

Pensions regulatory clearance

# Yes or no?

A guide for employers



Autumn 2005

This document has been produced to help employers understand when they need to consider seeking clearance from The Pensions Regulator for intended actions.

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# Are you considering any of the following?

- Acquisition
- Merger
- Divestiture
- Raising debt
- Granting security
- Share buy-back
- Unusual dividend payment
- Financial restructuring
- Organisational restructuring
- Merging pension schemes

If so, you may need to notify The Pensions Regulator and/or decide to seek 'clearance'.

# Pensions - A new regime with new players and new rules

The Pensions Act 2004 became effective in April 2005 with some of its aspects applying retrospectively to 27 April 2004.

Pensions schemes in deficit need to be treated as any other material unsecured creditor, and trustees of pension schemes must act independently in protecting the interests of this unsecured creditor.

A new Pensions Regulator has been tasked with protecting defined benefit pension schemes. It can fine individual directors, and impose cash injections and cross-company guarantees on connected entities. To minimise risk, organisations need to implement new controls on those decision-making processes that may impact the security of pension schemes.

## Seeking clearance to avoid 'Anti-avoidance' action

'Anti-avoidance' provisions of the Act prevent employers from rearranging their affairs to avoid their pension obligations. Organisations with UK defined benefit pension schemes must consider the impact on their pension scheme of any financial or organisational action or restructuring.

In particular, the Regulator has the power to impose:

- **Contribution notices (CN)** on individuals or entities that have been party to an act, or a deliberate failure to act, aimed at avoiding pension obligations.
- **Financial support directions (FSD)** on associated or connected parties where the employer is 'insufficiently resourced' to support the pension scheme.
- **Restoration orders** that require a pension scheme's financial position to be restored to a pre-transaction position.

However, employers may choose to seek a 'Clearance statement' from the Regulator to avoid it imposing a CN or a FSD in respect of actions (or lack of action) that the employer wishes to take.

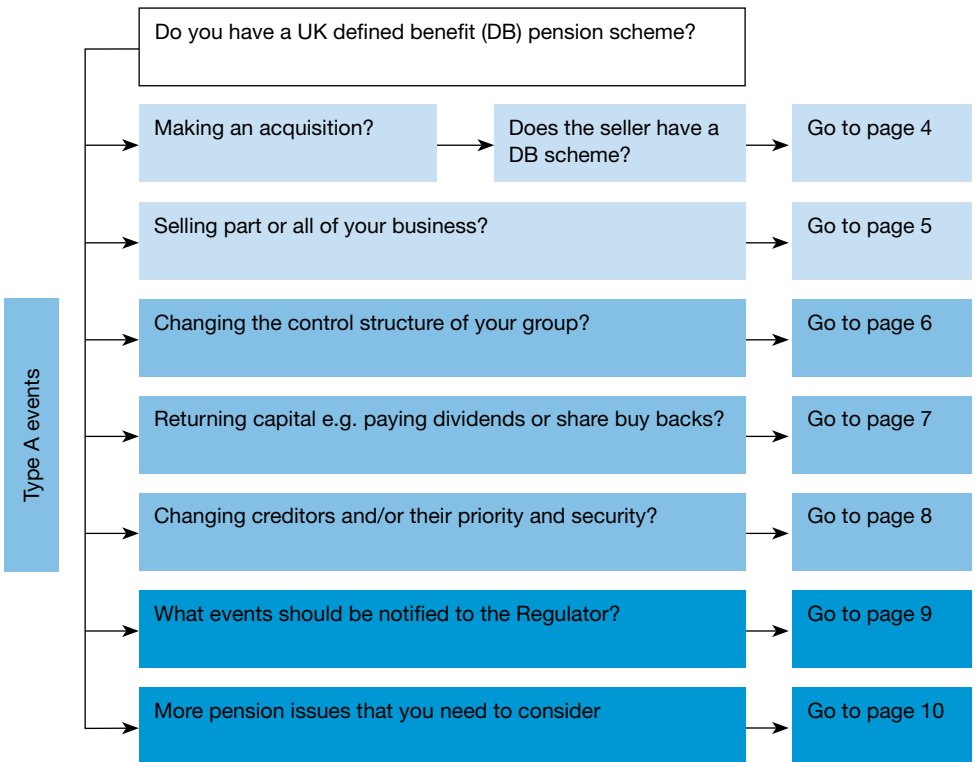
This document can help to determine whether seeking clearance is necessary or appropriate. If you are in any doubt about which actions to take, please contact PwC (details on page 12) and we will introduce you to a relevant member of our multi-disciplinary pensions team.

