October 2024

Guidance:
PPF's Power to Modify Contracts

Guidance on the Board of the Pension Protection Fund's power to modify relevant contracts under Regulation 2 of the Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006

1. Introduction

1.1. The Pension Protection Fund ("**Fund**") was established to pay compensation to members of eligible defined benefit pension schemes when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover Pension Protection Fund levels of compensation.

1.2. The Fund is a statutory fund run by the Board of the Pension Protection Fund (the "**PPF**"), a statutory corporation established under the provisions of the Pensions Act 2004 (the "**Act**"). The PPF became operational on 6 April 2005.

2. Transfer of Contracts to the Pension Protection Fund

2.1. If the statutory requirements are met for the PPF to assume responsibility for a scheme, then the property, rights and liabilities of the scheme are automatically transferred to the PPF under Section 161 of, and Schedule 6 to, the Act. These rights and liabilities include contracts entered into by the scheme trustees or managers in relation to the scheme.

2.2. Regulation 2 of the *Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006* permits the PPF to modify contracts so transferred in two circumstances:

(a) Where the contract contains a term or condition that the PPF considers to be onerous, the PPF may disapply such term or condition, or substitute a term or condition that the PPF considers to be reasonable (Regulation 2(1)).

(b) Where the contract is a "relevant contract of insurance" (e.g. an annuity taken out by the trustees in respect of a member), the PPF may amend that contract so that benefits are paid to the PPF instead of the member (Regulation 2(2)). This is because in such circumstances the PPF will pay to the member PPF-level compensation as set out in the Act, which may differ from the amounts payable under the annuity.

2.3. Regulation 2 is set out in full in Appendix 2 (*The Legislation*) to this document. The remainder of this guidance relates to the PPF's powers under regulation 2(1) to vary onerous contract terms.

3. The PPF's approach to contracts entered into by trustees

3.1. The PPF already works closely with the trustees of schemes in assessment periods and reviews the contracts that they have in place to see how they should be dealt with when a scheme transfers to the Fund.

3.2. Trustees will enter into many different contracts over the lifetime of a scheme. Some contracts will operate on a time cost basis and may not need formal termination when the transfer to the PPF occurs under section 161 (e.g. solicitors' retainers). Others may require notice to be given in advance of the transfer notice (e.g. administration agreements).

3.3. The PPF's preferred approach is to terminate contracts in accordance with their terms or for the trustees to negotiate a mutually agreed variation with the counterparty to allow for termination.

4. Guidance on onerous contracts

4.1. To date, the PPF has not identified any term that it would wish to disapply or vary under Regulation 2(1). Accordingly, this guidance can only set out the broad principles which the PPF would expect to apply in determining whether and how to exercise its discretion under Regulation 2(1). However, the PPF cannot fetter or restrict its statutory powers and the PPF reserves the right to exercise its rights under regulation 2(1) as it sees fit in accordance with the regulation and the PPF's objectives.

4.2. The word "onerous" is not defined in the regulation and would ultimately have to be decided by the courts as a matter of statutory interpretation. However, the dictionary definition of "onerous"[1] – "*unreasonably burdensome, involving obligations which outweigh the possible benefits*" – indicates that it is a stringent requirement to satisfy. The PPF also recognises the importance of commercial certainty in contracts entered into by trustees and that it would not be in the interests of the PPF, trustees or the pensions industry for the power to vary or disapply contractual terms to be used, or indeed be available, widely.

4.3. The PPF has also considered analogous powers to amend contracts under other Acts.[2] Although these comparisons have proved useful for the PPF, the powers under regulation 2(1) must be considered against the purposes for which they were given which we consider to be:

(a) to enable the PPF to absorb all the rights and liabilities of a scheme into the Fund expeditiously, and

(b) to protect the financial interests of the Fund (and accordingly the levy payers).

4.4. Having considered the purposes and scope of the power, the PPF considers it would not ordinarily seek to disapply or substitute terms in contracts that have been negotiated at arms' length by trustees in the ordinary course of their trustee business, even if it is felt that the trustees negotiated a poor deal. The PPF has decided that the test it will apply in exercising its powers under regulation 2(1) is to disapply or vary contractual terms which are substantially unfair or manifestly prejudicial to those purposes.

