Enhancing the occupational pension schemes' sanctions regime.

The Pensions Regulator's (TPR's) existing sanctioning powers do not sufficiently deter occupational pension scheme sponsoring employers or scheme trustees from engaging in wrongdoing in relation to their pension scheme. The existing criminal offences target only a limited list of breaches; and existing financial penalty amounts are set so low as to only be an effective deterrent for low-level breaches rather than more serious ones.

Government intervention is intended to strengthen the existing sanctions regime by widening the scope of sanctions and increasing the maximum penalties available for not engaging appropriately with TPR or not complying with relevant legislation and regulations.

Creating a stronger and more comprehensive sanctions regime will support TPR across all of its functions and enable it to become 'clearer, quicker, tougher.' This is designed to reduce the potential for abuse and wrongdoing within the occupational pensions industry.

The intended effect of these proposals is to improve the security of members' pensions by (i) introducing additional deterrents in order to motivate sponsoring employers to comply with legislative and regulatory requirements, (ii) enabling TPR to react in a more efficient and proactive way when wrongdoing occurs, and (iii) appropriately punishing unscrupulous sponsoring employers.

1. Policy background – additional detail of the preferred option

The preferred option includes the following:

- Introducing three new criminal offences:
    1) Two offences for wilful or reckless behaviour in relation to a pension scheme - this will create a more comprehensive and cohesive criminal sanctions regime by creating two overarching offences capturing a wider range of serious avoidance behaviour; and
    2) One offence for failure to comply with a Contribution Notice (CN)[1]- this is intended to strengthen TPR's CN power by introducing a proportionate deterrent, and helping trustees enforce CNs;
- Introducing a new civil penalty of up to a maximum of £1million to appropriately address more serious breaches; and,
- Extending the list of duties and requirements which attract a civil sanction when breached.

More detail is set out in Table 1 below. A number of the offences listed are already in law and we intend only to change the fining power applicable, i.e. there will be no changes in the requirements, but a different sanctioning power will apply where the requirements are not met as a result of 'wrongdoing'. In other cases, the existing requirements have been amended or new offences are being introduced, in those cases they are assessed either in Regulatory Impact Assessments (RIAs)[2] or within this summary bill impact assessment. The subject of this section is just sanction and fines.

[1] A Contribution Notice (CN) is a fault-based mechanism by which TPR issue a demand to pay a set amount of money where a person was party to an act, or failure to act, which had a particular main purpose to avoid a liability to the scheme or which was materially detrimental to scheme members.

[2] These are in other annexes within this summary bill IA.

Table 1. Summary of the proposed changes.

Criminal Offence	Offence	Target
Avoidance of employer debt	Criminal offence: up to 7 years imprisonment and/or unlimited fine	Any Person
Conduct risking accrued scheme benefits	Criminal offence: up to 7 years imprisonment and/or unlimited fine	Any Person
Failure to comply with a Contribution Notice	Criminal offence: Unlimited fine	Sponsoring employers and others associated or connected
Financial Penalty	**Penalty**	**Target**
Avoidance of employer debt	New civil penalty: up to a maximum of £1 million	Any Person
Conduct risking accrued scheme benefits	New civil penalty: up to a maximum of £1 million	Any Person
Failure to comply with a Contribution Notice	New civil penalty: up to a maximum of £1 million	Sponsoring employers and others associated or connected
Failure to comply with the notifiable events framework	New civil penalty: up to a maximum of £1 million	Sponsoring employers and trustees
Failure to comply with the requirements for a Declaration of Intent	New civil penalty: up to a maximum of £1 million	Sponsoring employers and others associated or connected
Knowingly or recklessly providing false information to TPR	New civil penalty: up to a maximum of £1 million Please note: A criminal offence already exists for this offence.	Any person who is required to provide information to TPR, as per the legislation.
Knowingly or recklessly providing false information or failing to provide required information to Trustees	New civil penalty: up to a maximum of £1 million	Any person who is required to provide information to Trustees, as per the legislation.
Amending Existing Penalties	**New Penalty**	**Target**
Non-compliance with information requests (including inspections and interviews) or delays in providing information	Fixed and escalating civil penalty. The Government will develop the levels of fines as part of its secondary legislation package.	Any person targeted by TPR under section 72 to 75 of the Pensions Act 2004
Failure to provide a Chair's Statement, failure to provide on time or providing a poor quality statement	The civil penalty under the existing section 10 of the Pensions Act 1995, and the criminal offence under the existing section 80 of the Pensions Act 2004.	Trustees

Source: DWP, ‘Protecting Defined Benefits Pensions Schemes- A Stronger Regulator' Consultation response[3].

