Regulatory intervention report

Issued under s89 of the Pensions Act 2004 in relation to the Martin Currie Retirement and Death Benefits Plan

September 2018

The Pensions Regulator

The Pensions Regulator has granted clearance for an agreement reached with Martin Currie Investment Management Limited (MCIM) in relation to the Martin Currie Retirement and Death Benefits Plan. This report sets out the background to our interventions, the matters that drew our attention, and the outcome.

Background

Martin Currie Investment Management Limited (MCIM) is a UK-based fund manager. The pension scheme in question was the Martin Currie Retirement and Death Benefits Plan (the scheme).

On 1 January 2014, Capital Requirement Directive IV (CRDIV) came into effect for regulated financial businesses. This included banks, building societies and investment firms and set out a more stringent, prudential framework for capital reserving. In practical terms, the updated requirements mean financial institutions have to reserve for the full accounting deficit for any defined benefit (DB) pension schemes they support. Previously, only five years' worth of deficit repair contributions needed to be taken into account.

In the case of MCIM, reserving for the full accounting deficit would have placed them in temporary breach of Pillar 2 guidance (guidance which provides an indication to financial institutions as to adequate levels of capital to retain to serve as a buffer in distressed scenarios), a situation which, if unaddressed, may have led to a formal resolution process being initiated by the Financial Conduct Authority (FCA).

Action MCIM took: Flexible apportionment arrangement

MCIM asked the scheme's trustees to enter into a flexible apportionment arrangement (FAA) so the scheme could be transferred to another employer. The replacement employer was Martin Currie Holdings Limited (MCHL) - the ultimate parent company for the Martin Currie group under which all subsidiaries are aggregated and which is a non-trading holding company, based off-shore in Bermuda.

MCHL was not subject to the same financial regulations as MCIM (and other UK based companies in the Martin Currie Group), including the CRDIV capital requirements.

Flexible apportionment arrangements (FAAs)

A FAA is a mechanism that allows an employer to depart from a scheme, effectively removing its funding obligations, without a 'section 75 debt' becoming due, either partly or in its entirety.

A section 75 debt is the amount of money estimated by the scheme actuary to be required to secure the scheme's liabilities by purchasing life assurance annuities for each scheme member to pay their benefits in full.

As a result of an FAA, a replacement employer(s) will take over responsibility for all of the departing employer's liabilities.

Before an FAA can go ahead, there are a number of specific criteria and tests which must be met some of which the trustees must be satisfied with. Trustees should seek independent advice before confirming their agreement and they must fully consider their duties.[1]

An FAA is a 'notifiable event', which means it has to be reported to us. While the notification should confirm that the necessary tests have been met, we will also make our own enquiries if we have any questions or concerns.

While the FAA was being considered by the trustees and employer, a third party, Legg Mason Inc (LM), a US-based fund manager, entered into discussions to acquire the Martin Currie Group.

This acquisition went on to complete in October 2014 following the FAA. The trustees and Martin Currie took legal and covenant advice, including the extent to which the off-shoring might adversely affect the security of member benefits.

1
https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/multi-employer-schemes-and-employer-departures

In return for agreeing to the FAA, the trustees accepted, among other things, the following mitigation package:

- MCHL (the non-trading Bermuda based ultimate group parent) became the statutory employer.
- A guarantee from MCIM: up to the value of £26m, or 110% of the scheme's PPF liabilities (whichever was less).
- The scheme was made party to an 'earn out' provision in the LM purchase agreement, which has the potential to provide significant additional funding to the scheme, based on the future performance of the business. In essence, a proportion of the deferred consideration from that sale may be payable to the trustees, capped at the technical provisions deficit of the scheme as at 1 April 2018. This would be reliant on the value of the business increasing between 2016 and 2018, driven by significant EBITDA growth.

Our concerns

We had no immediate concerns regarding the overall funding position of the scheme, but the FAA and mitigation accepted by the trustees presented us with other concerns, which included the following:

- Replacing the employer with a non-UK registered company raised issues of 'material detriment'. The material detriment test is met when we are of the view that an act, or failure to act, impacts on the likelihood of members receiving their benefits. A relevant example of a scenario from our material detriment code of practice states:

> "The circumstances in which the regulator expects to issue a contribution notice as a result of being of the opinion that the material detriment test is met are... [the] transfer of the sponsoring employer out of the jurisdiction or the replacement of the sponsoring employer with an entity that does not fall within the jurisdiction".[2]

- The level of protection provided by the guarantee was inadequate compared to the scheme's previous position. The scheme previously had a full, uncapped 'section 75 debt' claim against the trading company MCIM.
- Future payments to the scheme from the earn out provision were contingent on events outside the trustees' control and relied upon improved business performance, which could not be guaranteed.
- Although we had no immediate concerns about the solvency of the Martin Currie Group, we had significant doubts about whether the offshore MCHL would be recognised by the Pension Protection Fund (PPF) in the event of an insolvency. The scheme's future eligibility for the PPF was, therefore, in doubt as there was no guarantee that an application to the courts could ensure that a future insolvency would be recognised.

