Pension Schemes Act 2021

New criminal offences and Pensions Regulator powers

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insolvency lawyers' association

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Highlights of the new regime

Increased risks where corporate activity involves a group with a UK defined benefit pension scheme

Wide new criminal offences

Widened potential for civil liability

New procedural requirements

- Corporates, directors, lenders, commercial counterparties and advisors all in scope
- Unlimited fines/7 years in prison for criminal offence
- Associated £1m civil penalties
- Additional widened ability for the UK Pensions Regulator (TPR) to make connected third parties liable for pensions deficits
- Came into force on 1 October 2021

- Mandatory advance notifications to the UK Pensions Regulator
- Mandatory accompanying impact statements
- Impact on deal timing: procedural steps needed in advance of signing
- £1m civil penalties for failure to comply
- Expected to come into force in October 2022

Wide range of restructuring activity impacted including:

- **Decisions to continue trading (or to file)**
- **Bridge and other financing**
- **Granting security**
- **Asset/business sales**
- **Lender actions**
- **Loan to own/sale of debt**
- **Compromising pension liabilities**

Consideration of pensions at an early stage is vital to ensure compliance and mitigate risk

Agenda

Drivers for change

Previous regime

New regime: Pension Schemes Act 2021

Future developments and managing risk

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Drivers for change

Drivers for change

High profile insolvencies

BHS

carillion

Select Committee investigations

Pensions Regulator

'failed in all its objectives'

'feeble and timid'

'reactive and slow-moving'

Trustees

'outgunned in negotiations'

'largely powerless'

Directors

'scant regard for…the impact on… pensioners'

'aversion to pension scheme deficit repair funding'

funding the pension schemes considered a 'waste of money'

Focus on Pensions Regulator’s powers

Apr 2016	BHS files for administration
Jul 2016	Select Committee report on BHS
Dec 2016	Select Committee report on DB schemes
Feb 2017	Pensions Green Paper
Jan 2018	Carillion liquidation
Mar 2018	Pensions White Paper
May 2018	Select Committee report on Carillion
Jun 2018	Protecting Defined Benefit Schemes – a stronger Pensions Regulator Consultation
Feb 2019	Response to a stronger Pensions Regulator Consultation
Oct 2019	Pension Schemes Bill first introduced to Parliament
Jan 2020	Pension Schemes Bill re-introduced to Parliament
May 2020	Corporate Insolvency and Governance Bill introduced to Parliament
June 2020	Corporate Insolvency and Governance Act receives Royal Assent
Nov 2020	Pension Schemes Bill leaves the House of Commons
Jan 2021	Pension Schemes Bill returns to Lords and Minister announces proposed timing
Feb 2021	Pension Schemes Act receives Royal Assent
Oct 2021	Pension Schemes Act 2021 came into force*

* New procedural requirements expected to come into force in October 2022

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Previous regime

Pensions Regulator powers: the pre-(and post) 1 October 2021 regime*

UK defined benefit pension schemes

Scheme funding

Trustee/company jointly agree
-
Powers under trust can give additional leverage
-
Pensions Regulator can intervene

Notification of certain corporate events

Limited specified events
-
No prior notification
-
Limited penalties

Moral hazard powers

Contribution notices
-
Financial support directions

* Notification requirements still in force. New requirements expected to come into force in October 2022

Civil ‘moral hazard’ powers: pre-(and post) 1 October 2021

Contribution notices

Act/failure to act

–

‘Connected’ or ‘associated’ person

–

Either: main purpose was to avoid pension liability

–

Or: materially detrimentally affected security of scheme benefits

–

Statutory defence to material detriment test

Reasonableness

Clearance

Financial support directions

No ‘fault’

–

‘Connected’ or ‘associated’ person

–

Either: ‘insufficiently resourced’ employer

–

Or: employer is ‘service company’

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Pension Schemes Act 2021

New criminal offences: from 1 October 2021

Offences with the penalty of imprisonment

Avoidance of employer debt

- Any person
- Act or course of conduct (or failure to act)
- Intended to prevent recovery of employer debt
- Intended to compromise or settle employer debt
- No 'reasonable excuse'
- Limited exemption for IPs

Criminal penalty (both offences):
unlimited fine
imprisonment for up to 7 years

Risking accrued scheme benefits

- Any person
- Act or course of conduct (or failure to act)
- Material detriment to security of scheme benefits
- Knew or ought to have known
- No 'reasonable excuse'
- Limited exemption for IPs

Separate civil penalty regime (both offences):
fine of up to £1m
TPR view of 'reasonableness'