# Do you require pensions regulatory clearance?

The Regulator expects or encourages clearance to be sought in the case of Type A 'specified events'. A 'specified event' is an event affecting an entity that is financially detrimental to the ability of a defined benefit scheme to meet its pension liabilities.

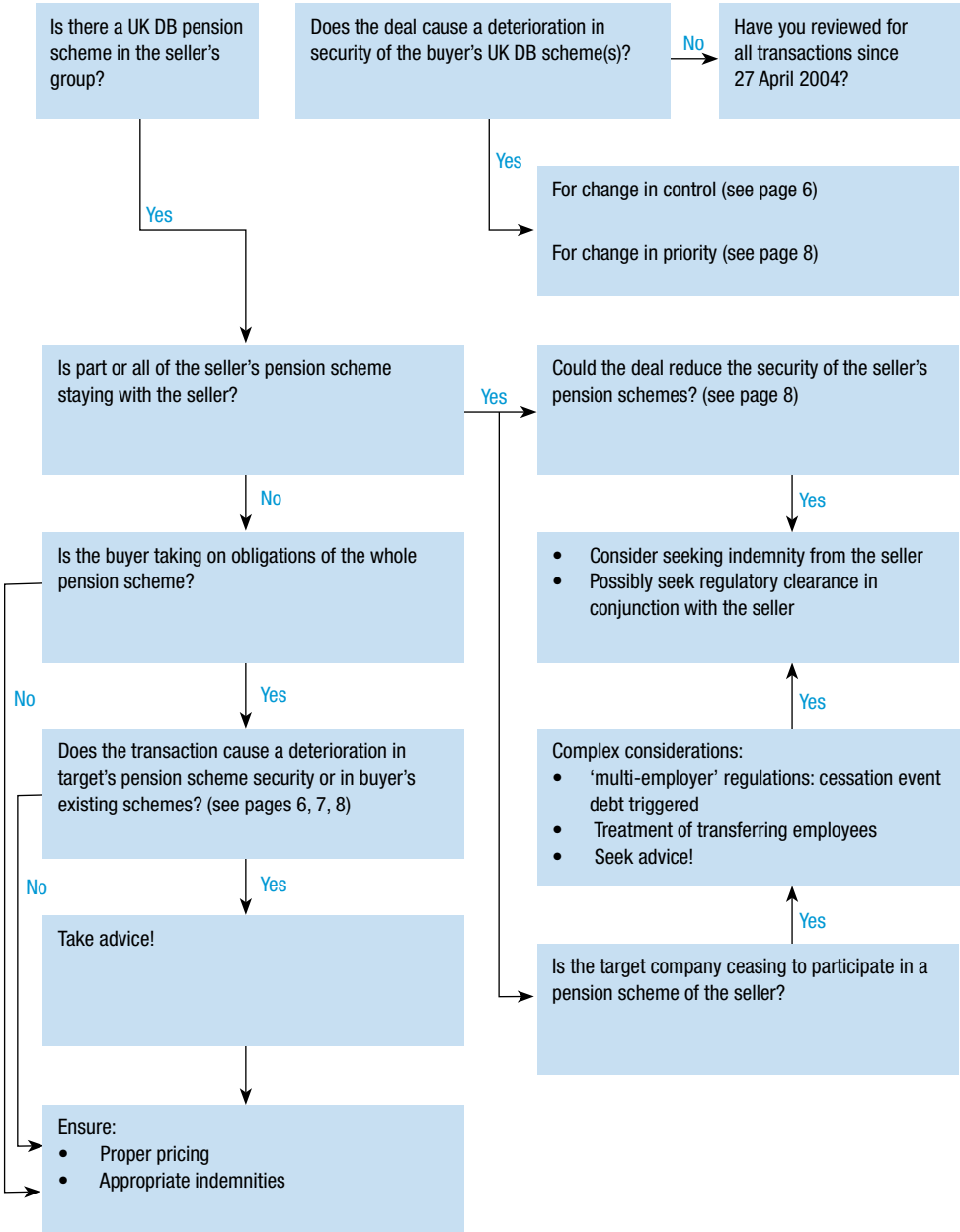
For an event to be considered 'financially detrimental', the scheme must be in

deficit. For the purposes of clearance applications, the Regulator will normally consider the deficit to be that determined by the FRS17 pension accounting standard (there are some circumstances where this is not the case – seek clarification if required). In future, it is likely that the individual scheme's funding target will be the measure used.

