

## The regulator's statement

How the Pensions Regulator will regulate the  
funding of defined benefits

**September 2008**  
**First published May 2006**

[www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)

## **Contents**

- 1 Background
- 2 Our general approach to scheme funding
- 3 How we will identify schemes subject to Part 3 presenting the greatest risk
  - Technical provisions
  - Recovery plans
  - Relationship between technical provisions and recovery periods
- 4 What we will do if a scheme triggers or comes to our attention for other reasons
- 5 Special circumstances
  - Employers subject to economic regulation
  - Not-for-profit organisations
  - Multi-employer schemes
  - Cross-border schemes
- 6 Schemes still subject to the MFR
- 7 How we may use our powers for schemes subject to Part 3
- 8 Failure to complete the requirements of Part 3
- 9 Contribution failure
- 10 Determinations
- 11 Our powers summarised

## Background

- 1.1 This statement sets out the approach that the Pensions Regulator ('the regulator') is taking to the regulation of the funding of defined benefit occupational pension schemes ('DB schemes'). The statement covers schemes subject to the scheme funding provisions in Part 3 of the Pensions Act 2004. The statement also outlines our approach to schemes that are, for the time being, subject to the minimum funding requirement (MFR).
- 1.2 A draft was issued on 31 October 2005 as part of a consultation document. This draft has been revised to take account of comments received in response to that consultation and subsequent developments.
- 1.3 Under Part 3 of the Pensions Act 2004 ('Part 3'), the trustees of DB schemes are responsible for decisions on scheme funding. In meeting these duties trustees should have regard to the regulator's code of practice No 3, *Funding defined benefits*. The code provides practical guidelines and sets out the standards of conduct and practice expected from those who must meet the requirements under Part 3. We will support trustees who comply with their duties.
- 1.4 The regulator's role in regulating the funding of DB schemes is to further its statutory objectives which include protecting the benefits of members of occupational schemes and reducing the risk of calls on the Pension Protection Fund (PPF).<sup>1</sup> We may intervene in schemes where the trustees have failed to comply with their duties and if the funding of their scheme poses a risk to our statutory objectives.
- 1.5 The purpose of this statement is:
  - to inform trustees, employers and their respective advisers on how the regulator will regulate the funding of defined benefits; and
  - to help trustees and others take informed decisions in relation to scheme funding.

<sup>1</sup>

See section 5 of the Pensions Act 2004.

## **Our general approach to scheme funding**

- 2.1 Our long-term objective is to strengthen scheme funding through the effective implementation of the scheme funding framework. We therefore expect that schemes will become progressively better funded over time. This in turn should have the effect of reducing the total risk to members' benefits and the PPF. This should also reduce the PPF's estimation of total risk used to calculate the annual levy and reduce costs to levy payers.
- 2.2 All DB schemes will be implementing the funding framework for valuations with effective dates which fall on or after 22 September 2005. Our desired outcome is that by the end of 2009 all DB schemes will have completed scheme funding valuations, and that those with a shortfall will have agreed a recovery plan which takes into account:
  - prudent assumptions for estimating the value of the assets needed to cover the liabilities as they fall due; and
  - an appropriate recognition of risks to members taking account of what is reasonably affordable for employers.
- 2.3 While we have powers to intervene, our aim is that trustees and employers will work effectively without our intervention. Our position is that trustees should come to an agreement which takes full account of affordability for employers. In particular, we recognise that a healthy ongoing business will be in the best position to ensure its pension obligations are met in the long term.
- 2.4 Our approach is to:
  - promote, through our code of practice and other forms of guidance and communication, good understanding by trustees, employers and their advisers of the matters they should consider when they agree their scheme's statutory funding objective and any recovery plan needed to raise funding to that level;
  - intervene in those schemes where the funding objective is imprudent or the recovery plan is inappropriate, so as to protect members' benefits and/or reduce risks to the PPF;
  - be transparent with trustees, employers and their advisers about the ways in which we intend to focus our resources on schemes that are likely to pose the greatest risk.

