

Consultation document

Revised clearance guidance

September 2007

www.thepensionsregulator.gov.uk 

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INTRODUCTION

This is a consultation document on the revised guidance on the 'clearance' process operated by the Pensions Regulator ('the regulator'), the body that regulates work-based pension arrangements.

The clearance process involves the regulator issuing a clearance statement that gives assurance that, based on the information provided, the regulator 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.

To date, the clearance process has been very successful in allowing corporate activity more generally to continue whilst helping to secure beneficial outcomes for pension schemes and their members.

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.

The world has moved on since then. After running our regime for two years, we have now assessed behaviours in the marketplace and have decided to publish some revised guidance.

In that period, the concerns voiced by many that clearance would have a negative impact on corporate activity have not materialised.

Other significant developments in the marketplace include:

- the way in which the market has increasingly considered the pension scheme as a creditor;
- the impact of FRS17 in driving greater recognition in the market of the importance of the pension scheme.

Our revised guidance, on which we are seeking comments, reinforces the need for mitigation to the pension scheme where there is detriment as a result of a type A event. The revised guidance sets out the central principles that we expect all trustees and employers involved in corporate events to follow. As the nature of corporate transactions and the legal relationships between schemes and employers are often complex, the guidance itself is aimed primarily at professional advisers working alongside trustees and employers.

We have also made it clear that, where schemes already have technical provisions under the scheme-funding framework and if such an event occurs, trustees have the right to reopen a recovery plan by triggering a new scheme

valuation at any time. If they do so, they should take account of the level of detriment and the guidance provides further detail about what this covers. Equally, perhaps because of the time involved in going through a new full scheme funding process, trustees may choose to consider mitigation in relation to the specific event and the detriment that arises for the scheme.

It is our continued belief that the best outcome for members is likely to be an appropriately funded scheme with a solvent employer. We will continue to deploy our resources in a risk-based way to achieve that objective.

This paper provides a summary of the key differences in the guidance document, as well as the draft revised guidance itself. On page 52, we have included 10 questions on which we invite comments and feedback from interested stakeholders. We would also be interested in any additional points that stakeholders may wish to raise on any aspect of this paper.

The deadline for submission of responses to this consultation paper is 2nd November 2007.

More information on how to submit responses can be found on page 53.

KEY DIFFERENCES

The aim of the guidance

The purpose of the April 2005 guidance was to introduce and explain how the new process of clearance would operate. This version of the guidance focuses on our expectations of professional advisers working with trustees and employers in considering events that may have a detrimental impact upon a pension scheme. We have provided some help in relation to employer covenant and the assessment of covenant, and on how parties should work together to minimise or eliminate detriment. We have also sharpened up the parts that deal with the process of applying for clearance.

Greater clarity in respect of mitigation

A type A event will involve detriment to the scheme. Whenever there is material detriment, then trustees, in conjunction with their professional advisers, will need to consider the appropriate mitigation that should be put in place in order to ensure that scheme members are protected.

In considering levels of mitigation, it will be important to consider the security that currently exists for the scheme, both through the sponsoring employer and in relation to parent employers and/or connected and associated parties. Trustees should consider that security when determining the appropriate level of mitigation to ensure that the scheme is no worse off as a result of the transaction.

Should trustees establish that there is security beyond that taken into account in assessing the covenant of the sponsoring employer – for example, within a

wider group of employers – they will also wish to consider whether that security can be crystallised for the scheme, for example through the use of contingent assets.

In all circumstances, whether or not the trustees are aware of such wider security, employers and advisers should consider the impact of an event on security for the scheme, as these will be issues that the regulator will have regard to when considering whether to impose a contribution notice or financial support direction.

The guiding principles

We have updated the guiding principles that trustees and employers should apply when dealing with events that may impact on the pension scheme and when applying for clearance. We have also updated the guiding principles that govern the behaviour of the regulator when considering clearance.

Type A events

We have re-presented the way in which trustees and employers identify whether an event is materially detrimental.

The April 2005 clearance guidance broadly classifies events into four categories, in order to assist parties to identify those for which clearance should be considered. For the three main types of employer-related events (change in priority, return of capital, change in control structure) there is a test for detriment, depending upon the funding level of the scheme. Each type of employer-related event then has its own test of materiality, to establish whether a particular event is type A.

This approach was appropriate at the time, as both clearance and the office of the regulator were new. These categories and tests in the April 2005 guidance form part of a document that also provides guiding principles and states that the spirit of the guidance should be observed, particularly in circumstances that are not explicitly covered. However, it has become apparent that some applicants and advisers are interpreting the guidance more restrictively than had been intended.

We wish to encourage a move away from reliance upon prescriptive tests to a more principle-based approach, and to assist trustees, employers, professional advisers and other relevant parties to assess the real impact of any event on the pension scheme.

There are a number of changes to achieve this approach.

Type B and type C events

The terms 'type B' and 'type C' have been removed, because these categories are rarely identified or referred to in practice. We have kept the term 'type A events' because this term is widely recognised and used. Type A

events are events for which clearance applications are appropriate, and are any events that have a materially detrimental impact on the pension scheme.

In order to assist in the identification of type A events, we have split these into scheme-related and employer-related events, to draw a distinction between events involving corporate activity and those that relate more directly to the scheme. In practice, many events can be broken down into component events, which may include both employer- and scheme-related events. We have described how parties should consider these.

Scheme-related events

We have added a fuller description of scheme-related events that could potentially be type A. Two examples are compromises and apportionment of pension deficit. In recent months, we have seen an increase in scheme-related events, such as the introduction and use of apportionment rules.

The April 2005 guidance referred to compromises, which will always be type A events, irrespective of whether there is a deficit in the scheme. Because the spirit of the April 2005 guidance should be observed, particularly in circumstances not explicitly covered, all scheme-related events are currently considered by reference to that guidance on compromises.

To assist trustees and others in understanding the impact that apportionments and other sorts of scheme-related events can have on the scheme's likelihood of obtaining support from an employer, we have now included a much fuller description of scheme-related events.

Employer-related events

The list of examples of employer-related events that could potentially be type A has been extended to include more events for which clearance may be a consideration.

Materiality tests

For certain events that are scheme related, there are clear circumstances in which an event will be considered to be materially detrimental, and these circumstances have been explained. In all other circumstances, the trustees, employers and other parties will need to judge the impact of any event by comparing the employer covenant pre and post the event, applying certain principles and making a judgement as to whether the impact is material.

The complex nature of corporate transactions and the legal relationships between schemes and their sponsoring employers mean that professional advice will often be required for significant events. To some extent, though, it is likely that, as trustees and employers become more familiar with this process, it will become easier.

The relevant deficit

The relevant basis for assessing the liabilities of the scheme and identifying whether an employer-related event is a type A event has been updated to take account of the changed environment. The basis in most cases will still be the higher of a scheme's ongoing funding level, its technical provisions or FRS17/IAS19, but it now also includes the section 179 basis where this is higher.

Technical provisions are now explicitly referred to, as these figures are becoming available for more schemes. The section 179 pension protection risk-based levy basis was not thought relevant in April 2005, because it was considered that FRS17 would usually be a stronger measure. However, this is not the case for some schemes.

There are exceptions to the general rule. For example, where the event is significantly detrimental to the scheme's ability to meet its liabilities, including where there is a significant weakening of the employer covenant, then trustees and employers may judge that using the highest of the FRS17/IAS19, section 179, technical provisions or ongoing deficits as the relevant deficit does not properly reflect the impact of the event. In these cases a higher basis would be appropriate. This builds upon the reminder we issued on the existing guidance in May 2007.

In addition, section 75 (buy-out) will be the basis for the relevant deficit where there are going concern issues, the scheme is in wind up, or there is scheme abandonment.

The purpose of the relevant deficit is to narrow the category of detriment events for which clearance would be appropriate. Trustees and employers should consider and act upon any event that has a detrimental impact on the scheme, but the regulator cannot consider all these events, and has therefore set triggers to allow us to operate a risk-based approach to clearance.

Finally, we propose publishing an updated clearance application form at the same time as the revised guidance.

