UK PENSION SCHEMES ACT 2021 – NEW CRIMINAL OFFENCES IN FORCE AND GUIDANCE PUBLISHED: LENDERS TAKE NOTE

The new criminal offences introduced by the Pension Schemes Act 2021 in relation to defined benefits ("DB") pension schemes are now in force. They are accompanied by guidance published by the Pensions Regulator setting out the approach it will take in the investigation and prosecution of the new offences. The guidance, albeit not binding, gives some useful examples in a lending and restructuring context of where the Regulator would not expect to use its powers and will be critical for lenders in evaluating the new regime. In this briefing, we consider the new DB pensions landscape and what it means for lenders and transactions.

Key issues

- The new criminal offences introduced by the Pension Schemes Act 2021 in relation to DB pension schemes came into force on 1 October 2021
- Of particular relevance to lenders is the new criminal offence of engaging in conduct that detrimentally affects scheme benefits, which applies to *anyone* (regardless of their connection or otherwise with the scheme/employer)
- The Pensions Regulator has published guidance on its approach to the new criminal offences, which includes helpful examples in a lending and restructuring context of where it would and would not expect to exercise its powers
- Lenders will need to navigate the new pensions landscape on transactions with a DB pension scheme in the picture

BACKGROUND

The motivation behind the Pension Schemes Act 2021 (the "2021 Act") was to bolster the Pensions Regulator's ("TPR") powers. As well as strengthening TPR's existing powers under the Pensions Act 2004 (the "2004 Act"), the 2021 Act introduces new criminal sanctions and financial penalties to punish wrongdoing in relation to DB pension schemes, which can be imposed on parties with no formal connection to the schemes e.g. lenders (although insolvency practitioners are carved out). Of particular relevance to lenders is the new criminal offence (which applies to anyone) of engaging in conduct that detrimentally affects in a material way the likelihood of accrued scheme benefits being received absent a reasonable excuse for doing so (see the text box below).

In our previous two briefing notes[1], we considered the key concerns for lenders arising out of the new offence and the draft guidance consulted on by TPR in relation to the criminal offences. The new criminal offence is now in force (it does not have retrospective effect although facts predating 1 October 2021 may be taken into account as part of TPR's investigations e.g. when

[1] UK Pension Schemes Act: Lenders Beware and UK Pensions Regulator consults on policy for new criminal sanctions

looking at evidence of intention) and the final guidance has been published. These will have to be taken into account by lenders on transactions where there is DB pension scheme, together with the existing moral hazard regime under the 2004 Act which lenders may be familiar with. We consider below the patchwork of pensions provisions for lenders to navigate on transactions and the comfort offered by the guidance in relation to the criminal offence.

Engaging in conduct that "detrimentally affects in a material way the likelihood of accrued scheme benefits being received"	
Offence	A person, if prosecuted, will be guilty of an offence where (on a criminal burden of proof i.e. beyond reasonable doubt) they: (a) do an act or engage in a course of conduct (including a failure to act) that detrimentally affects in a material way the "likelihood" of accrued scheme benefits being received (the ***act element***); (b) they knew or ought to have known that the course of conduct "would" have that effect (the ***mental element***); and (c) they did not have a "reasonable excuse" for engaging in such conduct (***reasonable excuse***).
Penalty	A maximum custodial sentence of up to 7 years and/or a fine (unlimited) or new civil penalty up to £1m.

THE POLICY GUIDANCE

The new criminal offence is cast widely and does not contain any carve-outs for lenders. Many activities, including common lending activities, could cause a "material detriment" to a pension scheme and the absence of carve-outs means that lenders will have to rely on the reasonable excuse defence. The policy is therefore critical in providing colour on the scope of the offence and TPR's general approach to reasonable excuse in the context of lending as illustrated by the lending examples and case study (although it should be noted that where TPR prosecutes, the determination of whether a person has a reasonable excuse is ultimate a matter for the criminal courts).

Scope: the policy has been helpfully strengthened and expanded since the original draft subject to consultation. It now confirms (consistent with the policy intent behind the new legislation) that "*the vast majority of people do not need to be concerned – we don't intend to prosecute behaviour which we consider to be ordinary commercial activity*" and that prosecution is aimed at "*the most serious examples of intentional or reckless conduct* ". This is reassuring in framing the scope of the offence around egregious conduct, together with the parameters set by the criminal standard of proof (beyond reasonable doubt) and the requirement that pursuit of conviction is in the public interest.