2.5 This approach is underpinned by the following guiding principles that derive from the legislation, code of practice and our overall regulatory approach:

- **protecting members** – we will support trustees and employers working to maximise protection of the benefits that the employer promised to pay and that members are expecting;
- **scheme specific** – it is not our role, nor is it consistent with government policy, to set a funding standard, because each scheme needs to take account of its particular circumstances;
- **risk-based** – regulatory intervention should be focused on the schemes that pose the greatest risk to members' benefits and the PPF. While it is never possible to eliminate all risk, those in a position to do so should seek to mitigate those risks wherever it is reasonable to do so;
- **proportionate** – trustees should aim to correct any shortfall as quickly as the employer can reasonably afford. We intend to distinguish between those schemes where rapid elimination of the shortfall would have a serious adverse impact on the employer's viability and those where employers could potentially afford to pay off the shortfall more quickly;
- **preventive** – we need where possible to act before risks materialise;
- **practicable** – we need an approach that can be operated within the constraints of the information and resources available to us;
- **referee not player** – the responsibility for ensuring that schemes are fully funded rests with trustees and employers with the help of their advisers. The regulator will not interfere with this responsibility where it is properly discharged.

2.6 To ensure that appropriate scheme funding arrangements are put in place in line with these principles, we intend to give a particular focus to the technical provisions and recovery plans agreed by trustees and employers along with the cases where no agreement has been reached. We will consider challenging those arrangements where the technical provisions are not prudent or the recovery plan is inappropriate. In particular, we will consider the specific circumstances of the scheme, especially:

- the strength of the employer and its ability to pay off the shortfall, and
- the scheme's maturity.

### **3. How we will identify schemes subject to Part 3 presenting the greatest risk**

3.1 Funding-related risks may come to our attention through a variety of means, including:

- where the trustees report to us that they have failed to reach agreement on scheme funding under section 229(1) of the Pensions Act 2004;
- any report from an actuary who is unable to certify either the calculation of the technical provisions or the schedule of contributions, under sections 225(3) and 227(9) of the Pensions Act 2004;
- any reports made to us under other sections of Part 3;
- recovery plans submitted to the regulator, under section 226(6) of the Pensions Act 2004;
- reports of notifiable events submitted to the regulator under section 69 of the Pensions Act 2004;
- scheme returns submitted to the regulator under sections 64 of the Pensions Act 2004;<sup>2</sup>
- requests for clearance for a corporate transaction under sections 42 and 46 of the Pensions Act 2004;
- trustees' requests for guidance/discussion on their funding plan proposals; or
- market intelligence.

3.2 Each of these could lead to us responding and intervening. As a proactive risk-based regulator, we shall seek to identify those risks on which we need to focus in particular. The approach we will take to assessing whether regulatory intervention would be effective where risks come to our attention is set out in section 4.

<sup>2</sup>

From summer 2006 the scheme return will collect information on valuation results needed under FRS17 and IAS19.

- 3.3 There are more than 10,000 DB schemes and we expect the majority of them to have a shortfall and, therefore, require a recovery plan. In the light of this fact we need a means to help us focus our attention on the schemes that are likely to pose the greatest risk. We will therefore use a filter mechanism based on triggers to identify schemes whose funding plans seem more likely to be based on imprudent or inappropriate assumptions. This will enable us to focus our attention on pension schemes that might merit scrutiny to determine whether the trustees have made reasonable decisions.
- 3.4 The triggers are only component parts in our regulatory toolkit and not the standards against which we will measure DB pension schemes. They are not targets.
- 3.5 There will be immature pension schemes with strong employers which will trigger in spite of not posing any risks. There will also be pension schemes with weak employers which will not trigger but which do pose risks. Therefore, trustees should not rely on the trigger mechanism to tell them whether they have set prudent technical provisions or appropriate recovery plans in the context of their scheme.
- 3.6 The triggers relate separately to technical provisions and recovery plans, recognising that they are interlinked. We are conscious that in some cases trustees may need to strike a careful three-way balance between the cost of the employer's contributions going towards eliminating a shortfall and those going towards providing the continued accrual of benefits, while maintaining the viability of the employer.
- 3.7 The triggers can be operated from the information that schemes already need to produce for other purposes, for most part recovery plans and scheme returns, and therefore do not create additional burdens for pension schemes.
- 3.8 As our and trustees' experience of the new pension scheme funding regime develops, the triggers will be kept under regular review taking into account scheme behaviour and market conditions.
- 3.9 All schemes that trigger will be subject to some form of further assessment process to help us decide whether our intervention would be appropriate. We may in some circumstances look at or intervene in schemes that have not triggered, although this will not be our primary focus.

