

Pensions Client Directorate

**The powers of the Pensions
Regulator**

**Amendments to the
anti-avoidance measures in
the Pensions Act 2004**

April 2008

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Executive summary

1. The legislative framework protecting pensions is generally working well. Key features of the framework include the scheme funding arrangements under the Pensions Act 2004, the role of trustees in running pension schemes, and provisions on employer debt. The Pensions Regulator has worked within this framework in a risk-based way, seeking to educate and enable before taking enforcement action, and only acting where it is proportionate to do so. This approach protects both members' benefits, and reduces the risk of liabilities falling on the Pension Protection Fund (PPF) – indirectly reducing costs on other employers.
2. Innovation in the pensions market is welcome, but Government must ensure that regulation is keeping pace with new risks that emerge from innovation. The Government therefore proposes to amend the anti-avoidance powers of the Pensions Regulator to ensure that they remain appropriate to address material risks, without imposing undue burdens on pension schemes, employers or the wider business community.
3. The particular focus of the Government's attention is the launch of new business models, which among other features, may look to sever the link between the employer and the pension scheme in order to operate well-funded occupational pension schemes for profit. These models, which operate outside the regime regulated by the Financial Services Authority, may be detrimental to scheme members' benefits, and have a cost consequence for the PPF which could be transferred to continuing schemes through the PPF levy.
4. The Government considers that these business models are characterised by the following kinds of features:
 - Moving the employer or pension scheme to another jurisdiction;
 - Splitting the operating company from the pension scheme without appropriate mitigation for the pension scheme;
 - Splitting the assets from the operating company without appropriate mitigation for the pension scheme;
 - Transferring scheme assets and liabilities to another scheme which did not have adequate support from an employer;
 - Running a scheme for profit without adequate account being taken of member interests;
 - Business models in which risk is predominantly borne by scheme members, but high investment returns would benefit investors.
5. In order to ensure that that the Pensions Regulator's powers remain adequate, in particular to address the risks presented by new business models, the Government proposes to make the following amendments:

- Introducing a new alternative test that could trigger the issue of a Financial Support Direction (FSD) – at present, a single entity must be identified who would be able to provide financial support before the FSD is issued, but the FSD could be broader and spread the requirement for support among a number of parties.
 - Introducing a new alternative test that could trigger the issue of a Contribution Notice – this would enable the Regulator to issue Contribution Notices where a course of conduct is materially detrimental to the scheme’s ability to pay members’ benefits; and
 - Removing ‘otherwise than in good faith’ from one of the limbs of the existing test for issuing a Contribution Notice
6. There is a risk that the Government’s announcement could prompt the kind of undesirable market behaviour that it is seeking to prevent, prior to new regulation coming into effect. To mitigate this, **the Government intends that these changes should be effective from 14 April 2008**, the date Mike O’Brien QC MP announced the Government’s intention to consult on the amendments.
7. To provide sufficient certainty for business about how these alternative tests would be applied in respect of transactions occurring between 14 April 2008 and the date the legislation comes into force, the Pensions Regulator issued a statement on 25 April 2008 in parallel with this consultation. **The Regulator’s statement makes it clear that it will not apply these amendments to the grounds for the powers in respect of these transactions unless one or more of the actions or situations listed above (at paragraph 4) is the subject of the proposed use of the power.**
8. The Regulator’s statement provides an important assurance for business that the changes will remain appropriately targeted. In addition there are a number of other safeguards:
- The Pensions Regulator’s Clearance Guidance; and
 - Statutory matters that the Regulator must have regard to in order to act reasonably in using its Contribution Notice and Financial Support Direction powers;
 - Existing protections against the unreasonable issue of Financial Support Directions – for example, to persons who have not been involved with a pension scheme (see s. 43(7) of the Pensions Act 2004).
9. The Government also proposes a future safeguard provision for a ‘statutory defence’ against the use of the new powers in relation to Contribution Notices. This would apply if a party can demonstrate that they could not reasonably have foreseen the effect of a transaction would not be the subject of a Contribution Notice.

10. The ability to transfer members in bulk between schemes is a valuable tool for scheme sponsors and trustees, and the majority of bulk transfers are undertaken for sound reasons.
11. The Government has identified unforeseen effects however in the way the legislation operates in the context of acts or bulk transfers, and considers that the following amendments are necessary:
- clarifying that the Regulator can issue a Contribution Notice following a course of conduct rather than only in response to an isolated act or failure to act – this change would not permit the Regulator to withdraw clearance that has already been given. If a clearance statement has been issued in relation to an individual transaction, then that transaction could not form part of a ‘course of conduct’ triggering the issue of a Contribution Notice though, as now, that clearance would fall if facts prove to be materially different.
 - if the Regulator would have issued a Contribution Notice but for the fact a bulk transfer has taken place, it could do so after the transfer; and
 - if the bulk transfer itself is materially detrimental to the likelihood that members’ benefits will be paid, the Regulator could issue a Contribution Notice – this could include, for example, circumstances where the bulk transfer has frustrated the Regulator’s power to issue an FSD
- 12. In order to treat all parties fairly, the first of these changes (clarifying that a contribution notice may be issued in respect of a course of conduct) will have retrospective effect from 27 April 2004, the other changes will have retrospective effect from 14 April 2008.**
13. The Government proposes to take a regulation-making power which is sufficiently broad-based to enable amendments to be made to ensure that the Regulator has effective powers to deal with the risks resulting from innovation in the market, and to make sure that the effect of the powers is clear to all parties in the market. The Government’s intention is to introduce this power as soon as Parliamentary time allows following this consultation process. Regulations made under this power would be subject to the affirmative procedure, which means that they would have to be agreed by both Houses of Parliament before coming into effect. The Government proposes to make all amendments to primary legislation discussed in this consultation by means of these regulations. The Government will consult on draft regulations in due course. The Government welcomes views on its proposals, and its estimates of the costs and benefits of the proposals. The Government does not expect a major increase in the number of events being brought to the Pensions Regulator for voluntary clearance – or effects on the vast majority of corporate transactions which take place – as a result of the proposals in this document. Nevertheless the pensions industry and wider business community will continue to have recourse to the Regulator’s voluntary clearance process: this offers opportunity to seek assurance that the Regulator will not use its

anti-avoidance powers in relation to an event that it has cleared, providing all the relevant facts are disclosed.

14. The Government's proposals do not change the operation of the Regulator's established voluntary clearance process which already includes consideration of the effect of an act on the security of the pension scheme. In providing clearance the Regulator will be bound not to use its existing powers, or those resulting from this consultation in relation to the transaction. The Regulator does not anticipate any extension to the time taken to grant clearance as a result of the proposals.

1. Introduction

Summary

This Chapter sets out the context for this consultation. The legislative framework protecting pensions is generally working well. Key features of the framework include the scheme funding arrangements under the Pensions Act 2004, the role of trustees in running pension schemes, and provisions on employer debt. The Pensions Regulator has worked within this framework in a risk-based way, seeking to educate and enable before taking enforcement action, and only acting where it is proportionate to do so. This approach protects both members' benefits, and reduces the risk of liabilities falling on the PPF – indirectly reducing costs on other employers.

Innovation in the pensions market is welcome – but Government must ensure that regulation can keep pace with any new risks that emerge from innovation. The Government therefore proposes to extend the powers of the Regulator in certain ways. The Government does not expect a major increase in the number of transactions being brought to the Regulator for clearance – or effects on the vast majority of corporate transactions which take place as a result of the proposals in this document.

The Government welcomes views on its proposals, and its estimates of the costs and benefits of the proposals. The Government will consult on draft regulations in due course.

