

Revised clearance guidance

Consultation report

March 2008

Contents

Introduction	3
The draft guidance	4
The consultation.....	4
Pre-consultation.....	4
Consultation.....	4
The outcome of consultation	5
The responses in detail	5
Principle-based approach	5
Structure	6
Employer covenant and professional advice	6
Interaction with employer debt regulations	7
Relevant deficit	8
Mitigation	8
Application process.....	8
Other comments	9
<i>Type A events</i>	9
<i>Case examples</i>	9
Appendix A: Consultation questions	10
Appendix B: List of respondents to the consultation.....	11

Introduction

In September 2007 we published a draft of the revised guidance on the clearance process operated by the Pensions Regulator ('the regulator') for consultation.

The clearance process involves the regulator issuing a clearance statement that gives assurance that, based on the information provided, we will not issue a contribution notice or a financial support direction in respect of a particular event, such as a corporate transaction. Contribution notices and financial support directions require money to be paid into, or financial support put in place for, a defined benefit pension scheme. These provisions act as a powerful deterrent and encourage employers to fully support their pension arrangements.

We first published guidance on the clearance process in April 2005. That guidance gave the industry and the wider market clarity on how we would approach the clearance process. However, the world has moved on since then; and after running our regime for nearly three years, assessing behaviours in the marketplace and the feedback we have received from parties who had been through the clearance process, we decided to update the guidance to reflect the way that both the regulator and the market have developed since April 2005.

The development of this revised guidance involved consultation with a wide range of people. We are very grateful for the many helpful and constructive comments we have received. Whilst overall we have not altered the fundamental approach within the guidance, we have amended the structure and made other changes to address the concerns and comments received.

This document describes the consultation that has taken place on this guidance and explains how the consultation has shaped the final version. The final version of the guidance was published on 20 March 2008 and is available on our website at www.thepensionsregulator.gov.uk.

The draft guidance

The draft guidance issued for consultation did not contain a change in our approach to clearance, but there were a number of key differences to the existing guidance designed to clarify and reflect developments in the market since April 2005. These were:

- The guiding principles – we revised and updated the principles trustees and employers should apply when dealing with events that impact on the scheme, and also updated the principles that govern the regulator's behaviour when considering clearance.
- Mitigation – we revised the sections on mitigation to provide more detailed information on the types of mitigation that could be considered.
- Type A events – we re-presented the way employers and trustees identify whether an event is type A. This meant a number of changes:
 - we removed type B and C events as in practice they were rarely referred to;
 - we emphasised the principle-based approach, encouraging parties to focus on the real impact of the event on the scheme; and
 - we divided type A events into employer-related and scheme-related, and we added more examples of both employer-related and scheme-related events that could potentially be type A.
- The relevant deficit – we updated the relevant deficit so that now technical provisions are explicitly referred to. The basis in most cases would still be the higher of a scheme's ongoing funding level or its technical provisions or FRS17/IAS19, but it would now also include the section 179 basis where this is higher. We also built on the clearance reminder issued in May 2007 and explained that in some cases the relevant deficit will be measured on a higher basis where there is an event that is significantly detrimental.

The consultation

Pre-consultation

From March to May 2007 we posted an invitation for feedback on the existing guidance on our website. We also ran a workshop in March 2007 on the existing guidance for those who had been involved with the development of the April 2005 guidance.

Consultation

A consultation document, containing the draft guidance and related points for consideration by reviewers, was published on our website on 10 September 2007. Consultation closed on 2 November 2007. The consultation period was eight weeks. We issued a press release to draw attention to the consultation exercise.

The outcome of consultation

The overall response to consultation was mixed but in the main positive. We received 35 responses (detailed at Appendix B) and participants generally welcomed the emphasis on a more principle-based approach, but there were concerns about the lack of certainty that a principle-based approach provides compared to a prescriptive approach.

The responses came from a cross section of trustee and employer organisations as well as professional advisers, with the majority, as might be expected, coming from employers, employer groups and their advisers. The views between trustees and employers were quite polarised. Trustee groups or advisers were generally positive, welcoming the increased emphasis on the principle-based approach and the more detailed guidance for trustees around the employer covenant. Employers and their representatives were more critical, mainly about the lack of certainty.

Although we asked a number of questions on areas in which we were particularly interested in feedback, the majority of respondents chose to provide detailed responses rather than specifically answer the questions posed. We have therefore summarised the written comments received from respondents by the main themes that emerged. This, along with the Pensions Regulator's responses, is provided in the following section of this document. A list of the consultation questions is also attached at appendix A.

The responses in detail

This section provides more detailed comment on the key issues emerging from responses to the consultation.

Principle-based approach

This was the main issue for most respondents, and opinion was polarised. Some respondents were supportive of the increased emphasis; some were supportive but recognised that a principle-based approach brings less certainty than a prescriptive approach; and some were concerned about this resulting lack of certainty. The concerns were mainly from employers or their representatives.

While we recognise the concerns around the lack of certainty we believe that our articulated approach is the right way forward. A more restrictive and prescriptive approach could contribute to employers and trustees not properly considering the real impact of an event on a scheme.

