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Managing pensions risk: new Pensions Regulator powers and criminal offences

Highlights

- Following the general election, the government has reintroduced the Pension Schemes Bill (the 'Bill') into Parliament.
- The Bill includes a number of provisions which will significantly impact corporate activity involving groups with a UK defined benefit pension scheme.
- Two new criminal offences of 'risking accrued scheme benefits' and 'avoidance of employer debt' are proposed, each carrying a maximum penalty of seven years in prison.
- The circumstances in which the Pensions Regulator (the 'Regulator') can make connected third parties (such as group companies, directors and major shareholders) liable for pension scheme deficits by issuing a 'contribution notice' will be significantly widened.
- There will be new requirements to give advanced notification and provide statements to the Regulator about the impact of certain corporate activity on a pension scheme, and failure to comply with these requirements could result in new civil penalties of up to £1m.
- The Regulator's investigatory powers will be strengthened, and the Regulator will have a power to require any person to attend an interview and a power to inspect records at parties' premises (including unannounced raids).
- Other new criminal offences have been included in the Bill for (i) failing to comply with a contribution notice, (ii) refusing to attend an interview with, or answer questions from, the Regulator, and (iii) providing misleading information to the Regulator in relation to notifiable events and the new statements.
- There will also be civil penalties of up to £1m when misleading information is given to pension scheme trustees.

Introduction

High profile insolvencies in the UK over the last few years have demonstrated that corporate groups can face intense and sometimes highly public scrutiny if they make decisions that could detrimentally impact a UK defined benefit pension scheme operated within the group. That scrutiny may take place a considerable time after the corporate activity in question when the circumstances of the group have radically changed, and will inevitably be conducted with the benefit of hindsight. For example, companies may face investigations from the Pensions Regulator (the 'Regulator') where funds have been returned to shareholders (eg through dividends or capital reductions) many years prior to its financial difficulties.

As promised in its manifesto, the new Conservative government has reintroduced the Pension Schemes Bill (the 'Bill') into Parliament. The Bill was originally laid before Parliament shortly before its dissolution for the general election. The Bill includes legislation which will significantly increase the risk of scrutiny of corporate actions involving groups with UK defined benefit pensionschemes, including:

- introducing new criminal offences which could, in certain circumstances, lead to a wide range of ordinary corporate activity attracting criminal liability; and
- widening the circumstances in which the Regulator can issue a 'contribution notice'.

There will also be new procedural requirements for corporate activity, which will give pension scheme trustees and the Regulator greater and earlier leverage. These procedural requirements will be bolstered by new investigation powers for the Regulator and penalties for providing misleading information.

Business activities of groups with a UK defined benefit pension scheme could therefore become much more challenging. If passed into law, directors of corporate groups, trustees or even third parties such as banks and professional advisers could face significant criminal or civil liability for acts or omissions in relation to UK defined benefit pension schemes. As a result, it will be more important than ever for corporate groups to ensure that the impact of corporate activity on their UK defined benefit pension schemes is carefully considered and appropriately mitigated.

This briefing summarises at a high level the impact of the proposed legislation and what corporates and their directors can do to ensure that their corporate decision-making properly considers and addresses the impact of corporate activity on group pension schemes with the aim of both reducing the risk of any future investigation being instigated, and putting the group and its directors in the best position possible to defend any such action.

New criminal offences

The Bill proposes two new key criminal offences, each of which would carry a maximum penalty of seven years in prison:

(i) risking accrued scheme benefits; and

(ii) avoidance of employer debt.

Both of these offences are very broad in their scope, and go beyond the stated policy aim of deterring 'reckless' and 'unscrupulous' behaviour. The government's consultation paper issued in June 2018 (and outlined in the government's white paper in March 2017) (see our briefing Pensions White Paper - Increased scrutiny for corporate transactions) proposed a single offence of 'wilful or reckless' behaviour in relation to a pension scheme which was meant to tackle 'irresponsible' employers and reckless behaviour.

In addition, the way that the offences have been framed in the Bill means that these offences target a wider range of parties than just those connected to the scheme's sponsoring employer, such as directors, as they are drafted to apply to any person. Acts of third parties, including banks, investors, and commercial counterparties, as well as acts of pension scheme trustees and professional advisers, could all fall within the scope of these new criminal offences.

(i) Risking accrued scheme benefits

The new criminal offence of 'risking accrued scheme benefits' would impose criminal liability where a person engages in an act or course of conduct in a way that they know or ought to have known would have a materially detrimental effect on a defined benefit pension scheme, unless they have 'reasonable excuse'. This is a broad test, with significant uncertainty and potential for difference of views on when it will apply, which will make the assessment of 'reasonable excuse' incredibly important.

(ii) Avoidance of employer debt

The new criminal offence of 'avoidance of employer debt' would impose criminal liability where an individual acts in a way that prevents the recovery of an employer debt which is due to a defined benefit pension scheme or otherwise compromises or settles such a debt, again without having 'reasonable excuse'. Statutorily-sanctioned arrangements which are commonly used to manage pensions liabilities in a wide range of corporate transactions and restructurings such as apportionment arrangements, as well as other forms of compromise of employer debts such as company voluntary arrangements could all fall within the scope of this offence. As such, trustees, corporates and their directors will have to carefully consider their use going forward to avoid potential criminal liability.