## Technical provisions

3.10 The technical provisions trigger will help us identify those schemes where we may take a closer look at how the trustees have determined their technical provisions. In setting this trigger we have taken into account:

- that neither Government, legislation nor the regulator require ongoing schemes to fund to the solvency (full buy-out) level whereby all accrued liabilities could be secured immediately by the purchase of insurance policies;<sup>3</sup>
- that trustees should take into account scheme specific factors such as the strength of the employer's covenant and scheme maturity when determining a funding strategy for the scheme;
- the value placed on pension liabilities by employers in company accounts in accordance with FRS17 or IAS19. Research undertaken for the regulator by PricewaterhouseCoopers shows that the equity markets have already largely factored in much of the impact of FRS17;
- the funding level that would be required to secure the level of benefits that the PPF would provide in the event of employer insolvency.<sup>4</sup> The regulator has a statutory objective to reduce the risk of calls on the PPF and that risk is spread across all schemes (and ultimately employers) who pay levies to the PPF; and
- that the legislation translates into UK law the requirement of the European Pensions Directive that schemes should be fully funded against their technical provisions.

<sup>3</sup> Hansard: Standing Committee B, Tue 23 March 2004 (Morning), Pensions Bill (2004) – Ninth Sitting.

<sup>4</sup> Using the valuation required for the calculation of the risk-based levy under s179 of the Pensions Act 2004.



- 3.11 So that we can make an initial assessment of the adequacy of technical provisions, we will compare these with a range between two liability values: section 179 liability and FRS17<sup>5</sup> liability (IAS19<sup>6</sup> liability where available), irrespective of which of the two is higher. Whether a scheme triggers where it falls within the range would depend on its maturity and the employer's strength. The trigger point for a relatively mature scheme with a weak employer is likely to be set towards the higher of the two values. Conversely, the trigger point for a relatively immature scheme with a strong employer is likely to be towards the lower of the two values. We will use externally available information, including information from credit rating agencies, to assess the strength of the employer's covenant in the first instance.
- 3.12 As part of the filter we will apply a sense check to the FRS17 and section 179 figures using other available information, including buy-out valuations.
- 3.13 Defining the technical provision trigger as a range between section 179 and FRS17/IAS19 liability values does not mean that either of these values is to be used as a funding target. Nor does it mean that schemes have to change their investment strategy. The use of a prudent discount rate for technical provisions does not necessarily require trustees to adopt the same assumptions for their investment strategy, so long as they are comfortable with the employer's covenant and have allowed for the risk that the employer may not be able to cope with any adverse experience.

## Recovery plans

- 3.14 Trustees of schemes with shortfalls need to prepare a recovery plan to show how the shortfall is to be eliminated. The regulator's code of practice<sup>7</sup> indicates that 'Trustees should aim for any shortfall to be eliminated as quickly as the employer can reasonably afford. What is possible and reasonable, however, will depend on the trustees' assessment of the employer's covenant.' It also states that trustees 'should take into account [amongst other things] the employer's business plans and the likely effect any potential recovery plan would have on the future viability of the employer'. The intention here is to help employers eliminate funding deficits as soon as reasonably possible whilst maintaining an environment that supports the employer's business.

