

UK Pensions Regulator's new criminal powers are a wake-up call to companies planning corporate transactions

The UK Pensions Regulator is gaining stronger powers, which will have a significant impact on companies undertaking activities such as M&A, secured borrowing, and restructuring. Following best practice and thinking ahead have become more important than ever

UK Pensions Regulator's new criminal powers are a wake-up call to companies planning corporate transactions

The UK Pensions Regulator is gaining stronger powers, which will have a significant impact on companies undertaking activities such as M&A, secured borrowing, and restructuring. With sanctions set to include custodial sentences and hefty fines, it is more important than ever to make sure best practice is followed to protect pension schemes and those running them, as **Nicholas Greenacre**, **Ben Davies** and **Mathew Boyle** of global law firm White & Case discuss.

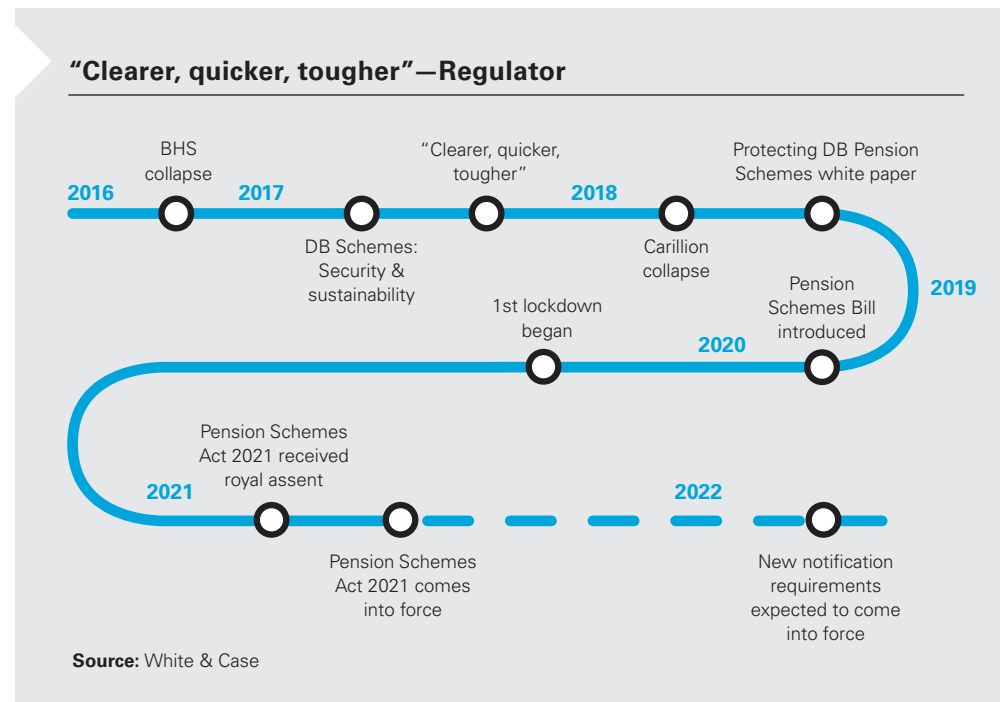
The authors would like to thank **Dan Mindel** and **Alex Hutton-Mills** of pensions corporate finance advisor Cardano for their contributions to this article.

The Pension Schemes Act 2021, which came into force on 1 October 2021, has given the UK's Pensions Regulator (TPR) a host of new powers including the ability to impose criminal sanctions or prosecute offences relating to defined benefit (DB) pension plans.

The legislation was the result of several years of work, with its roots in the high-profile collapse of retailer BHS and its pension schemes in 2016 and the liquidation of construction firm Carillion two years later. The two events helped spur the government into proposing the changes, which are now being implemented.

TPR already has strong existing anti-avoidance powers set out in the Pensions Act 2004 relevant to corporate transactions, including M&A deals and restructurings, where there is a UK DB pension plan in the group.

It has the power to issue a contribution notice (CN) requiring an employer (or connected or associated person) to pay a contribution to the pension plan of up to the full pension plan deficit, where a transaction is materially detrimental to the likelihood of plan members receiving their pension benefits.



It can also issue a financial support direction requiring an employer (or connected or associated person) to put in place financial support—usually a corporate guarantee—for the pension plan where the existing employer is 'insufficiently resourced'.

Following several high-profile pension scandals in the UK, in particular the BHS case where it was perceived that TPR had insufficient powers to protect pension plan members, the government published



1 Oct 2021

The Pensions Scheme Act 2021 came into force on 1 October 2021

a white paper in 2018 focused on the protection of DB pension schemes.

