Client Alert | Employment, Compensation & Benefits

A Sharpening of the Pensions Regulator's Claws

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Introduction

The Pensions Regulator ("**TPR**") has wide-ranging statutory powers to intervene in the running of work-based pension schemes[1]. The most prominent of these are the so-called "moral hazard powers". To date, TPR has used these powers sparingly and indicated that it is primarily concerned with 'larger' defined benefit ("**DB**") pension schemes. But the landscape appears to be changing.

Following the administration of BHS in the Spring, and the ongoing negotiations with Sir Philip Green in respect of the BHS pension scheme, TPR has been very much in the public eye. Depending on the outcome of these negotiations, the Government has hinted at extending TPR's powers.

Additionally, 2016 has shown TPR's appetite to intervene on behalf of smaller DB schemes. It has also issued a record amount of fines relating to defined contribution ("**DC**") pension schemes. With TPR's intervention in all types of pension scheme seemingly on the increase, employers should ensure that they and the trustees, whose costs the employer ultimately picks up, are compliant with their statutory duties, whether this be under a DB or DC scheme, to avoid any fines or intervention by a more proactive Pensions Regulator.

Moral hazard powers

TPR may exercise its moral hazard powers to prevent an employer of a DB scheme avoiding their funding obligations, leaving the Pension Protection Fund ("**PPF**") to pick up their pension liabilities. In particular, TPR has the power to issue a contribution notice ("**CN**")[2] or a financial support direction ("**FSD**")[3]. For all their notoriety, since their introduction under the Pensions Act 2004, TPR has only issued CNs and FSDs in a very limited number of circumstances (currently three CNs and four FSDs). However, following the issuance of warning notices[4] in connection with the BHS pension scheme, these figures could change.

The BHS controversy has caused the Government to hint at a potential extension of the powers of TPR. However, no clear indication has been given as to what form this might take. Potential options include: broadening the scope of TPR's powers to seize assets other than cash, or giving TPR further powers to intervene in transactions. TPR has shown no obvious desire to acquire additional powers, as with these additional powers would come additional responsibilities and workload. Whether the Government decides to grant TPR further powers may well hinge on whether a satisfactory outcome (from the Government's perspective) can be reached regarding the BHS pension scheme.

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1. Legislation defines work-based pensions as occupational pension schemes, personal pension schemes and stakeholder pension schemes with direct payment arrangements in place for employees.
2. A CN requires a specified sum of money to be paid to the pension scheme (or the PPF).
3. A FSD requires the recipient to put in place financial support for the pension scheme, which must remain in place while the scheme is in existence.
4. A warning notice specifies the power (e.g. issuing a CN or FSD) that TPR wishes to exercise and provides supporting information and evidence. The recipient of a warning notice has the opportunity to respond before a decision is made by TPR's Determination Panel as to whether TPR may exercise such power.

BHS

BHS was bought by Sir Philip Green in 2000 for £200 million, and, following a subsequent sale in 2009 to the Taveta group (ultimately controlled by his wife), was sold in March 2015 to Retail Acquisitions Limited ("**RAL**"), owned by Dominic Chappell, for £1. In 2000, BHS's two DB schemes had a combined surplus of £43 million, yet by 2015, this had worsened to a deficit of £345 million (both figures on the statutory funding basis[5]). In March 2016, just prior to going into administration, the pension deficit of these schemes on the buyout basis[6] was £571 million.

An investigation was launched into the sale and acquisition of BHS by the Work and Pensions Committee and a Business, Innovation and Skills Committee. Out of the investigation, it transpired that certain dividends were paid in excess of profits, in particular, with the Greens receiving £307 million in the period 2002-2004. Further findings were that Sir Philip Green had known that Dominic Chappell was a "manifestly unsuitable purchaser" and that both Taveta and RAL had "feeble corporate governance". In November, it was announced that warning notices had been issued to Sir Philip Green, two Taveta group companies, RAL and Dominic Chappell. Negotiations between TPR and Sir Philip Green to agree a deal to plug the pension deficit, are ongoing. If such a deal cannot be reached, it may be left to TPR's Determination Panel to decide the outcome, which may result in the issuance of CNs or FSDs. The Government is watching this matter with keen interest.