- 1.1. Pension scheme members should have confidence that the pensions they are promised by their employer will be delivered. This is crucial for the sustainability of our pensions system and for individuals to be able to plan and save for their retirement. The Government is committed to ensuring that there are appropriate safeguards in the regulatory framework to provide scheme members with adequate protection.
- 1.2. In order to give this confidence, pensions need backing to withstand unexpected events such as investment underperformance or unforeseen increases in liabilities as a result of improved life expectancy. That backing may take the form of either an ongoing employer of substance or adequate capital standing behind the promise – just as FSA-regulated insurance companies are required to hold capital against their risks.
- 1.3. The regulatory regime for pensions is designed to help employers provide pensions for employees on the understanding that the employer will stand behind these risks related to unexpected events. It is built on an assumption that the employer is offering the scheme as a deferred employee benefit – and is not seeking to operate the scheme for profit.

- 1.4. Recent developments in the market have seen new profit-seeking parties operating in the pensions regime rather than the FSA regime. This may be on the grounds that liabilities can be met more cheaply under the pensions regime. This model changes the relationship between the employer and the pension scheme and puts the trust model under some strain; this has consequently highlighted areas where the 2004 Act anti-avoidance powers need to be updated and strengthened to ensure that they remain adequate.
- 1.5. This consultation addresses the questions that underlie these developments. The Government wishes to ensure that the Regulator has the powers it needs to mitigate asymmetric risks to members and the Pension Protection Fund (PPF) if it considers there is inadequate provision for risk in any business model.
- 1.6. The Government also seeks to ensure that there is fairness between members and shareholders and other investors: if shareholders or investors would benefit from profits when investments perform well, it is right for them to stand behind members' benefits when times are harder, so that promised benefits are delivered.

Legislative background

- 1.7. The Pensions Act 2004 introduced major reforms to the legislative framework that regulates and protects occupational pensions. Among other measures, it:
 - introduced new scheme-specific funding arrangements for defined benefit schemes;
 - replaced the former Occupational Pensions Regulatory Authority (Opra) with a new risk-based Pensions Regulator; and
 - created the Pension Protection Fund (PPF) – a new institution which pays compensation to members of defined benefit pension schemes which wound up underfunded when the sponsor employer suffered an insolvency event.
- 1.8. The new institutions opened for business in April 2005. The administrative costs of both are funded by levies on occupational pension schemes, while the costs of providing PPF compensation are met through a levy on the defined benefit pension schemes whose members benefit from PPF protection; since 2006/7, this pension protection levy has been calculated in a way that takes into account the risk that each scheme and employer poses to the PPF.
- 1.9. The Government identified that the introduction of the PPF created new issues of 'anti-avoidance'. That is, that unless suitable safeguards were built into the legislation, it might be possible for unscrupulous scheme sponsors to manipulate their affairs in such a way that the liabilities of the scheme were

dumped on the PPF – effectively meaning that the sponsors of continuing pension schemes would pick up the costs of meeting pension promises made by others.

- 1.10. New powers were therefore introduced from 27 April 2004 to enable the Regulator to address the risk that employers could sidestep their defined benefit pension promise. These powers complement and build on the existing safeguards provided by pensions legislation – in particular:
- Scheme-specific funding arrangements;
 - The role of trustees; and
 - Legislation placing debts on employers.

Scheme-specific funding arrangements

- 1.11. In December 2005, the new scheme funding arrangements came into force and replaced the former Minimum Funding Requirement. These arrangements brought significant new protection for members of defined benefit pension schemes, while offering trustees together with employers flexibility to meet the funding requirement in the most appropriate way for their scheme. In particular:
- All such schemes are subject to a statutory funding objective that they must have sufficient and appropriate assets to cover the amount required on an actuarial calculation to make provision for their liabilities which take into account the financial strength of the employer at the time of the valuation;
 - Trustees must obtain actuarial valuations at least every three years; and
 - If the valuation indicates that the funding objective is not met, the trustees must prepare a recovery plan setting out the steps that will be taken to restore the funding position, and must send a copy of the plan to the Regulator.
- 1.12. Legislation places responsibility for the key decisions affecting the funding arrangements for a defined benefit scheme with the trustees, but in making these decisions trustees are required to obtain the scheme actuary's advice and, generally, the agreement of the sponsoring employer. Where, exceptionally, the trustees and the employer cannot reach agreement the Regulator has a range of targeted powers to help resolve matters. The Regulator monitors the key features of the submitted recovery plans.
- 1.13. All indications are that the majority of trustees and employers appear to have positively embraced the scheme-specific nature of the regime. The practical guidance in the Regulator's Code of Practice on the funding of defined benefits is being followed and schemes are, in general, usually taking the principle of reasonable affordability into account in eliminating the disclosed deficit. The vast majority of recovery plans appear reasonable and

appropriate to the Regulator with over 80% of schemes producing plans no longer than 10 years in length; the average plan length is 7.5 years.

- 1.14. To date the Regulator is pursuing detailed investigations into a small percentage of recovery plans (estimated 3%). However, most recovery plans can be resolved with negligible involvement by the Regulator.

The role of trustees

- 1.15. The primary responsibility for protecting members' interests falls to the trustees of the pension scheme, who have a fiduciary duty to act in the interests of members. The Regulator also has powers to support this vital role: it provides information and guidance, can remove trustees where appropriate, and can appoint trustees where necessary.
- 1.16. An amendment to the Regulator's power to appoint trustees was discussed and agreed at Commons Committee stage of the current Pensions Bill on 19 February. This amendment has two effects:
- It permits the Regulator to appoint trustees where it is reasonable to do so, and not only in cases where it is necessary to do so; and
 - It creates a new ground on which the Regulator could appoint trustees, permitting them to be appointed where it is in the interests of the generality of scheme members.
- 1.17. This amendment made it clear that the power would be available to the Regulator in a number of circumstances in which the appointment of trustees was the most appropriate option – and not just in circumstances where the appointment of trustees was the only option.

Employer debt

- 1.18. The scheme-specific funding arrangements set out how schemes should be funded on an ongoing basis to meet the pension promise; section 75 of the Pensions Act 1995 and associated regulations set out how to calculate the debt owed by an employer to a pension scheme in certain circumstances, for example, if an employer becomes insolvent, withdraws from a multi-employer scheme, or if a scheme is wound up. In general terms, the debt is usually the employer's share of the difference between the value of scheme assets, and the total sum required to purchase annuities for all scheme members. The purpose of the debt is to ensure that all pension promises are met in full at the time when the employer stops supporting the scheme.
- 1.19. In order to balance the rights and expectations of scheme members' the responsibilities of trustees, and the need to protect the PPF from undue exposure to risk with commercial needs of the employer, Approved Withdrawal Arrangements were introduced in September 2005. These

changes allow a departing employer's debt to be reduced where an appropriate guarantee is put in place.

- 1.20. Revised employer debt regulations came into effect from 6 April 2008 (affecting both single and multi-employer schemes). These revisions are designed to strike a balance between making the previous employer debt regulations more flexible in their operation, and discouraging the avoidance of pension liabilities by scheme sponsors.
- 1.21. A number of important changes were introduced by these regulations including easements for employers who cease to employ an active member, but intend to employ one within the subsequent 12 months, more flexible Withdrawal Arrangements (which in some cases will no longer require the approval of the Regulator), and tighter apportionment rules. Transitional provisions will also apply to transactions already agreed or in negotiation to continue to use old rules for up to twelve months of these regulations coming into force.