Criminal offences: TPR policy

Targeting 'more serious or reckless conduct', not commercial norms

Material detriment

- Targeting same actions as current contribution notice 'material detriment' test
- Knowledge not assessed with benefit of hindsight
- Unlikely to prosecute where contribution notice statutory defence established
- Limited comfort given on impact of contribution notice clearance
- Helpful comfort given on 'avoidance of employer debt' offence where statutory s75 debt mechanisms used

Reasonable excuse

- **Was detrimental impact incidental or part of the purpose?**
- **Was detriment adequately mitigated?**
- **If not, was there a viable alternative?**
- Was there consultation with trustees/TPR?
- Has scheme been treated fairly compared with other parties?
- Professional advisors acting in accordance with their duties will usually have reasonable excuse

Clear evidence in contemporaneous records will be crucial

Civil 'moral hazard' powers: the pre-(and post) 1 October 2021 regime

Contribution notices

Act/failure to act

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'Connected' or 'associated' person

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Statutory defence to material detriment test

Reasonableness

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Clearance

Financial support directions

No 'fault'

–

'Connected' or 'associated' person

–

Either: 'insufficiently resourced' employer

–

Or: employer is 'service company'

Widened 'moral hazard' regime (post 1 October 2021)

Two additional grounds for contribution notices:

'Employer insolvency' test – s.38C PA04

Statutory defence

Reasonableness

'Employer resources' test – s.38E PA04

Where the Pensions Regulator is of the opinion that an act or failure to act materially reduced the debt likely to be recovered from the employer in the event of an immediate insolvency

Where the Pensions Regulator is of the opinion that an act or failure to act reduced the resources of the employer in a manner which was material when compared to the buy-out deficit of the pension scheme

New penalties for failing to comply with a contribution notice: criminal fine and civil penalty up to £1m

Mandatory procedural requirements (not yet in force)

Status	• Consultation on draft regulations closed October 2021 • Awaiting final regulations • Expected in force October 2022	
What requirements?	• Stage 1: Mandatory notification to TPR	• Stage 2: Second notification and accompanying statement to trustees & TPR • Accompanying statement to include main terms, impact on pension scheme, mitigation proposed
What events?	• Change of control/offer to acquire • Sale of material proportion of business or assets (25%) • Material (25%) securities with priority over pension scheme • Further notification if material changes or decision not to proceed	
What timing?	• "decision in principle" or "offer" made	• "main terms" have "been proposed"
What penalties?	• £1m civil fine for failure to comply • £1m civil fine or criminal offence to provide misleading information to trustees/TPR	

Restructuring case study

- Alpha plc operates a large UK defined benefit pension scheme, which has a large deficit. There is no security in favour of the pension scheme.
- Alpha is currently experiencing financial distress.
- The directors are considering interim financing to enable a wider restructuring to be negotiated with key stakeholders. Next week is the quarter end and large creditor payments are due.
- The lenders have indicated that they might be supportive but that any interim financing must be on a secured basis.
- Options being considered for the wider restructuring include potentially compromising pension liabilities.

Directors

Company

Lenders

Restructuring advisers

Restructuring case study: decision-making

Continuing to trade where directors believe the company has reasonable prospects of a successful restructuring

Agreeing short-term lending facilities with security ranking ahead of the pension scheme

Following a statutory procedure (such as a CVA) to compromise employer debts or manage pension liabilities

On-going consideration of pensions impact and engaging with trustees and Pensions Regulator will be even more important

Restructuring case study: "any person"

Restructurings require broad support from a range of stakeholders and advisers, many of whom could be (criminally) liable under the 'any person' drafting

- **Professional advisers** may be wary of their advice leading to criminal or civil liability, making it difficult for distressed corporates to obtain proper legal and financial advice
- The carve-out for **insolvency practitioners** may not cover their advice in the initial stages of a restructuring
- **Creditors** requiring security ranking ahead of the pension scheme to provide financing could be criminally liable if the restructuring fails

Reasonable excuse

- Lack of clarity makes assessment of risk difficult
- Clearance may not be an option for day-to-day decisions such as continuing trading
- Greater importance of documented governance and reasoning around decisions, including consideration of impact on the pension scheme

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Future developments and mitigating risk

Future developments and mitigating risk

Future developments

Regulations on procedural requirements expected to come into force in October 2022

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Consultation on “notifiable events” code and guidance expected before regulations come into force

Managing risks

Identify pensions issues early

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Careful assessment of risks, appropriate advice

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Strategy for engaging with trustees, Pensions Regulator and Pension Protection Fund

–

Beware potential timing impact of new procedural requirements and Pensions Regulator resourcing

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Documenting actions and decisions

Annex

Provision of information

"Knowingly or recklessly providing false or misleading information"