The white paper contained a number of recommendations aimed at strengthening TPR's moral hazard powers, many of which have subsequently been implemented in the Pension Schemes Act 2021.

Employers running DB pension schemes should get to grips now with the details of the new powers because early engagement with pension trustees and mitigation

in advance will benefit both the business and the scheme.

The use of a bespoke mitigation solution will be helpful—for example, seeking specialist investment advice or documenting an agreement with trustees to plan for the scheme’s ultimate wind-up. These types of solutions will reduce regulatory risk for the company.

New criminal sanctions

The most eye-catching change in the new legislation is the introduction of criminal offences relating to anti-avoidance activity in relation to a DB pension plan. There are three new criminal offences.

The first offence is engaging in an act intended to prevent the recovery of, compromise or reduce a statutory section 75 debt due to a DB pension plan.

This offence is subject to the additional requirement that the person must also have known or ought to have known the act would have that effect; or not have had a reasonable excuse for engaging in the act.

The second offence is engaging in an act that detrimentally affects the likelihood of accrued pension scheme benefits being received. As with the first offence, those accused must have been aware the act would have that effect, or not have had a reasonable excuse for engaging in the act.

Anyone guilty of these new offences is liable to a fine of up to £1million, a prison term of up to seven years, or both.

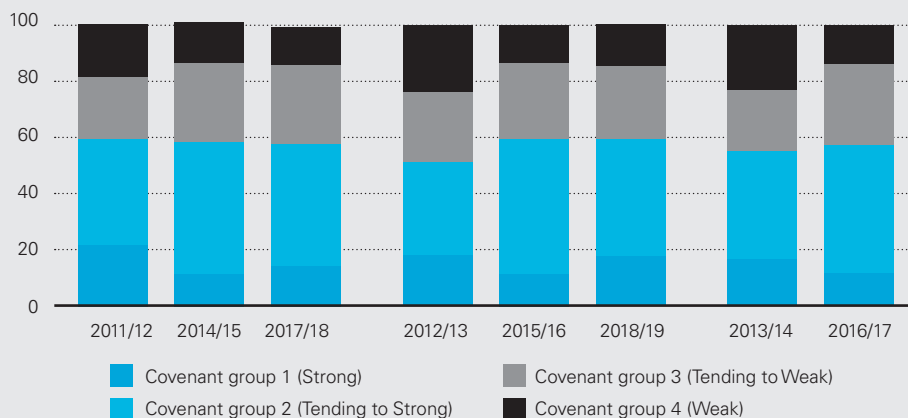
Thirdly, a failure to comply with a CN from TPR will also be a criminal offence for the first time.

The potentially wide application of the new criminal powers to ‘any person’ is noteworthy. This contrasts with TPR’s existing anti-avoidance powers which apply only to employers in DB schemes and connected companies or directors.

During the act’s passage through parliament, this aspect was controversial and received some criticism from industry bodies and in the House of Lords. In theory, it means that banks, purchasers, investors, professional advisers

Evolution in TPR covenant ratings over time, by tranche

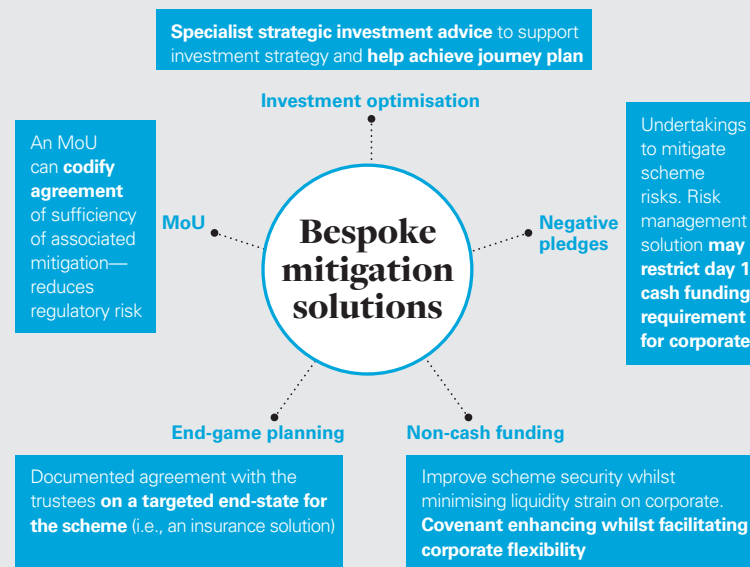
Large proportion of schemes is Tending to Weak, and at greater risk of regulatory scrutiny. Grouped in three-year periods—each scheme is only assessed every three years, and each grouping represents the same schemes.



