CBI Response to 'Protecting defined benefit pension schemes – a stronger Pensions Regulator'

1) **We have set out a number of proposed changes to the existing Notifiable Events Framework.**
   a) **Do these proposals strike the right balance between improved regulations on business and protecting pensions?**
   b) **Alternatively, are there any other significant business events which you think should be captured?**

The vast majority of DB pensions schemes are well regulated and well managed. In the main, businesses take a considered and responsible approach to decisions regarding their scheme and recognise the importance of effective regulation in ensuring a level playing field. We now see that the combined assets in the largest UK firms' pension schemes outweighing their liabilities for the first time in over a decade.[1] The Pension Protection Fund ensures that the cost of any scheme failure is shared amongst employers. This is another reason why firms want effective legislation – each scene failure ultimately costs them more in levies. The PPF remains well funded despite the few high-profile corporate failures. This highlights that problems with DB schemes are few and far between. Whilst it is right for Government act in response to these failures, changes must be appropriate above all else and knee-jerk reactions must be avoided.

The Notifiable Events Framework needs to equip the Regulator with appropriate oversight of the DB pensions landscape so that it can identify warning signs that a scheme may be in trouble and seek to provide support or require action. The framework could also be useful as part of a strategy to help the Regulator target those that are not playing by the rules. Businesses agree that there is room for improvement with current framework. However, they believe that the current proposals would wrap compliant firms in needless red tape and could undermine the Regulator by drowning it in notifications from compliant firms that would make it harder to identify the real warning signs. No detail has yet been provided on a possible expansion of the Regulator's resource and businesses see that effectively managing the increased workload, as the Regulator exists today, would be extremely challenging and could result in difficulties for businesses as they wait for notifications to be processed. The Regulator must be smart in the information that it requests from firms and the Notifiable Events Framework must not become clearance by proxy or act as a brake on business activity.

Businesses have also raised practical concerns about the vague wording used in the drafting of the proposed additional Notifiable Events, such as the reference to a "material part" of a business, "funding responsibility", and "20% of scheme liabilities" that could leave the rules open to interpretation and result in uncertainty and legal dispute. The CBI also believes that a well-targeted and proportionate approach would treat the same event differently depending on the funding position of the scheme in question. Some events that might indicate the need for the Regulator to take a closer look where a scheme has a significant deficit, could be entirely innocuous in a scheme in surplus.

The Regulator should also consider the fact that the impacts of these proposals are likely to differ based on the type or maturity of schemes. It is important that the regulator does not create a framework that it is disproportionate or leaves firms unsure of the boundaries and their obligations.

2) **Have we captured the right criteria for a significant change in the make-up of a board of directors?**

Businesses are unconvinced about the Regulator's ability to process the amount of notifications that it is likely to receive, if all the newly proposed Notifiable Events are added to the framework. To avoid becoming overloaded, the Regulator must be smart in what information it requests from businesses. CBI members have identified several scenarios where a Chief Transformation Officer or Chief Restructuring Officer might be appointed that would not be a signal of a scheme or sponsoring business that may be in distress. Therefore, adding this criterion for notification would be an unhelpful addition to the Regulator's workload and so should be dropped.

3) **We are proposing to bring forward or specify more clearly the timing of reporting notification of certain events (as described above), for instance to the point at which Heads of Terms are agreed for some transactions. Is this appropriate or is there a better time/ event to pin the reporting notification to?**

[1] *FTSE 100 pension schemes move into surplus for first time in 10 years,* City A.M., 1st August 2018

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Businesses are wary of the implications of having to report certain events at the Heads of Terms stage as there could be detrimental commercial implications for schemes and their sponsors if certain (and particularly price sensitive) information becomes publicly available too early in the transactional timescale. Further information is required about how the information contained within notifications would be managed by the Regulator, and how it is required to respond to FOI requests. In addition, when CBI consulted its members, there was a lack of agreement about exactly what would amount to the 'Heads of Terms' stage triggering new requirements. It would be very problematic if this proposal came into force in its current form without further guidance on the definition of this term.

Businesses are also mindful that transactional details at the Heads of Terms stage are still liable to change very significantly. Therefore, notification may not be practically desirable as the eventual outcome may not reflect the notification provided. This could result in avoidable false positives for the Regulator which further adds to its workload. A preferable option would be for businesses to provide notification only the stage when the details of a deal are confirmed.