Draft guidance

Clearance Guidance

(Consultation draft: September 2007)

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INTRODUCTION

1. The Pensions Regulator ('the regulator') is the regulatory body for work-based pension schemes in the UK. The Pensions Act 2004 gives the regulator a set of specific objectives, which are:
 - to protect the benefits of, or in respect of, members of occupational pension schemes;
 - to reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund; and
 - to promote, and to improve understanding of, the good administration of work-based pension schemes.
2. *Clearance* is the term used to describe the voluntary process of obtaining a clearance statement from the Pensions Regulator that gives assurance that based on the information provided, the regulator will not use its anti-avoidance powers to issue contribution notices or financial support directions in relation to a defined benefit occupational pension scheme, an event, and the applicants for clearance. Events include transactions, agreements, decisions, other acts and failures to act.
3. Contribution notices require payment to be made into a defined benefit scheme, and financial support directions require financial support to be put in place for a scheme.
4. These powers are only part of the regulator's approach to ensuring that schemes are properly funded, administered and supported. The regulator also has powers in relation to scheme funding, as well as other powers to protect members' benefits, such as powers to wind up schemes or to appoint an independent trustee in certain circumstances. Further information about these other powers can be found on our website at: *(Link to be inserted to regulatory powers)*

About this guidance

5. This guidance is primarily aimed at professional advisers who should bring it to the attention of trustees and employers involved in defined benefit occupational pension schemes. It will also be relevant to parties who are connected and associated with employers, and their advisers. It has been updated in light of our experience of operating clearance, and reflects the way that both the regulator and the market have developed since clearance was introduced in April 2005.

6. While the April 2005 guidance did state that the guiding principles and the spirit of the guidance should be considered, it has become apparent that some applicants and advisers have been interpreting that guidance more restrictively than was intended. It is possible that a restrictive and prescriptive interpretation could prevent employers and trustees from properly considering the impact of an event on a scheme. This guidance aims to assist professional advisers to work with employers and trustees and help them consider the impact of an event.
7. It is clear that there are many events that could be detrimental to the ability of a scheme to meet its liabilities ('detrimental events'). However, in line with its commitment to operate in a risk-based and proportionate manner, the regulator expects clearance to be sought only in relation to type A events. Type A events are all events that are materially detrimental to the ability of the scheme to meet its pension liabilities.
8. This guidance provides information about:
 - assessing the impact of the event on the pension scheme;
 - identifying type A events;
 - what action trustees and employers should take, including negotiation, mitigation and monitoring the employer covenant.
9. This guidance gives further information about:
 - applying to the Pensions Regulator for clearance; and
 - what happens during the clearance process.
10. It is not practical to devise guidance that contains sufficient detail to cover all possible circumstances and events. This guidance does not attempt to list all possible type A events.
11. Professional advisers, in particular, should ensure that all parties involved in a possible type A event, including scheme trustees, are familiar with the content and spirit of this guidance.
12. This guidance is not a clearance statement, and it does not bind the regulator's use of its powers, whether or not there is a type A event in accordance with this guidance.

Our approach

13. Broadly speaking, the regulator's power to issue a contribution notice is triggered by an act or a failure to act, whereas the power to issue a financial support direction arises because of the circumstances of the employer. However, it may be that an event leads us to conclude that it would be reasonable to issue a financial support direction. Therefore, clearance applications will generally

relate to an 'event', which could include a transaction, an agreement, a decision or any act or failure to act.

14. Clearance applications are appropriate for all type A events. These are events that are materially detrimental to the ability of a scheme to meet its liabilities. Type A events are either employer-related events or scheme-related events. Employer-related events are only type A events if the scheme has a relevant deficit. Trustees and employers therefore need to recognise and understand type A events.
15. We have developed guiding principles that trustees and employers should apply when dealing with events that may impact on the pension scheme and when applying for clearance.

Trustees and employers

- Trustees and employers should recognise and understand that a pension scheme in deficit should be treated in the same way as any other material creditor.
- Trustees should recognise and understand their powers and duties and act appropriately, including managing any conflicts.
- Trustees should consider taking independent professional advice where appropriate.
- Trustees and employers should work together in relation to events that may be detrimental to the ability of the scheme to meet its liabilities or to the benefits of the scheme members, communicating and sharing appropriate information.
- Trustees and employers should understand the nature and the impact of the potentially detrimental event and the appropriate mitigation for the event.
- Trustees and employers should recognise that the regulator will wish to know about all events that have a materially detrimental effect on the ability of a scheme to meet its liabilities.

16. We have also developed guiding principles that govern the behaviour of the regulator in considering clearance.

The Pensions Regulator

- The regulator's preferred outcome is an appropriately funded scheme with a solvent employer.
- The regulator will deploy its resources in a risk-based manner, targeting risk in a proportionate, responsive, flexible, pragmatic, transparent and reasonable way.
- The regulator will seek to protect members' benefits and reduce the risk of calls on the Pension Protection Fund, while at the same time recognising commercial activity and business needs.

Using this guidance

17. In this guidance, certain terms have the following meanings:

Scheme: is (in general) any private sector occupational pension scheme, but does not include a scheme which only provides money purchase benefits or is exempt from contribution notices and financial support directions as prescribed under sections 38(1)(b) and 43(1)(b) of the Pensions Act 2004 respectively.

Employer: is, for the purposes of the contribution notices and financial support directions, employer of persons in the description of employment to which the **scheme** in question relates, as defined by section 318(1) of the Pensions Act 2004 and as may be extended to apply to former employers under 318(4) of the Pensions Act 2004 and see also paragraph 61.

Wider employer group: can consist of any person who is connected to or associated with the employer.

Pension debt: is the whole or any part of a debt (including a contingent debt) which was, or might become, due from the employer in relation to the **scheme** under section 75 of the Pensions Act 1995.

Application: is an application made for a Clearance Statement under:

- section 42 of the Pensions Act 2004 in respect of the regulator's power to issue a Contribution Notice; or
- section 46 of the Pensions Act 2004 in respect of the regulator's power to issue a Financial Support Direction.

18. In addition, some terms, which are shown as **bold** in the text, are defined in the glossary of terms at Appendix B (*to be added in final guidance*).

What is clearance?

19. Clearance is a term used to describe the voluntary process of obtaining a clearance statement from the regulator.
20. A clearance statement in relation to a contribution notice is a statement by the regulator that, in its opinion and in the circumstances described in the clearance application, it would not be reasonable to impose any liability on the named applicants under a contribution notice.
21. A clearance statement in relation to a financial support direction is a statement by the regulator that, in its opinion and in the circumstances described in the clearance application, it would not be reasonable to impose the requirements of a financial support direction, in relation to the scheme, on the named applicants.
22. The regulator can also issue a clearance statement in relation to contribution notices which states that, in its opinion and in the circumstances described in the clearance application, the applicant would not be a party to an act or a deliberate failure to act. This would require a higher standard of proof and therefore extensive due diligence, and it would not usually be appropriate or proportionate for the regulator to consider these statements.
23. Contribution notices and financial support directions are powers that were introduced by the Pensions Act 2004 in order to protect the benefits of scheme members and to ensure that pension liabilities are not avoided or unsupported. Contribution notices require payments to be made to the scheme, and financial support directions require financial support to be put in place for the scheme, in both cases by employers or **connected** or **associated** persons.
24. Further information about these powers can be found in Appendix A.

The effect of clearance

25. Clearance only relates to the named applicants, the relevant scheme and the **events** described in the application. A clearance statement does not relate to any other events or circumstances, whether prior to, subsequent to or concurrent with the event described in the application.
26. For example, if the regulator issues a financial support direction clearance statement in relation to the sale of the employer as described in the application, then this clearance statement will not restrict the regulator's powers to act in relation to any other events or circumstances. Using the same example, a clearance statement would not prevent, for instance, the regulator issuing a financial

support direction in relation to a return of capital that occurs after the sale of the employer; a prior apportionment of an employer's pension debt; or security granted to lenders as part of the transaction, but which was not described in the clearance application.

27. In some circumstances, the regulator may decide not to grant clearance. Clearance does not represent approval of an event, and a failure to obtain clearance does not, by itself, prevent an event from proceeding.
28. A clearance statement will not bind the regulator if the circumstances giving rise to the regulator's powers to issue a contribution notice or a financial support direction (as appropriate) are materially different from the circumstances described in the clearance application. Therefore, a clearance statement may be ineffective if the event is inaccurately or incompletely described in the application, or if the circumstances change in a material way. In such a case, the regulator may consider whether to exercise its powers.
29. The granting of clearance does not have any impact on the regulator's powers, other than the power to issue contribution notices or the power to issue financial support directions (as applicable).

Who is clearance relevant to?