4.5. As mentioned above, the PPF has yet to encounter an onerous term, but we believe the following have the potential to be onerous and we review such terms and contracts closely as part of the assessment process:

(a) contracts entered into with persons connected to or associated with the trustees;

[1] Oxford English Dictionary
[2] The liquidator's powers to disclaim onerous property (section 178 *Insolvency Act 1986*) and the liquidator's/ administrator's powers to unwind transactions at an undervalue (section 238) and extortionate credit transactions (section 244) and the *Unfair Contract Terms Act 1977*.

(b) contracts entered into with persons connected to or associated with the trustees;

(c) terms that provide for a specified outcome if a transfer to the PPF under section 161 occurs or becomes likely – for example, a financial charge on transfer;

(d) terms triggered by insolvency events in relation to a sponsoring employer or any term expressly triggered by an event under Part 2 of the 2004 Act (such as a scheme rescue, the issue of a notice under section 160 of the Act or a transfer under section 161);

(e) terms restricting the liability of a third party to the trustees. The PPF would consider using its powers to modify such terms to comply with the *Unfair Contract Terms Act 1977*;

(f) termination provisions. In particular any terms imposing a penalty on cancellation or termination or a long notice period or the absence of any termination provisions.

4.6. We would also expect trustees and managers to consider such terms carefully in any event when entering into contracts, taking legal advice as appropriate.

5. ISDA Agreements

5.1. A number of counterparties to ISDA Agreements with pension schemes raised concerns about the possibility of the PPF using its powers under section 161 of the Act to disclaim contracts of that nature. This led to some counterparties to ISDA Agreements with trustees or managers inserting an "Additional Termination Event" in the termination clauses of their ISDA Agreements, providing that the transfer of a scheme to the PPF will be a termination event which (if triggered) would lead to termination of all derivative transactions under the ISDA Agreement.[3]

5.2. Derivative contracts play an important role for trustees and managers – and also for the PPF – in contributing to the reduction of risks and facilitating efficient portfolio management. A premature termination of transactions by including such Additional Termination Events is generally not in the trustees' or the managers' interests and may lead to the crystallisation of liabilities and the benefit of those derivative contracts being lost. To prevent situations where derivative transactions would be unnecessarily terminated upon a transfer to the PPF, the PPF recommends the use of standard drafting for a PPF-specific Additional Termination Event, which we believe represents a fair balance between the interests of the PPF and financial counterparties to relevant ISDA Agreements.

[3] It should be noted that a power to terminate or modify any contract in consequence of the transfer to the PPF would be void by virtue of paragraph 5 of Schedule 6 to the Act.

5.3. Our recommended provision to include in an ISDA Agreement in this scenario (with the relevant scheme as Party A and the relevant counterparty as Party B) is as follows:

"It shall be an Additional Termination Event (and Party A shall be the Affected Party and all transactions shall be Affected Transactions) when:

(a) the Board of the Pension Protection Fund ("PPF") determines: (i) under section 143 of the Pensions Act 2004 (the "Act") that Party A's protected liabilities (within the meaning of section 131 of the Act) exceed its assets; or (ii) approves under section 144 of the Act a valuation under section 143 of the Act which verifies that Party A's protected liabilities exceed its assets;

(b) the PPF determines under section 152(2) of the Act that it must accept responsibility for Party A; or

(c) the PPF approves under section 158(3) of the Act an actuarial valuation which verifies that Party A's protected liabilities exceed its assets;

provided that in each case there shall be no Additional Termination Event if the PPF prior to termination by Party B has executed and issued an irrevocable deed to Party B that it will not, following the issue of a transfer notice pursuant to section 160 of the Act, use its powers under section 161 of the Act (or any regulations made thereunder) to disapply or amend any terms or conditions of this Agreement or terminate this Agreement (unless such disapplication, amendment or termination is permitted under the express terms of the Agreement)."

5.4. The PPF has entered into irrevocable deeds (as further outlined below in paragraph 5.6) based on this or similar wording on a number of occasions since we first recommended the use of the standard Additional Termination Event following a 2009 consultation and the PPF continues to strongly encourage trustees and managers to adopt this wording in ISDA Agreements which they enter into or which are entered into on their behalf by their fund managers.