2. Evidence behind the rationale for intervention

The Department undertook a comprehensive review - including industry consultation and working closely with the TPR - of the condition of Defined Benefit (DB) occupational pensions, and published a White Paper ‘Protecting defined benefit pensions’ in March 2018[4]. The paper concluded that ‘although most employers want to do the right thing, we need to guard against the small minority of employers who may be content to put it at risk’.

The Department sought feedback on the proposed new sanctions as part of the White paper consultation document 'Protecting Defined Benefits Pensions Schemes - A Stronger Regulator' in June 2018. The consultation response attracted strong engagement from the Pension’s community with over 71 responses received from a range of respondents, including pension professionals, employers, representative bodies and trustees. Respondents to the consultation on balance, supported the changes in the system of sanctions. A number of respondents commented that a practical and proportionate regime could be an effective deterrent and should not impact on properly run businesses.

Behavioural evidence/studies tend to suggest that proportionate and well-targeted sanctions and fines do help deter wrongdoing. For example, Hasehuln et al (University of California, Berkley)[5] conclude that ‘personal experience with a fine can motivate long-term behaviour’. Behavioural evidence is discussed in more detail in the White Paper.

3. Scope - numbers potentially affected

The proposed changes are primarily designed for and will be applicable to all funded private sector Defined Benefit (DB) schemes. In some cases, such as ‘non-compliance with information requests’ the proposed changes will also have an impact on occupational Defined Contribution (DC) schemes. However, only a small subset will be affected as the majority comply with the requirements and will not be affected. There are 5,524 DB schemes[6], with approximately 14,000 sponsoring employers in total[7]. There are 30,590[8] occupational DC schemes with more than two members.

3.1 Extending the sanctions regime

Those impacted here are not only those who are sanctioned, but also those who are deterred from wrongdoing. We assess business cost to be nil on the basis that monetary impacts associated with deterred wrongdoing, and fines issued where wrongdoing occurs, are not treated as a cost. However, to illustrate potential scale of impact more generally we present the following illustration of the numbers of cases anticipated to be sanctioned / fined. Business impacts are discussed in more detail further down.

3.2 Provisional ex-ante estimates or assumptions of number of cases sanctioned / fined – for illustrative purposes

By looking at the numbers of sanctions in other business areas, we anticipate the number of civil sanctions issued to vary between 5 and 50 per annum. The lower bound estimate is based on the 5 CN cases at the investigation stage and one at the warning notice stage as

[3] Government Response to the Consultation on Protecting Defined Benefit Pension Schemes- A Stronger Pensions Regulator Link – page 24-25
[4] Link
[5] Link
[6] The Purple Book 2018- Link, page 10
[7] Protecting Defined Benefit Pension Schemes- Link , page 3.
[8] DC Trust 2019- Link, Table 1.18

at December 2017[9]. The upper bound estimate is arrived at by using the total number of financial penalties imposed by the FCA in the years 2014/15, 2015/16 and 2016/17. This figure has ranged between 15 and 43 per annum over this period[10]. This approximation has been rounded to 50 per annum to be prudent in the context of high uncertainty.

We anticipate that the number of criminal convictions could vary between 0 and 5 per annum. The upper bound of this is based on the 5 CN cases at the investigation stage as at December 2017. Both the wilful and reckless behaviour in relation to a pension scheme and failing to comply with a contribution notice are related to CNs that have been issued. We arbitrarily assume 0 to 2 are expected to lead to custodial sentences and 0 to 3 are expected to lead to substantial fines.

4. Business impacts

4.1 Costs to Business of extending the sanctions regime.

4.1.1 Familiarisation and implementation cost.

The subject of this assessment is sanctions and not changes to the requirements of how pension schemes have to be run. Schemes have to be familiar with the requirements and what defines wrongdoing in the baseline, and comply with them, no matter what fine or sanction is associated with them. On this basis, we assess that changes in sanctions and fines per se does not result in any additional familiarisation cost.

In addition, TPR intend to update its compliance and enforcement policies for occupational pension schemes once the legislation comes into force so that any changes are well communicated.

4.1.2 Ongoing cost

Ongoing cost to business is assessed to be nil. This is primarily on the basis that sanctions or fines, which result from wrongdoing, are not to be treated as a cost. Equally, not issuing a fine (where issuing it is reasonable) is not treated as a benefit to business due to the same argument – not preventing and / or punishing wrongdoing is not treated as a benefit from societal value judgement point of view.