Intervention on behalf of "smaller" DB schemes

In October 2016, TPR published a report documenting its intervention in the case of a smaller DB scheme. TPR has previously issued statements providing that, as part of its risk-based approach, before intervening in the running of DB schemes it will consider the extent of the DB scheme's liabilities. TPR therefore "*may not engage directly with a large number of smaller schemes*". However, as if to clarify its position, in this report TPR stressed that it will consider using its moral hazard powers in respect of "smaller" schemes where appropriate.

In this case, TPR intervened and used the threat of its moral hazard powers as a deterrent to ensure members of a DB scheme[7] received their full benefits, following the sale of the sponsoring business. The size of the scheme was 101 members and the deficit of the scheme on the buyout basis was £7.7 million. Intervention by TPR was only initiated after an application for clearance was made to TPR, which was a condition of the transfer. Clearance is a voluntary process and if it is granted, it gives assurance that TPR will not exercise its moral powers in relation to the circumstances set out in the application.

Enforcement of auto-enrolment obligations

Legislation that has been implemented gradually since June 2012 requires all employers in the UK to enrol eligible workers automatically into a pension scheme and pay mandatory minimum contributions. This obligation applies from the employer's staging date. The staging date depends on the number of individuals in the employer's PAYE scheme on 1 April 2012[8]. If TPR suspects that an employer is breaching its duties, it has various enforcement powers at its disposal, including issuing a:

- **Compliance notice**: Requires an employer to take (or refrain from taking) particular steps to remedy the contravention of its duties; or
- **Unpaid contributions notice**: Requires an employer to pay unpaid contributions. Interest may be added at a rate of 4.2% plus the increase in the RPI.

If such breaches are not remedied, TPR may order two levels of penalties:

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5 This funding basis assumes that a DB scheme is a going concern. Annual deficit repair contributions under a recovery plan are calculated on this basis.

6 This funding basis is used for calculating the debt that an employer owes a DB scheme in certain scenarios (including when the pension scheme winds up). It is the cost of securing member's benefits by purchasing an annuity from an insurance company.

7 Database Group Ltd Retirement Benefit Scheme.

8 New employers set up between 1 April 2012 and 30 September 2017 will have staging dates between 1 May 2017 and 1 February 2018.

- **Fixed penalty notice**: Up to £400.
- **Escalating penalty notice**: For more serious or persistent breaches. Escalating penalties varying according to employer size from £50 - £10,000 a day.

  Earlier in 2016, Swindon Town Football Company Limited paid an escalating penalty notice of £22,900.

The table below documents the increasing use of TPR's powers. The last six months, in particular, show a significant increase in the issuance of all notices. This period is the staging date of employers with less than 30 individuals in their PAYE scheme on 1 April 2012.

Period / notice	Compliance	Unpaid Contributions	Fixed penalty	Escalating penalty	Others (inc. Information notice / inspection warrant)
1 July 2012 – 31 Mar 2014	14	1	0	0	3
1 April 2014 – 31 March 2015	1682	22	424	5	36
1 Apr 2015 – 31 March 2016	6,241	400	2,002	122	47
1 Apr – 30 Sep 2016[9]	18,465	501	4,589	614	145

Although the potential liability that TPR can impose on an employer through the exercise of its moral hazard powers is often huge, because of the size of buyout deficits in DB schemes, the risk of TPR exercising such powers has to date been low. By contrast, the table above demonstrates that, although the amount of liability that TPR can impose on an employer in respect of a DC scheme is relatively low, the risk of such powers being exercised is increasingly growing.

Other use of TPR powers

2016 has also seen TPR active in issuing fines to trustees in respect of other compliance matters, including: the late filing of annual governance statements (a mandatory £2,000 fine) and the late filing of scheme returns (fine issued only £300 per trustee, but TPR may impose fines of up to £5,000 per individual trustee or £50,000 for a corporate trustee). These fines reflect TPR's increased scrutiny of DC occupational pension schemes and follow the introduction of legislation and regulatory guidance aimed at improving DC scheme governance. This looks set to continue with the introduction of the Pension Schemes Bill 2016-17, which provides that TPR will have the power to authorize and de-authorise master trusts according to strict authorisation criteria.

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[9] The main powers that TPR anticipate using in this period.