

M&A, RESTRUCTURING, RE-FINANCING AND DIVIDENDS LIKELY TO BE HIT BY NEW PENSIONS OFFENCES AND REGULATORY SANCTIONS

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Legal Briefings

The Pension Schemes Act 2021 finally received Royal Assent yesterday, paving the way for the most significant reform of the regulatory regime for defined benefit (DB) pension schemes since its introduction in 2006. The Act introduces new criminal offences and new regulatory powers for the Pensions Regulator that could:

- significantly impact corporate activity, including M&A and the payment of dividends in some scenarios
- restrict the scope for distressed businesses with DB pension schemes to secure fresh investment or take on additional debt, particularly where the scheme has a material deficit, and
- impact the feasibility, manner and desirability of restructuring a business or group with a DB scheme.

In short, the new powers include **new criminal offences and civil sanctions** which could be applied to **company directors, lenders, investors, sellers, purchasers and advisers** who take action which, broadly speaking, is materially detrimental to a DB scheme, where they do not have a reasonable excuse for their actions.

Although the new powers are not expected to come into force until mid-2021 at the earliest, directors and other parties who are in scope should have regard to these new powers immediately in the context of corporate transactions, restructuring and re-financings and before paying dividends to shareholders.

SUMMARY OF NEW POWERS

The Pension Schemes Act contains several notable provisions, including:

1. NEW CRIMINAL OFFENCES FOR COMPANY DIRECTORS AND OTHER PARTIES WHO TAKE ACTION TO AVOID OR REDUCE AN EMPLOYER DEBT OR THAT JEOPARDISES BENEFITS UNDER A DB SCHEME

These offences would be committed where any person, broadly:

- i. takes action or engages in a course of conduct that detrimentally affects in a material way the likelihood of benefits accrued under a DB scheme being received, where the person knew or ought to have known that the act would have such an effect and there was no reasonable excuse
- ii. takes action or engages in a course of conduct that prevents the recovery of the whole or part of a section 75 employer debt or reduces or compromises such a debt in any way, where the person intended the act to have that effect and there was no reasonable excuse, or
- iii. fails to comply with a section 38 contribution notice.

The sanctions for these offences include up to seven years imprisonment, a fine or both. In practice, these offences could apply where, for example:

- a company takes on new security which ranks ahead of a DB scheme
- a profitable part of a business is sold
- directors seek to make use of the new corporate moratorium or to compromise a debt

owed to a DB scheme, or

- a dividend is paid to shareholders when a business is in distress.

2. NEW CIVIL PENALTY OF UP TO £1 MILLION THAT CAN BE IMPOSED ON DIRECTORS AND OTHER PARTIES IN A RANGE OF CIRCUMSTANCES

This includes where a person:

- i. is a party to an act or failure to act the purpose or one of the main purposes of which is to, broadly, avoid or reduce the amount of a section 75 employer debt that is, or which may become, due to a scheme (for example, as a result of the sale of a group company) and where it was not reasonable for the person to act or fail to act in the way that they did
- ii. is a party to an act or failure to act that, broadly, is materially detrimental to the prospect of benefits being paid under a DB scheme, where the person knew or ought to have known that the act or failure would have that effect and where it was not reasonable for the person to act or fail to act in the way that they did, or
- iii. knowingly or recklessly provides the Regulator or trustees with false or misleading information.

Proceedings for these criminal and civil offences can be brought by the Pensions Regulator, the Secretary of State, or by the Director of Public Prosecutions.

3. TWO NEW TRIGGERS FOR ISSUING CONTRIBUTION NOTICES

By way of reminder, a contribution notice may be issued on directors of a DB pension scheme sponsor and on connected and associated parties, including other group companies and directors of companies within the same group to pay a sum into a DB scheme.

The new triggers will apply where the Regulator is of the opinion that:

- i. an act or failure to act would have materially reduced the amount of the employer debt (calculated in accordance with section 75(4) of the Pensions Act 1995) likely to be recovered by a DB scheme on the hypothetical insolvency of one or more of the scheme's sponsoring employers at the time of the relevant act or failure to act, where the value of the assets of the scheme was less than the amount of the liabilities of the scheme (as estimated by the Regulator, broadly speaking, on a buy-out basis) at that

time, or

- ii. an act or failure to act reduces the value of the resources of a DB scheme's sponsoring employer to a material extent relative to the amount of that employer's estimated section 75 debt in relation to the scheme.

The first trigger could apply where, for example, a company takes on additional debt which ranks above a DB scheme in the event of the company's insolvency or as a result of corporate restructuring.