30. Clearance applications may be made by those parties who could be subject to a contribution notice or financial support direction in relation to a scheme. This could include the employer and those connected or associated with the employer. Parties that may become an employer, or become connected or associated with an employer (for example a purchaser), may also wish to apply for clearance.
31. Where this guidance refers to the 'employer', in the case of a multi-employer scheme this should be taken to include all employers. In addition, the parts of this guidance that relate to the employer, and in particular to steps that the employer should take, may apply equally to connected or associated parties or to parties that may become connected or associated.
32. We expect trustees to be involved in any application for clearance relating to their scheme. As part of a clearance application, the trustees will be asked to comment on whether or not they support the application.
33. While some corporate trustees may be connected or associated with employers, it will not usually be appropriate for a trustee to apply for

clearance, because of the conflicts the application would create between the trustee's duties to members and his personal interests. In most cases, corporate trustees will not have any assets (other than the scheme assets), so the practical risk of contribution notices or financial support directions will be minimal.

PART I – CONSIDERING DETRIMENTAL EVENTS

34. It is clear that there are many events that could be detrimental. However, in line with its commitment to operate in a risk-based and proportionate manner, the regulator expects clearance to be sought only in relation to **type A events**. Type A events are all events that are materially detrimental to the ability of the scheme to meet its pension liabilities. **Employer-related events** will only be type A events if the scheme has a **relevant deficit**.
35. Trustees and employers (supported by their professional advisers) need to work together to ensure that, in relation to any possible **detrimental event**, they:
- understand their duties and powers;
 - have systems in place to identify at an early stage when a detrimental event is occurring;
 - communicate with each other;
 - understand the nature and assess the impact of the event; and
 - take appropriate action to minimise or eliminate the detriment to the scheme by agreeing appropriate mitigation.
36. It is always important for trustees and employers to recognise any possible detrimental event, so that they can take action to minimise or eliminate the consequential detriment. Much of the content of this guidance will therefore be relevant to trustees and employers whether or not there is a type A event occurring, and professional advisers should bring it to their attention.

The role of the trustees

37. Trustees have the prime responsibility for safeguarding members' interests. Their powers and duties are set out in statute, trust and pensions law and in the scheme's governing documents, for example the trust deed and rules. They must be familiar with those powers and duties and should act in accordance with them.
38. For example, trustees may have the power to set contributions and/or wind up the scheme in certain circumstances. Trustees also have a duty to report breaches of law and certain **notifiable events** to us, and may request that the regulator exercise its powers – for example, to wind up the scheme – if it is necessary in order to protect the interests of the generality of members.
39. Furthermore, trustees must implement controls to adequately ensure that the scheme is administered and managed in accordance with the scheme's trust deed and rules and in accordance with the requirements

of the law. This is further explained in the regulator's *Code of Practice No.9 – Internal Controls (Link to be inserted to Code)*.

40. Trustees should identify, at an early stage, any material risks to members' benefits. A deterioration or weakening of the **employer covenant** could represent a risk to members' benefits. It is therefore incumbent upon the trustees to establish procedures to identify and measure these risks, and to take appropriate action. For more information on how to monitor the employer covenant, please see paragraphs 153 to 162.
41. The scheme, if in deficit on any basis, is a creditor of the employer. Usually because of the size of the deficit, it is a material creditor and, although not identical to a large unsecured bank loan, particularly because of the long-term nature of the pensions obligation it does have many similarities in the form of:
 - its size relative to other unsecured creditors;
 - its importance to the company.
42. When negotiating with an employer, trustees should adopt the approach of a bank that has advanced a large unsecured loan. Employers should view the scheme in a similar way. For more information on negotiation, see paragraphs 125 to 130.
43. Throughout negotiations, trustees and employers must be aware of the need to maintain confidentiality (paragraphs 131 to 134) and ensure that conflicts of interest (paragraphs 135 to 142) are identified and managed appropriately.
44. Trustees must ensure that they maintain an adequate and current level of knowledge and understanding of the nature of the employer–trustee relationship.
45. Trustee knowledge and understanding requirements are further explained in the regulator's *Code of Practice No.7 – Trustee Knowledge and Understanding (Link to be inserted to Code)*. Trustees can also access the Pensions Regulator's free e-learning programme at: www.trusteetoolkit.com (*Link to be inserted to the trustee toolkit*)

Identifying when a detrimental event is occurring

46. Employers and trustees should put in place systems and procedures to ensure that trustees are able to monitor the employer covenant. This will involve ensuring that trustees have:
 - appropriate information, allowing them to form a present and ongoing understanding of the employer covenant;

- an early indication of possible detrimental events; and
- information to enable them to understand the impact of any detrimental event on the scheme.

Assessing the event

47. Trustees and employers should assess whether any detrimental event is a **type A event**.
48. Any detrimental event, including all type A events, will have one or more of the following effects, either immediately or in the future:
 - it prevents the recovery of the whole or any part of the pension debt; or
 - it prevents the pension debt becoming due, compromises or settles the pension debt; or
 - it reduces the amount of the pension debt which would otherwise become due; or
 - it weakens the employer covenant, because:
 - it has an impact on the ability of the employer to meet its ongoing funding commitments to the scheme, or an impact on those commitments; or
 - it reduces the dividend that would be available to the scheme in the event of employer insolvency.
49. In order to assess whether an event is a type A event, trustees and employers must determine whether the event is an **employer-related event** or a **scheme-related event**.
50. If there is an employer-related event that is materially detrimental to the ability of a scheme to meet its liabilities, it will only be a type A event if the scheme has a relevant deficit (see paragraphs 80 to 88).
51. If there is a scheme-related event that is materially detrimental to the ability of a scheme to meet its liabilities, it will be a type A event whether or not the scheme has a relevant deficit.
52. Assessing the impact of an event may be a complex process. Where trustees feel they may not have the necessary financial or legal skills to allow them to assess an event, they should consider obtaining independent professional advice. If trustees decide not to take independent professional advice, they should document the reasons for this decision, as well as their views on the particular event.

53. When assessing any event, trustees and employers should also refer to the guidance on the Abandonment of Defined Benefit Pension Schemes, available on the website at: *(Link to be inserted to guidance on abandonment of defined benefit pension schemes)*

Employer-related type A events

Assessing an employer-related event

54. To assess whether an employer-related event is a type A event, trustees and employers should:
- compare and contrast the pre- and post-event employer covenant;
 - assess whether any weakening of the employer covenant is to such a degree that the event could be considered to be materially detrimental to the ability of the scheme to meet its liabilities; and then
 - identify whether the scheme has a relevant deficit.

The employer covenant

55. The employer plays a vital role as the scheme sponsor. It effectively underwrites the risks that the scheme is exposed to, including existing underfunding, longevity, investment and inflation.
56. The employer covenant consists of the employer's legal obligations to the scheme and its **financial position** (both current and prospective).
57. Trustees should also consider the covenant of the **wider employer group**. This will be of particular importance where:
- the financial position of the identified employers is not of sufficient strength to support the scheme;
 - the employers have indicated that the trustees should take the financial position of the wider employer group into account when assessing the employer's financial position;
 - there is existing support for the scheme from the wider employer group, for example in the form of a parental guarantee; or
 - there is interdependency between entities in the wider employer group and the employer.

58. The wider employer group can consist of any person who is **connected** to or **associated** with the employer. Trustees should remember, though, that only certain employers will be legally liable for section 75 debts or contributions to the scheme. Therefore, trustees should be cautious about over-reliance on the covenant of the wider employer group.
59. When assessing the employer covenant, the trustees may also consider the employer's willingness to fund the scheme. However, they should be aware that assurances from the employer that are not legally binding may not protect the position of the scheme.

Assessing the employer's legal obligation to the scheme

60. It is always necessary for the trustees to identify the employers in relation to a scheme. This is important, because the scope of legal obligations to the scheme will define the extent of support for the scheme that trustees can legally enforce. The financial position of the employer and other relevant parties will determine the extent to which any legal obligations can be met.
61. Identifying the employers, and analysing and assessing their legal obligations to the scheme, can be a complex issue and will normally require legal advice. Trustees should identify:
- those employers who could be liable, now or in the future, to pay a debt under section 75, and ascertain the likely amount of the debt that may become due from each employer in a multi-employer scheme (which may depend upon the trust deed and rules, as well as statute);
 - those employers required to pay contributions to the scheme and, in a multi-employer scheme, assess the proportion of the total contribution that is payable by each employer;
 - those employers participating in the scheme and who are bound by the scheme's trust deed and rules, and identify the employer's powers and obligations under the deed and rules;
 - those employers who could be liable for **contribution notices** or **financial support directions**;
 - those employers whose insolvency could result in the scheme entering a Pension Protection Fund assessment period.
62. In some cases, former employers will be included in the above categories because of the relevant statutory definitions.
63. Trustees should remember that some employers may not fall into all of the above categories.

