

**The Pension Regulator's consultation document on its "Code of Practice 12:
Application of the material detriment test"**

A response by

The National Association of Pension Funds

February 2009

Introduction

1. The National Association of Pension Funds (NAPF) is the leading voice of workplace pensions in the UK. We speak for 1,200 pension schemes with some 15 million members and assets of around £800 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.
2. The NAPF welcomes the opportunity to respond to the consultation by the Pensions Regulator (TPR). We start with some general comments. Then we set out our responses to the four specific questions asked on page 7 of the consultation document, and to the descriptions of the five circumstances set out on page 12.

General Comments

3. The NAPF supports the Government's stated aim behind its widening of TPR's anti-avoidance powers in the Pensions Act 2008; the protection of pension scheme members from the risks of non-insured buyouts is paramount. However, we are also concerned that the continued provision of defined benefit pensions in the UK is not inadvertently discouraged by the granting of powers which may be unnecessarily wide.
4. As set out in our response to last year's DWP consultation on the powers of the Pensions Regulator, the NAPF believes that the new material detriment rules will work to the benefit of pension provision only if the circumstances in which they apply are clearly set down in legislation. In our view, this would ideally take the form of a list of actions or situations deemed to characterise material detriment being set down in secondary legislation. That list would then be easy to revise in the event of further innovation in the types of transaction taking place. However, we can see that the Government's approach of setting out the circumstances in which material detriment might occur only in a Code of Practice could work – but only if sufficient details and examples are included. As the Code is currently drafted, we do not think that it provides enough information and guidance. Without additional detail being available, employers will not have the certainty needed to allow corporate activity to continue unencumbered.
5. Parliament agreed to extend the Regulator's powers to issue contribution notices on the basis that it was needed to protect against 'new business models'. As s38 and s38A of the Pensions Act 2004 and the draft Code of Practice stand, statements of assurance and intention aside, we believe they could be wide enough to catch any number of normal business activities. In addition to the examples we have provided below, one situation which might be caught by the

draft proposal is granting security over a participating employer to a lender. While a company would need to consider Clearance in this circumstance, it could not reasonably be described as a type of new business model which the extended s38 power is intended to catch. Therefore, if employers are to have confidence that ordinary business activities, which are likely to be particularly prevalent and critical over the forthcoming months, can be undertaken in confidence that the Regulator would not consider them ripe for attack under the extended powers, then much more comfort needs to be included in the Code. If that comfort is not forthcoming, then an employer is likely to feel the need to take significant levels of advice and make a Clearance application at a moment when it could least afford to do so. If that Clearance application necessitates mitigation then the extension of s38 will have a result that was neither intended nor envisaged by Parliament when passing the legislation.

6. Because the 'new business models' which the legislation aims to provide protection against cannot yet be identified, adopting a principles-based approach to defining characteristics of relevant situations does not, we believe, create a Code of Practice that is as practical as stakeholders would want it to be. Creating a 'catch-all' code inevitably raises suspicion that more might be caught than is apparently intended.
7. NAPF recommends that the definitions in the Code are made tighter, more specific and backed, in guidance, by practical examples. We would like the descriptions of the circumstances to be as definitive as possible, but open to future revision as the pensions market evolves.

The consultation's specific questions

Q1 Does this draft code meet the requirements of the Act?

8. In format, the Code appears to meet the minimum requirements of the Act. However, the lack of precision in the descriptions of the five circumstances raises doubt as to whether the requirements have been properly met. The NAPF believes that TPR's planned guidance to accompany the Code will help clarify matters with practical examples; but we also feel that the wording in the Code needs to provide greater certainty for employers and advisers.

Q2 Does the code identify correctly those circumstances where the regulator should consider use of the material detriment test?

9. The NAPF feels that in the draft wording, the descriptions are too vague to support any claim that circumstances have been correctly identified. We comment on each description in the next section.

Q3 Do you think the circumstances described include any areas where the regulator should not be considering use of the material detriment test, and if so how should the circumstances be narrowed?