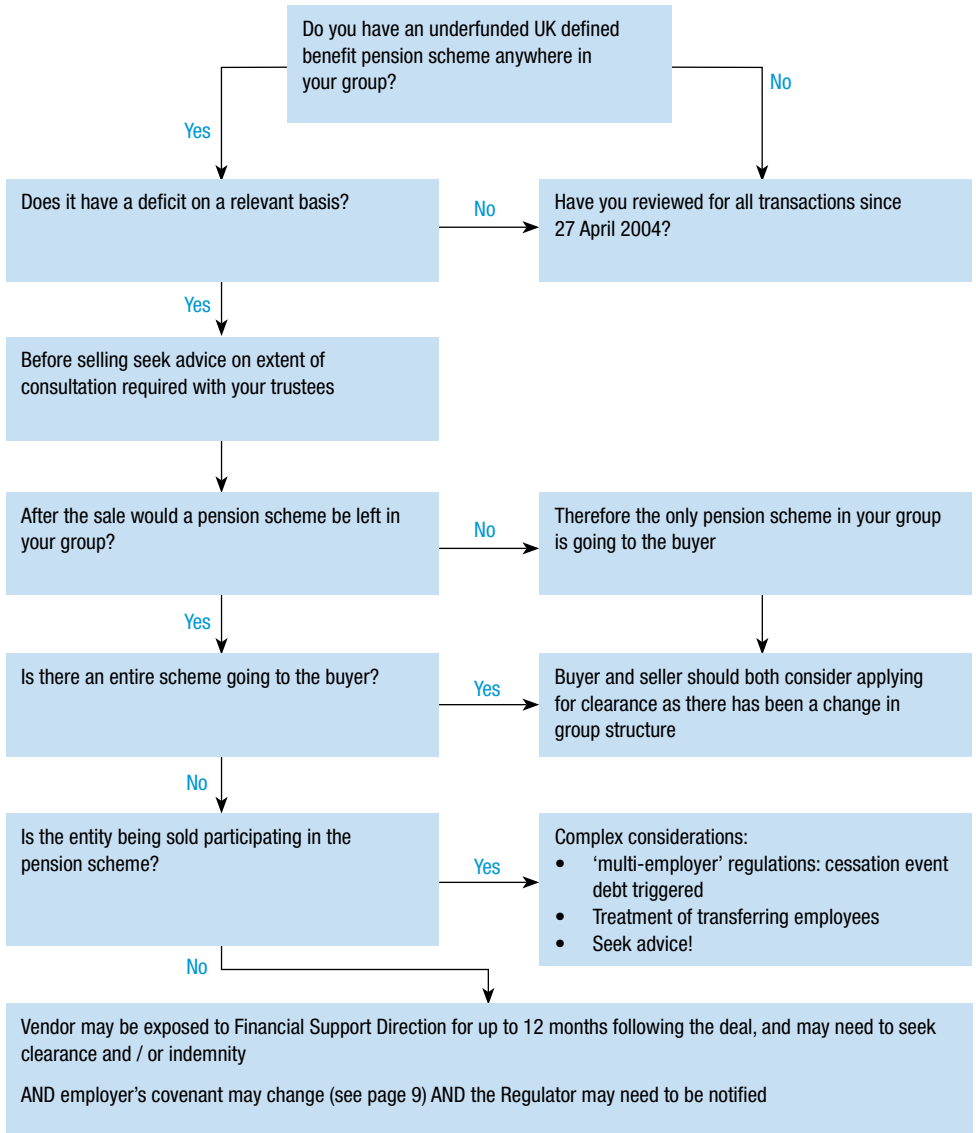


The Regulator encourages parties to seek clearance for Type A events

# Making an acquisition



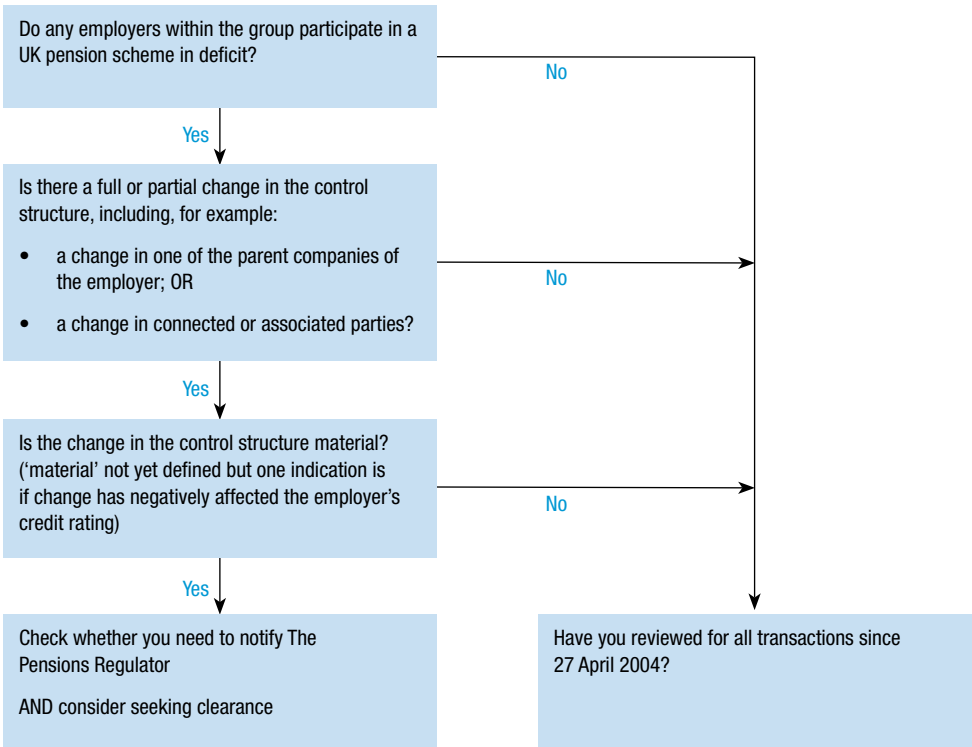
# Selling part or all of your business



Important - what are you doing with the proceeds from the sale? [Go back to page 3 to review Type A events.](#)

