EXPLANATORY MEMORANDUM TO

THE PENSIONS REGULATOR (EMPLOYER RESOURCES TEST) REGULATIONS 2021

2021 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument sets out what constitutes the resources of the employer for the purposes of the "employer resources test" and sets out the basis for how the value of the resources of the employer is to be calculated, determined and verified. The "employer resources test" is one of two new jurisdictional tests introduced by the Pension Schemes Act 2021[1] through which The Pensions Regulator can assess if an act or failure to act satisfies the requirements for issuing a contribution notice which imposes an obligation on the recipient to pay a specified sum of money to a defined benefit pension scheme.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is Great Britain.

4.2 The territorial application of this instrument is Great Britain.

4.3 The Department for Communities in Northern Ireland will be producing its own corresponding legislation replicating these regulations for Northern Ireland.

5. European Convention on Human Rights

5.1 The Minister for Pensions and Financial Inclusion has made the following statement regarding Human Rights:

"In my view the provisions of The Pensions Regulator (Employer Resources Test) Regulations 2021 are compatible with the Convention rights."

[1] https://www.legislation.gov.uk/ukpga/2021/1/section/103/enacted

6. Legislative Context

6.1 The Pension Schemes Act 2021 inserts two new tests[2] into section 38(5) of the Pensions Act 2004,[3] which if met, would allow The Pensions Regulator to issue a contribution notice where all the other requirements under section 38[4] have also been met. The contribution notice regime enables The Pensions Regulator to impose a demand on a target to pay a specified amount of money to a defined benefit pension scheme. The contribution notice regime forms part of the anti-avoidance powers, alongside for example the Financial Support Directions, to enable The Pensions Regulator to intervene and seek redress where an act or failure to act results in detriment to a defined benefit pension scheme.

7. Policy background

What is being done and why?

7.1 The sponsoring employer of a defined benefit pension scheme is responsible for ensuring the scheme is adequately funded to pay members pensions when they fall due. The Pensions Regulator has oversight of occupational pensions and, where necessary, can take actions to safeguard pension scheme members under pension legislation.

7.2 Section 38 of the Pensions Act 2004 enables The Pensions Regulator to issue a contribution notice imposing an obligation on the recipient to pay a specified sum of money to a defined benefit pension scheme if the conditions in section 38(3)[5] are satisfied. Those conditions include where The Pensions Regulator is of the opinion that the person was a party to an act or a deliberate failure to act that is detrimental to the scheme.

7.3 In its response to the consultation on Protecting Defined Benefit Pension Schemes,[6] the Government proposed increasing the flexibility available to The Pensions Regulator to issue a contribution notice by introducing a jurisdiction test. This is assessed by reference to the impact on the sponsoring employer and is in keeping with the overall policy intent of The Pensions Regulator to be clearer, quicker and tougher.

7.4 To achieve this, the Pension Schemes Act 2021 introduced two additional tests to the contribution notice regime, one of which is the “employer resources test”. The Pensions Regulator has faced difficulty in forecasting the medium and long-term performance of a business for the purposes of the existing ‘material detriment test’ due to the need to extrapolate into the future with the uncertainty and challenges that causes evidentially. The “employer resources test” is therefore designed to assess this on a snapshot basis, removing the need to forecast how the employer might or might not have performed in the future absent the act or failure to act.

7.5 This instrument specifies that the “employer resources test” will be determined as the profits of the employer before tax. Regulation 4(2) sets out how the value of the resources of the employer is to be determined and calculated. It also provides for the exclusion of exceptional and non-recurring items by The Pensions Regulator in order that a normalised position can be established on which to assess any impact of the act

[2] https://www.legislation.gov.uk/ukpga/2021/1/section/103/enacted
[3] https://www.legislation.gov.uk/ukpga/2004/35/contents
[4] https://www.legislation.gov.uk/ukpga/2004/35/section/38
[5] Ibid
[6] Government response to Protecting Defined Benefit Pension Schemes consultation

or failure to act on the employer's ability to support their defined benefit pension scheme.

7.6 Regulation 4(3) confirms that The Pensions Regulator will determine what are exceptional or non-recurring items and to provide clarity as to how it will go about this determination. Regulation 4(4) requires The Pensions Regulator to have regard to the financial reporting standards relating to accounting practices of the Financial Reporting Council[7] to provide some certainty about the approach that will be taken.

