



HM Treasury

Banking reform:

response to the consultation on
draft pensions regulations

February 2015



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1 Introduction

The banking reform pensions regulations

1.1 The Independent Commission on Banking (ICB), chaired by Sir John Vickers, was established in 2010 to make recommendations on the reforms necessary to avoid future financial crises. The ring-fencing of retail from wholesale/investment banking was a key recommendation of the ICB. Ring-fencing should insulate retail banking services (whose continuous provision is essential to financial stability and to the wider economy) from shocks originating elsewhere in the global financial system, make banks simpler and easier for the authorities to resolve and reduce the perceived implicit government guarantee to systemically important banks.

1.2 The government legislated to implement the ring-fence via the Financial Services (Banking Reform) Act 2013. In line with ICB recommendations, the Banking Reform Act includes provisions allowing the Treasury to require by regulation that ring-fenced banks (RFBs) ensure that they cannot become liable for the pension schemes of other entities.

1.3 The draft banking reform pensions regulations implement this requirement on ring-fenced banks to ensure that they are not, and cannot become, liable for the pension liabilities of other entities (except other RFBs in their group, or wholly owned subsidiaries of RFBs) and provide a framework in which restructuring of any existing pension arrangements which do not meet these requirements can be carried out.

The 'Banking reform: draft pensions regulations' consultation

1.4 In July 2014 HM Treasury published the consultation document 'Banking reform: draft pensions regulations'. The document invited comments on a draft statutory instrument 'Banking Reform Pensions Regulations' ("the draft regulations") and was published alongside an impact assessment. These documents can be found at:

<https://www.gov.uk/government/consultations/banking-reform-draft-pensions-regulations>

1.5 The consultation ran until 16 October 2014, during which time the government received 10 written responses from interested organisations. A list of the organisations that responded is provided in Annex A.

1.6 This document summarises the responses received and sets out the government's views on the issues raised and any resultant actions taken. The government is grateful to all those who contributed their views during the consultation process.

The Pensions Working Group

1.7 Since the consultation was published the government has set up a working group with industry. This Pensions Working Group is chaired by HM Treasury and brings together interested industry parties and regulators. To date this has acted as a forum for discussing the draft regulations. Going forward this will change focus to supporting stakeholders through the process of implementing changes to their pension schemes. The Pensions Working Group met during the consultation period and comments given in that meeting were considered alongside the written consultation responses.

Summary of consultation questions and issues raised by respondents

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2.1 Overall the views from respondents were mixed and in many places there were clear differences between responses from the banks and responses from the trustees.

2.2 Each stakeholder who replied raised a significant number of issues, with a mix of suggested policy changes, technical drafting issues and requests for clarity about how the legislation would be applied in practice.

2.3 The responses provided map onto a number of clear topics. However the questions asked did not match well to the topics that were most discussed by respondents and many respondents put the bulk of their points into their covering letter or in response to the open ended question 7. Other times the same issue was raised in answer to multiple questions depending on the respondent.

2.4 This section therefore briefly summarises the questions asked and the topics that respondents raised following each question. The next section goes into more detail into all of the key topics, the government's view on each topic and how the legislation has been changed.

How respondents replied to each question

Question 1: Do you have any views on the approach taken in the regulations to the allocation of liabilities associated with employment before 2026 (or 5 years after the bank becomes subject to ring-fencing, if later than 2026)?

2.5 The regulations did not prescribe whether liabilities associated with employment before 2026 need to fall inside or outside the ring-fence. Respondents expressed support for this flexibility and for the general flexibility granted by these regulations.

Question 2: Do you have any views on the approach taken in the regulations to liabilities associated with on-going employment with a body other than a ring-fenced bank?

2.6 The regulations prescribed that from 2026 a RFB cannot have any shared liability arrangements with any other entities (except other RFBs in their group, or wholly owned subsidiaries of RFBs). Some respondents suggested that the rules about shared liability arrangements be changed. This is discussed in detail in chapter 3. Other respondents expressed support for the flexibility of the regulations. Other respondents raised technical issues, also discussed in more detail in chapter 3.