<sup>5</sup> We are aware that some employers, particularly those participating in multi-employer schemes, account for pension costs under FRS 17 using a DC approach. In these cases we will use s179 trigger test only for technical provisions and we will apply this test to the scheme as a whole.

<sup>6</sup> We will use IAS19 figures where these are used in place of FRS17.

<sup>7</sup> See paragraphs 101 and 102 of the regulator's code of practice No 3, *Funding defined benefits*.

3.15 In setting the recovery plan trigger we considered:

- the progressive increase in the maturity of defined benefit schemes, particularly those closed to new entrants, one measure of which is the liability weighted average period to pensions coming into payment. Some available estimates suggest that this is likely to vary between 15 years for a relatively immature scheme to five years for some mature schemes;<sup>8</sup>
- the progressively increasing risk as the time horizon increases of an employer weakening, and in extreme cases its insolvency;
- the continuing risks to the PPF of schemes remaining significantly underfunded, bearing in mind that the cost of carrying this risk is spread across all schemes liable to pay levies to the PPF and ultimately their sponsoring employers;
- the potentially increasing costs to schemes over future years if the current increases in longevity continue;<sup>9</sup>
- increasing member awareness of funding risks to their pensions, in particular resulting from the introduction of summary funding statements that may increase pressure on trustees to keep recovery periods relatively short;
- that for around 65-80% of the sample of employers that PwC used for our modelling purposes, the increased payments to the pension scheme needed to clear FRS17 shortfalls within ten years would represent less than a quarter of free cashflows; and
- the legislative requirement that recovery plans must set out the period over which any shortfall is to be met and that they must be appropriate having regard to the nature and circumstances of the scheme.

<sup>8</sup>

Standard & Poor's guidelines for UK pension schemes to eliminate shortfalls.

<sup>9</sup>

Available figures suggest that life expectancy at age 65 has improved by over four years for men and over three years for women over the last 20 years. Source: GAD population cohort projections.

- 3.16 Taking these factors into account, the circumstances where a scheme will trigger will include:
- (i) the recovery plan is longer than ten years;
  - (ii) the recovery plan appears to be significantly back-end loaded (higher contributions towards the end); or
  - (iii) assumptions underlying the recovery plan, especially investment assumptions, appear inappropriate.
- 3.17 We may also look at pension schemes where we believe that the employer can reasonably afford to pay off the shortfall more quickly, but in such cases we will focus our resources on schemes with weak or weakening employers.
- 3.18 Our position is that the best means of delivering the members' benefits is usually for the scheme to have the continued support of a viable employer. Therefore, when considering the reasonable affordability of a recovery plan, we will pay particular attention to the future viability of the sponsoring employer, recognising the balance between paying down pension fund deficits now and employers investing in the business.
- 3.19 In setting the trigger for the assumptions underlying the elimination of the shortfall (shown in the recovery plan), we recognise that the assumptions for the likely investment returns on scheme assets might, depending on the specific circumstances of the scheme, involve a higher allowance for equity investment than that implied by the prudent assumptions underlying technical provisions. However, we will be on the alert for any recovery plans which do not appear to be appropriate, as well as those that appear either unrealistic or too optimistic.

#### **Relationship between technical provisions and recovery periods**

- 3.20 As mentioned earlier, the technical provisions and recovery period triggers cannot be used in isolation and we will need to look at the interaction between the two for each pension scheme. If a scheme triggers, whichever trigger is the reason, our primary focus will be to ensure that the technical provisions have been calculated using a method and assumptions that are prudent given the scheme's circumstances.

The trustees must still set technical provisions based on prudent assumptions regardless of the extent to which the employer's ability to make good a shortfall is constrained.