Anti-avoidance powers

- 1.22. One of the key 'anti-avoidance' issues identified in the development of the 2004 Act was the possibility that employers could seek to avoid triggering an employer debt, or prevent the full amount of the debt being payable or recovered. The Act therefore provides the Regulator with powers to deal with avoidance behaviour. Ministers recognised that new issues of anti-avoidance could arise over time and committed to keep these powers under review, and bring forward amendments to them if needed.
- 1.23. The two main anti-avoidance powers available to the Pensions Regulator are:
- the **Contribution Notice (CN)**, which can be issued to an employer or someone associated or connected with the employer who is involved in an act or a deliberate failure to act to prevent recovery of a pension debt, or otherwise than in good faith, to prevent the full amount of the pension debt becoming due. A Contribution Notice requires the recipient to pay a specified amount of money to the pension scheme; and
 - the **Financial Support Direction (FSD)** to an employer or someone who is connected or associated with the employer, which would require that the recipient put in place appropriate financial support for an occupational pension scheme, where the sponsoring employer of the scheme is a service company, or is insufficiently resourced.
- 1.24. The Regulator operates a voluntary clearance procedure in relation to its anti-avoidance powers. This allows parties involved in corporate transactions and other events that could impact upon a pension scheme to seek assurance from the Regulator that it will not use its anti-avoidance powers in

relation to that event. The clearance process was introduced at the same time as the powers to provide certainty to the market

- 1.25. Since 2005 the Regulator has pursued a deliberate strategy of education, enablement and enforcement which has meant that it has focused on promoting trustee understanding and behaviours, and on improving standards through key pieces of guidance and the trustee toolkit, with powers used only as a last resort. The very existence of the anti-avoidance powers, in particular, has acted as a powerful deterrent allowing the Regulator to facilitate and work closely with trustees and employers to ensure an appropriate outcome for schemes and their members. Indeed these powers have also supported trustees, allowing them to better protect members' interests in circumstances where an employer may not have considered the impact on the scheme.
- 1.26. While its emphasis is clearly on educating and enabling, the Regulator is not afraid to use its powers where it considers it is right to do so. It has issued two determinations to issue Financial Directions and has used its powers to disqualify one trustee.
- 1.27. Its overall regulatory approach in this area has won plaudits from stakeholders. In particular parties have been pleased with the way in which the clearance regime is operated. This allows parties involved in corporate transactions to seek clearance from the Regulator that it will not use its anti-avoidance powers in relation to that particular transaction. The Regulator has a reputation for acting in a responsive and proportionate manner dealing quickly and pragmatically with the applications it receives.

This consultation

- 1.28. Recent developments in the market have led the Government to question whether these powers remain adequate and if, in an evolving market, scheme members continue to enjoy the appropriate level of protection. We welcome innovation in the management of pension risk but it should not shift the risk disproportionately onto scheme members or the PPF by leaving schemes without the security that an employer brings, or the capital that would be required of an FSA-regulated insurer promising to pay pensions, to stand behind the risks. It is essential that we strike a balance between maintaining an environment in which market solutions can flourish, while ensuring the Regulator has the right mix of powers to intervene where appropriate.
- 1.29. The Government does not wish to impose onerous burdens on all employers; it is committed to a rolling deregulatory review of pensions legislation to keep burdens to a minimum. It therefore believes that the appropriate way forward is to build on the existing powers of the Pensions

Regulator.

1.30. This consultation:

- Sets out the Government's aims in amending the anti-avoidance powers;
- Describes some behaviours that pose risks to member benefits and the PPF, and the Government's approach to tackling those behaviours; and
- Explains how the Government proposes to give legislative effect to these changes.

Retrospective effect

1.31. It is important that the Government's announcement of these proposals does not prompt the kind of undesirable market behaviour that it is seeking to prevent. To do so would not be in scheme members' interests, and it would present risks to the PPF and continuing schemes.

1.32. The amendments that result following this consultation will have retrospective effect. This means that the Regulator should generally be able to make use of them in relation to the relevant events or circumstances taking place on or after these proposals were announced by Mike O'Brien QC MP, Minister for Pensions Reform on 14 April 2008, but subject to the Regulator's statement (25 April 2008) issued in parallel with this consultation. This will ensure that all pension schemes are treated fairly, and prevent any party pushing through transactions which reduce the security of member benefits without these powers biting on the transaction.

1.33. The full details of each issue and how the retrospective effect applies are set out in the following Chapters of this consultation document. In brief, the Government proposes to:

- ensure that the aggregate resources of a whole group of companies may be considered when determining whether an Financial Support Direction can be issued – as an alternative test rather than always requiring the Regulator to identify one single company which is sufficiently resourced to enable the issue of a Direction (Chapter Two)
- enable Contribution Notices to be issued where the effect of an act is materially detrimental to the security of members' benefits (Chapter Two);
- remove a requirement requiring the Regulator to show that parties had not acted in good faith from one of the existing tests for Contribution Notices (Chapter Two);
- clarify that the issue of a Contribution Notice can be triggered by a course of conduct, and not just a single act or omission aimed at avoiding a debt to a pension scheme (Chapter Three);
- ensure that the use of anti-avoidance powers is not frustrated by 'bulk transfers' of members between pension schemes (Chapter Three).

1.34. The Government intends that the first of these measures – which would clarify that a **Contribution Notice may be issued in respect of a series of acts or failures to act as well as in respect of a single act or failure to act** – should have effect from the date that the anti-avoidance powers came into law, that is **27 April 2004**. This amendment does not extend the substance of the Regulator’s power but clarifies the position that a Contribution Notice may be considered in relation to multiple acts or failures rather than a single act or failure.

1.35. The Government intends that the **other amendments to primary legislation** should have effect from the date they were announced by Mike O’Brien QC MP, the Minister of State for Pensions Reform – that is, the Regulator would be able to use these revised powers **in relation to the relevant events or circumstances taking place on or after 14 April 2008**, subject to the Government’s introduction of legislation and Parliament’s approval. The way in which retrospective effect applies to each change is set out in the next Chapters. The Government believes retrospective effect is necessary to ensure that there are adequate safeguards in place to protect pension schemes should persons undertake transactions described in this document prior to changes to the regulatory regime.

1.36. To address uncertainty arising during the consultation period, the Pensions Regulator has confirmed that it will not apply the following additional grounds for the use of its powers:

- The new alternative test that could trigger the issue of a Financial Support Direction;
- The new alternative test that could trigger the issue of a Contribution Notice; and
- The removal of the words ‘otherwise than in good faith’ from s. 38(5)(a)(ii) of the Pensions Act 2004 in respect of transactions occurring between 14 April 2008 and the date new regulations come into force unless one or more of the actions or situations listed below is the subject of the proposed use of the power:
 - Moving the employer or pension scheme to another jurisdiction;
 - Splitting the operating company from the pension scheme without appropriate mitigation for the pension scheme;
 - Splitting the assets from the operating company without appropriate mitigation for the pension scheme;
 - Transferring scheme assets and liabilities to another scheme which did not have adequate support from an employer;
 - Running a scheme for profit without adequate account being taken of member interests;
 - Business models in which risk is predominantly borne by scheme members, but high investment returns would benefit investors.

1.37. During the period between 14 April 2008 and the amendments coming into force the Regulator will continue to operate its clearance process. In providing clearance the Regulator will be bound not to use its existing powers, or those resulting from this consultation in relation to the transaction. The Regulator does not anticipate any extension to the time taken to grant clearance as a result of the proposals.

How the Government proposes to give legislative effect to these changes

1.38. The issues discussed in this document are important, urgent and, in some cases, technically complex. The legitimate interests of employers, pension scheme members, trustees and other parties in the pensions industry must be balanced in order to ensure that the regulatory framework provides adequate security, without imposing undue regulatory burdens on legitimate business transactions.

1.39. The Government considers that the most effective way of achieving this balance is to enable thorough consultation on the proposals in this consultation document and, in time, on draft regulations.

1.40. The Government is therefore re-examining the powers granted to the Pensions Regulator under sections 38 to 56 of the Pensions Act, and proposes to take a regulation-making power which is sufficiently broad-based to enable amendments to be made to ensure that the Regulator has effective powers to deal with the risks resulting from innovation in the market, and to make sure that the effect of the powers is clear to all parties in the market. The Government's intention is to introduce this power as soon as Parliamentary time allows following this consultation process. Regulations made under this power would be subject to the affirmative procedure, which means that they would have to be agreed by both Houses of Parliament before coming into effect. The Government proposes to make all amendments to primary legislation discussed in this consultation by means of these regulations.