We took the view that the events appeared to be 'materially detrimental' to the scheme, and we were not convinced the mitigation package was sufficient to offset this detriment.

2
http://www.thepensionsregulator.gov.uk/codes/code-material-detriment-test.aspx

Our investigation

After we received the FAA notifiable event, we requested further information to clarify our understanding on a number of specific points, including the trustees' view of the FAA and the advice they had sought.

This initial information gathering was done via an informal request to the trustees. However, when we received the information we had asked for, we thought the circumstances warranted further scrutiny and we decided to open an investigation. We wanted to find out whether or not the FAA was materially detrimental, whether it was adequately mitigated and whether the relevant tests had been met for us to use our anti-avoidance powers – specifically our contribution notice (CN) power.

Anti-avoidance powers

We have power under the Pensions Act 2004 to issue a CN under sections 38 and 47 and/or a financial support direction (FSD) under section 43, which are often referred to as our 'anti-avoidance' or 'moral hazard' powers.[3]

Contribution notice (CN)

A CN requires a cash payment to be made to a scheme (or, in some circumstances, to the PPF by the respondent(s), which might be the scheme's sponsoring employer or a person(s) connected to or associated with the employer (including individuals)).

We can start our Warning Notice procedure seeking a CN up to six years after the act in question took place.

A CN may also be issued under section 47 of the Pensions Act 2004 following non-compliance with an FSD.

3
http://www.thepensionsregulator.gov.uk/guidance/guidance-clearance.aspx

As part of our investigation, we began by requesting additional information under our 'Section 72 information-gathering power' notices from the trustees and MCIM.

Section 72 information-gathering power

Section 72 of the Pensions Act 2004 gives us a wide-reaching power to require recipients of a section 72 notice to provide us with information and documents relevant to the exercise of our functions.

A request can be issued to anyone who appears to us to be in possession or control of any such information/documents. Failure to comply with a section 72 request is a criminal offence.

Once we had completed our review of this information, we reached the view that the FAA was materially detrimental and communicated this to the trustees and Martin Currie Group. We then met with the trustees and Martin Currie Group to explain why we reached this view and that in the absence of any action taken to address our concerns, we would be looking to exercise our CN power.

The agreement

While the Martin Currie Group did not accept our view of material detriment, we were nonetheless encouraged that they were willing to work with us to try and resolve our concerns.

Working closely with the trustees and the Martin Currie Group (while our investigation continued), we were able to accept a package of support which addressed the material detriment we had identified, as well as preserving some of the positive features of the first FAA.

This was implemented by a second FAA. Unusually – but appropriately given our investigation and the steps being taken to address our concerns – the employer submitted a clearance application in respect of this second FAA in 2017. The package proposed was acceptable to us as sufficient mitigation for the material detriment identified and clearance was granted.

The employer covered all costs incurred by the scheme when considering and executing the mitigation package.

The following table summarises the risks we identified at the start of our interventions and the comparative outcome as a result of the second FAA.

Risks and scheme position in 2014 and 2017

Risk	Position post-2014 FAA	Position post-2017 FAA	Outcome
Material detriment – PPF eligibility	PPF eligibility was potentially jeopardised as a result of the scheme being moved outside of the jurisdiction.	Scheme moved back into the UK.	Improved the confidence of the scheme's PPF eligibility.
Material detriment – employer covenant	In our view, the employer covenant was impacted by the employer being replaced by a holding company outside of the UK jurisdiction Protections were put in place in response to the replacement. ▶ MCHL was responsible for the scheme's s75 debt as a result of becoming the statutory employer. ▶ Scheme guarantees were capped at £26m. Previously, the claim on insolvency versus the operating business was uncapped. ▶ The scheme was to benefit from the earn out provision within the sales agreement with LM, contingent on future business performance.	The protections have been enhanced, and include the following: ▶ A s75 guarantee from MCHL. ▶ An additional guarantee from the wider group for 110% of the PPF benefits (not capped). ▶ Other restrictions are put in place to protect the position of the trustees and the scheme. ▶ The earn out payment is retained.	Enhanced employer covenant protections for the scheme.
Scheme governance - conflict and decision making	The actions and decisions taken by some members of the trustee board in 2014 called their independence and impartiality into question. This conflict overshadowed the decision to move the scheme outside of jurisdiction and whether it was in the best interests of scheme members.	A new independent trustee was appointed in October 2017 All members of the trustee board involved in the decisions taken in 2014 have stepped down.	Tighter scheme governance. Issues associated with the conflicted trustees are addressed by a refreshed trustee board.

