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27 October 2021

Dear Sirs

DEPARTMENT FOR WORK AND PENSIONS: STRENGTHENING THE PENSIONS REGULATOR'S POWERS: NOTIFIABLE EVENTS (AMENDMENTS) REGULATIONS 2021

I write to you on behalf of the Employer Covenant Practitioners Association ("ECPA") in response to your consultation document noted above.

Background to ECPA

The ECPA's member firms are can be found on the Association's website at https://ecpa.org.uk/members/ . Collectively the ECPA provides a forum where specialist employer covenant professionals:

- Discuss technical, legal and regulatory issues relevant to providing financial advice to clients – trustees or sponsoring employers – on matters connected with the employer covenant.
- Participate in discussion around relevant matters such as the Pensions Regulator and Pension Protection Fund and, where appropriate, to promote the views of the ECPA with those bodies.
- Act as a vehicle for raising the standards of, and promoting, the employer covenant financial advisory industry generally amongst the pensions community, including trade bodies, professional groups and potential clients - scheme Trustees or sponsoring employers.

At the heart of our work is the preservation of value for scheme members, supporting the ongoing viability of sponsors and schemes, and ensuring trustees' ability to deliver members benefits in full through the ongoing support of sponsoring employers.

The ECPA's responses to the Consultation questions

There is always the risk that a response from a professional body can be seen as partisan or self-interested. Our response seeks to be objective and is built off the very considerable experience of our members in advising on employer covenant-related matters with massively variable features and dimensions, particularly in relation to corporate transactions and events that might weaken the employer covenant.

The ECPA would welcome further engagement with the Department on this matter.

Responses to Questions

1. **Do you think that the definitions capture the policy intention? If not, please explain why.**

RESPONSE
The response to these questions reflects the expert views of employer covenant professionals of the ECPA. In our view, the definitions of "assets", "decision in principle" and "sale" are well intended and would capture events of delinquent employers who do not engage appropriately with the Trustee. We whole-heartedly welcome new rules, regulations and powers that guard against the actions of delinquent employers who put the security of members' benefits at risk. Subject to the comments noted below, we therefore view that they do capture the policy intention. We view that, in hindsight, a breach of these regulations, using these definitions, by a delinquent employer would be evident in most cases and therefore ease TPR's proper enforcement processes. This would also act as a deterrent. However, we must ensure that such new rules and definitions, aimed at preventing the delinquent employer "exception", do not place unnecessary burdens or handicaps upon the vast majority of "good" employers who sponsor defined benefit pension schemes, resulting in competitive disadvantage in comparison to other companies. Such a state could result in a reduction in the ability of sponsoring employers to carry out their normal business activities, attract investment etc., ultimately weakening the employer covenant and the security of members' benefits. The draft definition of "decision in principle" is likely to cause most concern to good employers around exactly when they must notify. A simple notification process, at the point that a transaction is more likely than not to progress, should not be unduly burdensome. It is however unrealistic that a well-governed company would reach such a stage without first engaging with other parties, including the Trustee where appropriate. As noted within the "background" narrative of this consultation document, the Notifiable Events regime is aimed at "*events which have the potential to cause harm to a pension scheme*". As the impacts of such events can be substantial, we would encourage employers to engage with the Trustee and its advisers in advance of reaching such a stage or making a "decision to sell", and for such engagement to have the potential to impact on the "go or no go" decision. We see this in practise now. The narrative of the consultation document further states that "*It is at that point, the company should start to consider the impact on the pension scheme*". An employer could therefore be deemed to have passed this point merely by engaging with the trustee at an earlier stage – an action which many good employers adopt, and one which should be encouraged.

The draft regulations would be improved if they sought to ensure that the event was notified in sufficient time in, advance of a transaction, such that TPR and the Trustee have had the benefit of any required interactions in advance of the deal completing. Strong guidance from TPR on the practical aspects defining the "decision in principle" will be required to ensure that the above risks do not manifest themselves. We also think it strange that the definition of "assets" excludes "money" – both from the perspectives that cash is an important asset within a business and should therefore be included, and that the term "money" (as opposed to "cash") is used. It should be made clear if "cash/money" should only be excluded from Gross Assets where debt also exists, that could be set-off against the cash balance in an insolvency.