1.41. In addition to the measures amending primary legislation discussed in this consultation document, the Government is considering whether secondary legislation should be amended. It will consult on draft regulations later this year if it concludes that amendments are needed.

Impact assessment

1.42. The overwhelming majority of pension schemes will not be affected by these changes. The Government's proposals seek to strike a balance between ensuring that the anti-avoidance powers remain adequate to mitigate risks, without placing an undue burden on business, employers or pension schemes. In operation, the Regulator has demonstrated that it takes a

proportionate approach to regulating pension schemes, and only uses its powers where it is reasonable to do so: this approach will continue to be underpinned by the proposed legislation.

- 1.43. A full impact assessment has not been published because it is believed that the proposals will have only a negligible impact on the private and voluntary sectors. Views on this assumption and on the likely costs and benefits would be welcome. If responses indicate that this assumption is incorrect, an impact assessment will be published alongside the consultation on draft regulation.

Impact on public sector business

Pensions Regulator

- 1.44. We expect that the administrative costs of these proposals would be met within the Regulator's existing budget. The proposals would not therefore alter the funding position of the Regulator or introduce additional costs to those pension schemes which are responsible for paying the general levy.

Clearance Applications

- 1.45. The Regulator has published guidance on clearance. This provides professional advisers, employers as well as those who are associated and connected with employers with information about when they may wish to consider seeking assurance from the Regulator that it will not use its powers in relation to an event.
- 1.46. The Regulator normally processes clearance applications within the applicant's timeframe. The Regulator does not anticipate that the proposals in this consultation would have any impact on this process.
- 1.47. The Regulator expects that there would be an initial increase in enquiries relating specifically to clearance issues, of around 10 per cent, while the market tests how these proposals would work in practice. These will not necessarily lead to formal applications to clearance.
- 1.48. The Government considers that the possible increase in enquiries and clearance applications triggered by the proposals may offset a historic decline in applications generally – and hence the proposed changes would not materially increase the volumes of applications from current levels over the longer term.

Enquiries

1.49. The Government expects that there will be an increase in general enquiries during and immediately following the consultation period but that this would reduce subsequently. The resource required to manage enquiries and to continue to deliver its business would be met within the Regulator's existing budget.

Impact on private and third sectors

1.50. The Regulator's summary of Corporate Risk Management activity is shown in the table below¹:

Clearances and withdrawals	2005-06	2006-07	2007-08
Clearances granted	148*	149	147
Withdrawals approved	*	26	13
Clearances refused	2	1	0
Enquiries received	1, 015	874	494

*148 is a combined figure for clearances and withdrawal approvals issued.

1.51. The proposed amendments would not represent a new burden on employers and businesses but would, for example, close loopholes that could otherwise allow unscrupulous employers to renege on pensions promises. The changes would also help to address those business models that reduce the security of a pension scheme which would leave members and the PPF exposed to unacceptably high levels of risk.

1.52. The Government's proposals, including the extension to the Regulator's power to issue a Contribution Notice, are not expected to result in a long-term increase in the number of applications for clearance statements. The proposals are framed to ensure that the powers are appropriately targeted on risks to pension schemes. For example, it may be appropriate to limit the use of the proposed change to the Contribution Notice power to situations in which the prospective recipient cannot show that they could not reasonably have foreseen that their actions could have a materially detrimental effect on the security of members' benefits.

1.53. This approach taken together with the Regulator's guidance on the sort of transactions that are likely to have a materially detrimental effect on pension schemes is expected to provide business with clarity on how the powers will work in practice. As part of its operations the Regulator expects to continue to assist stakeholders in understanding the clearance process, with a resulting reduction in potential cost for the industry.

¹ The Pensions Regulator annual report and accounts 2006-2007 HC762

- 1.54. The Government does not collect authoritative data on the cost to business of a clearance application. Informal consultation with members of the industry indicates that costs will vary significantly from case to case and may include legal costs for employer and trustees, an employer covenant review by the trustees and relevant actuarial advice. It is expected that for most employers however these costs will already form part of the normal due diligence process that would be undertaken in connection with a corporate transaction.
- 1.55. The Regulator estimates that some 10 per cent of its caseload is part of an ongoing series of corporate transactions. In these cases an employer covenant review may have already been undertaken, for example, which would reduce costs.
- 1.56. Of course clearance cases vary in complexity. Trustees seek an independent employer covenant review in the majority of clearance cases involving a corporate transaction or other event which might trigger a material change in the quality of the employer covenant to the scheme. In some more straightforward cases the scheme trustees may seek to utilise a recent employer covenant review that has been obtained as part of their scheme funding valuation process.
- 1.57. The Pensions Regulator has established effective relationships with its regulated community and it resolves a significant proportion of enquiries relating to clearance issues outside the formal application process. It is anticipated that this positive practice, which has been welcomed by the industry, would continue to address concerns and provide clarification where appropriate on these proposals. It is not possible however to quantify the potential mitigation in costs to the industry.

Q. The Government welcomes views on the assumptions about the impact of the proposals set out in this consultation document.

The Government welcomes comments on the extent to which its proposals meet its aims to:

- ensure members' benefits are protected, and trust and confidence in pensions is sustained;
- retain the central role of trustees in protecting members' interests;
- enable appropriate innovation in the pensions market, while maintaining regulatory oversight;

- equip the Regulator with the powers it needs to protect members' interests and the PPF, while ensuring these powers are proportionate;
- avoid undue burdens on sponsors of defined benefit pensions and help employers to retain defined benefit schemes – in part by reducing risk to the PPF;
- avoid impeding normal business activity; and
- deliver effective legislation.

1.58. Full details of the arrangements for responding to this consultation can be found in **Annex A**. A full list of the questions for respondents may be found at **Annex B**.

2. Ensuring the Regulator's anti-avoidance powers are appropriate to tackle material risks

Summary

To ensure that the Pensions Regulator's powers remain adequate, in particular to address the risks presented by new business models, the Government proposes to make the following changes:

- Introducing a new alternative test that could trigger the issue of a Financial Support Direction – at present, a single entity must be identified who would be able to provide financial support before the FSD is issued, but the actual FSD could be broader and spread the requirement for support among a number of parties.
- Introducing a new alternative test that could trigger the issue of a Contribution Notice – this would enable the Regulator to issue Contribution Notices where a course of conduct is materially detrimental to members' benefits; and
- Removing the 'good faith' test from the relevant limb of the existing Contribution Notice power

The Government intends that these changes should be effective from 14 April 2008, the date Mike O'Brien QC MP announced the Government's intention to consult on the amendments.

To provide sufficient certainty for business about how these alternative tests would be applied prior to legislation coming into force the Pensions Regulator issued a statement on 25 April 2008 in parallel with this consultation. **The Regulator's statement makes it clear that it will apply these amendments to the grounds for the powers in respect of transactions occurring between 14 April 2008 and the date new regulations come into force in relation to certain actions or situations.**

2.1. The Government welcomes innovation in the pensions market, but it must ensure that regulation is keeping pace with new risks that emerge from innovation. It therefore proposes to amend the anti-avoidance powers of the Pensions Regulator to ensure that they remain appropriate, without imposing undue burdens on pension schemes, employers or the wider business community.

2.2. The particular focus of the Government's attention is the launch of new business models, which among other features, may look to sever the link between the employer and the pension scheme in order to operate well-funded occupational pension schemes for profit. These models, which operate outside the regime regulated by the Financial Services Authority, may be detrimental to scheme members' benefits, and have a cost consequence

for the PPF which could be transferred to continuing schemes through the PPF levy.

