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Rescue
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Guy Opperman MP
Parliamentary Under-Secretary for Pensions & Financial Inclusion
Department for Work and Pensions
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17 May 2018

Dear Minister,

Protecting Defined Benefit Pensions in Insolvency and Situations of Financial Distress

I am writing to you on behalf of R3, the UK's insolvency and restructuring trade body, to outline our response to the proposals for defined benefit pension reform detailed in the Government's recent White Paper – 'Protecting Defined Benefit Pension Schemes'. Many of the proposed reforms will have an impact on the UK's world class insolvency and restructuring landscape. I hope the profession's views on the proposals will assist in the further development of Government policy over the course of 2018.

The insolvency and restructuring profession plays a key role in resolving the future of a financially distressed or insolvent company's pension scheme. When appointed as an office holder in an insolvency procedure, an insolvency practitioner will become responsible for the insolvent company and it is their duty to inform the Pensions Regulator (TPR) whether the company has a pension scheme, and to realise the company's assets before distributing any realisations to creditors in accordance with the statutory 'order of priority' for post-insolvency repayments. Pension scheme deficits are an unsecured debt, which rank alongside tax and trading debts. As advisors to struggling but still solvent companies, members of the profession also have a role in approaching TPR to discuss restructuring of pension schemes outside of an insolvency procedure.

We welcome the publication of the White Paper and agree that defined benefit pensions is an area where Government action is needed. This is particularly true with regards to distressed or insolvent scheme sponsors.

In our letter to your predecessor about the Green Paper, we made a number of key recommendations, including that:

- any new powers for TPR should be carefully considered so that they do not harm legitimate business activity, and that plans for a system of proactive TPR clearance for certain business activities were unnecessary;
- there should be a review of the commerciality of TPR's engagement with financially distressed or insolvent companies, and that there is a need to amend the test which determines whether TPR can agree a Regulated Apportionment Arrangement (so that an RAA could be agreed if there is 'a real prospect of insolvency in the foreseeable future'

rather than the current requirement for there to be an 'inevitable risk of insolvency within the next 12 months'); and

- pension fund trustees should be given more support to ensure they have the information and skills needed to scrutinise the scheme for which they are responsible.

We are pleased to report that the White Paper has allayed some of our concerns regarding new TPR powers. We particularly welcome the decision to not move ahead with plans for proactive regulatory clearance. From our own contact with TPR, we understand that focus of the new powers for TPR will be to ensure pension schemes are well-funded in the first place, thereby minimising the impact on a scheme of a sponsor's insolvency or financial distress.

Following the publication of the White Paper, there remain two areas where we believe further work is needed: the ability of TPR to engage in the restructuring of a pension scheme at an earlier point; and the support available for pension scheme trustees.

TPR Engagement

When working with a company in financial distress, insolvency practitioners (or other members of the restructuring profession) may approach TPR to consider a Regulated Apportionment Arrangement (RAA). An RAA allows a scheme sponsor in financial distress to detach itself from its defined benefit pension scheme liabilities; the scheme is then likely to end up with the Pension Protection Fund (PPF).

RAAs are only allowed in limited circumstances: the sponsor must be at 'inevitable risk' of insolvency within the next 12 months; the proposal should allow the scheme to receive more (from the sponsor) than it would in an insolvency; it must not be possible to achieve a better outcome by other means; and the scheme must be treated equitably compared to other creditors.

The insolvency and restructuring profession understands and respects the need for the PPF to be protected. It is understood that an RAA will only be suggested as an option of last resort when advising on the financial affairs of a struggling scheme sponsor.

However, the insolvency and restructuring profession has long argued there should be more flexibility in the use of RAAs and that the '12 month' rule mentioned above should be modified. In the profession's experience, the sooner a company restructures, the greater the chance that it will be able to fulfil its financial obligations. Failure to take action early often leads to financial positions deteriorating, destroying value for creditors – including a company's pension scheme.

By the time an RAA can be agreed, if indeed one *can* be agreed[1], the scheme sponsor is likely to have seen its financial position worsen and the value of what it can pay into a scheme as part of the RAA reduced. Further, with RAAs only able to be agreed once insolvency is 'inevitable', even if an RAA is agreed, there is a chance that it may come too late to save the scheme sponsor. Some R3 members report that the time taken to agree that the criteria for an RAA have been met can also mean that the values of final agreements end up being much lower than what was originally proposed.