64. Trustees should also identify any parties connected to or associated with employers that may become liable to contribute to or support the scheme under contribution notices or financial support directions.
65. Trustees should identify any other legal obligations between the employer, or an entity in the wider employer group, and the scheme – for example, in any guarantee, ancillary deed or agreement.
66. Trustees should examine the legal relationship between the employer and the wider employer group.

Assessing the employer's financial position

67. The factors to consider in assessing the current and prospective **financial position** of the employer (and, where relevant, the wider employer group) may include:
 - the nature and prospects of the industry in which it operates;
 - its competitive position and its relative size within that industry;
 - its management ability and track record;
 - its financial policies;
 - its profitability, capital structure, cash flow and financial flexibility; and
 - its credit rating (if any), which may have some bearing on these considerations. However, the credit rating on its own should not be seen as a substitute for an independent review, unless the detail of the analysis behind the rating is made available and is acceptable to the trustees.
68. The nature and structure of the wider employer group should also be considered, including the ultimate owners of the employer or the wider employer group. Trustee considerations may include:
 - the legal domicile of the companies within the wider employer group, including the ultimate owners;
 - any restrictions or limits on capital and cash flows within the wider employer group;
 - whether there is interdependency between the wider employer group and the employer, for example:

- whether the employer is providing services to the rest of the group;
 - whether the employer services debt that sits elsewhere in the group;
 - whether there is security over the employer's assets in respect of any debt; or
 - what additional funds, if any, exist within the wider employer group that the scheme may have recourse to, either through a financial guarantee or other legal right;
- what additional covenant, if any, is provided by the wider employer group, and whether the structure of the wider employer group adds strength to the covenant of the employer;
 - any investment timeframe of the ultimate owners, covering the manner in which they extract returns on any capital invested and whether the ultimate owners have any legal obligations to support the scheme;
 - the potential for the scheme to have access to additional funds from the wider employer group; and
 - the nature and enforceability of any contingent security provided to the scheme by the wider employer group.
69. Trustees should be careful to review the financial position of the employers and the wider employer group in the context of each entity's legal relationship with the scheme and the extent of its enforceable obligations.
70. It is important that trustees understand that they should keep the employer's financial position under regular review. For more information about monitoring the employer covenant, see paragraphs 153 to 162.

Assessing whether there has been a weakening of the employer covenant

71. When assessing the pre- and post-event employer covenant, trustees and employers should analyse both the employer's legal obligations to the scheme (to ascertain any change that might occur to the employer's legal obligation to support the scheme) and the employer's financial position (to ascertain the financial strength of the employer).
72. Trustees and employers should consider whether the event has any of the effects listed in paragraph 48.
73. In order to assess whether a particular event weakens the employer covenant, it is necessary to consider where the pension creditor sits

in the allocation of proceeds in the event of the insolvency of the employer, and then consider the impact of that event on the potential allocation.

74. The scheme is usually an unsecured creditor of the employer. The priority of an unsecured creditor, with regard to the realisation of the assets of a company in the event of insolvency and when compared to other creditors, is broadly summarised below:
1. creditors with **fixed charges**;
 2. preferential creditors;
 3. creditors with **floating charges**;
 4. unsecured creditors (usually including the pension creditor);
 5. subordinated creditors;
 6. equity.
75. When considering potentially detrimental events, it is therefore helpful to assess the effect on creditors, including the pension creditor.
76. Trustees and employers should also keep in mind the long-term nature of the employer's pensions obligation, and should therefore consider the employer's long-term future.
77. An event may also be detrimental because of its impact on the ability of the employer to meet its ongoing funding commitments to the scheme. This could be because of an event's effect on the employer's cash flow or balance sheet – for example, because of an employer's dividend policy, intra-group arrangements or debt repayments.

Assessing whether a weakening of the employer covenant is material

78. Where a weakening of the employer covenant has been identified by comparing the employer covenant pre and post event, the trustees and employers need to assess whether that weakening is materially detrimental to the ability of the scheme to meet its liabilities. The judgement as to whether an event is materially detrimental can be made by reference to and comparison of a number of factors, which may include:
- the amount by which the employer covenant is weakened;
 - the size of the employer after the event; for example, the net assets of the employer or wider employer group;
 - the size of the scheme; for example, the value of the assets or number of members;

- the amount of the scheme's relevant deficit (see paragraph 80).

79. This judgement will often be a complex matter, for which trustees may need independent professional advice.

Identifying the relevant deficit

80. An employer-related event will not be a type A event unless the scheme has a relevant deficit.
81. There is a distinction between the regulator's duty to protect all pension benefits (which ultimately points to the section 75 basis of measuring deficits) and the choice of a sensible deficit trigger for operating a risk-based approach to clearance.

Relevant deficit for employer-related events

The general rule

The relevant deficit for an employer-related event will usually be the highest of the scheme's deficits according to the following bases:

- FRS17/IAS19;
- section 179;
- technical provisions (where available);
- ongoing (where technical provisions are not available).

Exceptions

- The relevant deficit will sometimes be measured by a higher basis, reflecting the impact of an event identified by trustees and employers where the employer-related event is significantly detrimental to the scheme's ability to meet its liabilities (including where there is a significant weakening of the employer covenant).
- Section 75 (buy-out) will be the basis for the relevant deficit where there are going concern issues, the scheme is in wind up, or there is scheme abandonment.

82. There are five main bases for assessing a scheme's deficit:

- FRS17/IAS19 – current accounting standards for retirement benefits, the primary objective of which is to ensure that a company's statutory financial statements reflect, at fair value, the assets and liabilities attributable to the employees' retirement benefits entitlement and any related funding. The FRS17/IAS19 deficit will be the amount reported in the latest available audited statutory accounts, unless the trustees and the employer agree that an update to this amount is appropriate;

- section 179 – Pension Protection Fund valuation basis for the purpose of calculating the risk-based pension protection levy;
- technical provisions – a calculation, based on methods and assumptions generally agreed by the trustees and employer, of the amount needed at a particular time to make provision for the scheme’s liabilities. Technical provisions are individual to each scheme. This will not yet be available for every scheme. Further information can be found in the scheme-funding pages on the regulator’s website at: (*Link to be inserted to scheme funding guidance pages*);
- ongoing – the funding standard set for a scheme following a valuation by the scheme actuary. This will be relevant where technical provisions have not yet been calculated for the scheme;
- section 75 – often known as the buy-out basis. This is the scheme actuary’s estimate of the amount needed to secure the scheme’s liabilities with annuities purchased from a regulated insurance company.

The general rule

83. In most cases the appropriate relevant deficit will be measured on the higher of FRS17/IAS19, section 179, technical provisions or ongoing bases.

Exceptions

84. There are certain circumstances where the appropriate measure for the relevant deficit will differ from the higher of the FRS17/IAS19, section 179, technical provisions or ongoing deficits.
85. Where the event is significantly detrimental to the scheme’s ability to meet its liabilities, including where there is a significant weakening of the employer covenant, then trustees and employers may judge that using the highest of FRS17/IAS19, section 179, technical provisions or ongoing deficits as the basis for the relevant deficit does not properly reflect the impact of the event. In such cases, a higher basis would be appropriate.
86. Where there are reasonable doubts that the employer will continue as a going concern, where the scheme is in wind up, or the event may result in abandonment of the scheme (*link to be inserted to abandonment guidance*), then the relevant basis is section 75 (buy-out).
87. In addition, where the FRS17 deficit for the employer group cannot be allocated on a company-by-company basis, and technical

provisions are not yet available, the trustees may consider that some other basis would be appropriate.

88. The relevant deficit is a trigger for clearance and not an indication that employers and trustees should only fund schemes to this level. Any identified relevant deficit should not restrict the trustees' or the employer's duties, powers and obligations in relation to scheme funding under Part 3 of the Pensions Act 2004. The relevant deficit is designed to give clarity to the market as to when an employer-related event might be a type A event.