Our view is that simple tests and categories often do not reflect the complexity of corporate transactions and the true effect of events on pension schemes, and our experience of operating clearance has highlighted this. We recognise that initially a principle-based approach may be less familiar for some, though it is likely that, as parties to clearance become more familiar with this process, it will become easier.

Structure

We have made other changes to the guidance, for example to the structure, in order to improve the clarity of the document.

The consultation draft contained additional guidance on the employer covenant as well as expanding on the governance issues in the April 2005 guidance. Many respondents felt that the scope of the guidance was too wide and as a result the document was too long, making it inaccessible.

We have, therefore, removed the detailed content on monitoring the employer covenant as this is a general governance issue rather than specific to clearance. We intend to issue separate material on the employer covenant in general later this year. The clearance guidance retains some elements on covenant and governance considerations, but only those elements that are relevant to clearance, for example the content on assessing the employer covenant (which is central to the clearance process, particularly for employer-related events) and sections on the behaviours we expect from applicants and trustees as part of the clearance process.

Some respondents also pointed out that there was some confusion as to the audience type. The draft was stated to be aimed at professional advisers but much of the content appeared to be aimed primarily at trustees.

The clearance guidance is aimed primarily at professional advisers to both applicants for clearance and trustees. We have clarified the language in the guidance to make this clear.

As part of our commitment to inform, educate and assist both trustees and employers, we will continue to provide ongoing educative material relating to issues such as the employer covenant, corporate activity, clearance and scheme funding.

Employer covenant and professional advice

Whilst most respondents welcomed the guidance on assessing the employer covenant, and trustees in particular found it useful, there were concerns that the suggested list of information that could be exchanged between the employer and the trustees as part of ongoing monitoring of the employer covenant was too detailed; and, as a result, the relationships between employers and trustees could become strained.

As we now intend to publish separate material on the employer covenant we will consider this point and the comments received as part of the development of that guidance.

Examples of information that may be useful while assessing the employer covenant for the purposes of clearance are still included in the guidance, but it is clear that the level and type of information that is appropriate will depend upon the nature and materiality of the event.

There was also some concern over the expectation that trustees will always need advice. Many respondents pointed out that it may not always be appropriate to seek advice (which may sometimes be costly) and suggested that the need to get advice should be proportionate. The complex nature of corporate transactions and the legal relationships between schemes and their sponsoring employers mean that professional advice will, in our view, more often than not be required for type A events. However, the extent of advice that is appropriate will often depend upon the nature and materiality of the event and the circumstances of the scheme. If appropriate professional advice has not been obtained by parties to clearance, this is likely to delay or interrupt the application process.

Interaction with employer debt regulations

Some respondents highlighted a perceived inconsistency of approach between the draft guidance and the draft regulations on Employer Debt issued for consultation by the Department for Work and Pensions (DWP) in August 2007. A particular concern was the treatment of the apportionment of deficit. Apportionment of the deficit is a way of reducing the employer's debt that would otherwise be owed to a scheme.

We recognise the concerns around the treatment of apportionment: however, our role as a regulator is to fulfil our statutory objectives, including protecting members' benefits and reducing the risk of situations arising which may lead to a call on the Pension Protection Fund. In our view, apportionment of the deficit will in some cases pose an unacceptable risk to members' benefits. Therefore, while some apportionment may still be possible following the amendments to regulations, our view is that these and other apportionments may not always be appropriate for a scheme and should still be considered to be type A events.

Under legislation, 'approved withdrawal arrangements' must be approved by the regulator. The new Employer Debt Regulations introduce 'withdrawal arrangements' that do not require the regulator's approval. We would not expect all such arrangements to come to the regulator for clearance. However, there are some circumstances in which a withdrawal arrangement could itself be detrimental to the ability of a scheme to meet its pension liabilities, particularly if the guarantee does not sufficiently mitigate the fact that the debt is not being paid in full. This may be for a number of reasons, for example the choice of guarantor, the agreed payment events for the guaranteed debt (amount B), or because the agreement does not comply with statutory requirements and the non-compliance results in material detriment to the scheme.

Relevant deficit

It was suggested by some respondents that the section on the relevant deficit was overly complex with a resulting lack of certainty. Respondents queried the validity of using section 179 and FRS17/IAS19. Whilst it was accepted that these were appropriate if a scheme did not yet have its first scheme funding valuation, a third of respondents believed that technical provisions as a measure should be sufficient once the first scheme funding valuation had been obtained.

Our view is that section 179 is an appropriate measure for clearance given our statutory objective to reduce the risk of situations arising which may lead to a call on the Pension Protection Fund. FRS17/IAS19 remains appropriate because it has a certain level of objectivity and transparency. In addition, where an event is materially detrimental, pre-existing technical provisions are unlikely to reflect the impact of this event.

Mitigation

The extended list of appropriate types was well received. However, there was some concern as to the appropriateness of mitigation in all circumstances which, it was suggested, was an assumption in the guidance.