Question 3: Do you agree that the tools provided by the regulations are sufficient to allow the trustees or managers of a scheme to enact the separation or segregation of schemes required by the regulations?

2.7 The regulations give trustees powers to make significant changes to the banks pension schemes. The regulations give banks the power to apply to the court in cases where an agreement with trustees about a pension scheme cannot be reached. This question prompted a range of responses on the topics of trustees' powers and responsibilities, the clearance process, the court process and shared liability arrangements. These issues are examined in detail in chapter 3.

Question 4: Do you have any views on any existing provisions which may need to be disapplied in order for ring-fenced bank to comply with the regulations?

2.8 Respondents generally expressed support for the existing pension provisions. The issue of transitional tax relief for employees was raised, discussed in chapter 3. Respondents also raised further small technical issues and requests for clarity.

Question 5: Do you have any views on the regulations coming into force in 2015?

2.9 Responses here focused on timing, discussed in chapter 3, and a technical point about how these regulations will work prior to the ring-fencing obligations coming into force in 2019.

Question 6: Are there any other circumstances which ought to be provided for when a ring-fenced bank may not be able to negotiate its release from such arrangements, in order to comply with the regulations?

2.10 Respondents raised a number of issues relating to shared liability arrangements which are discussed in chapter 3 below. The issue of costs of separating pension schemes was also raised.

Question 7: Do you have any other views on the approach taken in the regulations?

2.11 A significant number of issues were raised in response to this open question. In particular respondents raised questions surrounding the issue of the clearance process and about the requirement to provide information to members. These issues are discussed in chapter 3.

Government response to

3 issues raised

3.1 This section goes into detail on the key topics, sets out the government's view on each issue raised and describes how the legislation has been changed.

General approach taken

3.2 In developing the draft regulations we tried to take a minimally prescriptive approach, setting out the end result that RFBs needed to reach (with separated pension liabilities) but not the process by which banks should reach this point. We have also tried to use existing pension provisions as far as possible. Respondents expressed support for this non-prescriptive approach. Nevertheless, maintaining this non-overly prescriptive approach does mean that many of the suggestions for greater clarity could not be dealt with in the regulations themselves. In most cases we have looked to address such issues through ongoing dialogue between banks, trustees, HM Treasury and the regulators to reach practical and operationally viable solutions.

3.3 The regulations did not prescribe whether liabilities associated with employment before 2026 need to fall inside or outside the ring-fence. Respondents expressed support for this flexibility.

The clearance process

3.4 Responses to the consultation: The draft regulations required the banks to apply for a Clearance Statement from the Pension Regulator (TPR) for any changes they would make as part of the ring-fencing process. All of the banks who responded to the consultation as well as some of the other respondents raised issues with the clearance process as initially proposed. They advised that the process would be overly burdensome as the rules seemed to suggest that clearance had to be sought for every minor change. They suggested that a materiality threshold be introduced and/or that the requirement to apply for clearance be removed altogether and perhaps replaced with a simpler process.

3.5 Government response: The government added a materiality threshold to the requirement to apply for clearance. A form of wording, agreed with TPR, was drafted consistent with existing pension legislation and the existing voluntary clearance regime. This new wording only requires banks to seek clearance if a change or a series of changes to their pension scheme or the employer group supporting it could be 'materially detrimental' to the scheme and its members. The clearance process was not removed altogether. The clearance process provides an important balance between the needs of trustees and banks and ensures that key information is brought to the attention of TPR. It would be difficult to create an alternative bespoke scheme and such schemes may not work as well as the existing clearance process.

3.6 Responses to the consultation: Some of the trustees suggested that the regulations should provide a greater incentive for banks to obtain clearance.

3.7 Government response: The approach taken provides a balance between fulfilling the needs of trustees for a clear process of disclosure and discussion whilst not being overly burdensome for the banks. Banks that do not obtain clearance could face regulatory action on the part of the PRA and will not have assurance that TPR will not use its anti-avoidance powers. We believe that this provides a sufficient incentive for the banks to try to obtain clearance. Furthermore

mandating banks to obtain clearance would also be at odds with the existing clearance regime which is voluntary.