7.7 Regulation 4(5) allows The Pensions Regulator to determine and calculate the value of resources of an employer in circumstances set out in regulation 4(6); for example, when the employer is not required to prepare annual accounts. When making a determination under regulation 4(6), The Pensions Regulator can specify the reference period it deems appropriate. Regulation 4(7) allows The Pensions Regulator to disregard any alteration of the accounting reference period made by an employer in prescribed circumstances. Regulation 4(8) sets out that when The Pensions Regulator makes a determination under regulations 4(3) or (5), it must take into account all relevant information in its possession and, having done so, no further verification is required.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 This instrument does not consolidate previous instruments.

10. Consultation outcome

10.1 A public consultation took place on a draft of 'The Pensions Regulator (Employer Resources Test) Regulations 2021', referred to at the time as 'The Pensions Regulator (Contribution Notices) Regulations 2021'[8], between 18 March and 29 April 2021.

10.2 There were 19 responses. Some agreed with the option selected by the Government for measuring the resources of the employer, which is to use profit before tax. This is a term widely understood by all involved and is less subjective than other options put forward. However, other respondents supported two options which had been considered but ruled out in the consultation: a holistic approach, combining aspects of different measures proposed and separately, an approach that uses EBITDA (Earnings Before Interest Tax Depreciation and Amortisation) as the measure when determining and calculating the value of resources of an employer.

10.3 The Government has considered these responses very carefully and is of the view that a holistic measure, such as assessing an employer's covenant strength, is too subjective, has no industry agreement in how to value it and is unlikely to meet the policy intent. EBITDA is also unsuitable as it is not a required accounting disclosure, is not covered by the financial reporting standards relating to accounting practices published by the Financial Reporting Council and is therefore not audited and open to more subjectivity.

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[7] https://www.frc.org.uk/accountants/accounting-and-reporting-policy/uk-accounting-standards

[8] Consultation on the draft Employer Resources Test regulations

10.1 The Government has not therefore been persuaded that the advantages of either of these approaches outweigh the use of profit before tax measure since the purpose of the "employer resources test" is to provide The Pensions Regulator with a simple snapshot view of the impact of the act or failure to act.

10.2 Some respondents pointed out that charities and not trading for profit employers would not be captured by only using a profit before tax measure. Amendments have been made to the regulations to include these type of employers, along with other minor drafting changes.

10.3 The Government's response including summarised consultation responses will be available alongside the consultation documents on GOV.UK, when a draft of The Pensions Regulator (Employer Resources Test) Regulations 2021 is laid.

11. Guidance

11.1 The test will be administered by The Pensions Regulator. Further information about its approach will be contained in its Code of Practice to be published by The Pensions Regulator later this year. It will also amend other related guidance as appropriate.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 The impact assessment for the Pension Schemes Act 2021 assessed the additional costs to business of familiarisation with the new regime to be £1.7 million. These regulations provide details of what constitutes employer resources and how they will be determined, calculated and verified and does not add any further costs to business. The number of actual contribution notices issued is very low (less than 10 since the regime was introduced in the Pensions Act 2004).

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses as the instrument applies to the activities of any business which sponsors a defined benefit pension scheme.

13.2 It is not possible to mitigate the impact of the requirements on small business without an adverse effect on scheme members. However, small businesses are less likely to sponsor a defined benefit pension scheme than large businesses.

14. Monitoring & review

14.1 The regulations do not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, Guy Opperman, Minister for Pensions and Financial Inclusion has made the following statement:

"A statutory review is not appropriate as the impact on business is minimal and a formal statutory review would be disproportionate for the small number of cases involved."

14.2 The approach to monitoring of this legislation is that the Government will work with The Pensions Regulator who will in turn work with the pensions industry in order to understand the impact of the revised legislation post-implementation.

14.3 The Pensions Regulator’s implementation of the new contribution notice provisions may take a number of years, since investigating potential avoidance activity can take time. Therefore, given that The Pensions Regulator will have some cases under the old regime, and some under the new regime (once the legislation is commenced), it is anticipated that it might take a few years before the impact of the revised legislation materialises. Additionally, the number of contribution notices issued is anticipated to remain very low.

15. Contact

15.1 Roy Manders at the Department for Work and Pensions for questions about the instrument (Roy.Manders@dwp.gov.uk).

15.2 Gareth Thomas, Deputy Director for Defined Benefit Policy, at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.

15.3 Guy Opperman, Minister for Pensions and Financial Inclusion, at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.