Examples of employer-related events

89. Some examples of employer-related events that could be type A events include:
- a change in priority – a change in the level of security given to creditors; for example, the granting or extending of a **fixed charge** or **floating charge** over assets of the employer or the wider employer group;
 - a return of capital – a reduction in the overall assets of the employer or the wider employer group; for example:
 - dividend payments;
 - share buy backs;
 - repayment of subordinated debt; and
 - distributions in specie, including de-mergers;
 - a change to group structure, including a change of control; for example, a change or partial change to the control structure of an employer or a change to the parties who could be subject to a financial support direction, which reduces the overall **employer covenant**. This could include, for example, a change to the parent company or the ultimate holding company of the employer. Note that a change of control may be accompanied by new or increased debt, which may be secured. A change of control may be a **notifiable event**;
 - a change to the employer in relation to the scheme, including replacement of a participating employer, the merger of two or more employers, or a change to the legal status of an employer – for example a change from a partnership to an LLP;
 - sale and leaseback transactions;
 - the granting or repayment of inter-company loans, particularly where the loan is not on arm's-length terms, where it is not properly documented or where there is credit risk;

- phoenix events – an arrangement resulting in the employer re-emerging as substantially the same entity following an insolvency event;
 - business and asset sales from the employer or the wider employer group;
 - a corporate event that would reduce sustainable cash flow cover for the wider employer group's funding commitment to the scheme; for example, an increase in debt or a reallocation of debt.
90. These are only examples, and this is not a complete list of employer-related events that could be type A events.
91. For example, a change in priority is more likely to result in a material weakening of the employer covenant if it does not relate specifically and solely to new money.
92. Similarly, a return of capital is more likely to be type A if any of the following apply to it:
- it is made by an employer to the wider employer group;
 - it is made to an entity outside the EU;
 - it is made to a party who could not be subject to a financial support direction;
 - it is a large or unusual return.
93. Measuring the effect of a change in control structure is difficult, but some guidance can be found in existing market practice, and in particular by looking at commonly applied financial ratios or banking covenants.
94. Other types of detrimental events can be assessed in a similar way. Trustees should keep in mind the impact on employer covenant, including the employer's legal obligations to the scheme, and its financial position. Trustees should assess any reduction in the dividend that would be available to the scheme in the event of employer insolvency, and the impact on the employer's ability to meet its ongoing funding commitments to the scheme, and any effect on those commitments.

Scheme-related type A events

Assessing a scheme-related event

95. Although a scheme-related event may have a direct impact on the employer's legal obligations to a scheme, the detriment resulting from a scheme-related event cannot be assessed solely by reference to the employer covenant. The method for assessing whether a scheme-related event is a type A event will vary, depending on the specific event. In addition, some scheme-related events will be directly detrimental to members' benefits rather than to the ability of the scheme to meet its pension liabilities, and these may also be type A events, depending on the particular circumstances.
96. Trustees should always consider an event both in terms of its immediate impact on the scheme and members' benefits, and in terms of the event's possible impact into the future.
97. Examples of scheme-related events that could be type A events include:
 - compromise agreements – an agreement entered into by the trustees to compromise the pension debt and reduce the amount that will be paid to the scheme;
 - apportionment of a scheme's deficit – the rules of some multi-employer schemes determine the amount of the pension debt due from a participating employer in certain circumstances, for example when that employer exits the scheme or when the scheme winds up. These are usually referred to as apportionment rules. The effect of the apportionment rule is to modify the amount of the pension debt that would otherwise become due;
 - non-payment of a section 75 debt for an unreasonable period (for example more than 12 months);
 - an arrangement that has the result of preventing a section 75 debt from triggering.
98. These are only examples, and this is not a complete list of scheme-related events that could be type A events.

Compromises

99. Any attempt to compromise the pension debt due to the scheme is always a type A event, irrespective of the level of the scheme's deficit before or after the compromise.

100. Schemes for which a compromise agreement has been reached may be ineligible for entry to the Pension Protection Fund. For more information on eligibility for the Pension Protection Fund, see www.pensionprotectionfund.org (*Link to be inserted to the Pension Protection Fund's website*)
101. Trustees and employers should note that any decision to compromise the pension debt is also a **notifiable event**.

Apportionment of a scheme's deficit

102. The use, amendment or insertion of an apportionment rule is a type A event, except where:
- it increases the pension debt that is immediately payable by an employer who can afford the increased debt; or
 - it is a practical option because the cost and complexity of the other alternatives (including calculation of the unmodified pension debt or an approved withdrawal arrangement) are far greater or disproportionate, and the apportionment results in a debt that is the scheme actuary's best estimate of the unmodified pension debt; or
 - the debt arises in circumstances in which there is no net reduction of employer covenant – for example, on the incorporation of an employer, an LLP conversion with the transfer of all of the previous employer's assets and liabilities, or on the consolidation of several employers within the employer group in certain circumstances.
103. An apportionment that does not have any of the above features is a type A event, irrespective of the level of the scheme's deficit before or after the apportionment. Such an apportionment will also be a type A event, irrespective of whether the power to apportion under the scheme's rules is only exercisable at a party's discretion or is automatic.
104. Trustees and employers should note that any retrospective apportionment – taking place after the pension debt has triggered – is always a type A event. Trustees should consider any impact on eligibility for entry to the Pension Protection Fund.

Any other scheme-related event

105. Any other scheme-related event which prevents the recovery of the whole or any part of the pension debt, prevents the pension debt becoming due, compromises or settles the pension debt, or reduces the amount of the pension debt which would otherwise become due may be a type A event, irrespective of the level of the scheme's deficit before or after the event.

Events that are related to each other

106. Trustees and employers should note that sometimes an event can be composed of several distinct events, or several events may be related to each other. If this is the case, then, as well as assessing the overall effect of the events, trustees and employers should assess each of the component events separately to establish whether it could be a **type A event**. There may be both employer-related and scheme-related components to the event – for example, on the sale of a business and the use of an apportionment rule. If so, it is possible that the employer-related component will not be a type A event, because there is no relevant deficit in the scheme, whereas the scheme-related component is a type A event. Where there are component or related type A events, trustees and employers should consider what the appropriate mitigation is for each event. Where applicants are applying for clearance for more than one type A event in relation to the same scheme, these should usually be described in one application.

Where an event is type A

107. Where the trustees have identified a possible detrimental event, the employer and trustees should negotiate the most appropriate mitigation.

Mitigation

108. Mitigation is action taken to minimise or eliminate any detriment to the scheme caused by an event.
109. The level and type of appropriate mitigation will vary, depending on the nature, circumstances and impact of the event and the funding level of the scheme, taking into account the relevant deficit (see paragraphs 80 to 88).
110. In considering levels of mitigation, it will be important to consider the security that currently exists for the scheme, both through the sponsoring employer and in relation to parent employers and/or **connected** and **associated** parties. Trustees should consider that security when determining the appropriate level of mitigation to ensure that the scheme is no worse off as a result of the transaction, taking into account the regulator's powers in relation to financial support directions and contribution notices.
111. When a scheme has already gone through the scheme-funding process, trustees have the right to reopen a recovery plan by triggering a new scheme valuation at any time. If they do so, trustees should take into account the level of detriment arising from the type A event, and the fact that, in granting clearance, the regulator forgoes its financial support direction and contribution

notice powers in respect of that event. Equally, perhaps because of the time involved in going through a new scheme-funding process, trustees may choose to consider mitigation in relation to the specific event and the detriment that arises for the scheme.

112. The appropriate mitigation should be identified for each type A event.
113. Any mitigation agreed should not restrict in any way the trustees' or the employer's duties, powers and obligations in relation to scheme funding under Part 3 of the Pensions Act 2004. Further information on these powers, duties and obligations can be found in the scheme-funding pages on the regulator's website at: *(link to be inserted to scheme funding guidance)*

Approach of parties to mitigation

114. Trustees should recognise that the scheme will usually be a material unsecured creditor of the employer and should act accordingly.
115. Trustees should seek appropriate independent professional advice to enable them to assess their powers and duties in relation to a detrimental event and ascertain what mitigation may be appropriate and what they should seek in negotiations.

Types of mitigation

116. There are different types of mitigation, for example:
 - additional contributions of cash or other assets;
 - an improvement in priority; for example, granting a fixed or floating charge to the pension creditor, alongside, or in priority to, a lender;
 - escrow accounts: an escrow account is an arrangement whereby the employer pays funds into an account that will pass to the scheme under certain conditions, otherwise being returned to the employer;
 - standby letters of credit, guarantees or insurance: employers may obtain these from banks or financial institutions to cover, for example, contributions to the scheme and/or the section 75 debt;
 - negative pledges: a negative pledge is a commitment by the company that something will not be done – for example, that no new security will be granted without the agreement of the trustees;

- parental and intra-group guarantees: where there is a wider employer group, the parent company or another company within the group can guarantee, for example, the payment of contributions and/or the payment of the full section 75 debt;
 - joint and several liability: the employers or the wider employer group can be made jointly and severally liable for the funding of, or debts due to, the scheme;
 - performance thresholds: trustees and employers may agree financial thresholds for the employer that, if breached, would have to be reported to the trustees. These would act as an early warning for trustees of any deterioration or change in the employer's financial circumstances and provide an early opportunity for dialogue;
 - scheme rule changes: making an amendment to the scheme's trust deed and rules to improve the trustees' powers – for example, including a new trigger for scheme wind-up, such as a change of control.
117. There may be other forms of mitigation. Which type is appropriate is dependent on the relevant circumstances.