The requirement to provide information

3.8 Responses to the consultation: Regulation 5 of the draft regulations required that the trustees of the pension scheme must provide information to the members (or survivors) of the scheme about any changes relating to the ring-fencing process. Some respondents suggested that this regulation was unnecessary as trustees are already required to inform members of pension schemes of changes to the scheme. Many other respondents expressed confusion about exactly how this regulation would apply to them and what rights members would have to request information.

3.9 Government response: The government accepted the arguments that this regulation was unnecessary and overly burdensome and following the consultation we removed the information requirements (Regulation 5 of the draft regulations) altogether, on the grounds that trustees are already required to provide such information.

Transitional tax protections for employees

3.10 Responses to the consultation: This issue was not raised in the consultation document. However respondents pointed out that the legislation as drafted is such that individual employees who have transitional tax protections may be disadvantaged by the process of restructuring pension schemes. This could include employees with a protected pension age, protected lump sum rights, or lifetime allowance protection.

3.11 Government response: There is currently large uncertainty over how individuals could be affected and over the commercial choices that the banks will want to make in order to separate pension schemes. Given this uncertainty we are not going to address this issue with a general provision in the regulations now. Furthermore we could not guarantee that we would be able to cover all the eventualities with a general provision at this stage. The government commits to addressing any transitional tax protection issues once we have a greater understanding of the route banks will take to implement the ring fence and the nature of any detrimental impact on individuals as a result of scheme changes.

Shared liability arrangements

3.12 Responses to the consultation: A few respondents suggested that a RFB should be allowed to have shared pension liabilities with supporting service companies. Respondents claimed that the requirement on RFB to use "its best endeavours" to obtain its release from shared liabilities with overseas entities was too strict. It was suggested that a grace period be granted for any unforeseen shared liabilities that come to light and for shared liabilities arising from acquisitions.

3.13 Government response: We believe that it is necessary to minimise risk to the RFB by preventing a RFB having shared pension liabilities with supporting service firms that are outside the ring-fence. Firms could have sizeable shared service companies with tens of thousands of employees, these firms may span international borders, and allowing shared pension liabilities could expose the RFB to significant risks. Each bank has a responsibility to prevent future shared liabilities arising, and granting grace periods or removing the obligation on a RFB to use "its best endeavours" to obtain release from a shared liability arrangement would weaken this responsibility. If a genuinely unforeseen or unavoidable liability arises then the PRA has power not to penalise the banks. In order to protect against these risks no changes were made as a result of stakeholder suggestions to weaken the rules on shared liability arrangements between RFBs and other entities.

The court process

3.14 Responses to the consultation: Regulation 6 of the draft regulations gave banks the power to apply to the court in cases where an agreement about a pension scheme cannot be reached. The court could then order changes to a scheme without consent of the trustees. Some trustees commented that this was too much unnecessary power to the banks or that trustees should be given an equal power.

3.15 Government response: The power granted to banks in Regulation 6 is necessary in order to ensure that a bank can achieve implementation of the ring-fence and avoid 'deadlock' in cases where trustees are acting unreasonably in the eyes of the court.

3.16 Trustees do not need have an obligation on them to ensure implementation of pensions ring-fencing and so it does not appear necessary for them to be able to bring proceedings for a court order for changes.

3.17 Minor changes were made to this draft regulation (now Regulation 5) to clarify that the court can order trustees to take the necessary steps to give effect to the pension scheme modifications which had been the subject of the application to the court.

Trustee powers and responsibilities

3.18 Responses to the consultation: One bank suggested that trustees should have an additional responsibility to support ring-fencing. Some responses from trustees suggested that trustees should have additional legal protections and more powers, such as the power to pass resolutions under section 68 of the Pensions Act (which would enable new circumstances in which trustees could make modifications to pension schemes by resolution).

