of skills and knowledge to ensure that the exercise of its powers in relation to corporate transactions does not interfere with the planned timetable for transactions to take place.
- The proposals are likely to impact on people who may not understand their obligations or their exposure, so TPR needs to have an effective communication and education strategy to accompany any new requirements and powers.
- A principles-based approach is needed to any new requirements around corporate transactions. This means that TPR needs to foster a common understanding with those who have to comply with the new requirements about when an event needs to be notified or declarations of intent need to be made.

We set out more detailed comments on the consultation proposals below.

Any enquiries should be addressed to Christine Scott, Head of Charities and Pensions, at cscott@icas.com.

Increased oversight of corporate transactions

We believe that any steps to increase TPR's oversight of corporate transactions should not be implemented in isolation from other measures:

- TPR will need to be properly resourced in terms of sufficiently skilled staff to ensure that corporate transactions are not unnecessarily hampered by TPR actions or by delays in making decisions.
- A robust communications plan should accompany any changes as it is not reasonable to assume that all those responsible for complying with any new requirements will be aware of them or that they understand the potential impact of non-compliance on the organisations they represent or themselves as individuals.

We believe that it could be difficult for those expected to comply with any new requirement to know when the threshold for communicating a notifiable event or making a declaration of intent to TPR has been met. For example, in relation to the notification of the sale of a material proportion of the business or assets of a scheme employer, how will 'material' be defined so that TPR and those responsible for notifying TPR have a common understanding? Also, in the case of a multi-employer scheme, how will those responsible for making a notification know at any particular point in time if a particular employer has funding responsibility for at least 20% of a scheme's liabilities?

We have particular concerns about the proposal that pre-appointment insolvency or restructuring advice should become a notifiable event. Restructuring works best when it is identified and action taken at an early stage. Company boards tend to be apprehensive in their acknowledgement that restructuring advice should be sought. Therefore, we would be concerned that a requirement to provide notification to TPR could act as a further barrier to directors taking positive action at an early date to seek advice.

In addition, it is unclear from the consultation document how 'taking independent pre-insolvency/restructuring' advice is to be interpreted. Restructuring covers a very wide range of possible activities. For example, operational restructuring, financial restructuring, working capital management, management restructuring, etc. All of this may be done to a greater or lesser extent to avoid insolvency depending upon how far down the 'decline curve' the sponsoring employer is. Does taking advice mean a phone call or meeting or is it restricted to a formal engagement of a particular nature? Would the advice have to be from an Insolvency Practitioner or would advice from unqualified and unregulated 'company doctors' or 'turnaround specialists', change management agents, etc be included?

The rationale behind notifiable events stated on the TPR website is to give "early warning of possible calls on the PPF". It is difficult to see a link between the granting of security over a debt and this being an early warning of a possible call on the PPF. There are likely to be other events which would be of greater potential significance than this. There are already provisions in insolvency legislation for transactions which aim to put a creditor in a better position than they would otherwise be in the event of insolvency and for general misfeasance or breach of duty by directors. This protects pension schemes and other creditors from transactions which may be aimed at protecting or favouring certain creditors over others. If a notifiable event of this nature is to be included in the final event, then it must be drafted in such a way as to minimise administrative bureaucracy given the proliferation of securities in general business and that a significant proportion of these will be a matter of public record. Any notifiable event of this nature may be more appropriately restricted to securities granted to connected parties or associates of the sponsoring employer and where the debt is significant to the overall funding of the sponsoring employer.

Improved Regulator's powers

We have no specific comments to make in relation to the classification of offences as civil or criminal or in relation to the possible quantum of any fines.

However, we note that TPR will have discretion as to how to exercise any new powers and their objective is to deter people from acting in ways which would lead to a civil or criminal penalty. We therefore emphasise the point we make earlier in our response, namely that TPR will need to communicate effectively with those who may be impacted about what powers it has and how it intends to exercise those powers.

In our response to the proposed FCA/TPR joint strategy we did raise concerns about the interpretation of some of the terminology used to articulate these powers within legislation. Our earlier comments are set out below and remain relevant to the proposals in this consultation.

“Looking towards the UK Government’s plans to introduce a criminal offence for those who have behaved recklessly in relation to a pension scheme, bringing charges is likely to be difficult: DB liabilities are corporate debt, but this is not their legal status.

Defining what constitutes ‘behaving recklessly’ will be difficult in itself as will determining the period over which the reckless behaviour took place. We believe it will be necessary to determine such a period in order to match the duration of the reckless behaviour to any deficit built up during that time and, ultimately, assigning responsibility for an element of the deficit to individuals. The volatility of scheme deficits is an additional factor making the measurement of the financial impact of reckless behaviour on a scheme highly judgmental.

Businesses do need to take managed risks to sustain and grow and scheme funding levels can vary due to circumstances, such as the longevity of scheme members or general economic conditions, which have nothing to do with sponsoring employers’ directors.

The accounting deficit in the accounts of an employer is designed to achieve comparability across the statutory accounts of entities which sponsor DB schemes. However, an accounting deficit would not be a suitable point to start assessing the financial impact of reckless behaviour as the measurement does not address the competing obligations of the employer.

Looking at a ‘live’ comparison, the successful prosecution of individuals involved in pension liberation schemes is very difficult and costly as proving the illegality of such schemes is very difficult. Case law has little bearing on such cases, with each case being a test case in itself.”

Anti-avoidance powers

We have no specific comments to make on the proposals in respect of contribution notices and financial support directions.

However, our general comments about the need for those who may be affected to understand what powers TPR has and how it intends to exercise these powers apply in respect of anti-avoidance powers.