Additional considerations for scheme-related events

118. For scheme-related events, trustees may be able to negotiate mitigation by way of changing the event itself. For example, appropriate mitigation for apportionment could include an amendment to the rule, so that:
- it is only exercisable at the trustees' discretion;
 - it is specific to a particular event, employer, time period or set of circumstances.
119. Trustees should also consider what amount should be payable to the scheme in relation to the particular event.
120. When considering apportionment, trustees should seek to understand the purpose of the apportionment and should be cautious about agreeing to the use, amendment or insertion of any apportionment rule without knowing the context.
121. When considering apportionment, trustees should question why a **withdrawal arrangement** is not being considered by the employer. The regulator has produced separate guidance on withdrawal arrangements, and this is available on the website at: (*Link to be inserted to guidance on Multi-employer Withdrawal Arrangements*).

122. Trustees should also understand whether there is any employer-related event linked with the apportionment, or the prospect of such an event in the near future. If there is a linked employer-related event, trustees and employers should seek the appropriate mitigation for that event and should also consider the appropriate mitigation for the apportionment.
123. When considering compromises, trustees should also seek to understand the purpose of the compromise, the history of the scheme and what the dividend would be for the scheme in the event of employer insolvency. Trustees should also consider and compare the outcome for other creditors, as well as the employer's situation following the compromise, in particular whether the scheme could receive further support in the future.
124. Trustees should always consider both the immediate and the possible future impacts of a scheme-related event.

Negotiations

125. Trustees should enter negotiations in relation to a type A event, whether or not the employer or other parties wish to apply for clearance. More information about applying for clearance is available in Part II of this document.
126. Trustees should consider whether they have the necessary negotiation skills and whether they should instruct independent professional advisers to assist them in the negotiation process. Trustees might consider that they also need independent professional advice to assess the impact of the event.
127. Trustees should not agree to any fettering of the trustees' powers or discretions or restrictions of their duties. For example, trustees should not fetter their discretions in relation to investment decisions and should not be restricted from discussing any matters with the regulator.
128. Trustees can also contact the regulator, who may be able to provide help and guidance.
129. In addition to negotiations relating to the event, parties may separately need to consider the **statutory-funding objective** and the impact on the technical provisions and any recovery plan that is in place.
130. Throughout negotiations, trustees and employers must be aware of the need to maintain confidentiality and ensure that conflicts of interest are identified and managed appropriately.

Confidentiality

131. Most of the information trustees receive in their position as trustees will be confidential. Confidentiality will be particularly important when trustees receive sensitive information about scheme members or the employer, including price-sensitive information. Trustees should be able to pass all information to their appointed professional advisers, if appropriate.
132. One way of ensuring that all parties understand the importance of confidentiality is to enter into a confidentiality agreement. This agreement should ideally be reviewed and revised every time a new trustee joins the board, rather than waiting until there is some important issue, which the employer may be reluctant to discuss because of confidentiality issues. The lack of a confidentiality agreement may cause delay, which would be a particular problem if quick action by trustees is required.
133. Confidentiality agreements should not restrict the trustees' duties or fetter their power of discretion or seek to prevent the trustees from contacting the regulator. If trustees feel that the terms of an agreement would affect their ability to carry out their duties as trustees, they should raise this with the employer and with the regulator, as appropriate.
134. Any information provided to the regulator will be treated as restricted information. The regulator is restricted by law from disclosing certain information without consent.

Conflicts of interest

135. As a significant stakeholder, schemes are an important consideration to all employers. It is, therefore, understandable that an employer may wish to ensure that those who hold senior positions and possess broad experience and specific relevant knowledge, form part of the trustee body. This is something that the trustees may also see as advantageous to the scheme.
136. However, such trustees, who may include directors of the employer, will often have conflicts of interest. Other conflicted trustees may include shareholders of the employer or union representatives. Trustees must remember that they should act at all times in the interests of all the beneficiaries (including all the scheme members) and not just the active members.
137. Conflicts will be particularly relevant when trustees are negotiating with the employer in relation to a possible detrimental event, including a **type A event**.

138. We would generally expect trustees to seek legal advice in those cases where material conflict is identified to ascertain the best way to manage it.

How can conflicts of interest be managed?

139. The regulator expects a trustee who could have a conflict of interest to notify other trustees at the earliest opportunity.

140. There are key activities that trustees and employers should consider, in order to manage conflicts of interest. These may include:

- documenting a policy on conflicts of interest, which should be supported by appropriate procedures on how conflicts will be identified, managed and monitored;
- maintaining a register of conflicts and potential conflicts;
- establishing a sub-committee to deal with decisions that does not include trustees who are conflicted;
- ensuring that information is sourced appropriately; for example, trustees may need to obtain independent professional advice to assess the financial circumstances of the employer or wider employer group of companies, particularly if the conflicted trustee is the main source of financial knowledge for the other trustees;
- identifying where it is appropriate to appoint an independent trustee; and
- seeking legal advice on how to deal with a conflict.

141. Where, in our view, conflict is presenting a significant risk to members' benefits, we may decide to take further action, such as appointing an independent trustee.

142. Further information and assistance on dealing with conflict of interest can be found in our free e-learning programme at: www.trusteetoolkit.com (*Link to be inserted to the trustee toolkit*)

Considering clearance

143. Clearance is only appropriate for type A events. Clearance is a voluntary process.
144. Clearance applications may be made by those parties who could be subject to a **contribution notice** or **financial support direction** in

relation to the scheme. This could include an employer or a person **connected** with or **associated to** the employer.

145. While some corporate trustees may be connected or associated with employers, it will not usually be appropriate for a trustee to apply for clearance, because of the conflicts the application would create between the trustee's duties to members and their personal interests.

When there is a type A event and clearance is not sought

146. If the trustees become aware of an event that they believe could be a type A event, they should raise their concerns with the employer and other relevant parties to the event, in order to ensure that appropriate mitigation is considered and to ascertain whether an application for clearance is being considered.
147. Where an application for clearance is not being considered and the trustees are concerned that no mitigation is being offered, or that mitigation is inadequate, they should consider contacting the regulator.
148. Certain occurrences relating to employers and schemes must be reported to us as **notifiable events**. For more information on notifiable events, see our separate guidance, code of practice and directions on the website at: *(Link to be inserted to guidance on the notifiable events framework)*
149. Where there has been a breach of the law, trustees are required to report the matter to us. For more information on reporting breaches of the law, see our code of practice and guidance on the website at: *(Link to be inserted to the Code)*

When a detrimental event is not a type A event

150. An application for clearance will not usually be an appropriate course of action if there is no type A event. However, when there is uncertainty as to whether there is a type A event, parties should take appropriate advice. Employers and trustees may consider contacting our corporate risk management team with an enquiry (see paragraph 188 for further details).
151. If there is no type A event but there is a detrimental event, or if an event is detrimental to the benefits of scheme members, the trustees and employer should still consider entering into negotiations to ensure that any appropriate mitigation is put in place.

When there is no detrimental event

152. Trustees and employers should continue to communicate and share information to ensure that any future detrimental events are recognised and dealt with appropriately.

How to monitor the employer covenant

153. Trustees should obtain information direct from the employer, supplemented, where appropriate, by the use of commercially available services or other sources.
154. In order to assess and monitor the employer covenant, trustees must first identify who the employers are in relation to their scheme (see paragraphs 60 to 66).
155. Trustees should form a view of the initial employer covenant, including the employer's legal obligations to the scheme and its financial position, by carrying out an analysis. Independent professional advice is likely to be necessary for this analysis.
156. Trustees should also consider the history of the employer, and should seek to identify any themes or trends, all the while bearing in mind that past performance is not necessarily a reliable indicator of future performance. Trustees should seek to understand the historical relationship between entities in the wider employer group, and should identify any past difficulties, such as breaches in banking covenants.

