

corporate briefing



Clearance – the Pensions Regulator consults on widening scope of guidance

Summary

The Pensions Regulator's proposed revisions to its clearance guidance will introduce a more principles-based approach to deciding whether an event should be considered for clearance.

While the basic concept that employers can seek clearance for type A events is unchanged, the scope of the revised guidance is wider than the original published in April 2005, covering:

- how trustees and employers should assess whether an event that is detrimental to the pension scheme has occurred;
- the level of mitigation that trustees should seek; and
- encouragement for trustees to seek mitigation even where the employer is not seeking clearance.

The consultation period closes on 2 November 2007. Watson Wyatt will be responding and we would encourage employers with concerns about the draft guidance to do so too.

Background

Under the Pensions Act 2004, the Pensions Regulator has specific 'anti-avoidance' powers in relation to corporate transactions and other events that might be considered detrimental to the security of benefits provided by a defined benefit pension scheme (see box on page 3). The Regulator recently demonstrated its willingness to use such powers, by serving a notice on a Bermuda-based company, Sea Containers Ltd, instructing it to provide financial support to two pension schemes of its UK-based subsidiary, Sea Containers Services Ltd.

The clearance process was introduced in April 2005, with the aim of providing greater certainty to employers carrying out corporate transactions involving defined benefit schemes. In brief, employers (including employers associated or who may become associated with a scheme's sponsoring employer) are able to voluntarily apply to the Regulator for a clearance statement. This statement effectively gives assurance that the Regulator will not use its powers in relation to a specific event.

On 10 September 2007, the Regulator published revised clearance guidance for consultation. The proposed guidance takes into account the Regulator's experience of running the clearance process since April 2005. In this briefing, we summarise the proposed guidance and consider its impact on employers.

The Pension Regulator's draft guidance

While there are many events that could be detrimental to the pension scheme, the Regulator continues to expect clearance to be sought only in relation to 'type A events', events which are considered materially detrimental to a scheme's ability to meet its pension liabilities.

There are two main category of detrimental event:

- **scheme-related events** – for example, actions preventing, compromising, reducing or unreasonably delaying the triggering or recovery of a Section 75 debt. Any material scheme-related event is considered type A
- **employer-related events** – the weakening of the strength of the employer's covenant.





Ordinarily, an employer-related event is only considered a type A event if the scheme is less than 100% funded on one or more of the following measures:

- FRS17/IAS19
- PPF Section 179 basis
- ongoing funding basis.

However, the draft guidance reinforces the comments made by the Regulator earlier this year. Where it is considered there is a **significant** weakening of the employer's covenant, a more stringent basis would be appropriate. In the most extreme cases (for example, where there are going concern issues for the employer, the scheme is in wind-up or there is scheme abandonment), the draft guidance suggests considering the scheme's funding level on a buyout basis is appropriate.

The draft guidance puts the onus on employers and trustees to put in place systems and procedures to monitor the employer covenant and trustees are encouraged to consider taking professional advice in assessing an event.

Where a type A event is identified, employer and trustees are encouraged to negotiate appropriate mitigation, to minimise or eliminate any detriment to the scheme, for example, paying additional contributions or putting in place contingent assets. Even where an employer does not wish to go for clearance, or the event is not considered type A but is still detrimental to the scheme, trustees are encouraged to negotiate mitigation and to contact the Regulator, should they consider any offer from the employer to be inadequate.

Commentary

While the basic concept that employers can seek clearance for type A events is unchanged, the scope of the revised guidance is wider than the original published in April 2005. If adopted much greater responsibility would be placed on employers and trustees to identify, assess and negotiate mitigation options for their pension schemes, even where the employer is not seeking clearance.

The revised clearance guidance would also catch more events that could affect the employer's covenant, resulting in far less clarity over whether corporate activity will be viewed as material by the Regulator. Employers face a much more difficult decision as to whether to just agree a suitable course of action with the trustees and risk a contribution notice or financial support direction, or apply for clearance and risk the Regulator imposing further security requirements on them. It remains to be seen whether this will turn the recent tide of sponsors deciding that they will progress transactions without obtaining clearance.

As a result of this lack of clarity, employers will need to undertake a full review of how they are monitoring clearance events to deal with the revised guidance. Regardless of whether a decision is made to apply for clearance, it is clearly important that pension issues are considered at the earliest opportunity during any proposed corporate transaction or restructuring.

“Employers face a much more difficult decision as to whether to ... progress transactions without obtaining clearance”



The Pensions Regulator's anti-avoidance powers and clearance

The Regulator has two key powers available to it arising from the Pensions Act 2004, the issuance of Contribution Notices and Financial Support Directions.

A **Contribution Notice** is applied where one of the main purposes of act or failure to act is preventing recovery of or reducing a Section 75 debt payable either now or in the future.

Financial Support Directions can be applied without regard to intent, whenever a company is inadequately resourced to meet its pension obligations (taken to mean the company's net assets are less than 50% of the scheme's buy out deficit) or is a service company and other group companies could help support the scheme.

Companies are able to apply to the Pensions Regulator for clearance that it will not use its anti-avoidance powers in relation to a specific corporate transaction.

Immediate actions

It is expected that the proposed guidance will be implemented shortly after the consultation period closes on 2 November 2007. Employers should consider:

- how the draft guidance impacts clearance in relation to any current and future corporate transactions and restructuring;
- the effect of agreeing Technical Provisions higher than their pension liabilities on accounting and PPF measures (as this potentially would mean that more events fall under the type A classification); and
- how to interact with trustees under the new guidance if it is adopted, including monitoring of potential type A events and pre-agreement of materiality levels.

Watson Wyatt will be responding to the consultation. However, employers are encouraged to respond to the Regulator with any concerns relating to the draft guidance.

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