'Reasonable excuse'

As noted above, unless a person has 'reasonable excuse', criminal liability could be imposed. However, the Bill includes no further details on how the 'reasonable excuse' requirement would operate. Even though the 'no reasonable excuse' requirement appears to be wide on its face, until there are settled examples of how the requirement works, it is likely to cause concern for directors, trustees and third parties given the potential for criminal liability.

It might be difficult to mitigate these risks as the 'clearance' process which is currently available to parties to obtain comfort that the Regulator won't exercise its 'moral hazard' powers would not be available to mitigate the uncertainties around the 'reasonable excuse' proviso. Parties may be able to use clearance indirectly, to provide useful evidence to demonstrate 'reasonable excuse', which may mean that clearance becomes more common for significant corporate activity. However, clearance is unlikely to be available or practicable for ordinary day to day corporate activity and so the existence of 'reasonable excuse' will have to be evidenced through other means.

Changes to the Regulator's 'moral hazard' powers

The Regulator currently has powers (known as 'moral hazard' powers) to make third parties contribute to or support a pension scheme by issuing 'contribution notices' or 'financial support directions'. When the conditions for imposing liability are met, the Regulator can use its powers if it considers it reasonable to do so.

The Regulator can use its powers against any party which is 'associated with' or 'connected with' a participating employer (or former employer) – even if they do not have a direct legal relationship with the pension scheme. This is a wide test and will, for example, catch other companies in the same corporate group as the employer, directors (or shadow directors) of an employer, or a shareholder with at least one-third of the voting rights of the employer.

Widening of the Regulator's moral hazard powers

In order to issue a 'contribution notice', there currently has to have been an act or failure to act with a main purpose of avoiding a pension liability or an act that has detrimentally affected the security of scheme benefits.

The Bill proposes to introduce two new limbs for imposing contribution notices, although both appear to cover some of the same ground as the existing 'material detriment' test. Under the proposed new legislation, the Regulator would be able to issue a contribution notice where an act or failure to act:

- materially reduced the debt likely to be recovered from the employer in the event of an immediate insolvency (the 'employer insolvency' test); or
- reduced the resources of the employer in a manner which was material when compared to the buy-out deficit of the pension scheme (the 'employer resources' test).

Both of these tests assess the 'materiality' of the weakening of the employer by reference to the section 75 debt, rather than to the value of the employer and its ability to pay. For example, a large employer with a small pension scheme which pays a large dividend when compared with the value of the scheme's section 75 debt would be caught by the new 'employer resources' limb even if it still has more than enough resources to support the scheme.

The widening of the grounds for issuing contribution notices could therefore increase the likelihood of the Regulator's moral hazard powers being exercised or threatened by the Regulator in relation to corporate activity.

New notification requirements and accompanying impact statements

Under existing legislation, in certain circumstances, sponsoring employers are required to notify the Regulator about specific corporate events. The Bill expands on these notification obligations and imposes new obligations on the 'appropriate person' (most obviously the scheme employer) to provide the Regulator with an 'accompanying statement' in relation to those events. Additional notification obligations would also be triggered by any material change to those events or where an event which has been notified does not actually take place.

Corporate events that could trigger the new notification obligations

The Bill does not specify the events that will trigger the new notification obligations as the detail will be set out in secondary legislation. However, the consultation envisaged that the new notification obligations would be triggered by (i) a change of control of the employer, (ii) a sale of material assets by an employer, and (iii) an employer granting security which ranks ahead of the pension scheme.

Accompanying statement

There will be a new requirement to provide the Regulator with an 'accompanying statement' about specified corporate events. This 'accompanying statement' will need to set out: (i) a description of the event; (ii) any adverse effects of the event on the relevant pension scheme; (iii) a description of steps taken to mitigate these effects; and (iv) a description of any communication with the pension scheme trustees about the event.

A copy of any notification to the Regulator and any accompanying statement must be provided to pension scheme trustees at the same time as they are provided to the Regulator.

Timing and penalties

The Bill provides that regulations may specify that the notice and accompanying statement must be given to the Regulator in advance of an event taking place, potentially a specified period in advance. This could have a significant impact on the timetable of corporate activity going forwards.

There will be civil penalties of up to £1m for a failure to comply with the new notification obligations or to provide an accompanying statement to the Regulator. Providing false or misleading information to the Regulator is already a criminal offence.

What action should companies be taking?

Legitimate business activities of groups with a UK defined benefit pension scheme could become much more challenging if the proposed legislation is passed into law. Directors of corporate groups could face significant criminal or civil liability for acts or omissions in relation to UK defined benefit pension schemes. As a result, it will be more important than ever for corporate groups to ensure that the impact of corporate activity on their UK defined benefit pension schemes is carefully considered at an early stage, appropriately mitigated and properly documented.

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