Governance

Our investigation into the 2014 FAA revealed significant concerns about the conduct of the trustees. A number of trustee board members had personal conflicts (they were shareholders in the Martin Currie Group and there could have been a perception that they had an interest in pushing through the mitigation package to clear the way for the LM sale). The conflicts were pervasive and not properly addressed as these trustees continued to be involved in the decision on the mitigation package.

As part of the overall agreement, we insisted that a new independent professional trustee be appointed, and this appointment occurred in October 2017. We also required all those conflicted trustees involved in the 2014 FAA agreement to step down from the board and they provided undertakings to refrain from taking on other occupational pension scheme trusteeships.

Our decision

Our concerns stemmed from the off-shoring of the scheme's employer back in 2014 and the inadequacy of the initial mitigation package put in place.

We reached the view that the new mitigation package was sufficient to address our concerns, including the impact of the original off-shoring being reversed by a second FAA. The scheme's financial position was also improved by the additional protections provided and guarantees put in place. The trustees took appropriate advice in relation to the second FAA to check whether the transaction documentation and associated guarantees would work as intended.

Following our assessment of the mitigation package and improvements captured in the second FAA, we decided not to use our CN power in respect of the first FAA. We therefore closed our investigation and granted clearance in respect of the second FAA.

Our approach

Lessons learned:

We were encouraged by the employer's positive efforts in seeking to resolve our concerns and believe the outcome demonstrates the benefits of working collaboratively with us. Had our views been sought from the outset, the employer may have avoided incurring time and financial costs further down the line.

It also highlights that even where employers and trustees reach an agreement, we may still intervene where we have concerns. In most instances, as in this case, it is most likely the employer who will have to deal with the consequences of poor trustee decisions and incur the costs associated with rectifying them. We would therefore encourage companies and trustees to engage with us when there is the potential for any commercial activity to have a materially detrimental impact on the position of the scheme.

Where we see signs of avoidance activity, we will investigate further to ensure members are protected. We are prepared to test our powers and take on difficult cases where we believe this furthers our statutory objectives. In this case, our view throughout the investigation was that moving the scheme's employer outside of UK jurisdiction was materially detrimental.

When the behaviours demonstrated by the trustees are considered to be poor, we will consider whether they are fit to remain in post. If we believe they should not retain this role, we may request that they step down. We have the power to remove trustees[4] or appoint other trustees[5] if we consider this appropriate. Trustees must be able to manage their own personal conflicts (including perceived conflicts), regardless of whether or not they believe they do not influence their trustee decisions. Where the conflict is so acute or pervasive in nature, trustees must be prepared to resign or appoint an independent trustee to manage that conflict[6].

Our door is always open to reasonable offers that represent a genuine alternative to the use of our anti-avoidance powers. We will not suspend or cease our investigations while considering mitigation offers. Our principal consideration is not simply the financial sum involved but whether the overall proposal will secure good outcomes for members of pension schemes and the PPF.

4
Under sections 3 and 4 of the Pensions Act 1995.

5
Under section 7(3) of the Pensions Act 1995.

6
See conflict of interest guidance:
http://www.thepensionsregulator.gov.uk/guidance/guidance-conflicts-of-interest.aspx#s1900

Timeline

January 2014: CRDIV funding requirements introduced

September 2014: First FAA effective

October 2014: Notifiable event form submitted to TPR

February 2015: Investigation opened

May 2015: S72 notice issued

July 2015: S72 responses received

August 2015 - December 2015: Internal review

January 2016: TPR case team initial view taken

April 2016: Discussions commenced with Martin Currie and trustees

September 2016: TPR view communicated to Martin Currie

September 2016 - November 2016: Negotiations

December 2016: Mitigation proposal

January 2017 - July 2017: Further negotiations regarding mitigation proposals (both with TPR and separately between the trustee and Martin Currie)

May 2017 - July 2017: Discussions on trustee conduct

August 2017: Clearance granted

August 2017: Implementation of the agreement

The regulator's consideration and approach to individual cases is informed by the specific circumstances presented by a case, not all of which are referred to or set out in this summary report.

This summary report must be read in conjunction with the relevant legislation. It does not provide a definitive interpretation of the law. The exercise of the regulator's powers in any particular case will depend upon the relevant facts and the outcome set out in this report may not be appropriate in other cases. This statement should not be read as limiting the regulator's discretion in any particular case to take such action as is appropriate. Employers and other parties should, where appropriate, seek legal advice on the facts of their particular case.

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