4.1.3 Other/wider business cost

We do not anticipate that targeted and proportionate sanctions applied to those engaged in ‘wrongdoing’, who are a small minority, will make any legitimate business / business activities less attractive to potential legitimate investors or business employees.

4.1.4 Sensitivity analysis

There may be some costs to business arising where a sanction or fine is applied by TPR but later successfully appealed. The challenge process itself carries a cost, and where a sanction is applied incorrectly the associated adverse monetary implications on business are to be treated as a cost. The legal system, in general, allows for compensation where punishment has been applied incorrectly. However, we do not claim that that necessarily reduces any damages to zero; but we anticipate any net costs associated with sanctions being (ultimately) incorrectly applied as negligible. The Department for Work and Pensions will be liaising with the Regulator and pensions industry and monitoring any practical developments following the introduction of the new sanctions and fines regime.

4.2 Business benefits

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[9] TPR management information referenced in Protecting Defined Benefit Pension Schemes- Link, page 49.

[10] FCA Enforcement annual performance account 2016/17- Link, figure 2.2 page 5

There may be an indirect benefit for business if as a result of the changes in the system of sanctions some businesses are deterred from wrongdoing and in turn helps to create more of a level playing field – i.e. those unlawfully compromising their DB scheme are not gaining comparative advantage over those meeting all requirements.

5. Costs and Benefits to scheme members

There will be no costs incurred for scheme members as they will not need to do anything– i.e. no familiarisation, implementation, or any ongoing costs for them.

The enhanced sanctions regime is expected, in some cases, to deter 'wrongdoing', which would otherwise put the scheme and its members' pensions at risk – hence a potential benefit to members. In all situations however the fine will still have to be paid. This could weaken the position of the employer and in some cases result in damage to the employer covenant. This could increase the chances of these schemes entering the PPF, which could result in lower benefits received by members. However, as the number of cases is expected to be relatively low and this is dependent on a number of additional factors it is not clear whether this would be the case. Due to the uncertainty surrounding this and the level of benefits that members are entitled to we consider this disproportionate to quantify.

6. Costs and Benefits to Government/TPR

6.1 TPR

TPR is anticipated to incur both gross costs and gross benefits. Financial penalties will be dealt with directly by TPR; and in relation to criminal offences, TPR will form the prosecution. As a result, TPR will incur a familiarisation cost in the form of training staff on the new system of sanctions, and ongoing monitoring costs because of resources/experts who will be needed to consider, prove, decide and communicate sanctions. On the other hand, the enhanced sanctions regime is expected, at least to some extent, to deter wrongdoing and improve compliance with TPR – which would result in savings to TPR. Net impact will depend on several factors, including how the deterrence effect plays out, which is not possible to quantify ex ante with any certainty.

There is a possibility that introducing the new system of sanctions may lead to over compliance. For example, businesses notifying events when there is not strictly a need, which could increase TPR's caseload. However, if schemes and employers read the requirements and are familiar with what is expected of them there is no reason we can assume that they will over comply with the regulations.

TPR is primarily funded by the Pensions Schemes Levy, which is collected from UK pension schemes by the Pensions Regulator (TPR) on behalf of the Department for Work and Pensions (DWP). This levy (as all other levies) is not a regulatory provision and thus does need to be reported on for the Business Impact Target (BIT).

6.2 HM Prison Service

There may be minor costs incurred by HM Prison Service, because of the new criminal offences and in turn custodial sentences for the two new offences that capture wilful or reckless behaviour in relation to a pension scheme.

A study by Ernst & Young (EY) found that on average company directors face sentences of four years or more[11]. Using this as a proxy we assume that the average sentence for this offence will be 4.5 years. It is assumed that prisoners will serve half their sentences (2.25 years) before being released on parole. The cost per prison place per annum is estimated to

[11] Assumption based on EY study which found that on average company directors face prison sentences of four years or more. Link

be £26,274[12]. Assuming there is one conviction per year and the average duration in prison is 2.25 years, after year one the number in prison will accumulate to two offenders in prison per year. As a result, it is estimated that the cost incurred to HM Prison Service is £26,274 in the first year and then £52,548 per annum thereafter.

7. Any other / wider economic or societal impact

There are wider benefits expected as a result of the new system of sanctions. It may lead to an increase in public confidence in (the security of) pension savings in general. Also, more proportionate sanctions and fines are anticipated to improve fairness.

The new system of penalties increases the individual liability and therefore could make it more difficult for schemes to recruit member nominated trustees. We do not treat this as a cost, if trustees comply with the requirements then the new system of penalties should not affect their decision to become a trustee.

[12] Link