

BBS briefing note

Code of Practice 12: Circumstances in relation to the Material Detriment Test

The Government has legislated to extend the “anti avoidance” powers of the Pensions Regulator to ensure that they remain fit for purpose. The Pensions Act 2008 introduces a new ground on which Contribution Notices can be issued, known as the “material detriment test”.

Following a consultation exercise, a draft Code of Practice covering this new provision has recently been laid before Parliament. Both the Code and the Regulator’s new power are expected to come into force in the Summer of 2009. However, the 2008 Act provides that the material detriment test will apply retrospectively from 14 April 2008.

This *BBS briefing note* summarises the new provisions.

A REMINDER

The Pensions Act 2004 provided the Pensions Regulator with “anti avoidance” powers to combat the risk of employers avoiding their liabilities towards underfunded pension schemes by restructuring their affairs. Since 6th April 2005, the Regulator has been able to issue Contribution Notices and Financial Support Directions ordering the recipient to make payments or provide financial support to a scheme. These provisions were covered in more detail in *BBS briefing note 05*.

Contribution Notices could previously be issued to any employer or connected person who, in the Regulator’s opinion, had been a party to an act, or a deliberate failure to act, a main purpose of which was:

- to prevent the recovery of all or part of a section 75 debt which was, or might become, due from the employer in relation to the scheme; or
- to prevent such a debt becoming due or reduce the debt that would otherwise have become due.

Contribution Notices can be issued in relation to acts, or failures to act, occurring in the last six years and on or after 27 April 2004.

PENSIONS ACT 2008

The Pensions Act 2008 introduces a third ground on which Contribution Notices can be issued, which is:

- where the Regulator is of the opinion that an act, or failure to act, has been materially detrimental to the likelihood of the accrued scheme benefits being received.

The Government has introduced this power as a response to the changing pensions market and the use of “new business models” as alternatives to pension buy-outs that may detrimentally affect members’ benefits and lead to calls on the Pension Protection Fund (PPF).

In determining whether an act or failure is materially detrimental, the Act requires the Regulator to have regard to matters it considers relevant, which may include:

- the effect of the act or failure on the value of the scheme’s assets or liabilities;
- the extent to which any person is likely to be able to discharge their scheme obligations (their liability to make payments or transfer assets to the scheme) in different circumstances, e.g. in the event of insolvency.

The Regulator must also be satisfied that it is reasonable to impose liability on the employer or connected person, taking into account the extent to which it was reasonable for the person to act, or fail to act, in the way that he did.



BBS briefing note (continued)

THE DRAFT CODE OF PRACTICE

The Code of Practice gives guidance on the types of circumstances in which the Regulator expects to issue a Contribution Notice under the material detriment test. The circumstances are:

- the transfer of a scheme out of the UK;
- the transfer of a sponsoring employer out of the UK, or the replacement of the employer with an entity that falls outside of the UK;
- where sponsor support is removed, substantially reduced or becomes nominal;
- the transfer of scheme liabilities to another arrangement leading to a significant reduction in the sponsor support or funding for these liabilities; and
- a business model or operation of the scheme which creates a financial benefit for the employer or some other person, where inadequate account has been taken of members' interests

Essentially, the Regulator is concerned with circumstances where risks are effectively underwritten by the PPF or members whilst others benefit from the arrangement.

STATUTORY DEFENCE

Under the 2008 Act, a Contribution Notice cannot be issued to a person on the basis of the material detriment test if the Regulator is satisfied that the following conditions are met:

- before becoming a party to the act or failure, the person gave due consideration to the extent to which it may result in a material detriment to the likelihood of accrued scheme benefits being received;
- if the person considered that the act or failure might have such an effect, he took all reasonable steps to eliminate or minimise the potential detrimental effects; and

- having regard to all relevant circumstances at the time of the act, or failure to act, it was reasonable for the person to conclude that it would not result in a material detriment to the likelihood of accrued scheme benefits being received.

SUMMARY

In summary, a Contribution Notice will only be issued on the material detriment basis if:

- the Regulator considers that the act or failure has been materially detrimental to the likelihood of accrued benefits being received;
- the statutory defence conditions are not met; and
- the Regulator is satisfied that it is reasonable to impose liability on the relevant person.

BBS VIEW

The Regulator has made it clear that the extended power is intended to affect only "a small number of schemes where pension liabilities are being actively avoided or put at unacceptable risk". Nevertheless, scheme sponsors should take care when reorganising their affairs and seek appropriate advice where necessary.

The availability of the statutory defence should provide comfort to diligent employers. However, employers are still able to apply for "clearance" if they require further assurance that the Regulator will not use its anti-avoidance powers in relation to a particular event.

This BBS briefing note is based on BBS's understanding of the law and is provided for information only. It should not be relied upon as a definitive statement of the law and detailed legal and financial advice should be obtained on the specific circumstances before proceeding.