Firms are also highly concerned about the prospect of having to notify earlier in the process as there is a large amount of business activity which is discussed, or scoped out, but never comes into fruition. If businesses are required to notify the Regulator for every one of these possible transactions, then the result for many firms would be multiple notifications each month about activity, most of which won't happen. This would unnecessarily increase the administrative burden on businesses and the amount of non-essential information provided to the Regulator.

4) What is the likely impact (either direct or indirect) on business of sponsoring employers being required to report earlier? How could the framework be modified to ensure that any adverse impact is mitigated?

Businesses have raised concerns about the confidentiality of information. Notifications, especially those relating to commercial deals, might require the sharing of price-sensitive information, such as the value of the company and the number of employees, that, if widely available, could have commercial implications. Therefore, businesses restrict the sharing of information relating to these transactions until a formal announcement to the City is made. CBI believes that more people being privy to this sort of information earlier in the transaction process increases the commercial risk for businesses and is the wrong approach. Any new notification requirements imposed by the Regulator must follow other existing notification obligations on corporate sponsors, particularly those relating to price sensitive information. Further, it is important that they take account of the fact that corporate entities may assume contractual obligations to counterparties around disclosure as part of transactional arrangements.

For companies with DB liabilities, there is also a worry that this would place them at an even greater competitive disadvantage compared to businesses with other pension models, such as Defined Contribution. This is due to the increased administrative burden as well as the commercial information that could then be available to competitors. CBI members feel that this would result in an uneven playing field.

5) Are there any additional changes that could further improve the design of the framework for sponsoring employers, trustees and the Regulator?

Whilst businesses agree with the principle of the Regulator having access to more information, so that it has greater oversight of the DB landscape, they are also mindful of the practicality of effectively processing the increased amount of information and then acting on it where necessary. The Regulator must consider how the expanded notification requirements will help it to identify schemes which are intent on avoidance as the managers of such schemes would likely circumvent the regulator by simply not complying with the notification framework. Therefore, simply collecting more information from largely compliant firms is unlikely to improve wider adherence to the rules and will simultaneously place additional administrative burdens upon these firms.

Members also want to better understand how the Regulator intends to react to the notifications that it receives – especially when considering the implications for corporate activity and scheme confidence. Members have particularly questioned whether notifications could become a trigger for, or inhibitor to, corporate debt restructuring which would be a negative consequence for both scheme and sponsor given that the Regulator does not, and should not, have the power to halt or mandate this essential business activity.

To help the Regulator adopt a more targeted approach to the notifications regime, CBI believes that there should be different rules for schemes with large deficits than for well-funded schemes. The CBI thinks that the Regulator's resource would be better utilised by focussing on increasing oversight in this group to help with identifying possible early warning signs.

6) We have set out a number of proposed transactions which would trigger a Declaration of Intent.
   a) Do these proposals strike the right balance between improved regulations on business and protecting pensions?
   b) Alternatively, are there any other significant business transactions which you think should be captured?

Businesses recognise the importance of engaging with their scheme trustees on an ongoing basis and believe that this is good practice for scheme management. However, firms are concerned about the Regulator introducing obligations to provide trustees with sensitive information at a specified point during business negotiations. Their key issue relates to the confidentiality of information that could impact on a business's commercial performance or stock value if it were leaked into the market.

It must also be considered that it is entirely possible that information contained in the Declaration could change as negotiations progress. This may mean that a deal is not concluded or that the deal does not fully resemble that which was declared. Businesses are keen to understand in more detail how the Regulator intends to monitor this and whether this would lead to sanctions. Uncertainty in this area could act as a brake on business investment which would undermine the case for introducing the Declaration. The Declaration of Intent would also seem to place an obligation on the employer to provide information that is only likely to be known by the buyer, such as the structure of the proposed transaction, the impact on the scheme and they buyer's future plans for it.

At a principle level, businesses do not agree with the concept of the Declaration of Intent, nor do they see how it would improve the current regulatory system as it is likely to only further overload the Regulator. If the Government's intention is to introduce a measure that ensures that employers are engaging with their trustees, then the Funding Code seems to be a more appropriate mechanism for doing so.

7) Is there any further information which could be included in a Declaration of Intent to improve understanding of the proposals to strengthen the position of the pension scheme?

Businesses do not believe that there should be any additional information that should be included in the Declaration and further do not agree with its introduction as a requirement for employers.

8) At which point in the transaction process should sponsoring employers a) engage with trustees and b) issue a Declaration of Intent to them?

The majority of employers engage with their trustees on an ongoing basis and believe that this is good practice for scheme management. However, firms are concerned about the Regulator introducing obligations to provide trustees with sensitive information at a specified point during business negotiations.