3.21 We will, however, be prepared to be more flexible when considering the appropriateness of the recovery plan. In deciding what (if any) action to take where a recovery plan has triggered, we will give full regard to the impact any alteration to the recovery plan may have on the employer's viability, including its ongoing ability to fund the scheme and its long-term health. Our position is that the best means of delivering the members' benefits is usually for the scheme to have the continued support of a viable employer.

3.22 Where a scheme's recovery plan triggers we will expect trustees and employers to be able to demonstrate that they have taken appropriate advice and all available steps to minimise the risk of the funding position deteriorating further, by:

- adopting an investment policy which strikes an appropriate balance between any upside potential of riskier asset classes whilst containing any downside risk; and
- achieving an appropriate balance between the cost of the employer's contributions going towards eliminating a shortfall and those going towards providing the continued accrual of benefits.

3.23 We may therefore require trustees and employers to consider a modification of future accrual of benefits, if the employer is unable to pay contributions at the required level and the trustees and employer have not properly considered this option.

#### **4. What we will do if a scheme triggers or comes to our attention for other reasons**

4.1 Once a scheme triggers or comes to our attention for other reasons we will further assess the scheme's circumstances. This will inform our decision whether to act. The criteria which will inform this assessment will be derived from some or all of the following:

- the likelihood that the trustees did not set prudent technical provisions or prepare an appropriate recovery plan;
- the potential impact on both members' benefits and the PPF;
- an assessment of how likely intervention is to protect those interests.

4.2 The purpose of our further assessment of the scheme will be to identify those schemes where the trustees have made either imprudent or inappropriate funding decisions, so that we can intervene, whether informally or by using our statutory powers, and achieve an improvement in the outcome. Our assessment will be made in the light of what we know, more broadly, about the scheme, the sponsoring employer, and the economic environment in which they are operating.

4.3 When a scheme triggers on its technical provisions, we will look more closely at the mortality improvement assumptions adopted by the scheme by looking at how much the:

- cohort life expectancy at 65 of a current 65-year-old is higher than the period life expectancy of a 65-year-old; and
- cohort life expectancy at 65 of a current 45-year-old is higher than the period life expectancy of a 65-year-old.

4.4 The judgement we place on this information will depend on the circumstances, and we would expect our operational practices to evolve over time in parallel with developments in industry practice and the evidence base.

4.5 Where schemes have adopted mortality improvement assumptions which do not appear to meet the criteria of our guidance, and the overall level of technical provisions causes us concern, we will usually ask trustees to justify their assumptions in the light of the advice they have obtained.

4.6 To help us make the assessment we are initially likely to ask for information that should be readily available, such as:

- management accounts;

- the latest audited accounts of the employer, together with other up-to-date information such as budgets and forecasts, including projected cash flow;
- the latest statement of investment principles and statement of funding principles;
- the latest actuarial valuation and any actuarial report;
- the minutes of the trustee meetings;
- the rules of the scheme; and
- where available, any independent reports or advice that may have been obtained by the trustees on matters such as scheme investments, the financial strength of the employer or the use of contingent assets.

4.7 We can also request or require trustees or other parties to provide additional information or documents if we need them.

4.8 If we do decide to take a closer look at a scheme, we will be interested in whether the trustees have followed the due process, including taking appropriate advice, to help us decide whether they have achieved the right outcome for the scheme, and whether it is necessary to take remedial action. We may, in particular:

- ask the trustees to demonstrate that they have taken all appropriate factors into consideration, including guidance in the regulator's code of practice No 3, *Funding defined benefits*;
- scrutinise the assumptions the trustees have chosen in the light of actuarial and other advice provided to them;
- consider the specific circumstances of the scheme and its employer, in particular the strength of the employer covenant;
- consider whether the trustees or employer have taken any other steps to mitigate the funding risk, such as a modification of future accrual; or
- consider whether trustees have accepted the use of a contingent asset to reduce risks arising from the recovery plan or, alternatively, to support technical provisions.