Material detriment and clearance: when assessing material detriment, the policy indicates that TPR will consider the same factors as it would when looking at a Contribution Notice (CN) on grounds of material detriment and TPR would expect a reasonable excuse to exist where a person is able to establish a statutory defence to such a CN. For lenders familiar with the moral hazard regime, the parallels with CNs will be helpful. Appendix 1 of the policy also contains a detailed comparison between the CN power and the new criminal offences.

The policy also confirms that the existing clearance procedure in respect of CNs does not apply to the new criminal offences and that a CN clearance statement will not automatically mean that a person has a reasonable excuse for the purposes of the offences. However, the policy does usefully confirm that the mitigation described in the clearance statement could be used as part of establishing a reasonable excuse and would be considered by TPR in the round.

Reasonable excuse and lending examples: with the caveat that it is ultimately fact and circumstance specific, Part E of the policy describes the principles-based approach TPR will apply when assessing reasonable excuse. The policy sets out three factors (see the text box) which will generally be significant in TPR's approach to assessing reasonable excuse, together with examples (including in the lending context) of where these factors would be at play. The common thread through the lending examples is that third party lenders acting honestly and lending on commercial terms should not be in the frame and are entitled to pursue their commercial interests, notwithstanding the impact on the scheme.

Reasonable excuse – 3 factors

- Was the impact on the scheme incidental to the act/omission
- Was adequate mitigation provided?
- Was there a viable alternative?

In relation to the first factor, an example is given of where a bank chooses not to lend to a sponsoring employer because of the risk that the pension scheme could cause the employer to become insolvent, which might expose the bank to losses. The employer subsequently fails due to its inability to refinance. The detriment to the scheme was an incidental consequence of the bank's actions.

In relation to the third factor, the policy helpfully confirms that the extent to which alternatives could have been explored will be context-dependent and will not involve the use of hindsight. The example is given that in some restructuring situations, events move at pace and decisions need to be made quickly to avoid material destruction of value in a way detrimental to all stakeholders. Restructuring plans under Part 26A of the Companies Act 2006 and Company Voluntary Arrangements are also listed as examples of activities where TPR would generally expect there to be a reasonable excuse (provided a number of conditions are met). While other restructuring processes such as schemes under Part 26 of the Companies Act are not specifically mentioned, we would expect such processes when used in a restructuring context and otherwise compliant with the statutory requirements, to benefit from a similar approach by TPR, bearing in mind the policy intent not to undermine ordinary commercial behaviour.

Two further examples are given in respect of lending to illustrate that TPR would not argue that a viable alternative would involve the bank taking an uncommercial decision e.g. lending on uncommercial terms. The first example is where an employer raises debt with prior ranking security to the scheme or with a yield higher than conventional bank debt, where the new debt is critical for the survival of the business. The second example is where the employer faces a liquidity crisis and the bank declines to increase the employer's unsecured facilities. The policy helpfully confirms that a person's awareness of potential harm to the scheme will not mean, in and of itself, that the person should have pursued an alternative course of action. In the case of the second example, although the bank may be aware that failing to lend more money could result in the employer's insolvency, TPR would not expect it to lend if it was against the bank's commercial interests.

On a cautionary note however, the policy gives an example in a lending context of where there was a less detrimental viable alternative. In this example, an employer breaches its banking covenants entitling the lender to withdraw facilities immediately, but where an extension of facilities by one month is highly unlikely to risk the lender's interests because the employer is entitled to significant payments from debtors over that period. The one-month extension is "likely" to be a viable alternative. This could put lenders in a difficult situation where they may have other valid reasons for withdrawing the facilities immediately.

Case study: the examples are supplemented by a case study in Appendix 3 where TPR applies the principles set out in the policy to a fictional scenario, assessing each party separately in terms of whether to prosecute. This is likely to provide some comfort to lenders as it makes clear that both an existing lender who refuses to continue lending and a new lender who lends on less favourable terms in this fictional scenario would not generally be prosecuted. While fact specific, key factors were that the lenders acted honestly and in good faith, having regard to their commercial interests, contrasting with a parent company which exerted undue pressure on the employer.

Status: the policy is not legally binding which ultimately means that only so much reliance can be placed on it by lenders. It will also evolve over time as TPR updates it to reflect any court decisions in relation to the new offence and their experience: the interpretation of the new offence is ultimately a matter for the courts.