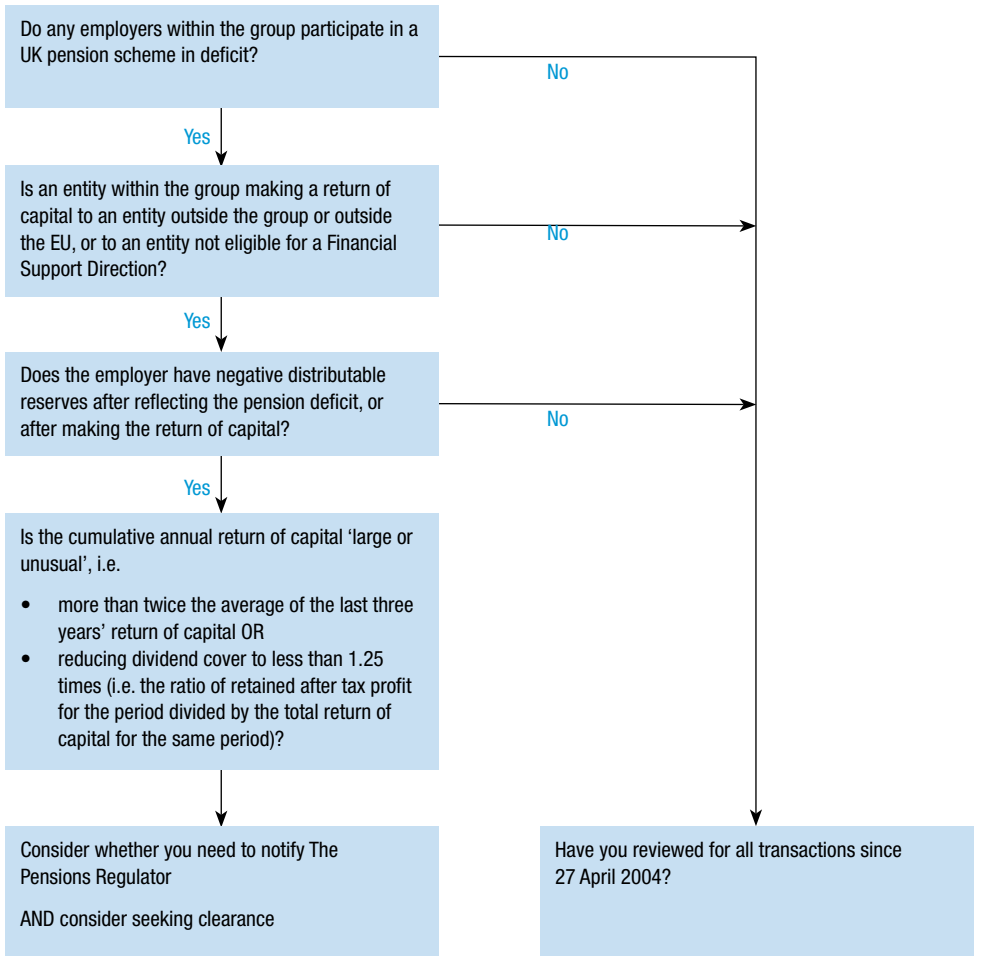
# Change in control structure

A change, or partial change, in the employer's group structure, which reduces the overall employer covenant, could affect the ability of an employer to meet its statutory pension debt and lead to the Regulator imposing a Financial Support Direction.



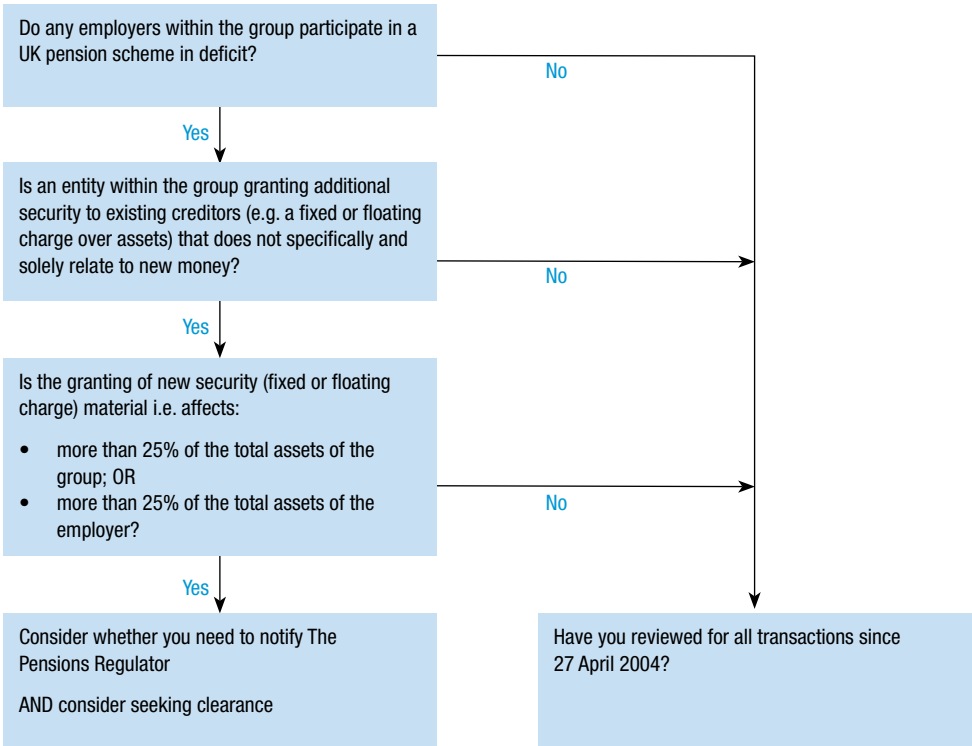
# Return of capital

A reduction in the overall assets of the company that could otherwise be used to fund a pension deficit. Examples include dividends, share buy backs, dividend strips, distribution in species and demergers.



# Change in priority

A change in the level of security given to creditors, with the consequence that the pension creditor might receive a reduced dividend in the event of insolvency. (For example, the granting or extending of a fixed or floating charge.)



# Notifiable events

The employer's covenant is its ability to meet its promises to the pension scheme. The following events that may reduce this covenant must be notified to the Regulator by the trustees, or employer, or both.