We remain of the view that if an event has a materially detrimental impact on the ability of a scheme to meet its liabilities, this detriment should be mitigated in some way to ensure that members' benefits are protected. The guidance does not tell trustees or employers how or to what level it should be mitigated, but provides information on the ways in which detriment may be mitigated.

Application process

Most respondents liked the content on the application process and welcomed the extra detail. The sections on what happens during the process and the timescales were particularly well received.

There was some suggestion that the amount of information to be included with a clearance application was onerous and in some cases difficult to obtain, thereby adding to the cost and time for obtaining clearance. Conversely, some respondents commented that it should not be restricted by asking only for relevant information, as trustees and employers may be unsure whether information is relevant or not.

We remain of the view that getting all the information we need to assess an application for clearance from the outset makes the application process smoother and faster for all parties. We have considered carefully the information we need in order to be able to assess an application for clearance and only require information that is relevant to the application. If parties are unclear which information is relevant, the clearance team is available to discuss applications or respond to enquiries.

Other comments

Type A events

Some respondents suggested that the extended list of employer-related events, which may be type A, appeared too wide and could capture normal trading events. It was suggested that business sales and sales and leasebacks should not feature on the list.

We have added some further explanation of the types of events that would not generally be considered type A. The list of examples of type A events provided is not exhaustive, and whether a particular event is type A will depend upon its impact on the scheme, assessed using the principles explained in the guidance.

The removal of type B and C events was supported and welcomed, and these no longer feature in the guidance.

Case examples

This was another area where opinion was quite polarised. Some respondents suggested that examples would be useful, particularly to illustrate the assessment of an event as type A and identifying the amount of mitigation. Other respondents cautioned against the risk of setting precedents by including examples.

We have carefully considered the issue of case examples in the light of the strong opinion of some respondents for their inclusion. However, we are conscious that the existing guidance was interpreted more restrictively than had been intended by some and, therefore, are deliberately emphasising a more principle-based approach, where employers and trustees focus on the impact of an event upon a pension scheme. When we assess an application for clearance we do so in the light of the individual circumstances of the event, and no two corporate transactions are ever the same. We believe that including case examples at this point in time could undermine the successful reinforcement of a principle-based approach as there is a risk that these could be interpreted restrictively. We have therefore decided not to include examples at this stage but will keep the matter under review.

In addition, as part of our commitment to inform, educate and assist both trustees and employers, we will continue to provide ongoing educative material relating to issues such as the employer covenant, corporate activity, clearance and scheme funding.

The regulator also provides the Trustee toolkit. This freely available e-learning programme contains material, such as tutorials and case studies, which consider various topics under the scope of the trustee understanding and knowledge regime, including issues associated with clearance. The toolkit is available at www.trusteetoolkit.com.

Appendix A: Consultation questions

This section lists the ten specific questions that were asked in the consultation document.

Structure and layout of the guidance

1. Does the guidance provide a clear enough background to the framework that underpins the process of considering events and the process of clearance?
2. Do you feel that you are able to extract the relevant information at a level that is appropriate for you? Is there sufficient technical detail where you feel it is required? Is there a sufficient level of background where it is appropriate for you?
3. Is the structure and layout of the guidance logical for your needs? Does it enable you to work your way through the process in a way that is logical for you?

Guiding principles

4. Do the updated principles provide sufficient guidance on how to approach the subject? Are there any principles you think apply and that should be added?

Type A events

5. Is the way in which type A events are re-presented clear? Is the more principle-based/judgement-based approach to assessing a type A event explained in sufficient detail to enable an assessment to be made of the impact of an event?
6. Does the guidance provide sufficient information for you to understand when clearance is an appropriate consideration?
7. Are the sections on employer covenant helpful in assessing detriment?

Relevant deficit

8. Does the guidance provide enough information for you to understand which relevant deficit trigger applies to a type A event in which situations?

Mitigation

9. Does the guidance provide sufficient clarity on how to determine what is appropriate mitigation in various circumstances?

Application process

10. Does the section on applying for clearance provide sufficient detail on what information should be provided and how the process works?

Appendix B: List of respondents to the consultation

Alchemy Partners LLP
Aon Consulting
Association of Consulting Actuaries
Association of Corporate Treasurers
Association of Pension Lawyers
AstraZeneca
Barclays
BDO Stoy Hayward LLP
Confederation of British Industry
Clifford Chance LLP
Dundas & Wilson CS LLP
Eversheds LLP
Freshfields Bruckhaus Deringer
Gazelle Corporate Finance Ltd
Hammonds
Hewitt
Hymans Robertson LLP
JLT Benefit Solutions Ltd
Kroll
Lane Clark & Peacock LLP
Macfarlanes
Mercer
National Association of Pension Funds
Pensions Management Institute
PricewaterhouseCoopers Legal LLP
Sacker & Partners
Society of Pension Consultants
Society of Turnaround Professionals
Standard & Poor's
Tesco
The Hundred Group
The Law Society of Scotland
Travers Smith
Watson Wyatt

One respondent preferred to remain anonymous.