4.9 Where trustees have agreed to the use of contingent assets to support:

- *the recovery plan* – we may take into account the value of the security provided by the contingent asset in determining whether we consider it

appropriate, bearing in mind a range of criteria relating to duration and enforceability;

- *technical provisions* – we may take into account the value of the security provided by the contingent asset which has strengthened the trustees assessment of the employer's covenant, when determining whether we consider it appropriate, again bearing in mind a range of criteria relating to duration and enforceability.

4.10 Further guidance on the approach we expect trustees to take when considering the use of contingent assets in a scheme's funding strategy are set out in separate guidance which will be available on the regulator's website during May 2006.

4.11 Where we decide that we need to intervene, we will use our formal powers only when we consider that we cannot achieve the same, or an equally good, outcome by using informal means. Our powers are summarised in section 11. We will also be sensitive to the potential impact of using our powers on the financial viability of the employer and hence its ability to support the scheme on an ongoing basis.

4.12 Trustees should not assume that the absence of any immediate regulatory intervention means that they satisfy the requirements of Part 3 or have set sufficiently robust provisions to adequately protect their members

## **5. Special circumstances**

- 5.1 All schemes will be regulated using the same general principles as outlined in section 4, but some practical considerations may be different depending on the nature of the sponsoring employer. Therefore, the triggers will still apply but the secondary assessment will take account of the nature of the employer and/or the specific circumstances of the pension scheme.

### ***Employers subject to economic regulation***

- 5.2 For sponsoring employers subject to economic regulation, the specific factors we would consider include:
- whether they are subject to periodic price reviews, because when formulating the recovery plan, trustees may need to consider how the periodic price reviews will impact on the employer's ability to eliminate the shortfall;
  - the existence of franchise agreements, such as in the rail industry. If the term for an existing franchise holder is coming to an end and the industry regulator would require the new franchise holder to seamlessly take on the pension scheme liabilities, then the Pensions Regulator would not necessarily require the existing franchise holder to remove any pension scheme shortfall before the end of the term of their franchise.

### ***Not-for-profit organisations***

- 5.3 For not-for-profit employers, the specific factors we would consider include:
- reliance of the sponsor on voluntary income, including legacies;
  - whether the employer has any other available funds (whether part of the unrestricted income funds or restricted funds the employer may have) which can be used to meet the pension scheme shortfall;
  - the opportunity to use unencumbered assets as a contingent security for the purposes of a recovery plan. Such security is often in the form of land and buildings which may currently be used for operational purposes, but would become available for sale if the not-for-profit organisation were to cease operating;
  - whether the employer has flexibility in determining the level of commitments they make to beneficiaries.



### ***Multi-employer schemes***

- 5.4 For multi-employer schemes we would take into account such factors as the type of scheme, ie whether an industry-wide one or one for associated employers, and the way in which scheme assets are invested, ie whether pooled or segregated.

### ***Cross-border schemes***

- 5.5 We will apply the same general principles to the regulation of the funding of cross border schemes operating within the European Union, as far as possible. Cross-border schemes are schemes which have one or more European employers who make contributions in respect of qualifying members located in a member state other than that from which the scheme is operated.<sup>10</sup> They must first be authorised and approved to operate cross-border and will provide evidence of their funding position on application.
- 5.6 Once approved to operate as a cross-border scheme, such schemes are required to be fully funded within two years of the valuation which revealed the shortfall<sup>11</sup> *and* submit annual funding valuations to the regulator. This means that recovery plans of the type envisaged for domestic schemes do not apply and therefore the recovery plan trigger cannot be used. However, we will operate the technical provisions trigger in the same way as for domestic schemes.
- 5.7 We will take account of the specific requirements for cross-border schemes in the secondary assessment process.

<sup>10</sup> 'European employer' and 'qualifying person' are defined in Regulations 2 and 3 of the Occupational Pension Schemes (Cross Border Activities) Regulations 2005 (SI 2005/3381).