5.5. If the PPF states that it "will not" use its powers under section 161 it will issue its deed regarding the ISDA Agreement before making its determination under section 143 or before the 'section 143 valuation' is approved by the PPF under section 144, as applicable, in which case an Additional Termination Event will not arise. However, if the PPF states that it is minded to use its powers under section 161, then an Additional Termination Event would occur and may be exercised by the counterparty at any time. In practice this will mean that the counterparty to the scheme under the ISDA Agreement (i.e., Party B) will have at least two months in which to decide whether to trigger the Additional Termination Event and terminate derivative transactions under the ISDA Agreement before the transfer notice is issued (at which point the power to vary the contract arises) because:

(a) when a determination is made under section 143 or a valuation made under section 143 is approved under section 144, the Trustees or Managers have 28 days in which to issue a summary to the members;[4]

(b) an application for a review of the determination or valuation may be made within two months of the trustees or managers providing such a summary.[5] Following a review there may be a further reconsideration, reference to the PPF Ombudsman and an appeal against such a determination;

(c) it is only when the time limit for that review expires (or any review, reconsideration, reference to the PPF Ombudsman and appeal is finally disposed of) that the valuation becomes binding;[6]

(d) it is only when the valuation becomes binding that a transfer notice may be issued.[7]

5.6. The PPF's confirmation is given in the form of an irrevocable deed to provide counterparties to ISDA Agreements with greater certainty. A draft of this irrevocable deed is included in Appendix 1 to this guidance. This deed will be executed on the basis that the PPF has been provided with all material terms and conditions of the ISDA Agreement by the trustees (including but not limited to the ISDA Master Agreement and any Schedule thereto, any Credit Support Annex and any other Credit Support Document and any confirmation for any transaction made thereunder). In the event that the PPF has not been provided with all such terms and conditions then the PPF reserves the right to exercise it powers under regulation 2(1) of the Regulations.

5.7. If appropriate, similar wording may be included in other forms of contract. However, the wording is unlikely to be appropriate for all forms of contract that trustees and managers may enter into. For example, it is unlikely that this wording would be appropriate or necessary in a contract for provision of actuarial services to the scheme because these contracts are usually on a time/cost basis. Following transfer there would be no further instructions and no need to formally terminate the contract. Any concern is generally only likely to arise in relation to clauses limiting liability. Additionally, we would not expect this wording to be necessary in the context of, for example, administration agreements as, whilst these are generally terminated on notice, the assessment period usually provides sufficient time to give notice in advance.

6. Administrative law and Human Rights

6.1. As a statutory corporation, the PPF is also subject to the principles of administrative law and the *Human Rights Act 1998* when exercising its powers under regulation 2(1).

6.2. The PPF is aware that a statement that it regards any particular terms as not onerous may give rise to legitimate expectations. Article 1 Protocol 1 to the *European Convention on*

[4] *Pension Protection Fund (Provision of Information) Regulations 2005*, regulation 4 and schedule 2.
[5] Section 207 *Pensions Act 2004*; *The Pension Protection Fund (Review and Reconsideration of Reviewable Matters) Regulations 2005*, regulation 3(1)(a).
[6] Section 145 *Pensions Act 2004*.
[7] Section 160(3) *Pensions Act 2004*.

Human Rights protects the right to property, which includes contractual rights. The PPF is aware that in the application of its power under regulation 2(1) it must strike a balance between the purposes of the PPF and the rights of the party to the contract in order to comply with Article 1 Protocol 1.

6.3. For example, in considering the power under regulation 2(1), the PPF has considered the power of a liquidator to disclaim onerous property. A liquidator may disclaim a long-lease which would otherwise prevent a liquidation being completed, but the landlord would still be a creditor in the liquidation for damages for loss of rental income.[8] The PPF would expect to adopt a similar approach if amending the termination provisions of a contract.

7. Procedure

7.1. The PPF's standard procedure is to review during the assessment period any contracts that are expected to remain in place and transfer with the relevant scheme.

7.2. If the PPF finds an onerous term or contract it will notify the counterparty and trustee explaining why it considers the term or contract to be onerous.

7.3. The PPF can only exercise this power following the issue of the transfer notice. Following the issue of the transfer notice the PPF reserves the right to exercise the power without any warning where there is an immediate risk that its interests would be significantly harmed. The PPF also reserves the right to exercise this power at any time and will not limit the exercise of this power to at or shortly after the transfer of the contract to the PPF under section 161.