10. We have given some examples in our answers to the next section of such areas which could be captured by the circumstances described. We believe that the descriptions should be more specific and, where possible, be based on situations that have arisen in practice. In effect, this would involve a move towards almost a set of rules within the Code, which would be open to future revision as new practical examples occur.

Q4 Are there any further circumstances which you think may present unacceptable risks to members' benefits or the PPF where the regulator should consider the material detriment test?

11. We have identified no additional circumstances.

The five circumstances set out in the draft Code of Practice

12. The heading and opening paragraph of this section could make it clearer that TPR would only expect to issue a Contribution Notice in the listed circumstances if:

- it considered the material detriment test to be met;
- it considered it reasonable to issue the notice; and
- the statutory defence was not made successfully.

We believe that this could prevent anyone concluding that events falling within the list of circumstances could lead to the issue of a CN, even where they may not be detrimental to the scheme.

13. It might also be helpful to include the requirement for TPR to be of the opinion that it is reasonable to issue the notice in paragraph v, under the heading "Background and purpose of the code".

(i) The transfer out of the jurisdictions of the United Kingdom of the scheme.

14. The NAPF believes that this wording is too loose to give effect to the intention here – and some NAPF members have expressed confusion as to this intention. If the plural 'jurisdictions' relates only to the compass of both the Regulator and the Pension Protection Fund (PPF) – which we believe it does – why not state as such? We understand, for example, that it is possible to transfer the operation, assets and liabilities of a scheme to, say, Ireland (thereby being subject to the Irish regulatory regime), whilst remaining within UK tax jurisdiction as a registered pension scheme with HMRC. Some clarification would be welcome here.

(ii) The transfer out of the jurisdictions of the United Kingdom of the sponsoring employer if by doing so there is a material reduction in the level of employer support or legal and regulatory protection for scheme members.

15. Our members have made similar comments on this description. It seems to refer to the possibility of a company being transferred outside the UK and we are left a little puzzled as to how that might be achieved. Some practical examples in accompanying guidance would be welcome.

16. It might be helpful to add "or other person with **scheme obligations**" after "sponsoring employer", which may be a shell company, with the substantive support for the scheme coming from a guarantor.

17. The NAPF is grateful to TPR for being given the chance to meet to discuss our concerns during the consultation period. In that discussion it seemed to be clear that the common significant strand behind circumstances (i) and (ii) is the move away from the jurisdictions of the Regulator and the PPF. We suggest that this is made clear in the final version of the Code.

(iii) The severing of employer support for the scheme so that employer support is removed, is substantially reduced or becomes nominal.

18. Again, the wording here worried many NAPF members. Firstly, the internal logic: surely, if employer support is 'severed', then it is removed entirely and the notions of reduction or becoming nominal are superfluous? But there was also some confusion as to whether the circumstance would apply where alternative support comes into play – as in the case of an insured buyout. We believe that this is covered by the phrase "or any other person" in paragraph 2 (i) of the draft Code, but we recommend that this point is given greater emphasis in the final version.

(iv) The transfer of liabilities of the scheme to another scheme or arrangement which does not have sufficient employer support or is not sufficiently well funded.

19. While this description could include non-insured buyouts (the main stimulus behind the introduction of the material detriment test) it could potentially take in a great deal else, too. One example might be a bulk transfer from a poorly funded scheme to one that is better funded, albeit 'not sufficiently well funded' measured by whatever criteria will be used. We feel, yet again, that this needs to be more tightly defined.

(v) A business model or the operation of the scheme in such a way that is designed to create a financial benefit for the employer or some other person from the scheme, but where inadequate account has been taken of the interests of the members of the scheme, including where risks to members are increased.

20. This is the circumstance we feel would benefit most from some illustrative examples in any accompanying guidance. We appreciate that the term 'business model' is deliberately broad enough to capture new types of transaction as they develop. But as it stands this definition can also capture transactions already in the commercial arena, such as where a participating employer guarantees another group company's liabilities, which we believe is not TPR's intention. Our preference would be for a clear statement that, at present, the focus of the Code is on non-insured buyouts. And that as other potentially offending 'business models' develop, they will be identified and described in a revision of the Code.