Source: TPR, Cardano

Potential bespoke mitigation solutions

In light of the changing regulatory landscape, a tailored solution is likely to be required to facilitate desired corporate activity.



Source: Cardano



The most eye-catching change in the new legislation is the introduction of criminal offences relating to anti-avoidance activity in relation to a DB pension plan



International companies need to be particularly aware of the changes, as they put the UK on a different course to much of the world

and pension scheme trustees will potentially be subject to the new powers where a transaction is detrimental to a pension scheme.

It should be noted that actions by insolvency practitioners acting in accordance with that role are excluded from the scope of these offences.

While there is inevitably significant uncertainty at this stage as to how TPR will exercise its new criminal powers, it is generally expected that these will only be relevant to the most serious breaches. This has been confirmed by TPR’s guidance on how it intends to exercise the powers. The regulator said the offences are not intended to affect normal commercial activity, and that it will prosecute ‘the most serious examples of intended or reckless conduct that were already within the scope of our contribution notice power’.

Stronger CN powers

TPR’s existing power to impose a CN on employers, their directors and connected companies has been extended by the introduction of two new and potentially quite wide and discretionary grounds for the issue of a CN.

These new grounds are TPR believing that:

- An act would have materially reduced the amount that could be recovered by the pension scheme had the employer become insolvent (as estimated by TPR); or
- The act would have reduced the value of the employer’s resources and that reduction was material.

Dan Mindel, managing director of pensions corporate finance advisor Cardano, points out that the new employer insolvency test focuses on the role of the pension scheme as an often-material creditor of the sponsor.

‘Assessing likely insolvency

outcomes and how they are impacted by corporate events can be complicated and require robust insolvency outcome analysis’, Mindel adds.

In line with the existing statutory defence to a CN, the defence to a CN being issued on these grounds is that the person has given due consideration to the potential breach of the law and has taken all reasonable steps to eliminate or minimise the potential for their act to have this effect.

In the past, typical approaches to mitigating the detriment caused have involved making additional cash contributions to the pension scheme. However, as some schemes become better funded, non-cash options such as security or guarantees, or contingent funding arrangements, have become more popular.

‘The diverging positions of UK schemes have led to a greater focus on tailored approaches to providing mitigation. Side agreements on



£1 million

A failure to notify TPR and to provide a supporting statement could lead to a fine of up to £1 million

future funding targets and investment strategies are increasingly common to help schemes reach their end game in a cost-effective manner’, says Cardano managing director and partner Alex Hutton-Mills.

A key element of preparing for the new powers will be early engagement with pension trustees around the impact of the transaction on the scheme, and taking suitable steps to ensure that the statutory defence is available in the event of a future challenge from TPR.

New notification requirements

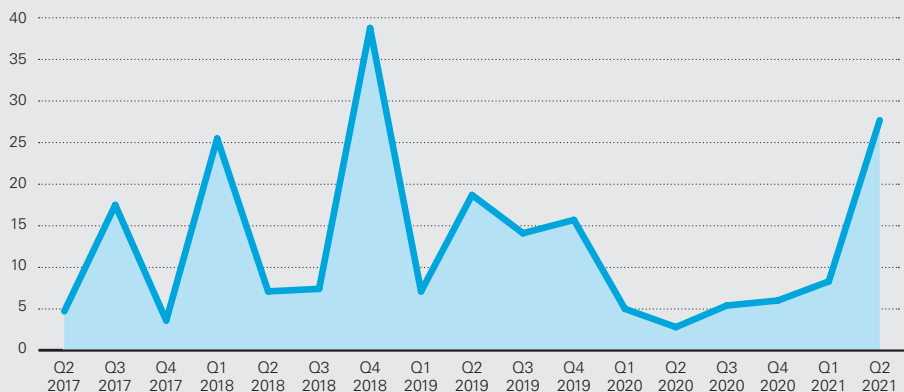
Another important provision in the act, which is expected to come into force in early 2022, is a new requirement for planners of certain corporate transactions to provide TPR and the pension trustees with a written accompanying statement. This will have to include information about the transaction, and how any detriment caused to the pension scheme by the transaction is to be mitigated.

According to the latest draft regulations published by the government, the events triggering this requirement are expected to be:

- The intended relinquishing of control of a scheme employer by a controlling company;
- The intended sale by a scheme employer of more than 25 per cent of its business or assets; and

Number of inward UK M&A deals by quarter

The number of deals involving takeovers of UK sponsors by foreign companies is rising



Source: PPF, Cardano

□ The intended granting by a scheme employer of security comprising more than 25 per cent of its consolidated revenue or gross assets in priority to debt due to the pension scheme

This new requirement is likely to apply to a wide range of corporate transactions and will have to be factored in by companies at an early stage in their transaction planning.