7.4. Where a contract contains a termination event in a form materially similar to the wording set out in paragraph 5.2 of this guidance, the PPF will execute and issue to the counterparty a deed in the form annexed to this guidance. There will be no Additional Termination Event where the deed has been executed prior to termination by the counterparty.

8. Contact details

8.1. For general information on this or any other matter relating to the Pension Protection Fund, please contact us on 0345 600 2541 or at information@ppf.co.uk.

[8] Section 178(6) *Insolvency Act 1986*.

Appendix 1: Deed

THIS DEED is made by **THE BOARD OF THE PENSION PROTECTION FUND** on [*insert date*].

RECITALS:

(A) *The Board of the Pension Protection Fund* (the "**PPF**") was established under the *Pensions Act 2004* ("the **Act**") to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to provide the levels of compensation as set out in the Act. Where the requirements under the Act for the PPF to assume responsibility for a scheme are met, then all the property, rights and liabilities of the scheme (including any contracts entered into by the trustees in relation to the pension scheme) are automatically transferred to the PPF under section 161 and Schedule 6 to the Act.

(B) The **[*Name of Pension Scheme*]** (the "**Scheme**") commenced an assessment period (as defined in section 132 of the Act on **[*Insert date of commencement of assessment period*]**.

(C) The trustee[s] of the Scheme are parties to an [ISDA Master Agreement][9] with [Name of counterparty as stated on ISDA Agreement] dated [] ("the Agreement").

(D) Under regulation 2(1) of the *Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006* (the "**Regulations**"), where section 161(1) of the Act applies and the PPF considers that a contract relating to the property, rights and liabilities of the scheme contain terms or conditions that the PPF considers to be onerous, the PPF may disapply any such term or condition or substitute for the term or condition a term or condition that the PPF considers to be reasonable.

(E) Following review of the Agreement as supplied by the Trustees, the PPF has not identified any term of the agreement that it would wish to disapply or vary under regulation 2(1) of the Regulations and wishes to enter into this Deed to declare that it will not exercise such powers.

OPERATIVE PART:

1. Subject to clause 2, the PPF irrevocably undertakes that, should it assume responsibility for the Scheme following the issue of a transfer notice under section 160 of the Act), the PPF will not exercise its powers under regulation 2(1) of the Regulations[10] to disapply any term or condition of the Agreement or substitute a new term or condition for any term or condition of the Agreement.

2. This Deed is executed on the basis that the PPF has been provided with all material terms and conditions of the Agreement by the Trustees (including but not limited to the Master

[9] The same type of termination events, and therefore a need for a confirmation by the Board that it will not exercise its powers, could be applied in a longevity contract issued by an insurance company. See also footnote 2.
[10] Regulation 2(2) contains a power to alter the payee of a relevant contract of Insurance and this power would need to be retained.

Agreement and any Schedule thereto, Credit Support Annex and any other Credit Support Document thereto, and any confirmation for any transaction made thereunder). In the event that the PPF has not been provided with all such terms and conditions then the PPF reserves the right to exercise it powers under regulation 2(1) of the Regulations.

3. Any capitalised terms used in this notice and not otherwise defined shall have the meanings specified in the Agreement.

Executed as a Deed and Delivered on the date first set out above.

The Common Seal of	)
THE BOARD OF THE	)
PENSION PROTECTION FUND	)
was hereunto affixed	)
and authenticated by:	)

....
Authorised Signatory

Name: ....

Title: ....

Appendix 2: The Legislation

Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 (2006 No. 580)

Board's power to modify relevant contracts

2. –

(1) Where section 161(1) of the Act (effect of the Board assuming responsibility for a scheme) applies, and the Board considers that a contract relating to the property, rights or liabilities of the scheme contains terms or conditions that the Board considers to be onerous (whether triggered by the insolvency event in relation to the eligible scheme or otherwise) the Board may –

(a) disapply such term or condition; or

(b) substitute for the term or condition, a term or condition that the Board considers to be reasonable.

(2) Where –

(a) any rights or liabilities under a relevant contract of insurance are transferred to the Board by virtue of section 161(2)(a) of the Act; and

(b) as a result of that transfer, the Board is required, by reason of a term of that contract, to pay a specified amount, or specified amounts to a specified person who, immediately before the time mentioned in section 161(2)(a) of the Act, was a member of the scheme or a person entitled to benefits in respect of such a member,

the Board may modify that term of that contract so that benefit under that contract shall be payable to the Board.