<sup>11</sup> Recovery plans as modified for cross-border schemes: s226 of the Pensions Act 2004 As modified by paragraph 6(2)(b) of schedule 2 of the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377)

## **6. Schemes still subject to the MFR**

- 6.1 It is in the interests of both employers and trustees to increase funding levels in the run up to their scheme's first actuarial valuation under Part 3. We are therefore engaging with and encouraging trustees of pension schemes that are for the time being subject to MFR requirements to:
- aim at funding targets higher than those implied by the MFR;
  - bring the requirements of the scheme funding regime to the attention of the employer at the earliest opportunity; and
  - begin discussing options for an increase in contributions over and above MFR level, depending on what contribution arrangements are already in place.
- 6.2 Any reduction in an existing funding shortfall will also have the benefit of reducing the level of the risk-based levy paid to the Pension Protection Fund.

## **7. How we may use our powers for schemes subject to Part 3**

- 7.1 A summary of the regulator's powers is provided at [www.thepensionsregulator.gov.uk/aboutUs/powers.aspx](http://www.thepensionsregulator.gov.uk/aboutUs/powers.aspx).
- 7.2 We aim to use our powers sparingly, acknowledging that trustees and employers will usually wish to comply voluntarily with the legal requirements. We will help them to do this where appropriate with explanation and encouragement.
- 7.3 Where problems come to our attention we are likely to request more information. Where appropriate we will refer trustees to parts of the relevant code of practice, suggest actions that would secure compliance with the legislation, and allow a reasonable time for these actions to be completed. We will always indicate the time after which, if compliance has not been achieved, we will consider using our formal powers.
- 7.4 Where we have to use a formal power, we will do so in a proportionate and risk-focused manner, taking account of the particular circumstances of each scheme.

## **8. Failure to complete the requirements of Part 3**

- 8.1 We may intervene where we become aware that the trustees have failed to complete the requirements of Part 3 by the 15-month statutory deadline or are not making effective progress towards meeting this deadline. This may be because the trustees have been unable to reach agreement with the employer on any of the following matters:
- method and assumptions for the calculation of the technical provisions;
  - content of the statement of funding principles;
  - content of a recovery plan; and/or
  - content of the schedule of contributions.
- 8.2 The new scheme funding framework anticipates a partnership between trustees and employer and the regulator will not wish to intervene unless absolutely necessary. We will therefore encourage trustees to demonstrate that they have considered and explored all reasonable avenues, including professional alternative dispute resolution (ADR) such as mediation and/or modification of future accrual of benefits, before we intervene. See also the regulator's code of practice No 3, *Funding defined benefits*.
- 8.3 Trustees must report any failure to complete the process due to a failure to agree. We will want to understand why this completion has not been achieved. It is for this reason that trustees should provide us with, amongst other things, details of any negotiations between them and the employer, together with their reasons for not being able to agree.<sup>12</sup> We may also ask for some or all of the information as outlined in paragraphs 4.3 and 4.4.
- 8.4 If we consider that the differences between the parties are capable of being reconciled within the legislation we are likely to indicate those areas where an agreement might be sought and give a limited amount of additional time for the parties to reach one. We might also suggest that additional calculations are obtained from the actuary and suggest the use of professional ADR services.

<sup>12</sup>

See paragraph 160 of the regulator's code of practice No 3, *Funding defined benefits*.

8.5 If it is clear, however, that agreement cannot be reached, either from consideration of the parties' initial positions or following a further period of negotiation granted by us, we may, amongst other things, decide to:

- require a skilled person's report, for example from the actuary in respect of calculations of technical provisions using one or more methods and sets of assumptions notified by the regulator;
- modify the future accrual of benefits;
- issue a direction as to how the technical provisions are to be calculated, indicating the method and assumptions to be used;
- direct how a recovery plan is to be drawn up, including its length;
- impose a schedule of contributions;
- issue a freezing order whilst consideration is given to ordering a scheme wind-up; or
- order a scheme wind-up.