To the Pensions Regulator

- Criminal offence (current position): fine or up to 2 years in prison
- Civil penalty (new): up to £1m

To the pensions trustees

- Civil Penalty (new): up to £1m
- Where person "intends or could reasonably be expected to know" that it will be used in trustees capacity

New investigatory powers

Pre-1 October 2021		Post 1 October 2021	
Powers	**Penalties**	**New powers**	**Penalties**
Wide Pensions Regulator powers to require disclosure of information and documents	Criminal fine up to £5,000 for failing to provide documents/ information without reasonable excuse	Wider power to require attendance at interview (including professional advisers)	Criminal fine up to £5,000 subject to 'reasonable excuse'. Fixed and escalating penalty notice for failure to comply
Pensions Regulator power to inspect premises and documents held on those premises	Criminal fine and/or imprisonment up to 2 years for intentionally suppressing, concealing or destroying documents	Widened powers to inspect premises which hold documents "relevant to the administration of the business of the employer" and documents "relevant to a change of works or asset sale"	Criminal fine up to £5,000 subject to 'reasonable excuse'. Fixed penalty notice for failure to comply

Bios

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Tharusha initially joined the people & reward team in London as a pensions knowledge lawyer and is now a senior associate with more than 14 years' experience of advising employers and trustees of UK defined benefit pension schemes. Tharusha advises on a broad range of pensions matters including:

- the application of the UK Pensions Regulator's powers to make third parties (including non-UK parties) liable for funding deficits and managing pensions risk in light of the new pensions criminal offences and wider powers of the UK Pensions Regulator;
- liability management exercises and de-risking and funding strategies;
- pensions aspects of corporate and financing transactions (including in distress situations) where either the seller or purchaser group includes a UK defined benefit pension scheme; and
- general legal and regulatory issues in operating a defined benefit pension scheme and pensions disputes.

Tharusha's recent experience (in the distressed context) includes:

- Advising the joint administrators of the Acradia group on pensions aspects of the administration of the group and subsequent sales of certain brands.
- Advising a US based multi-national cosmetics group on the pensions issues relating to a restructuring moratorium.
- Advising a large glass manufacturer on pensions issues relating to restructuring activity.

Tharusha is also a full member of the Association of Pensions Lawyer and is one of the co-editors of the association's monthly newsletter to members.

Sally Montague

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Sally is a senior associate in the restructuring and insolvency team based in London.

She has experience acting for lenders, corporates, directors, insolvency officeholders and other key parties in the restructuring and insolvency market.

During her time at Freshfields, Sally was seconded to the Amsterdam office for six months.

Sally's recent experience:

- Advising the shareholders of Nordic Aviation Capita on its restructuring and Chapter 11.
- Advising Credit Suisse on its exposure to the Greensill Group.
- Advising the joint administrators of various Arcadia entities on the sales of the Arcadia brands.
- Advising a group of term loan lenders in relation to Intu SGS.
- Advising House of Fraser on its English and Scottish company voluntary arrangements, schemes and administration.
- Advising BrightHouse on its high yield bond restructuring implemented by way of exchange offer.
- Advising IGas Energy, a leading UK onshore oil and gas explorer and producer, on its capital restructuring.
- Advising Intermediate Capital Group on its role as facility agent and lender under a mezzanine facility agreement to a Luxembourg entity in the N&W Global Vending Group.
- Advising H.C. Starck, a leading global technology metals business headquartered in Germany, on its restructuring and an amendment and extension of its senior and mezzanine facilities.
- Advising the joint administrators of Kaupthing Singer & Friedlander Limited, a subsidiary of Kaupthing Bank HF.
- Advising the joint liquidators of Clinton Cards in relation to a court order setting a bar date in respect of claims for administration expenses from landlords.
- Advising on numerous solvent liquidations.

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Christopher Heritage is a Director at Cardano Advisory, the leading provider of covenant and related advisory services for defined benefit pension schemes.

Chris qualified as a chartered accountant at EY, working in the business' Assurance department before moving internally to the Restructuring practice, where his experience was predominantly focused on working on pension covenant advisory mandates across a number of industries.

Since moving to Cardano Advisory in May 2016, this experience has grown to providing covenant advice to both Trustees and Sponsors of final salary pension schemes as part of the triennial valuation process, as well as in the context of specific scenarios, such as transactions, apportionments and regulatory involvement (including a number of expert covenant reports commissioned by the Pensions Regulator).

Most recently, Chris spent six months in the second half of 2021 on secondment at the Pensions Regulator, supporting both the Events Supervision and Business Analyst teams there during what is proving to be a busy period for the regulator.

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Thank you