2. **Can you see any unintended consequences of these amendments?**

RESPONSE
As noted in our answer to Q1, we must ensure that the amendments, aimed at preventing the delinquent employer "exception", do not place unnecessary burdens or handicaps upon the vast majority of "good" employers who sponsor defined benefit pension schemes, resulting in competitive disadvantage in comparison to other companies. Such a state could result in a reduction in the ability of sponsoring employers to carry out their normal business activities, attract investment etc., ultimately weakening the employer covenant and the security of members' benefits. The draft definition of "decision in principle" is likely to cause most concern to good employers around exactly when they must notify. A simple notification process, at the point that a transaction is more likely than not to progress, should not be unduly burdensome. It is however unrealistic that a well-governed company would reach such a stage without first engaging with other parties, including the Trustee where appropriate. As noted within the "background" narrative of this consultation document, the Notifiable Events regime is aimed at "*events which have the potential to cause harm to a pension scheme*". As the impacts of such events can be substantial, we would encourge employers to engage with the Trustee and its advisers in advance of reaching such a stage or making a "decision to sell", and for such engagement to have the potential to impact on the "go or no go" decision. We see this in practise now. The narrative of the consultation document further states that "*It is at that point, the company should start to consider the impact on the pension scheme*". An employer could therefore be deemed to have passed this point merely by engaging with the trustee at an earlier stage – an action which many good employers adopt, and one which should be encouraged.

3. **Are there any unintended consequences of this approach? What is the impact on multi-employer schemes and the employers? Is there a simple way of apportioning liabilities which would work for all multi-employer schemes?**

RESPONSE
We support the removal of the "liabilities" threshold and agree that the materiality hurdles suggested should be applied individually to any statutory employer within a multi-employer scheme. Multi-employer schemes are complex and employers who might, on some bases, appear to have a small direct obligation to a scheme, could be heavily relied upon for covenant strength, particularly in last-man-standing arrangements. We welcome the simplicity of this approach and believe it could act as a "lowest common denominator" to ensure that all appropriate transactions would be identified, subject to one addition that captures "trading profits" (and to further comments on the definitions under Q6 of this response). As cash flow from profits is usually the most important element of a company's ability to sponsor a pension scheme, the statutory definitions should be widened to cover profits. Profits do not necessarily vary directly with either revenue or assets, particularly in "stress" scenarios, where one element / unit of a business may be healthy, and account for a substantially greater proportion of profits and cash flow than its relative turnover or assets would suggests. In circumstances where an employer is considering selling such a business unit, it would necessarily have determined the recorded and planned profitability of the business unit as part of its sales process. The identification and measurement of profits in these circumstances should therefore be straightforward. Absent the addition of "profits" to these regulations, one could miss circumstances where a business unit that accounts for say 15% of turnover, 10% of assets, but 80% of profits, to the material detriment of the scheme.

4. **Do you agree that "when the main terms have been proposed" is an appropriate point for the notice and statement to be issued? Can you see any unintended consequences of using this definition? At what point would it be reasonable for employers to have discussions with the trustees about the intended transaction?**

RESPONSE
In reality, the timing and construction of such events are varied and difficult to define precisely. There are likely to be differences in the perception of which terms are "main terms" for different parties i.e. from a shareholders perspective, the deal price may be the main term, but from a Trustee perspective, the funding characteristics and future strategic objectives are likely to be the predominant factors. The draft regulations would be improved if they sought to ensure that the event was notified, and the Statement produced, in sufficient time in, advance of a transaction, such that TPR and the Trustee have had the benefit of any required interactions in advance of the deal completing. Strong guidance from TPR on the practical aspects defining the point at which the "main terms have been proposed" will be required to ensure that the above risks do not manifest themselves.