## 9. Contribution failure

- 9.1 The schedule of contributions that the trustees agree with the employer comes into force once certified by the scheme actuary. The schedule sets out in detail each participating employer's commitment to pay contributions for the next five years or the period of the recovery plan if longer (it includes both the employer's contributions and active members' contributions deducted from pay). The trustees must make a report to the regulator and scheme members where a contribution failure is likely to be materially significant to the regulator in the exercise of its functions. The regulator's code of practice No 3, *Funding defined benefits*, gives guidance on whether or not trustees should make a report.
- 9.2 When the regulator receives a report we will seek to understand the cause of the contribution failure and are likely to ask for an explanation from the employer. If we decide to intervene we may, amongst other things, decide to:
- issue an improvement notice to the employer where there appear to be general procedural or system problems that have not been resolved;
  - impose a financial penalty on the employer if an improvement notice has been ineffective or if the contribution failure appears to have been deliberate;
  - recover unpaid contributions on behalf of the trustees if the trustees themselves are unable or unwilling to do so;
  - modify the future accrual of benefits under the scheme if the employer is unwilling or unable to pay contributions at the level required and the trustees and the employer are not able to agree themselves to such a modification;
  - issue a financial support direction if it seems appropriate to do so and the conditions are met;
  - issue a freezing order if it appears that the employer may not be able or willing to continue to pay contributions at the level required; and/or
  - in extreme circumstances order the scheme to be wound up where the employer is unwilling or unable to pay adequate contributions to the scheme.

## **10. Determinations**

10.1 A determination may take place when:

- the regulator has investigated a case and has grounds for believing that a breach may have occurred which is within its power to sanction or prosecute;
- the regulator proposes to invoke one of its Part 3 powers;
- a problem has arisen in a scheme that we consider can be put right with the use of one of our powers; or
- trustees, managers, members or the employer have applied to the regulator for us to use one of our powers.

10.2 Guidance on our determination procedures is provided at [www.thepensionsregulator.gov.uk/regulate-and-enforce/determinations.aspx](http://www.thepensionsregulator.gov.uk/regulate-and-enforce/determinations.aspx)

## 11. Our powers summarised

Power
s10 PA 95 – Impose a civil penalty
s13 PA 2004 – Issue an improvement notice
s14 PA 2004 – Issue a third party notice
s15 PA 2004 – Apply for an injunction or an interdict
s16 PA 2004 – Issue a restitution order
s17 PA 2004 – Power to recover unpaid contributions
s22 PA 2004 (s11 PA 95) – Power to wind up an occupational pension scheme
s23 PA 2004 – Issue a freezing order
s33 PA 2004 (which amends s3 PA 95) – Issue a prohibition order (prohibiting a trustee)
s34 PA 2004 (which amends s4 PA 95) – Issue a suspension order (suspending a trustee)
s35 PA 2004 (which amends s7 PA 95) – Appoint a trustee
s36 PA 2004 (which amends s23 PA 95) – Appoint an independent trustee
s71 PA 2004 – Require a skilled person's report
s72 PA 2004 – Require the disclosure of information
s73 PA 2004 – Inspection of premises
s231(2)(a) PA 2004 – Modify the future accrual of benefits
s231(2)(b)(i) PA 2004 – Direct how technical provisions should be calculated
s231(2)(b)(ii) PA 2004 – Direct the period to be covered by the recovery plan
s231(2)(c) PA 2004 – Impose a schedule of contributions
s38 PA 2004 – Issue contribution notices where there is avoidance of employer debt
s43 PA 2004 – Issue financial support directions where avoidance of employer debt is suspected
s47 PA 2004 – Issue a contribution notice where there has been non-compliance with a financial support direction
s52 PA 2004 – Issue a restoration order where there has been a transaction at an undervalue
s58 PA 2004 – Regulator's right to apply under s423 of the Insolvency Act 1986
s292 PA 2004 – Power of the regulator to ring-fence assets
s294 PA 2004 – Stopping disposal of assets of institutions administered in other member states