Firstly, they worry about confidentiality of information as the proposed detail of the Declaration could impact on a business's commercial performance or stock value – and could imperil the transaction proceeding - if it became publicly available too early in the transaction timescale.

Secondly, they identify that rules would need to provide flexibility as the implications would be different for listed and unlisted companies. For the former, notifying earlier than the point of market announcement would conflict with the requirements of the listing rules on the disclosure of price-sensitive information. For unlisted companies, businesses do not see a declaration of intent being viable before discussions with shareholders had begun.

9) What would be the impact (both direct and indirect) of our proposals on businesses, for example on transactions or administration costs of notification?

There is currently no legal requirement for trustees to be involved in business transactions and CBI members believe that these proposals would introduce this requirement 'by proxy'. Whilst the vast majority of businesses see frequent and detailed engagement with their trustees as a key part of good scheme

management, making this a legal requirement would represent a significant change for employers and could have commercial implications. Government has not stated that it intends to introduce the requirement for firms to engage trustees at a particular point during business transactions, but the CBI fears that this could be the unintended impact of these proposals.

Businesses also need to understand how the Regulator would view circumstances where the Declaration of Intent may not accurately reflect the eventual business transaction as members feel this could happen quite frequently. They also wonder how this might interact with the new penalties and sanctions regime.

10) What more could we do to increase trustees' involvement in negotiations to ensure there is due consideration of the potential transactional risks to pension schemes?

The Funding Code could be a better route for encouraging trustees' engagement with negotiations as trustees could call an early actuarial valuation if they had concerns about a transaction, therefore requiring trustee involvement. One of the main business difficulties with providing more information to trustees relates to wariness about confidentiality of information and the risk of commercially sensitive information being leaked.

11) Are these the right areas for the Pensions Regulator to focus on in relation to improvements to their existing guidance? Should anything else be considered?

Businesses agree that improved guidance in the areas cited in the consultation document would be beneficial and so support the proposed review. However, it is important that rules around voluntary clearance are well integrated with any rules for the proposed Declaration of Intent, if it were to be introduced.

12) What are the likely effects and impacts on business and trustees of the introduction of this proposed new system of penalties?

Businesses support meaningful penalties for firms that do not abide by the rules. It is vital that there is a level playing field for businesses and CBI members agree that it is right for the Regulator to have appropriate powers to achieve this.

However, businesses have flagged concerns in this area about the use of vague language, such as 'wilful or reckless', that creates uncertainty. There is also a difficulty in that 'wilful or reckless' behaviour can often only be determined retrospectively and what may have been a normal business decision can become detrimental because of external factors judged with the benefit of hindsight, such as a recession, and it is unfair for businesses to receive penalties in these circumstances. Above all, businesses need clarity about what activity the regulator is intending to penalise so that they can ensure that they are compliant.

Businesses also identify a difficulty in assessing the appropriateness of the proposed penalties for non-compliance with the funding code as the detail is still unknown. Firms are unconvinced about the effectiveness of the code and think that giving it legislative force could change its purpose from a best practice code to a set of mandatory practices. Even if this is Government's intention, doing it 'through the back door' is the wrong approach.

13) Are there other behaviours that should attract sanctions? If so, what are they?

Businesses feel that the proposed penalties system goes too far in some areas so could not support additional sanctions being added.

14) We have proposed a new civil penalty (up to a maximum £1m) for example to take action for non-compliance with providing a declaration of intent. Will this deter wrongdoing? If not, what would be a suitable deterrent?

Given the business lack of support for the introduction of the Declaration of Intent, firms question the need to have criminal penalties attached to non-compliance with that part of the rules.

15) We have proposed a new criminal offence for wilful or reckless behaviour in relation to a pension scheme, and for failures to comply with Contribution Notices and the Notifiable Events Framework. Do you agree with these proposals? Will this deter wrongdoing? If not, what would be a suitable deterrent?

Firms recognise that it is important for Contribution Notices and the Notifiable Events Framework to be adhered to. However, businesses have concerns with this proposal due to the lack of clarity of the wording 'wilful or reckless'. They are wary that these terms are open to interpretation and worry that the introduction of this offence in the current form could lead to disputes. Businesses are keen to understand exactly what sort of activity the Regulator is hoping to capture with the introduction of this but are not convinced that failure to comply should result in criminal conviction, especially when existing legislation and law could be used for prosecutions in the most serious of cases, for example where there has been fraudulent activity. At present, businesses could not agree with these proposals.