The insolvency and restructuring profession accepts that there is a difficult balancing act to strike in protecting the PPF and discouraging companies from 'dropping' their pension liabilities on the one hand, and relaxing the RAA rules to allow for earlier and easier restructurings on the other.

[1] A July 2017 FOI request response by TPR reported that only 28 RAAs had been agreed since they were introduced in 2009 – just over three per year.

However, the profession believes that the current rules serve to undermine payments to the PPF and do not effectively 'protect' the fund.

R3 has recommended that the criteria for an RAA be altered so that an RAA can be agreed when there is 'a real prospect of insolvency in the foreseeable future' rather than the current requirement for there to be an 'inevitable risk of insolvency within the next 12 months'. As part of this change, TPR could review whether there is 'a real prospect of insolvency' by seeking an independent expert report (a process which could be similar to using section 71 of the Pensions Act 2004 in order to call upon an independent advisor) for an assessment of the sponsoring company's position. This independent judgement would help justify TPR's actions to stakeholders, and could also be used to review insolvency practitioners' proposals.

R3 is pleased to see that the White Paper "[commits the Government] to working closely with the Regulator, PPF, stakeholders and pensions industry to look at whether it is possible, without increasing risk to scheme members, to make improvements to the RAA process, thereby increasing the potential for positive outcomes for businesses which might otherwise fail."[2] R3 respectfully urges the Government to begin this work as soon as possible, and we would appreciate the opportunity to engage with the Government on this issue.

I would also like to take this opportunity to clarify a comment in our letter to your predecessor in response to the Government's Green Paper. This earlier letter (12 May 2017) referred to R3 members waiting for significant periods of time for TPR to make a decision about restructuring proposals. I should clarify that R3 members do report that the length of time between first proposing and finally agreeing an RAA can be significant, but that TPR does make decisions on specific proposals in a reasonable timeframe.

Support for Trustees

As part of the White Paper's plans to 'safeguard' schemes, the Government has proposed a number of new responsibilities for scheme sponsors and trustees.

While R3 agrees that trustees have a crucial role to play in the effective administration of defined benefit (and other) pension schemes, there remains a concern that the White Paper does not offer enough support for trustees to meet the additional responsibilities which have been proposed. In R3 members' experience, and as the White Paper itself points out[3], trustees often struggle to meet their existing obligations effectively. Further responsibilities without further support could exacerbate this problem.

Pension fund trustees should have the support they need to ensure they have the information and skills needed to effectively scrutinise the scheme for which they are responsible. Trustee capabilities and skillsets should be improved, too. The Government should also give consideration to ways to increase the number of trustees who are independent from the sponsor of the scheme for which they are responsible (this is particularly true for smaller companies). Trustee boards could include a paid 'independent trustee' who can provide full time advice, although this would be an additional cost to the scheme sponsor.

Additionally, R3 has previously pointed out that the provision of information to trustees can be limited to the statutory triennial review of a scheme's valuation and rescue plan. To ensure trustees have a clear picture of the viability of a scheme's rescue plan, regular monitoring of the covenant,

[2] White Paper, Paragraph 211
[3] White Paper, Paragraph 88

funding and investment risks being faced by the scheme by both the trustees and the sponsor should be encouraged and facilitated. In particular, in between triennial reviews of schemes' valuations and rescue plans, trustees would be much better equipped if they were provided with information about the sponsor's ability to fund a scheme's recovery plan.

We very much look forward to working with your Department on its work to put the proposals in the White Paper into effect, and working together on the areas above where further action is required. We want to make sure that the UK's insolvency and restructuring framework and pensions framework operate in tandem effectively.

We would be delighted to meet with you or your officials to discuss these matters further and we will be in touch with your office to establish your interest in meeting. In the meantime, if you or your officials require any further information please do not hesitate to get in contact with R3's Public Affairs and Policy Officer, James Jeffreys, on 020 7566 4220 or james.jeffreys@r3.org.uk.

Yours faithfully,

S Frith

Stuart Frith
R3 President