Information from the employer

157. Employers should recognise that it is in the best interests of all concerned to have properly informed, knowledgeable and competent trustees. To achieve this, they should share information relating to the employer covenant and plans for the scheme with the trustees at the earliest opportunity. This should also help the application process proceed more quickly and efficiently.
158. Under the **scheme administration regulations**, the employer and its auditor or actuary is obliged, on request, to provide trustees with such information as the trustees or their professional advisers reasonably require for the performance of their duties. This includes information reasonably required to assess the employer covenant.
159. The employer is also required under the scheme administration regulations to make the trustees aware, within one month of its occurrence, of any event that could reasonably be considered of material significance to the trustees or their professional advisers in the exercise of their functions. This includes **type A events** and any events that may impact on the benefits of scheme members. In

practice, the regulator would expect employers to notify trustees of type A events much earlier.

160. Employers and trustees should put in place procedures that allow information to be shared. Information that may be routinely supplied by the employer to the trustees may include:
- regular updates on the group's financial position, including key performance data and future business plans;
 - an early indication of any event that may potentially impact on the employer or the scheme; such events would include, but not be limited to, type A events and notifiable events;
 - statutory company accounts (and management accounts if appropriate) to ascertain its profitability, capital structure, cash flow and financial flexibility;
 - independent business reports;
 - confirmation of compliance with banking and other creditor covenants;
 - early information relating to the granting of new security and changes to existing security; and
 - any reviews of the scheme, or any plans or proposals in relation to the scheme.

Information from commercially available services

161. Types of commercial services from which information may be obtained are listed below. Information provided by these services may also be obtained direct from the employer:
- rating agencies or credit scoring institutions;
 - credit specialist advisers.
162. Other information which may be available from commercially available services, include:
- information that relates to the risk-based element of the Pension Protection Fund's levy;
 - any new developments in the credit advisory services market aimed at assisting the trustees to evaluate the employer's financial position.

Publicly available information

163. Examples of publicly available information would include:

- press reports;
- the employer's website.

PART II – APPLYING FOR CLEARANCE

164. This part of the guidance provides more information on the process of applying for clearance from the Pensions Regulator, including the type of information applicants will need to supply and the timescales involved.

How to apply

165. A party seeking clearance may apply by completing an application form (available from our website), enclosing the associated information and documents and sending all this electronically to: clearance@thepensionsregulator.gov.uk

or by post to:

Corporate Risk Management
The Pensions Regulator
Napier House
Trafalgar Place
Brighton
BN1 4DW

Information and documents to be included in an application

166. Any application for clearance should include full and accurate disclosure. Clearance statements will only be effective in relation to the event detailed in the application to the regulator. A clearance statement will not bind the regulator if the circumstances giving rise to the regulator's powers to issue a contribution notice or a financial support direction (as appropriate) are materially different from the circumstances described in the clearance application.
167. To allow the regulator to consider an application for clearance, the application form should include relevant documents, examples of which are listed below.

Corporate documents

168. To be provided with all clearance applications:
- family tree showing composition of the wider employer group, and identifying the employers;
 - table showing the estimated outcome for creditors pre and post event, both at group level and employer level on an ongoing and an insolvent basis.

169. To be provided where relevant:

- relevant correspondence with key stakeholders regarding the event (for example negotiations with trustees);
- latest statutory accounts of all relevant entities (additionally latest draft accounts where prepared);
- financial forecasts/management accounts for all relevant entities;
- financial and other reports relevant to the event for which clearance is being sought and the employer's viability;
- fair value reports or opinions, where the event for which clearance is being sought involves a related party transaction;
- up-to-date valuation of significant assets of particular relevance to the employer or other applicants, the event or the scheme;
- details of debt and any other creditor that ranks above the pension scheme;
- details of intra-group balances and guarantee arrangements; and
- summary of related party transactions not disclosed in the statutory accounts provided.

Scheme information and documents

170. To be provided with all clearance applications:

- any documents relating to the effect of the event on the scheme or actions to be taken to improve the position of the scheme;
- any independent reports that the trustees have commissioned in respect of the events described in the application;
- where trustees have not taken independent professional advice, the document recording this decision, as well as the trustees' views of the events described in the application;
- a copy of the current and complete winding-up power from the scheme's trust deed and rules;
- a copy of the current power to set contributions from the scheme's trust deed and rules;
- a copy of the most recent actuarial valuation of the scheme;
- a copy of the assumptions used in assessing the scheme deficit on an FRS17/IAS19 basis, where relevant;
- a copy of any proposed rule amendments relating to the event; and
- a copy of any existing apportionment rule from the scheme's trust deed and rules.

171. Clearance applications should only contain relevant information. Lengthy submissions will increase the time it takes us to consider an application. Extracts or summaries of documents should be provided whenever possible. As a general principle, information provided to the regulator should be similar to the amount of information and level of detail provided to non-executive directors of a quoted company to allow them to make informed decisions.

172. Documents attached to an application should be clearly indexed.

Multiple applicants

173. If there is more than one applicant for clearance, it is preferable to have all applicants included on one application form. Each applicant must be clearly identified, for example by registered company name and number. If there are numerous applicants, they should be listed in a separate annex to the application. The application form must be signed by, or on behalf of, each applicant.
174. Applicants should be named individually, not just described only by reference to their connection or association with an employer.
175. Where one applicant wishes to apply for clearance in relation to different or separate circumstances, a separate application form may be appropriate. This may be the case, for example, where a seller and purchaser both wish to apply for clearance. Whenever possible, copies of any related application forms should be attached and referred to.
176. If there are related applications, the application process is likely to proceed more efficiently if the applicants liaise with each other as appropriate.

Withdrawal arrangements and type A events

177. If an application is made relating to a **withdrawal arrangement** and there is a related type A event for which parties wish to apply for clearance, separate applications should be made in relation to the withdrawal arrangement and in relation to clearance. The regulator has produced separate guidance for withdrawal arrangements, and this is also available on the website at: *(Link to be inserted to guidance on Multi-employer Withdrawal Arrangements)*
178. In most cases, the withdrawal arrangement will be relevant to the clearance application, and therefore the arrangement should be agreed by the relevant parties, and the application for approval submitted before the clearance deadline.

Retrospective clearance

179. Applications for clearance may be made after the type A event has occurred. However, a retrospective clearance application may, in some circumstances, restrict the trustees' ability to negotiate for effective mitigation. Applications made before an event is finalised are therefore encouraged.

What happens when an application is received?

180. Once the regulator's corporate risk management team has received the completed application form, a multidisciplinary case team will be allocated.
181. The case team will usually discuss the application with the applicants and the trustees to seek clarification or explore the facts of the case further.
182. After an application is received, the regulator has the power to ask for further information or to request that the application be amended.
183. It is inappropriate for the regulator to intervene on behalf of every scheme in relation to every **type A event**. Our preference is to be a referee in most transactions, rather than a player. We recognise, however, that this is an aspiration and that we will need to drive best practice, and it should be noted that the regulator has objectives over and above those of trustees, including the objective to reduce the risk of calls on the Pension Protection Fund.
184. Where the insolvency of the employer is likely and the scheme may be assessed by the Pension Protection Fund, then the Pension Protection Fund may be included in any discussions with the applicants and trustees. The Pension Protection Fund is a separate body from the regulator.
185. Once we have received the final, signed application form with sufficient information, we will formally consider whether to issue a clearance statement. In some circumstances, clearance may not be granted.
186. A decision by the regulator to issue a clearance statement is subject to a formal statutory process.
187. If we are minded to grant clearance, we will issue all **directly affected parties** with a 'warning notice'. This is a document that describes the circumstances set out in the application and that the regulator is relying on, and that warns the directly affected parties that the regulator is considering issuing a clearance statement based on these facts.
188. All directly affected parties will have an opportunity to provide representations on the warning notice and any representations received before the stated deadline are considered prior to issuing any determination to grant clearance. The time allowed for representations will usually be discussed with the directly affected parties.

Timescales for clearance

189. Our timescales for dealing with an application for clearance will be reduced if applicants carry out the following steps as early as possible:
- involve the trustees;
 - deal with any trustee conflicts;
 - discuss and agree mitigation proposals;
 - take appropriate independent professional advice;
 - inform the corporate risk management team of the likely clearance application, and provide an outline of the event;
 - inform the corporate risk management team of any timescales and external deadlines, and provide an explanation of those deadlines;
 - liaise with any parties that are making a related application, as appropriate;
 - ensure that the applicants and the trustees will be available to discuss the application with the regulator; and
 - provide the appropriate information to support the application.
190. These steps will help us try to meet any reasonable timescales or deadlines the applicant may have.
191. During the clearance process, the parties should inform the relevant case team within corporate risk management if there are any changes to the proposed event or external deadlines.