16) If yes, should the maximum penalty for these offences be:
- **a) Unlimited fines?**
- **b) Custodial sentence and/or fine for the worst offenders – do you have views on the appropriate maximum term?**

17) What more can we do to support the Pensions Regulator in enforcing legal requirements in an effective and proportionate way?

Businesses wonder whether more support could be provided to the Regulator to enable it to do more electronic monitoring of market activity and publicly available data. This could help it to enforce more proactively and could lessen the administrative reporting burdens on businesses. For example, businesses point to shorting around Carillion which they feel could have been picked up on by the Regulator.

18) We have set out a number of proposed changes to the way Contribution Notices function.
- **a) Do these proposals strike the right balance between improved regulations on business and protecting pensions?**
- **b) Alternatively, what else could we do to improve the way Contribution Notices work?**

Businesses support the principle of 'reasonableness' in the Contribution Notices system and believe that the proposed changes may bring some common sense to the process. However, businesses require more detail from Government on how the changes would work practically before being able to properly assess the possible benefits or detriments.

19) What would be the most appropriate way of protecting the value of the Contribution Notice through uprating? What are the likely impacts of this?

Businesses recognise the need for the Regulator to be able to uprate the impact of a Contribution Notice however they also feel that if it is possible for the impact to be indexed up then it should also be possible for this to be indexed down, where appropriate.

20) What could be the impacts of changing the date at which the cap was calculated to a date closer to the final determination?

Businesses feel that changing the date on which the cap is calculated could introduce unnecessary uncertainty into the process as the figure is likely to change, potentially significantly, in the run up to the calculation date. This would be an unwelcome step for businesses as it would leave them unsure of their exposure.

21) What would be the likely impacts on business of a more streamlined Financial Support Directive?

Businesses believe that the proposed changes to Contribution Notices are generally reasonable. However, they are not supportive of the Financial Support Direction regime as they believe that the strengthening of Contribution Notices leaves FSDs without purpose. Firms feel that there is no need to have both and that the Contribution Notice system could be expanded to cover the remit of FSDs.

22) How could we best amend the 'insufficiently resourced' test to make it simpler and clearer?

23) We propose to tighten up the forms of financial support the target is required to make to the scheme to include cash payments or statutory guarantees.
- **a) What would the impact of this approach be on business?**
- **b) Are there other forms of support we should take into consideration?**

The most material change for businesses relates to the suggestion the FSDs would be able to result in a cash call on a connected or associated employer. This is a much more specific requirement than presently exists and may make it more difficult for firms to comply with the Directions if they are required to provide cash. Members have also questioned how FSDs imposed by the Regulator might interact with financing contractual requirements that may prevent a company from doing certain things, for example where banks may prevent a company from giving charge or security over assets to another party.

24) What would be the impact on business of a longer 'lookback' period?

Firms are concerned that a longer 'lookback' period may result in businesses being deterred from engaging with positive business activity because of the prospect of retrospective activity later. Whilst it is extremely important that businesses consider in detail the merits and risks to their pension schemes of different activity, the regulator must not go so far as to make businesses 'freeze' altogether as this would be unnecessarily damaging.

25) The proposals in this consultation are suggested as ways in which the Pension Regulator's powers could be increased or improved in order to clamp down on corporate wrongdoing and ensure improved compliance with all legal responsibilities by sponsoring employers.

a. Do these proposals strike the right balance between improved regulations on business and protecting pensions?

b. Alternatively, do you think there are other areas where the Pensions Regulator's powers could be increased or improved to achieve our intended outcomes?

As highlighted in our response to the DB Green Paper, CBI members recognise the importance of the Regulator and are open to working with Government on targeted, well-evidenced changes to regulation designed to improve the system. But, in an area where poorly thought through regulation has caused significant problems in the past, Government must tread carefully and work with business. If this goes wrong, poor new law could create opportunities for those who would seek not to stand by their schemes and weaken the position of their competitors who stand by their promises to scheme members.

Firms feel that the regulator already has substantive powers and that generally it is fair and tough. In seeking to further extend its powers of oversight over schemes in trouble and non-compliant firms, businesses worry that the Regulator may become overloaded and become paralysed due to the amount of information that it will need to process. This could then flow through into the system and leave businesses unsure of how and whether they are able to proceed with commercial activity. This must be avoided. We must also ensure that the regulatory framework is evidence driven and targeted so that it does not have a detrimental impact on firms that are playing by the rules.

In addition, businesses have stated firmly that the boundary between the funding code and legislation must be clear and well-defined.