Must be notified by the employer				
A decision by a controlling company to relinquish control of an employer company	An action by the employer that will result in a debt due to the scheme not being paid in full	A breach of banking covenants, other than where the bank or other institution agrees with the employer not to enforce the covenant	The employer receives advice that it is trading wrongfully or a director (or former director) knows that there is no reasonable prospect of avoiding going into insolvent liquidation	
A change in an employer's credit rating, or the employer ceasing to have a credit rating	Conviction of a director or partner for an offence involving dishonesty	A decision by the employer to cease to carry on business in the UK	Two or more changes in key employer posts (e.g. the chief executive and any directors responsible for employer's financial affairs) in the previous 12 months	
Must be notified by the trustees				
A trustee decision that will result in a debt due to the scheme not being paid in full	A trustee decision to grant benefits, or a right to benefits, to a member that costs more than £1.5m (or 5% of scheme assets if lower)	Two or more changes in scheme auditor or scheme actuary in the previous 12 months	A trustee decision to grant benefits, or a right to benefits, on more favourable terms than those provided for by the scheme rules without either scheme actuary advice or additional funding where the actuary so advised	A trustee decision to pay/accept a transfer payment in respect of one or more individuals, which is more than £1.5m (or 5% of scheme assets if lower)

These may be subject to change, and you should seek advice on the most recent situation.

# What else do employers need to consider?

Have you thought about.....?	What does it mean for the employer?
New rules for accounting disclosures?	<p>For all year ends after 31 December 2005, the full deficit (as determined under FRS17 or IAS19) will have to be accounted for.</p> <p>How will this affect your distributable reserves?</p>
New rules for scheme funding?	<p>New scheme funding rules will apply to all actuarial valuations completed after 22 September 2005. Trustees have more powers than before, and can be expected to demand that deficits get plugged more quickly. Expect greater demands on your cash.</p> <p>Are you ready to negotiate with the trustees against this increased cash call?</p>
The PPF Levy?	<p>This is a new tax on pension schemes to support the Pension Protection Fund. This tax is based on the size of your deficit and your credit rating. You can influence the calculation of this levy.</p> <p>Do you understand the materiality of this levy for you and how you can influence it?</p>
The impact of an employer leaving your multi-employer scheme?	<p>The liabilities for an employer leaving the group used to be calculated on minimum funding requirement (MFR) basis. No longer. The buy-out basis (which is considerably higher) may now be applied and may have to be paid outright or supported in some way.</p> <p>How does this affect your ability to buy and sell companies?</p>
Deficit solutions?	<p>Over 90% of Britain's large employers have a pension deficit on an accounting basis, and every plan is in deficit on a buy-out basis. Do you know your own situation using a measurement method appropriate to your business? How can you reduce this debt? Could you be paying less or using more creative solutions to reduce or meet your deficit?</p> <p>Do you know the optimal way to manage this debt?</p>

# What else do employers need to consider?

Have you thought about.....?	What does it mean for the employer?
Personal conflicts of interest?	<p>Trustees must act (and be seen to act) independently from the sponsoring employer. Are you a trustee? Should you stay as one? Do you know what to do in situations in which there are conflicts of interest?</p> <p>What actions do individual trustees need to take to avoid conflicts of interest?</p>
Independent advice?	<p>Have you reviewed your relationship with your advisers, ensuring you have clarity in whose interest their advice is being provided?</p> <p>Are your advisers acting independently from those advising the trustees?</p>
Measuring the employer's covenant?	<p>Your trustees are now required to understand the strength of the employer's covenant and how it changes when you take a corporate action. Do you know what is meant by this covenant and how it is assessed?</p> <p>Do you understand your covenant and its impact on funding, PPF levy, Regulator scrutiny, etc?</p>
Balance of power between trustees and company?	<p>Trustees have a lot of new powers, even if currently they are not fully using them. Do you understand the balance of powers between you and your trustees? Are these powers being discharged appropriately? How can you get control back?</p> <p>When did you last understand what powers you do and don't have to control your pension arrangements?</p>

# Contacts

We recognise that, to effectively manage their pension obligations, employers require commercial solutions and that purely technical pensions solutions no longer suffice. At PricewaterhouseCoopers, we have a dedicated UK multi-disciplinary pensions team that helps employers and trustees address their pension challenges. The team comprises specialists in the areas of corporate

finance and transactions, valuations, structuring, business recovery, taxation, accountancy, regulation, actuarial and pensions.

Members of this team have worked with the new Pensions Regulator to develop the clearance procedures, and are uniquely qualified to help and advise employers in this area of change and risk.

For further information, please contact your usual PricewaterhouseCoopers adviser, or one of the members of our multi-disciplinary pensions team listed below:

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