2.3. The Government considers that these business models are characterised by the following kinds of features:

- Moving the employer or pension scheme to another jurisdiction;
- Splitting the operating company from the pension scheme without appropriate mitigation for the pension scheme;
- Splitting the assets from the operating company without appropriate mitigation for the pension scheme;
- Transferring scheme assets and liabilities to another scheme which did not have adequate support from an employer;
- Running a scheme for profit without adequate account being taken of member interests;
- Business models in which risk is predominantly borne by scheme members, but high investment returns would benefit investors.

2.4. In order to ensure that that the Pensions Regulator's powers remain adequate, in particular to address the risks presented by new business models, the Government proposes to make the following amendments:

- Introducing a new alternative test that could trigger the issue of a Financial Support Direction (FSD) – at present, a single entity must be identified who would be able to provide financial support before the FSD is issued, but the FSD could be broader and spread the requirement for support among a number of parties.
- Introducing a new alternative test that could trigger the issue of a Contribution Notice – this would enable the Regulator to issue Contribution Notices where a course of conduct is materially detrimental to the scheme's ability to pay members' benefits; and
- Removing 'otherwise than in good faith' from one of the limbs of the existing test for issuing a Contribution Notice

2.5. There is a risk that the Government's announcement could prompt the kind of undesirable market behaviour that it is seeking to prevent, prior to new regulation coming into effect. To mitigate this, **the Government intends that these changes should be effective from 14 April 2008**, the date Mike O'Brien QC MP announced the Government's intention to consult on the amendments.

2.6. To provide sufficient certainty for business about how these alternative tests would be applied in respect of transactions occurring between 14 April 2008 and the date the legislation comes into force, the Pensions Regulator issued a statement on 25 April 2008 in parallel with this consultation. **The Regulator's statement makes it clear that it will not apply these amendments to the grounds for the powers in respect of these transactions unless one or more of the actions or situations listed**

above (at paragraph 2.3) is the subject of the proposed use of the power.

- 2.7. The Regulator's statement provides an important assurance for business that the changes will remain appropriately targeted. In addition there are a number of other safeguards:
- The Pensions Regulator's Clearance Guidance; and
 - Statutory matters that the Regulator must have regard to in order to act reasonably in using its Contribution Notice and Financial Support Direction powers;
 - Existing protections against the unreasonable issue of Financial Support Directions – for example, to persons who have not been involved with a pension scheme (see s. 43(7) of the Pensions Act 2004).
- 2.8. The Government also proposes a future safeguard provision for a 'statutory defence' against the use of the new powers in relation to Contribution Notices. This would apply if a party can demonstrate that they could not reasonably have foreseen the effect of a transaction would not be the subject of a Contribution Notice.

Financial Support Direction – insufficiently resourced test

- 2.9. The power to issue a Financial Support Direction under section 43 of the Pensions Act 2004 permits the Regulator to direct an employer or an associated or connected person to put in place financial support for a scheme, where the employer is insufficiently resourced and may therefore not be able to properly fund the scheme.
- 2.10. The Regulator may only issue a Direction however in a case where the employer is service company or insufficiently resourced.
- 2.11. For the purposes of insufficiently resourced there must be a single person associated or connected to the employer who is sufficiently well-resourced that it has the resources itself to meet the difference between the employer's resources and at least half the section 75 debt to the scheme.
- 2.12. Once the insufficiently resourced employer and an associated or connected party who is sufficiently well-resourced has been identified, the Regulator may then issue a FSD to any associated or connected person or to the employer itself or to a combination of those persons. But it must first establish a single person sufficiently well enough resourced to meet the test.
- 2.13. This inconsistency between the conditions required to satisfy the test for issuing a Financial Support Direction and the parties that could be subject to the Direction once the test has been met means that the members of a group of companies, for example, could divide up the resources of the group

amongst themselves so that no one of them has sufficient resource to meet the difference. The test will therefore not be satisfied, with the consequence that no Financial Support Direction could be issued.

- 2.14. To address this issue Government proposes to amend the test so that as an additional alternative to the current test which requires just one person who must be well-enough resourced to meet the difference, the test could also be satisfied if a group of associated or connected persons is between them well-enough resourced to meet the test. This would be more in line with the support that can already be required under an FSD and would remove the risk that a group of companies could manipulate their affairs to avoid the issue of a Direction.
- 2.15. This proposed change would not extend the reach of the FSD power to potential parties who could not currently be subject to an FSD; it would still be necessary for the Regulator to demonstrate that a person was “connected or associated” with the employer in question. It would not change the persons who could be liable to support a scheme, or the nature of that support, if an employer is insufficiently resourced.
- 2.16. The Government recognises that in order for this alternative test to apply fairly, it is necessary that the group of persons whose aggregate resources were considered to be sufficiently resourced to meet the test should themselves be associated or connected with each other – and not simply connected to the under-resourced employer sponsoring the pension scheme.
- 2.17. The safeguards set out at s.43(7) of the 2004 Act, which detail matters to which the Regulator must have regard when deciding whether it is responsible to issue a Financial Support Direction will continue to apply.
- 2.18. This proposal would have retrospective effect for acts occurring, or failures to act first occurring, on or after the date of announcement of these measures: 14 April 2008, subject to the Regulator’s statement of 25 April 2008 described at paragraphs 2.1-2.6 above.

Q. The Government welcomes views on its proposal that the resources of the whole group of associated or connected persons should be considered when assessing whether a Financial Support Direction can be issued.

Why the Government is proposing to amend the power to issue Contribution Notices

- 2.19. The anti-avoidance powers set out in the Pensions Act 2004 were particularly focused on employers deliberately avoiding debts to their pension schemes. In this, the powers have been notably successful, in part due to their deterrent effect. However, the pensions market has developed

significantly since 2004, with a range of innovative approaches being proposed to enable scheme sponsors to have greater certainty about the extent of their pensions liabilities.

- 2.20. The Government welcomes the innovative thinking in the market, and does not wish to quash solutions which work well for scheme members and sponsors. But where new business models bring new associated risks to member benefits, it is right to consider whether new regulatory tools are required to counter those risks.
- 2.21. The Government's view is that the best way to counter these risks is to build on the established framework of powers set out in the Pensions Act 2004, and ensure that they are sufficiently effective to deal with the risks that are better understood in the light of the Regulator's experience.
- 2.22. In particular, the Government considers that the current tests set out in s. 38 of the Act, which enables the issue of Contribution Notices, may be circumvented. In effect, these tests require the Regulator to consider and prove the intent in the mind of a potential subject of a Contribution Notice.
- 2.23. This test of 'intent' may frustrate the effective exercise of Regulatory powers in circumstances in which an informed observer might consider it would be appropriate to act to protect pension scheme members' benefits. For example, it could be difficult to intervene on a transaction in which the interests of the pension scheme (or the employer's liability towards that pension scheme) appeared not to have been considered, even if the outcome of the transaction materially reduced the security of the pension scheme.
- 2.24. The Government therefore proposes to amend s. 38 in order to also permit the issue of a Contribution Notice when an alternative test is met. This test would focus on the effect of the transaction in question, rather than the motivations of the parties to the deal. The Government believes that this approach would offer transparency and objectivity to parties. It would also parallel the approach taken in tax legislation, in which HM Revenue and Customs may use various anti-avoidance powers either:
- If the main purpose of the act is to avoid tax; or
 - If the main benefit of the act is to avoid tax.
- 2.25. The Government is concerned that stakeholders should understand how this test could apply to transactions in which they are involved – and that the Regulator should have the flexibility to act when pension schemes face important risks as a result of planned transactions.
- 2.26. One possible approach would be to frame a “before and after” test that would also permit the issue of a contribution notice if an act, failure to act or course of conduct was materially detrimental to the likelihood of a member

receiving current and future benefits from the scheme of which he is a member after the conduct in question. This would, of course, exclude the role of the PPF so that detrimental acts were not excused just because compensation is separately available.