The policy also only sets out the approach of TPR. Prosecution can also be instituted by the Secretary of State or the Director of Public Prosecutions, although the former has confirmed in writing that prosecutions other than by TPR would be rare. Nevertheless it is unfortunate that the policy does not represent common and complete guidance.

INTERACTION WITH THE EXISTING MORAL HAZARD REGIME

Since 2004, TPR has had relatively extensive rights to intervene in corporate activities under the moral hazard regime. The 2004 Act enabled TPR to require the provision of additional support for underfunded DB pension schemes in the form of CNs and financial support directions ("FSDs"), which could be issued to employers and anyone "associated" or "connected" with such employers, which could in certain circumstances include lenders. The 2004 Act also imposed requirements on employees and trustees to notify TPR of certain events e.g. breach of a banking covenant.

Lenders may therefore be familiar with and have had to take account of the 2004 Act on transactions. For example, where share security is taken over a company in a group with a DB pension scheme, there may be documentary provisions intended to avoid a security agent becoming associated or connected with the scheme by virtue of the security. Loan agreements may also contain representations, undertakings and events of default around the issue of CNs and FSDs to the group which could deplete the group's resources. In some transactions, there may also be engagement upfront with TPR and clearance may be made a condition precedent.

From the perspective of lenders, these considerations will continue to apply and need to be considered on transactions involving a company with a DB pension scheme. The 2021 Act adds two new grounds for CNs which came into force on 1 October 2021 so there are increased circumstances when a CN can be issued: TPR will also be able to issue a CN if an employer insolvency test or an employer resources test are satisfied. The new criminal offence is a further factor to take into account, with the added threat of criminal liability. Lenders will need to consider upfront the impact of the lending or restructuring transaction on the scheme, with the guidance in mind, and pensions advice may need to be sought. There is not a clearance procedure in respect of the new offence, although, as noted above, the clearance procedure in respect of the moral hazard regime may offer some assistance. This patchwork of pensions provisions for lenders to navigate on transactions will grow still further with the new notification requirements which are in the pipeline as we outline below, although this may be somewhat ameliorated in due course by the overlapping powers policy which we also outline below.

IN THE PIPELINE

New notification requirements: The 2021 Act provides for employees to notify TPR of a decision in principle by the employer to grant or extend relevant security over its assets in priority to the DB pension scheme. It is supplemented by a new duty for a "relevant person" (the employer and others connected or associated with the employer) to give notices and statements to TPR in respect of the event. This information is required at a later stage in the transaction than the notifiable event notification, when the main terms have been proposed. The new notification requirements are expected to come into force in 2022 and the Department for Work and Pensions are consulting on the draft regulations in relation to them until 27 October 2021. Once the new requirements are in force, compliance with these could be made a condition precedent where they apply to a transaction.

Overlapping powers policy: TPR has published a consultation on the interaction of their new powers introduced by the 2021 Act with their existing powers under the 2004 Act in view of their overlap. In some situations, TPR will have the option to use different powers in relation to the same set of facts – these options may be regulatory (e.g. CNs, FSDs and financial penalties) and/or criminal. The consultation (which closes on 22 December 2021) sets out an overlapping powers policy and TPR's approach where this overlap occurs, together with policies on monetary penalty powers and information gathering powers. The policies may help lenders to understand how TPR will approach its arsenal of powers which may assist when they are considering the DB pensions position on transactions.

WHAT DOES THIS MEAN FOR LENDERS?

The new DB pensions landscape comprises a patchwork of provisions for lenders to navigate, some of which may already be familiar. The new criminal offence has gained the most press attention in view of its potential criminal sanctions, although in practice, the policy is useful in providing some much needed guidance on the new offence, including confirmation that it is aimed at the most serious examples of intentional or reckless conduct and the inclusion of specific examples in relation to normal lending activity and certain restructuring mechanisms which are not expected to be caught are helpful. Fundamentally though, only so much reliance can be placed on the policy in the absence of it being legally binding (and the fact that it does not cover when either the Secretary of State or Director of Public Prosecutions might be expected to pursue a prosecution). As a result, there will always be some degree of risk for lenders dealing with a group with a DB pension scheme. It will therefore be imperative to consider the pensions position upfront on transactions where there is a DB pension scheme in the picture.

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