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UK Publishes White Paper Proposing Defined Benefit Plan Regulatory Changes – Including Possible Criminal Penalties

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On March 19, 2018, the UK Department for Work & Pensions (DWP) published a long-awaited white paper calling for reforms in the defined benefit plan system, titled "Protecting Defined Benefit Pension Schemes". These constitute the most comprehensive set of UK pension reforms in over a decade. While the reforms set out are not radical in nature, multinational companies with UK pension plans and those employees in them responsible for global pension governance (or planning to acquire UK companies with such plans) may wish to consider the directions that these reforms will take. Some ideas are also worth being aware of as they may also find currency in other countries dealing with defined benefit plan funding issues.

The proposed reforms will not be implemented immediately; they represent the government's proposals and plans for future consultation, legislation and regulatory frameworks. However, some elements, such as new rules encouraging consolidation of pension schemes for "economies of scale" and as a de-risking approach, may happen sooner than other proposals.

The proposals of the White Paper generally fall into three major categories:

I. Strengthening The Pensions Regulator (TPR), an entity somewhat similar to the US Employee Benefit Security Administration (EBSA). This would include:

- Giving TPR more powers to conduct investigations and to issue punitive fines on those who deliberately put pension schemes at risk
- Making it a criminal offence to commit willful or grossly reckless behavior in relation to a pension scheme
- Strengthening the "notifiable events framework" (similar to US reportable events) and the "voluntary clearance" regime (generally, a process for having the TPR agree

not to require more financial support for the plan in the event of a change in control, a little akin to the PBGC's "early warning system")

II. Strengthening Scheme Funding. This would include:

- Revising TPR's Funding Code of Practice as to how prudence is demonstrated
- Revising what factors are appropriate to consider in recovery plans (i.e., plans for recovery to full funding)
- Ensuring that a long-term view is considered when setting out the statutory funding objective
- Greater cost transparency
- Requiring trustees to provide more information on their approach to managing the risks of the scheme

III. Encouraging Pension Consolidation. The White Paper stresses that it would be good policy to encourage more pension consolidation, particularly by small and medium-size schemes. (akin to US mergers of assets and liabilities, though the plan sponsors may not be related; this has some resemblance to de-risking proposals in the US of the type that were discouraged by IRS Revenue Ruling 2008-45). The White Paper notes that this is in part due to the prohibitive expense of de-risking through a buy-out by an insurance company. The White Paper recommends:

- Consultation this year on proposals for legislation and authorization to facilitate new forms of consolidation vehicles, including "commercial" consolidators. For example, different models might have different or no continuing obligations by the employer.
- Consideration of minor changes to permit benefit simplification when schemes are consolidated. The purpose of this would be to reduce costs through a simplified benefit structure.

Where Does This Go From Here?

Altogether, the White Paper notes that most UK defined benefit schemes are working well and paying promised benefits, but it expresses a need for a tougher approach for those few whose irresponsible decisions impact their pension schemes.

Certainly, many of these provisions will take some time to implement, likely not until 2019. However, tighter regulation can be anticipated.

At the same time, the increasing effort needed to maintain a defined benefit scheme in the UK could make the expansion of pension consolidators a self-fulfilling prophesy. Already, for example, a commercial consolidator of UK defined benefit occupational schemes known as The Pension SuperFund has launched that has indicated it expects to grow to 20BN GBP. Investors would share in any surplus achieved by the Superfund after benefits are paid.

The White Paper acknowledges that the UK government also intends to make recommendations later in the year for "collective defined contribution" schemes (also known as "defined ambition" schemes, though designs vary widely). Altogether, therefor, changes seem to be on the horizon for UK defined benefit schemes. Those tasked with the governance for these plans will want to be watching for them.

If you have any questions, please contact David Powell or your regular Groom lawyer.

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