2.27. This proposal would have retrospective effect for acts occurring, or failures to act first occurring, on or after the date of announcement of these measures: 14 April 2008, subject to the Regulator's statement of 25 April 2008 described at paragraphs 2.1-2.6 above.

Q. The Government welcomes comment on the issues that should be considered in drafting legislation to introduce this test, and in particular the proposal set out above.

Ensuring employers and others are clear about the implications of the new test

2.28. The Government recognises that a wide range of transactions could potentially fall within the scope of the new test it proposes as a basis for issuing Contribution Notices. It does not, however, consider that the overwhelming majority of pension schemes should be the subject of Contribution Notices. It therefore considers that, in line with the widely-welcomed risk-based approach the Pensions Regulator has adopted to using its regulatory powers so far, legislation and guidance should target the use of the new power on areas prompting particular concern about the risk to member benefits or the Pension Protection Fund. This is consistent with the Regulator's approach to dealing with clearance applications to date.

2.29. There are important legal safeguards in place which govern the use of the anti-avoidance powers, and the Regulator must act reasonably in using its powers or it could be subject to judicial review. In addition, legislation sets out a specific procedure which must be followed before the Regulator can issue a Contribution Notice (or a Financial Support Direction), which allows for any party which might be affected to put their case and have their arguments considered before the Regulator makes a determination:

- Before considering using one of its powers, the Regulator will satisfy itself that it has sufficient evidence on the case. It may write to parties to ask questions.
- The Regulator will then issue a warning notice stating that it is considering using one of its anti-avoidance powers. The parties who would be directly affected are able to make representations to the Regulator about the case and possible use of its powers.
- The Regulator would then present a case to its Determinations Panel – a body separate from the executive of the Regulator – who would consider whether the case was sufficiently well-made. The Panel could hold oral hearings in determining the case.

- If the Determinations Panel decided to issue a Contribution Notice or a Financial Support Direction, its decision could be appealed to the Pensions Regulator Tribunal.
- The Tribunal may reconsider all the facts of the case including any new evidence not previously considered by the Determinations Panel. The Tribunal will then make a fresh determination which will be binding on the Regulator.
- There is a right of appeal from the Tribunal (separate from judicial review) on a point of law to the Court of Appeal or, in Scotland, the Court of Session.

2.30. The Government considers that in developing policy in this area, a number of principles apply:

- The choices made by a party should be judged against the options that were available at the time in question, and the information the party had or should have had about the risks of each option – it is not a test of hindsight.
- The Regulator should only be able to use its powers where those choices have adversely affected the security of members' benefits, or are likely to do so in the future.
- The powers should be used proportionately – a marginal weakening of the scheme's position should be a lesser priority for action than a more significant threat.
- The implications of the powers should be clear for sponsors – and sponsors should be able to make informed decisions about courses of conduct without seeking clearance from the Regulator in the majority of cases.
- The powers should give sufficient flexibility to the Regulator to act against key risks to the scheme's ability to pay benefits, and there should not be undue barriers to their use that could preclude proportionate action to protect members' benefits.

Defining detriment

2.31. In considering whether an action had material detrimental effect, the Government considers that parties would need to consider a number of aspects of the security of members' benefits, which could include:

- the assets of the scheme of which the relevant members are members;
- the liabilities of that scheme;
- the resources of any employer sponsoring the scheme (both on an ongoing basis and in any potential insolvency of that employer);
- the resources of the corporate group or those connected or associated with the employer;
- the business activities and operations of the employer and the location of such business activities and operations;
- the strength of legal obligations to the scheme;

- the investment strategy of the scheme and, in particular the extent to which any strategy involves an asymmetric allocation of risk between the scheme and any other party involved in the investment; and
- the jurisdiction in which any obligation to fund the scheme would be enforceable.

Q. The Government welcomes views on whether a non-exhaustive statutory checklist of factors to consider in any detriment test would be useful for parties who could be subject to the issue of a Contribution Notice under the new test

Factors to be considered in assessing whether it is 'reasonable' for the Regulator to issue a Contribution Notice

2.32. As a public authority, the Regulator is already subject to various controls to ensure that it is acting reasonably. The Pensions Act 2004 builds on these controls by setting out a list of factors at s.38 to which that the Regulator must have regard where relevant when considering whether it would be reasonable to issue a Contribution Notice. These factors are:

- (a) the degree of involvement of the person in the act or failure to act which falls within subsection (5)
- (b) the relationship which the person has or has had with the employer (including, where the employer is a company within the meaning of subsection (11) of section 435 of the Insolvency Act 1986 (c 45), whether the person has or has had control of the employer within the meaning of subsection (10) of that section),
- (c) any connection or involvement which the person has or has had with the scheme,
- (d) if the act or failure to act was a notifiable event for the purposes of section 69 (duty to notify the Regulator of certain events), any failure by the person to comply with any obligation imposed on the person by subsection (1) of that section to give the Regulator notice of the event,
- (e) all the purposes of the act or failure to act (including whether a purpose of the act or failure was to prevent or limit loss of employment),
- (f) the financial circumstances of the person, and
- (g) such other matters as may be prescribed.

2.33. The Government proposes to extend this list by including the following factors:

- the reasonableness of the person's actions in the circumstances; and
- the value of benefits received directly or indirectly by that person from the employer or the scheme.

Q. The Government welcomes views on the additional ‘reasonableness factors’ it proposes to prescribe should be taken into account when considering the issue of a Contribution Notice

Characteristics of detrimental effect

2.34. The Government considers that sponsors, trustees and others would find it helpful to have guidance on the sort of transactions which are likely to have material detrimental effect on pension schemes. It is therefore considering whether to set out some of the characteristics of detrimental effect.

2.35. While the Government does not think that an exhaustive list would be appropriate, it might be desirable for some features of transactions which might prompt the Regulator’s consideration. Some of the actions or situations which might be subject to these new provisions are:

- Moving the employer or pension scheme to another jurisdiction;
- Splitting the operating company from the pension scheme without appropriate mitigation for the pension scheme;
- Splitting the assets from the operating company without appropriate mitigation for the pension scheme;
- Transferring scheme assets and liabilities to another scheme which did not have adequate support from an employer;
- Running a scheme for profit without adequate account being taken of member interests;
- Business models in which risk is predominantly borne by scheme members, but high investment returns would benefit investors.

2.36. This non-exhaustive list is illustrative of the transactions which can pose increased risks to members, and notwithstanding the Regulator’s statement (25 April 2008), would not preclude the Regulator acting with regards to other transactions which take place on or after the introduction of the changes – that is, the date that the final legislation comes into force. The Government is not seeking to target any particular business model in identifying these features, or seeking to prevent profit-making organisations being involved in administering pension schemes in the interests of scheme members.

2.37. However, the Government would be concerned by business models in which:

- the interests of investors and pension scheme members were opposed, and in which that conflict was not managed effectively; or
- the model depends on undertaking to pay pensions without ensuring that there is an ongoing employer or adequate capital standing behind the pension promise.

Q. The Government welcomes views on the value of setting out such a non-exhaustive list, where to set out this list and on the proposed characteristics.

Q. The Government welcomes views on other provisions that could be included in legislation or elsewhere to ensure that the new test to issue Contribution Notices is effectively targeted on risks to scheme members' benefits.