The second trigger could apply, for example, on the sale of a valuable part of a business or following the payment of excessive dividends.

A statutory defence to these new triggers is available but it is only likely to apply in limited circumstances.

IMPACT OF NEW POWERS

The scope of the Regulator's new powers are significantly wider than many within the industry had originally expected and the threshold which would need to be met in order for the new criminal sanctions to be applied is significantly lower than the Government indicated prior to the legislation being introduced.

In particular, the new criminal offences will apply:

- **to “any person” who engages in an act or course of conduct covered by the new offences** – this means that the new criminal sanctions could potentially be applied to:

- i. directors of companies that support a DB scheme
- ii. directors of other group companies (including Top Cos) even where they are not "connected or associated" with a scheme sponsor
- iii. investors, and
- iv. persons within banks or other financial institutions who finance a company or group with a DB scheme.

Any person acting in their capacity as an insolvency practitioner is expressly excluded from the scope of these offences.

- **where the person takes such action without a "reasonable excuse"** – this threshold is significantly lower than that which applies in the context of similar criminal offences, such as fraudulent trading, which requires a director to have acted with intent to defraud a company's creditors. It is also unclear what will amount to a "reasonable excuse", particularly where decisions and actions are being examined with the benefit of hindsight and, presumably, in circumstances where things have gone wrong. For example, would it be considered reasonable:

- i. for a director to have secured additional finance which ranks above a DB scheme in an attempt to rescue a business which subsequently failed?
- ii. for a company to maintain what the Regulator may consider to be excessive dividend payments in order to attract investment into a business that failed a short time after the dividend was paid?

In the first instance, it will be for the Regulator to determine what amounts to a “reasonable excuse”, although this will ultimately be a matter for the Courts to determine.

The Government sought to address concerns about the scope of these new offences by promising that the Pensions Regulator will publish guidance on how it will enforce them before they come into force. It is expected that this guidance will be published for consultation shortly.

Even aside from these new offences, the existence of the new civil fines of up to £1 million which may be imposed on directors, investors, banks and any person who performs or knowingly assists with a relevant act (including advisers) and the expanded contribution notice powers will greatly increase the risks associated with transactions involving a company or group with a DB scheme or the restructuring of such a company or group.

OTHER KEY PROVISIONS

The Act also contains other important provisions which:

- **introduce significant new funding requirements for DB schemes** – generally speaking, these new requirements are likely to result in sponsors being forced to pay more money into their schemes more quickly
- **significantly increase the Regulator’s information gathering powers, extend the notifiable events regime and introduce tougher sanctions for non-compliance**
- **introduce a statutory framework to enable collective defined contribution schemes to be established**, and
- **introduce a regulatory framework for pension dashboards.**

WHEN WILL THESE NEW POWERS COME INTO FORCE?

These new powers are not expected to come into force until mid-2021 at the earliest to give the Pensions Regulator time to consult on and issue guidance on how and in what circumstances it plans to exercise them. During the passage of the legislation through Parliament concerns were raised about the extent to which the new powers could be applied retrospectively. However, in a [written response](#) to a parliamentary question Pensions Minister, Guy Opperman, confirmed that:

“None of the provisions in Part 3 of the Bill [which contains the new regulatory powers and criminal offences] will be retrospective and the new criminal sanctions and information gathering powers will apply to all schemes where the act occurs, or in the case of a series of acts commences, after the powers come into force.”

Despite this assurance, directors, lenders and investors would be well advised to have regard to these new powers immediately when making decisions because:

even though it appears from the Minister’s statement that actions and decisions taken prior to these powers coming into force will not be capable of triggering the exercise of these new powers, once the powers are in force, they could be triggered by any related acts (such as restructuring or re-financing) that take place after that time, and

it is still likely that the Regulator could have regard to actions and decisions taken now when deciding whether or not it is reasonable to exercise its new powers where a trigger event occurs after the new powers are in force (as it did in relation to ITV, where the Regulator issued a Financial Support Direction (FSD) against ITV in connection with the establishment of BoxClever, a joint venture vehicle for its TV rental business, which took place before the FSD regime was even contemplated).

Therefore, directors, investors, banks and others who are within the scope of the new criminal offences and regulatory sanctions should have regard to them immediately in the context of all future corporate transactions, restructurings and re-financings and before paying dividends to shareholders where any such activity may prejudice a DB scheme.

If you wish to discuss these changes further please contact any of our experts below or speak to your usual Herbert Smith Freehills contact.

To keep up to date with our views on the Act and our upcoming podcast series detailing the various provisions, subscribe to our [Pensions blog](#).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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