5. **Does the definition of relevant security meet the intention that it will apply to granting of security which may affect the employer's ability to support the scheme? Are there any unintended consequences? Should other specific types of security be included or excluded? Is it appropriate to specify a 25% threshold by reference to revenues or assets as proposed?**

RESPONSE
The definition of "security" should cover all instruments which take priority over the pension scheme creditor in the event of an insolvency, or introduce the risk of the instrument holder gaining control over all or a material part of the business within the employer covenant net. We view that any definition of Gross Assets should exclude "right of use" assets under IFRS 16, as these typically inflate the gross value of assets (and therefore reduces the likelihood that a security would trigger the threshold) and are typically not subject to a company charge (as they are not owned by the company). Similarly, we note that Gross Assets include intangible non-current assets, such as intellectual property, goodwill etc., the value of which can be greatly diminished in stressed scenarios. It is within these scenarios that notification is most important. We therefore suggest that within non-current asset categories, only tangible assets are included within Gross Assets. We also view that fixed charges over specific "chattel" assets (or "corporeal moveable" assets in Scotland) can also be materially important to employer covenant e.g. ships, aircraft, locomotives, and should not therefore be excluded from these regulations. We view that refinancing of existing debt should only be excluded if the refinancing is on identical terms to those that already exist, in terms of quantum, margin, covenants etc. The 25% threshold appears appropriate, to maintain a balance between appropriate regulatory notification and unnecessary administrative burden. We would however expect well-governed employers to continue to engage with Trustees on the occurrence of any transaction which is material in the context of the employer and the scheme.

6. **Do you agree this is a reasonable definition of revenue and assets? If, not, how do you consider they should be defined?**
7. **Do you consider that 25% of the revenue or assets is an appropriate level? If not, please indicate what you think is an appropriate level and why?**
8. **Do you agree that disposals which have taken place or agreed within 12 months of the date of the notifiable event should be taken into account when calculating the 25% threshold? If not, please explain why.**

RESPONSE
We welcome the simplicity of this approach, and believe it could act as a "lowest common denominator" to ensure that all appropriate transactions would be identified, subject to one addition that captures "trading profits". As cash flow from profits is usually the most important element of a company's ability to sponsor a pension scheme, the statutory definitions should be widened to cover profits. Profits do not necessarily vary directly with either revenue or assets, particularly in "stress" scenarios, where one element / unit of a business may be healthy, and account for a substantially greater proportion of profits and cash flow than its relative turnover or assets would suggests.

In circumstances where an employer is considering selling such a business unit, it would necessarily have determined the recorded and planned profitability of the business unit as part of its sales process. The identification and measurement of profits in these circumstances should therefore be straightforward. The EBITDA definition of profits is widely used and understood, and could be adopted in this situation. Adjusted net profit, which in our view, is an inferior measure, would be better than nothing, and would tie into the Employer Resources Test. Absent the addition of "profits" to these regulations, one could miss circumstances where a business unit that accounts for say 15% of turnover, 10% of assets, but 80% of profits, to the material detriment of the scheme. The 25% threshold appears appropriate, although its application should be widened to ensure it captures all events which could be material to the employer. This would include the "25% of EBITDA" point raised above. It should also use the value of disposal proceeds as an input e.g. if disposal proceeds are greater than 25% of gross assets or revenue or EBITDA. We agree that a series of transactions can, in aggregate, result in a material change to the employer and the suggested approach with the draft Regulations appears at the shorter end of an appropriate period. In keeping with triennial valuation cycles, a 36-month rolling period would be more fitting. It is worth noting that regulations such as these will never capture all relevant scenarios. For that reason, we hope that it is made clear that employers must continue to engage with the Trustee in relation to any transaction which could have a materially detrimental effect on the employer covenant.

9. **Does this list provide all the information which should be notified to The Pensions Regulator? If not, what else should be included?**

RESPONSE
This appears reasonable.

10. Do you think that this meets the policy intention or are there any unintended consequences?

RESPONSE
We agree that this meets the policy intention. However, we are aware that this may place an increased formal reporting/notification burden on employers, particularly in light of the uncertainty around the definitions for "decision in principle" and "main terms" and could give rise to several notices being required in respect of a single transaction. Such potential magnification of issues is likely to increase the risk of additional unnecessary burden on good employers who are keen to meet the letter of the regulations, and could cause unnecessary confidentiality issues within a transaction. These issues would result in increasing the risks noted within our answers to Q1 and Q2, and could ultimately weaken the employer covenant to the detriment of the security of members' benefits.

We hope that these comments are of use to you as part of this consultation. We would welcome the opportunity to meet with you and your colleagues to discuss our comments and suggestions in more detail.

Yours faithfully

For and on behalf of
Employer Covenant Practitioners Association