Amending the existing power to issue Contribution Notices

- 2.38. In addition to providing the alternative test described above to permit the issue of a Contribution Notice, the Government also proposes to remove the provision that states that a Contribution Notice may not be issued where a party has acted in good faith², but their actions have had the effect of preventing the full amount of a debt becoming due.
- 2.39. The current test requires the production of evidence of bad faith, however operational experience has shown that this requirement can be easy to circumvent. For example evidence of intent may be concealed.
- 2.40. Under the current legislation, this requirement only applies to situations in which a party is seeking to prevent the full amount of a debt becoming due – it does not apply to situations in which a party is seeking to avoid recovery of a debt or to the Regulator's power to issue a Financial Support Direction. The Government considers that the lack of this requirement in these situations has not placed an undue burden on sponsors, or led to situations where the Regulator has used its powers unfairly.
- 2.41. Appropriate legislative safeguards will continue to govern the use of the Contribution Notice power. In particular, there is a statutory requirement on the Regulator to consider the reasonableness of using the power. In addition, the Government believes that employers and their advisers have developed significant experience in managing the pensions aspects of corporate transactions since April 2005, and it is not appropriate to retain a provision which could be used by parties to justify action on the grounds that they were ignorant of the implications for a pension scheme.
- 2.42. This proposal is consistent with the proposed new alternative test for issuing Contribution Notices, as it removes a requirement on the Regulator to prove from (mainly documentary) evidence the motivations of parties before it is empowered to issue Contribution Notices.
- 2.43. Stakeholders have recognised that the Regulator has exercised its powers in a risk-based way since its inception, only using its powers as a last resort. The Regulator will continue to operate its clearance procedure in a pragmatic, proportionate and responsive manner.

² Section 38(5)(a)(ii) Pensions Act 2004

2.44. This proposal would have retrospective effect for acts occurring, or failures to act first occurring, on or after the date of announcement of these measures: 14 April 2008, subject to the Regulator's statement of 25 April 2008 described at paragraphs 2.1-2.6 above.

Q. The Government would welcome comments on the proposed removal of the words 'otherwise than in good faith' from s. 38(5)(a)(ii) of the Pensions Act 2004

A statutory defence

2.45. The Government's preferred approach to achieving these aims is to provide a statutory defence for persons who could be subject to the issue of a Contribution Notice under the new alternative test. This would provide that the Regulator could not issue a Contribution Notice if the person could demonstrate that based on what they knew or what they ought to have known, they could not reasonably have foreseen that their actions could have a materially detrimental effect on the security of members' benefits. The Government considers this would mean that parties who conduct effective 'due diligence' on a transaction and take a view on its risks to the pension scheme would be able to show that they had considered the impacts on members of the affected pension scheme, provided that they had mitigated the risks effectively. Those who have adopted this approach would therefore minimise the need for additional work on their part as part of the transaction.

2.46. The Government has considered whether it would be appropriate to reverse the burden of proof – that is, to require the Regulator to demonstrate that the party should reasonably have foreseen the consequences of their action. The Government considers this to be a less attractive approach, as it could frustrate the Regulator in cases where it has clear evidence of detriment to the members. It could require the Regulator to show what was in the mind of the party at the time – including the information that was known or should have been known. The Government believes that the relevant parties behaving appropriately will be able to show in any particular case that they have already identified the relevant issues as part of their 'due diligence', and made appropriate provision as part of good practice.

2.47. This statutory defence would be available in cases where the Regulator was considering issuing a Contribution Notice under either:

- the test described under 2.19-2.27 above; or
- s. 38(5)(a)(ii) following the removal of the words 'otherwise than in good faith' as described in paragraphs 2.38-2.44 above.

Q. The Government welcomes views on its proposed statutory defence for parties who could be subject to the issue of a Contribution Notice.

3. Ensuring the Regulator can intervene where appropriate in relation to a course of conduct and bulk transfers between schemes

Summary

The Government has identified unforeseen effects in the way the legislation operates in the context of acts or bulk transfers, and considers that the following amendments are necessary to ensure that current legislation is :

- clarifying that the Regulator can issue a Contribution Notice following a course of conduct rather than only in response to an isolated act or failure to act;
- if the Regulator would have issued a Contribution Notice but for the fact a bulk transfer has taken place, it could do so after the transfer; and
- if the bulk transfer itself is materially detrimental to the likelihood that members' benefits will be paid, the Regulator could issue a Contribution Notice – this could include, for example, circumstances where the bulk transfer has frustrated the Regulator's power to issue an FSD

The Government considers that it is necessary for the Regulator to have the ability to make use of these amendments in relation to a course of conduct occurring on or after 27 April 2004 or bulk transfers occurring on or after 14 April 2008. In the first case, this is because the Government considers the legislation should always have been read in this way; in the second, this is to prevent features of current legislation highlighted by the 14 April announcement being exploited to avoid liabilities to pension schemes.

Clarifying that the Regulator can act following a course of conduct

3.1. The previous Chapter of this consultation document set out the principles of the anti-avoidance powers. In order to issue a Contribution Notice, the Regulator must have evidence that the main purpose or one of the main purposes of an act, or a failure to act was either:

- a. to prevent recovery of the whole or any part of a pension debt (under section 75 of the Pensions Act 1995), for example where an employer declares a dividend, avoiding payment of a debt; or
- b. otherwise than in good faith, to prevent the debt becoming due or to reduce the debt, for example through changes to scheme benefits, scheme mergers, bulk transfers or apportionment of pension liabilities.

3.2. The Government considers that it has always been the case that the legislation should be read to include more than one act or omission, but believes that it should be clear beyond doubt that the cumulative effect of a series of acts, or a series of deliberate failures to act (i.e – a course of conduct), should also satisfy the test for the Regulator to issue a Contribution

Notice, even if no single act would do so. It therefore proposes to amend s. 38 of the Pensions Act 2004 to confirm this.

- 3.3. As this change would merely clarify the wording initially considered by Parliament, the Government considers that it is appropriate for this change to have retrospective effect for acts occurring, or failures first occurring, on or after 27 April 2004: the date from which the powers currently have effect.
- 3.4. The Regulator does not envisage that this clarification will have any change in practice on how customers or the Regulator approach clearance as it is merely a clarification. Clearance applications frequently relate to a course of conduct – such as acts that are part of or relate to a corporate transaction.
- 3.5. An act or a deliberate failure to act' may be constituted as a series of acts, would require a 'course of conduct' in which the individual acts were connected in a relevant way and occurred within a reasonable timescale. This change would not permit the Regulator to withdraw clearance that has already been given. If a clearance statement has been issued in relation to an individual transaction, then that transaction could not form part of a 'course of conduct' triggering the issue of a Contribution Notice though, as now, that clearance would fall if facts prove to be materially different.

Q. The Government would welcome views on its proposed clarification of s. 38 of the Pensions Act 2004

- 3.6. Bulk transfers – the transfer of the assets and liabilities related to scheme members between pension schemes, usually without the consent of members – are an important tool for scheme sponsors and trustees. For example, an employer who takes over another company may wish to bring all its employees into the same pension scheme by transferring members from one scheme to another.
- 3.7. The majority of bulk transfers which take place are undertaken for sound reasons and the Government does wish to prevent these or other legitimate corporate activities from taking place. However, the Government does not believe it is appropriate that a bulk transfer can frustrate the effective use of the Regulator's anti-avoidance powers.
- 3.8. Experience of operating the anti-avoidance powers has demonstrated unexpected consequences of the legislation in relation to some cases involving bulk transfers. That is, in performing the bulk transfer, the link between the employer and the scheme that the members are actually in is severed, with two broad consequences:
 - If the Regulator was considering using its anti-avoidance powers before the bulk transfer took place, that action may no longer be possible; and
 - The act of bulk transfer itself may put members' benefits at risk.

3.9. The Government is not giving an opinion on the merits or legitimacy of any particular transaction. There are legal controls on the way in which employers exercise powers under pension scheme rules and where they exercise such powers for improper purposes they may incur legal liability. Depending on the terms of the powers involved and the steps taken, in some cases members may have claims for maladministration and/or breach of trust.