3.19 Government response: The government believes that these regulations provide sufficient flexibility to enable trustees and banks to agree to implement changes to support ring-fencing (with the ability of banks to ultimately seek judicial sanction where trustees unreasonably refuse) and any further obligations on trustees would be unnecessary, complex and may lead to a confusion of trustees' responsibilities. The government believes that trustees will have sufficient powers in order to implement changes to ensure the successful implementation of the ring-fence and granting additional powers would be unnecessary. Furthermore as these regulations do not require trustees to act in any way but in accordance with their duties to members no additional legal protections for them are required or justified. No changes were made as a result of these suggestions.

Timing issues

3.20 Responses to the consultation: Views on the regulations coming into force in early 2015 were mixed, with support from some respondents and suggestions from others that this date should be delayed. A few of the trustees suggested that the 2026 date for pension separation should be moved earlier.

3.21 Government response: These regulations coming into force as soon as possible will allow banks and trustees to start planning and using the mechanisms available under the regulations. To ensure that the banks and trustees have enough time to work out the optimal solution for separating their pension schemes we will retain the 2026 completion deadline. No changes were made as a result of these suggestions.

Minor changes made to the regulations following consultation

3.22 There were a number of requests for clarification on a range of issues and there were also a number of suggested technical changes to the regulations. Some of these led to changes in and tightening up of the regulations. These include:

- Regulation 1: We replaced the date “1st of January 2015” with “the day after the day on which they are made” to reflect that the regulations will not be in place by 1 January.
- Regulation 2: Previously a RFB could not have shared liability arrangements with its wholly-owned subsidiaries unless it was in a multi-employer pension scheme with the subsidiary. We have now allowed this. We amended Regulation 2(6) (which is Regulation 2(5) in the final regulations) so that it applied to subsidiaries of another RFB in the same group, but not an RFB’s own subsidiaries (deleted: “its wholly-owned subsidiary”).
- Regulation 3: These regulations provide a number of provisions to allow trustees to restructure their pension schemes. We made it clear that provisions in existing scheme rules may be used by trustees as well as the provisions provided here.
- Regulation 9: A transitional provision was inserted in the regulations to enable banks to start using these regulations in advance of the ring-fencing obligations coming into force in 2019.

3.23 Other minor technical changes have also been made to the regulations following additional legal scrutiny within government and following the Pensions Working Group meetings.

3.24 Some other suggestions for clarifications or minor changes did not result in changes to the legislation. We have addressed and will continue to address issues raised by key stakeholders through the Pensions Working Group.

4 Conclusion

4.1 In light of the consultation responses, the government made 2 substantial changes to these regulations in order to limit the burden on the banks and regulators. We added in a materiality threshold for clearance and removed the reporting requirements on trustees. The government also made a number of technical changes to the legislation to ensure that these regulations are clear and achieve their purpose.

4.2 The government also commits to addressing the transitional tax protection issues raised in responses to the consultation, as they become better understood.

4.3 The government will continue to hold a working group with industry to address any future issues, to provide clarity in any remaining areas of uncertainty and to work towards the successful implementation of these regulations.

4.4 The final version of these regulations was laid in Parliament for debate on 21 January 2015. This version has been published online, alongside an explanatory memorandum and an updated impact assessment, and can be found at:

<http://www.legislation.gov.uk/ukdsi/2015/9780111127667/contents>

A List of respondents

A.1 Responses to this consultation were received from the following:

Barclays Bank Plc

HSBC Holdings Plc

Lloyds Banking Group Plc

Santander UK Plc

Barclays Pension Fund Trustees Limited

The Royal Bank of Scotland Group Pension Fund

A forum comprising the chairs of trustee boards of pension schemes of the largest UK banks, including:

- The Barclays Bank UK Retirement Fund
- HBOS Final Salary Pension Scheme
- HSBC Bank (UK) Pension Scheme
- Lloyds TSB No.1 Scheme and Lloyds TSB No. 2 Scheme
- Nationwide Pension Scheme
- Royal Bank of Scotland Group Pension Fund
- Santander (UK) Group Pension Scheme

Association of Pension Lawyers

PricewaterhouseCoopers LLP (PwC)

The Society of Pension Professionals

HM Treasury contacts

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If you require this information in an alternative
format or have general enquiries about
HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gsi.gov.uk