UK Issues Guidance That Companies That Cannot Support Their Pension Obligations Should Not Pay Dividends

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On March 4, 2019, The Pension Regulator ("TPR"), the United Kingdom's primary regulator for pension schemes, released its "Annual funding statement 2019 for defined benefit pension schemes" (the "Funding Statement"). While the Funding Statement provides guidance on a number of areas of scheme governance, including the risk factors that trustees should evaluate when managing mature pension schemes, perhaps the most significant new guidance relates to corporate dividends.

As background, the UK government has been proposing since March 2018 to tighten the protection around pension funds following a number of high-profile plan sponsor collapses. TPR has the key role in this as it operates the Notifiable Events Framework, which is similar to the Pension Benefit Guaranty Corporation ("PBGC") "early warning system" and serves to protect the UK Pension Protection Fund and oversee deficit recovery plans for underfunded pensions.

The Funding Statement expresses TPR's concern that some employers have prioritized shareholders at the expense of making payments to schemes to mitigate underfunding. To address this concern, TPR has provided guidance and suggested that it will focus on this issue when engaging with schemes in 2019. Specifically, TPR stated three expectations on pension trustees and employers regarding dividends:

- Where dividends and other shareholder distributions exceed agreed upon deficit recovery contributions, TPR expects a strong funding target and recovery plans to be relatively short.
- If the employer is tending to weak or weak, TPR expects deficit recovery contributions to be larger than shareholder distributions unless the recovery plan is short and the funding target is strong.

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- If the employer is weak and unable to support the scheme, TPR expects the payment of shareholder distributions to have ceased.

TPR has the authority to direct how and over what period a funding deficit should be funded. Accordingly, it could intervene should a company pay dividends or engage in other activity where value leaves a company while the company has an obligation to support an underfunded scheme and require companies to stop making dividend payments.

US companies considering acquisitions in the UK and global governance committees of US-based multinational companies will want to consider these tightening requirements for underfunded UK pension plans. Also, while US regulators do not currently have broad authority to direct US companies to cease making dividend payments - and they have a number of tools already at their disposal, including the power to terminate a plan, enforce controlled group liabilities, and impose liens – keep in mind that policymakers sometimes look overseas for ideas. US plan sponsors that elected certain funding relief are already required to make additional contributions to underfunded US pension plans if the sponsor pays "extraordinary dividends."

For more background on the developing changes to UK defined benefit pension scheme funding, you can refer to our prior alerts:

https://www.groom.com/wp-content/uploads/2019/02/Multinational-Companies-Take-Note.pdf

https://www.groom.com/wp-content/uploads/2018/04/UK-Publishes-White-Paper-Proposing-Defined-Benefit-Plan-Regulatory-Changes.pdf

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