Regulator action prevented by effecting a bulk transfer

3.10. In the first of these cases, the Regulator could have been considering issuing a Contribution Notice before or after the bulk transfer took place. The Regulator may only issue a Contribution Notice where an employer (or a person associated or connected with the employer) is party to behaviour that is designed to prevent, avoid or compromise pension liabilities under section 75 of the Pensions Act 1995. This means that severing the link between the employer and the scheme containing the members may frustrate the use of this power, as the Regulator could not issue a Contribution Notice to require the former employer to make a financial contribution to the scheme that the members are actually in. It could only require contributions in relation to the former scheme which would no longer contain those members whose benefits have been put at risk.

3.11. The Government therefore proposes that where the Regulator could have issued a Contribution Notice but for the fact that the bulk transfer took place, it should still be able to issue that Contribution Notice.

3.12. The Government recognises that a consequential amendment would also be required to ensure that the contribution payable would be split appropriately between the transferring and receiving scheme: for example, if all members were transferred to a new scheme, then the new scheme should benefit from the full value of the Contribution Notice, but if only some of the members were transferred, then the value should be split in proportion with the assets and liabilities involved.

3.13. This approach would bring corporate transactions involving bulk transfers into line with corporate transactions involving the sale of employers together with their pension scheme(s). The Government considers that where necessary and appropriate, taking into account the conduct for which Contribution Notices would be imposed and the availability of clearance in individual cases, market solutions are available to deal with the allocation of liability between transferring and receiving employers and sellers and purchasers.

3.14. This change would have effect from 14 April 2008.

Q. The Government welcomes views on its proposal that the use of Contribution Notices should not be prevented by effecting bulk transfers.

Bulk transfers with detrimental effects

- 3.15. In some cases, the act of conducting a bulk transfer may itself be detrimental to members' benefits. For example, the destination scheme of the transfer may not offer adequate security for members – such as in cases where the employer's obligation to support the scheme is reduced, or in circumstances where the employer is less able to fund the scheme. The Government also intends that in circumstances where the bulk transfer has frustrated the Regulator's power to issue a FSD a Contribution Notice could be considered under the proposed new test (Chapter Two) if it is appropriate and reasonable.
- 3.16. The Government considers that such transfers would create a detriment that could permit the Regulator to issue a Contribution Notice under the new power described in Chapter Two.
- 3.17. This change would have effect for bulk transfers of liabilities occurring on or after 14 April 2008.

Q. The Government welcomes views on its proposal that the Regulator should be able to issue a Contribution Notice against a party that effects a bulk transfer that is not in the interests of members.

Annex A: Consultation arrangements

Who this consultation is aimed at

The Government welcomes contributions from employers and their representatives, the pensions industry, including pensions professionals, experts and advisers, trade unions and other pensions stakeholders.

Subject of consultation

This consultation concerns the Government's proposals to amend the powers of the Pensions Regulator to ensure that they remain adequate to address risks with introducing undue burdens on pensions schemes, employers or the wider business community.

Purpose of the consultation

The Government proposes to amend the anti-avoidance powers of the Pensions Regulator to ensure that they remain relevant and appropriately targeted on material risks to pension scheme members. The Regulator will continue to be required by legislation to use its powers in a reasonable way. The Government seeks to engage with stakeholders during this consultation process in order to design legislation that remains proportionate and effective.

Scope of Consultation

This consultation applies to England, Wales and Scotland.

Duration of the Consultation

The consultation period begins on 25 April 2008 and runs until 20 June 2008.

How can you respond to this consultation?

Please send your consultation responses to:

ADELPHI.REGULATORSPOWERS@DWP.GSI.GOV.UK

Pensions Client Directorate
Department for work and Pensions
1 – 11 John Adam Street
London WC2N 6HT

Please ensure your response reaches us by 20 June.

When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of a larger organisation, please make it clear who the organisation represents, and where applicable, how the views of members were assembled. We will acknowledge your response.

Queries about the content of this document

Any queries about the subject matter of this consultation should be made to:

Name: Ian Garland
Address: Department for Work and Pensions
1-11 John Adam Street, London WC2N 6HT

Phone: 020 712 2115
Email: Ian.Garland@dwp.gsi.gov.uk

Alternative ways of being involved in the consultation

We want to ensure that we get views from as broad a range of people as possible about this issue. As well as written responses to the questions we ask in this document, and any other points you would like to make, we will arrange discussion sessions and workshops for people to tell us what they think.

Details of the consultation events we have planned, and copies of the consultation documents, can also be found in the consultations section of our website <http://www.dwp.gov.uk/consultations/200x/>

We have sent this consultation document to a large number of people and organisations who have already been involved in this work or who have expressed an interest. Please do share this document with, or tell us about, anyone you think will want to be involved in this consultation.

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work & Pensions and published in a summary of responses received, and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purpose of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information which is provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as

part of your response, although we cannot guarantee to do this. We cannot guarantee confidentiality of electronic responses even if your IT system claims it automatically.

If you want to find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact:

Name: Charles Cushing
Address: Department for Work and Pensions, Adjudication and Constitutional Issues, Information Policy Division, Freedom of Information Unit, 1-11 John Adam Street, London WC2N 6HT
Phone: 0207 962 8581
Email: charles.cushing@dwp.gsi.gov.uk or carol.smith14@dwp.gsi.gov.uk

More information about the Freedom of Information Act can be found on the website of the Department for Constitutional Affairs³.

The consultation criteria

The consultation is being conducted in line with the Code of Practice on Consultation. The six consultation criteria are as follows, and the full version can be accessed at the Cabinet Office website:

- consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy;
- be clear about who may be affected, what questions are being asked, and the timescale for responses;
- ensure that your consultation is clear, concise and widely accessible;
- give feedback regarding the responses received and how the consultation process influenced the policy;
- monitor your department's effectiveness at consultation, including through the use of a designated Consultation Co-ordinator; and
- ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

Feedback on this consultation

We value your feedback on how well we consult. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact our Consultation Coordinator:

Name: Roger Pugh
Address: Department for Work and Pensions Consultation
Coordinator, Room 2A, Britannia House, 2, Ferensway, Hull
HU2 8NF
Phone: 01482 609571
Fax: 01482 609658
Email: roger.pugh@dwp.gsi.gov.uk

In particular, please tell us if you feel that the consultation does not satisfy these criteria. Please also make any suggestions as to how the process of consultation could be improved further.

If you have any requirements that we need to meet to enable you to comment, please let us know.

The Cabinet Office Code of Practice on Consultation recommends a minimum 12 week consultation period public consultations, unless there are good reasons for a limited consultation period. In this case, the issue is highly specialised and the Minister has agreed that a limited consultation is appropriate.

Annex B: Questions for consultation

The Government welcomes views on:

Chapter Two

- its proposal that the resources of the whole group of associated or connected persons should be considered when assessing whether a Financial Support Direction can be issued.
- the issues that should be considered in drafting legislation to introduce this test, and in particular the proposal set out above.
- whether a non-exhaustive statutory checklist of factors to consider in any detriment test would be useful for parties who could be subject to the issue of a Contribution Notice under the new test
- the additional 'reasonableness factors' it proposes to prescribe should be taken into account when considering the issue of a Contribution Notice
- the value of setting out such a non-exhaustive list, where to set out this list and on the proposed characteristics.
- other provisions that could be included in legislation or elsewhere to ensure that the new test to issue Contribution Notices is effectively targeted on risks to scheme members' benefits.
- the proposed removal of the words 'otherwise than in good faith' from s. 38(5)(a)(ii) of the Pensions Act 2004
- its proposed statutory defence for parties who could be subject to the issue of a Contribution Notice.

Chapter Three

- its proposed clarification of s. 38 of the Pensions Act 2004
- its proposal that the use of Contribution Notices should not be prevented by effecting bulk transfers.
- its proposal that the Regulator should be able to issue a Contribution Notice against a party that effects a bulk transfer that is not in the interests of members.