Hutton-Mills warns that these proposed notification requirements will, if approved, lead to compression of the deal timeframe, particularly for public takeovers.

‘Spotting the scheme early, taking advice and engaging quickly with trustees and TPR is a must to keep a deal on track’, he adds.

A failure to notify these events and to provide a supporting statement could lead to a fine of up to £1 million under TPR’s new powers.

The impact on restructuring

Many of the legislative changes introduced are a result of several recent high-profile corporate insolvencies, including that of BHS, which have left pension schemes underfunded and seen pensioners lose out on some of their benefits. BHS was sold by Philip Green in 2015 to Dominic Chappell for only £1 and when it collapsed a year later, there was a pension scheme deficit of £570 million.

TPR’s investigation into the collapse concluded that Green had sold the business to avoid liability for the pension schemes if the retailer became insolvent.

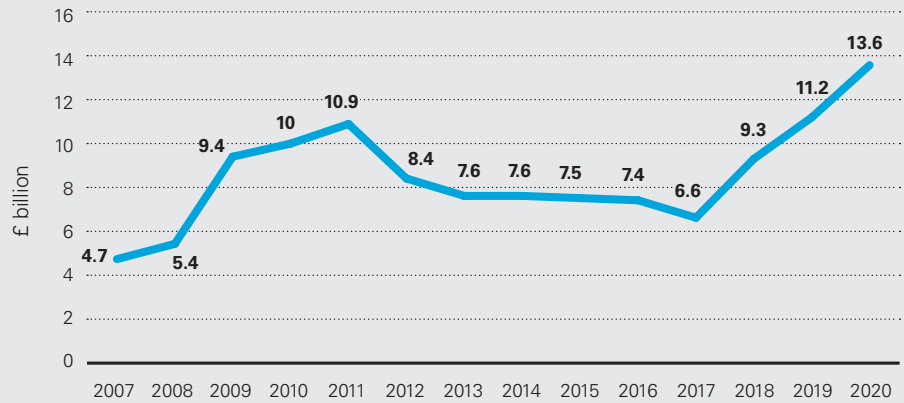
The case once again highlighted the vulnerability of pension schemes established within a financially distressed business.

Issues relating to pension schemes are often perceived to be low down the list of priorities when a business is being restructured, but TPR’s new powers should be a reminder to employers to factor pensions aspects into the deal early on and to actively engage with the pension trustees, TPR, or both.

Cardano’s Mindel says the heightened risks around pension schemes in restructurings should

Liabilities of schemes in PPF assessment

The size of distressed pensions liabilities being assessed for PPF entry was already on the rise pre-pandemic.



Source: PPF, Cardano



£570 million

The collapse of BHS left a pension scheme deficit of £570 million

be something that principals and advisers are on alert for.

‘Engagement with TPR and the Pension Protection Fund ahead of a process is crucial to stay out of their cross-hairs’, he notes. ‘Failing to do so could well attract scrutiny and lead to implications arising out of the new sanctions once the dust has settled’.

A wake-up call

TPR may seek to use its new powers in the early days as a deterrent to others, and this is another reason for employers to engage early both with pension trustees and TPR on relevant transactions.

Indeed, engagement with pension trustees remains of paramount importance—there are always actions which pension trustees could take that could have more immediate impact on the employer than TPR’s new powers.

International companies need to be particularly aware of the changes, as they put the UK on a different course to much of the world.

Ultimately, TPR’s criminal powers are not designed to stop corporate activity from taking place. But they should encourage more forethought and early mitigation of events that could otherwise have a negative impact on DB schemes.



A key element of preparing for the new powers will be early engagement with pension trustees around the impact of the transaction on the scheme, and taking suitable steps to ensure that the statutory defence is available in the event of a future challenge from TPR

Nicholas Greenacre

Partner, London

T +44 20 7532 2141

E ngreenacre@whitecase.com

Ben Davies

Partner, London

T +44 20 7532 1216

E bdavies@whitecase.com

Mathew Boyle

Legal Consultant, London

T +44 20 7532 1000

E mathew.boyle@whitecase.com

White & Case means the international legal practice comprising White & Case LLP, a New York State registered limited liability partnership, White & Case LLP, a limited liability partnership incorporated under English law, and all other affiliated partnerships, companies and entities.

This article is prepared for the general information of interested persons. It is not, and does not attempt to be, comprehensive in nature. Due to the general nature of its content, it should not be regarded as legal advice.

whitecase.com

© 2021 White & Case LLP

With thanks to Cardano for their input into this article.

cardano