Enquiries

192. The corporate risk management team is happy to accept preliminary enquiries by relevant parties, such as potential applicants or trustees. These can be made on a no-names basis if necessary, although the level of guidance the regulator can provide may be limited accordingly. Such preliminary enquiries should be made direct to the corporate risk management team by contacting: clearance@thepensionsregulator.gov.uk
193. Those considering making an application for clearance should note that preliminary enquiries are not a substitute for obtaining clearance. If an enquiry develops into a clearance application, our view may change as new information and details are provided.
194. The information we provide in the course of any enquiry, or in the course of a clearance application, is for guidance only and should not be taken as a definitive interpretation of the law.
195. The regulator does not accept liability for any reliance placed on any such information or guidance. Such information or guidance cannot

be relied upon as assurance that the regulator will not later use its powers in relation to an **event**.

Changes to the circumstances described in a clearance application

196. After clearance has been granted, any material changes to the event or circumstances described in the application should be notified to the regulator. If the parties wish to apply for clearance in relation to a materially different event or circumstances, a new clearance application must be submitted. If the regulator considers that the difference is not material, confirmation of this can be requested by the applicants.

APPENDIX A: CONTRIBUTION NOTICES AND FINANCIAL SUPPORT DIRECTIONS

Contribution notices

197. The regulator can issue a contribution notice to a person, requiring an amount up to and including the section 75 debt which is due from the employer, or the section 75 debt which might become due on the winding up of the scheme, to be paid to the scheme or the Pension Protection Fund, if the regulator is of the opinion that the main purpose or one of the main purposes of an act or deliberate failure to act was:
- to prevent the recovery of the whole or part of a section 75 debt which was, or might become, due from the employer in relation to the scheme; or
 - otherwise than in good faith, to prevent such a debt becoming due, to compromise or otherwise settle such a debt, or to reduce the amount of such a debt, which would otherwise become due,
- where a 'section 75 debt' is a debt arising under section 75 of the Pensions Act 1995, including a contingent debt under that section.
198. A contribution notice may be issued to a person who is party to the act or failure to act and who is also the employer or a person connected or associated with the employer. This includes parties who knowingly assist in the act or failure to act. A contribution notice may be issued to one or more persons.
199. The term 'persons', includes individuals, companies and partnerships, including limited liability partnerships.
200. The regulator must consider that it is reasonable to impose liability on a person to pay the sum specified in a contribution notice. This will depend on various matters, examples of which are outlined below:
- the degree of involvement of that person in the act or failure to act; for example, did the person sanction the business deal?
 - the relationship the person has or had with the employer; for example, is the person a director or a senior executive of the employer? Is the person a company that is the parent company of the employer?
 - any connection or involvement the person has or had with the scheme; for example, is the person a trustee of the scheme or an employer in relation to it?

- whether the act or failure to act was a **notifiable event** that the person had a duty to notify to the regulator but failed to do so;
 - all the purposes of the act or failure to act, including whether a purpose was to prevent or limit loss of employment;
 - the financial circumstances of the person; for example, the regulator may consider that it is appropriate for less than the full section 75 debt to be required if contributions to another scheme would otherwise be materially affected.
201. The regulator does not have to consider a matter listed above if it does not consider that it is relevant, and it must have regard to any other matters outside this list, for example the status of the scheme, if it considers that such matters are relevant.
202. The regulator can issue a contribution notice in relation to acts that occurred, or failures to act that first occurred, on or after 27 April 2004. The regulator can determine to issue a contribution notice up to six years after an act occurred, or up to six years after a failure to act first occurred or continued.

Financial support directions

203. The regulator can issue a financial support direction, requiring financial arrangements to be put in place to support a scheme, when the employer is a **service company** or is **insufficiently resourced** at the relevant time. There is no requirement for there to have been an act or failure to act. The 'relevant time' is a period of 12 months ending with the regulator's determination to issue the financial support direction.
204. A financial support direction can be issued to the employer or persons connected or associated with the employer. A financial support direction cannot normally be issued to an individual, except in specific circumstances.
205. Once the regulator has issued a financial support direction, those named in the direction must put forward proposals for financial support for the scheme. If the regulator considers these arrangements to be reasonable in the circumstances, it may issue a notice approving the arrangements.
206. The financial support arrangements which must be put in place under a financial support direction may include but are not limited to:
- where an employer is part of a group, all members of the group becoming jointly and severally liable for the pension liabilities in relation to the scheme;

- the holding company within the group becoming liable for the pension liabilities in relation to the scheme;
- an arrangement whereby additional financial resources are provided to the scheme.

207. The employer is a service company if:

- it is a member of a group of companies; and
- its turnover in the latest available statutory accounts is solely or principally derived from amounts charged for providing the services of its employees to other members of the group.

208. The employer is insufficiently resourced if:

- the value of its resources is less than 50 per cent of the estimated section 75 debt; and
- the value of the resources of a person who is connected or associated with the employer, when added to those of the employer, would be 50 per cent or more of the estimated section 75 debt.

209. Assessing a person's resources is a complex process. The Pensions Regulator (Financial Support Directions, etc.) Regulations 2005 prescribe how to determine what constitutes the resources of a person and how to determine, calculate and verify the value of a person's resources.

210. The regulator must consider that it is reasonable to impose the requirements of a financial support direction on a person. This will depend on various issues, examples of which are outlined below:

- the relationship the person has or had with the employer; for example, is the person a company that is the parent company of the employer?
- the benefits the person has received directly or indirectly from the employer; for example, has the person received assets or dividends from the employer, or shared common security or cash flow arrangements or gained tax advantages?
- any connection or involvement the person has or had with the scheme; for example, was the person a trustee of the scheme or an employer in relation to it?
- the financial circumstances of the person.

211. The regulator does not have to consider a matter listed above if it does not consider that it is relevant, and it may consider other matters outside this list, for example the status of the scheme, if it considers that such matters are relevant.

Connected persons

212. A **person** is connected with a company if:
- he is a director or shadow director of the company, or an associate of such a director or shadow director; or
 - he is an associate of the company.

Associated persons

213. A person is an associate of an individual if that person is, for example:
- the individual's **husband** or **wife** or **civil partner**; or
 - a **relative** of the individual; or
 - a relative of the individual's husband or wife or civil partner; or
 - the husband or wife or civil partner of a relative of the individual; or
 - the husband or wife or civil partner of a relative of the individual's husband or wife or civil partner.
214. A person is an associate of any person with whom he is in partnership, and of the husband or wife or civil partner or a relative of any individual with whom he is in partnership; and a Scottish firm is an associate of any person who is a member of the firm.
215. A person is an associate of any person whom he employs or by whom he is employed. Any director or other officer of a company is to be treated as employed by that company.
216. If a person is associated with another person then they are associates of each other.
217. A company is an associate of another company if:
- the same person has control of both, or a person has control of one and persons who are his associates, or he and persons who are his associates, have control of the other, or

- a group of two or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person of whom he is an associate.
218. A company is an associate of another person if that person has control of it or if that person and persons who are his associates together have control of it.

Control

219. A person is to be taken as having control of a company if:
- the directors of the company or of another company which has control of it (or any of them) are accustomed to act in accordance with his directions or instructions; or
 - he is entitled to exercise, or control the exercise of, one-third or more of the voting power at any general meeting of the company or of another company which has control of it.
220. Where two or more persons together satisfy either of the above conditions, they are to be taken as having control of the company.

How to respond to the consultation

The regulator would like to hear from interested stakeholders on the areas covered in this consultation paper. We would welcome feedback on the paper in general, but we are particularly interested in comments on the following areas.

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?

Responses may be made in any of the following ways:

- by email to guidance@thepensionsregulator.gov.uk
- by post to The Pensions Regulator, Napier House, Trafalgar Place, Brighton BN1 4DW

We may need to share the feedback you send us within our own organisation or with other government bodies. We may also publish this feedback as part of our response to the discussion paper. If you wish your comments to remain anonymous, please state this explicitly in your response.

If you wish your response to be kept confidential, please make this known and we will take the necessary steps to meet your request. However, please be aware that, should we receive a formal request, under Freedom of Information legislation we may be required to make your response available.

When responding, please advise whether you are responding as an individual or on behalf of an organisation (and if the latter, which organisation).

We would be grateful for any comments that you may have by 2nd November 2007.