Summary

• TPR has been granted a number of new powers in the Pension Schemes Act, including the ability to impose criminal and civil sanctions. The new powers are expected to increase focus on pensions in the context of corporate activity, putting schemes on a stronger financial footing and ultimately benefitting the members.

• There have been concerns that standard business practices may be caught within the new powers, impacting on sponsoring employers' ability to pay dividends, obtain debt or undergo corporate restructurings. There may also be a decline in lay trustees due to the perceived risk of involvement with a pension scheme.

• TPR and the DWP have highlighted that the powers will not impede upon standard business behaviour and is intended just for 'wilful and reckless' behaviour. The criminal and civil sanctions are expected to be used mainly as a deterrent.

• Consultation and guidance are expected before the powers are implemented in the autumn. In preparation for this, it is recommended that employers and trustees receive training and advice, as well as review corporate governance practices and liability insurance.

On the radar

The Pension Schemes Act features new powers for The Pensions Regulator from the autumn, including criminal sanctions for 'any person' acting to the detriment of the pension scheme without 'reasonable excuse'. Concerns have arisen that anyone, however distantly impacting a pension scheme, may be at risk of prosecution simply by going about standard business actions. To what extent are these fears justified and what preparations can be done while waiting for further guidance? Laura Blows finds out

Section 107 of the Pension Schemes Act, amending section 58 of the Pensions Act 2004 regarding sanctions for the avoidance of employer debt, may not sound likely to set alarms ringing, but its dry words have flashed up on the industry's radar as a cause for concern.

The Pension Schemes Act grants new powers to The Pensions Regulator (TPR), including extending its information-gathering powers by giving the regulator the power to require individuals to attend an interview, as well as extending the existing notifiable events regime.

It also includes two new Contribution Notice triggers that will apply where a party engages in an act or course of conduct that reduces the amount that may be available on the insolvency of a sponsor or which reduces the value of a sponsor to a material extent.

However, the new powers garnering the most attention are that of section 107, about criminal and civil sanctions, such as imprisonment of a maximum of seven years or fines of up to £1 million, which can be issued for such reasons as knowingly causing material risk to the likelihood of pension benefits being paid or providing misleading information.

"The government is committed to increasing protections for workers' retirement savings, and the Pension Schemes Bill will do just that. There must be no hiding place for those intent on jeopardising the retirement prospects of hard-working people," a Department for Work and Pensions (DWP) spokesperson says.

Speaking when the Pension Schemes Bill was announced in October 2019, TPR chief executive, Charles Counsell, said that the bill would give it the power to set and enforce clearer scheme funding standards in defined benefit (DB) pension schemes, while also providing early warning of potential problems.

"Where problems do arise, new criminal sanctions and civil fines will act as a strong deterrent against risky and reckless behaviour, giving us flexibility to issue fines at the appropriate level, depending on severity," he added.

"The powers in the bill are quite different to what was originally proposed in the white paper," LCP principal, Laura Amin, says. "Much of the focus of parliamentary discussion was on the new criminal offences and on their use to target 'wilful and reckless' behaviour (as originally proposed) compared to what is now in the bill and act. There was very little discussion on the detail of how the offences would be applied and little discussion on the detail of the new Contribution Notices and other powers."

Lincoln Pensions director, Luke Hartley, notes that while the new Contribution Notice tests may reflect the challenges faced by TPR in using its powers historically, the 'wilful and reckless behaviour' alludes to the pensions issues that arose from Carillion and Philip Green's interaction (or lack thereof) with the BHS pension scheme.

Worthy goals indeed, and yet the new TPR powers, particularly the criminal and civil sanctions, have been subject to a great deal of concern. Why so?

Concerns

A key worry has been the scope of the new provisions. "The Pension Schemes Act has given TPR the power to target a much broader range of behaviour and individuals. This legislation – particularly the new criminal offences and civil penalties contained in section 107 – means that instead of focusing on the rare incidents of rogue directors damaging pension schemes and savers, new criminal offences could apply to an extremely wide range of parties and actions," PLSA deputy director of policy, Joe Dabrowski, says.

"Before the bill passed into law, TPR already had a broad range of powers to extend pension liabilities beyond employing companies, to their 'associates' and 'connected persons'. The new offences however apply to 'any person'. Third parties such as banks, trade counterparties and landlords could find themselves at risk of being found to have committed a criminal offence in relation to normal interactions with a pension scheme, which previously carried no responsibility. So could government bodies that deal with the private sector, pension trustees, advisers, insurers, banks that lend to employers, investment counterparties, or anyone who deals with the employer in any capacity whatsoever.

"The PLSA has, and continues to, support the underlying policy objective of creating a criminal offence for the most serious conduct – especially in the wake of the well-publicised BHS and Carillion crises – that harms pension schemes. However, the legislation has set the bar much lower, despite the frequent and unanimous concerns expressed by the industry."

Also, the new criminal offences and £1 million civil fines will apply where the person takes such action without a 'reasonable excuse'. According to Herbert Smith Freehills regional head, Samantha Brown, it is unclear what will amount to a 'reasonable excuse', particularly where decisions and actions are being examined with the benefit of hindsight and in circumstances where things have gone wrong.

"TPR's new powers have significantly increased the risk-profile of running a DB scheme. Although trustees and their advisers are within the scope of the powers, we would expect both barrels of the regulatory gun to be pointing at employers. This provides a real incentive for employers to become more engaged with their trustees and scheme governance generally. They need to be doing the right thing and to be seen to do the right thing, under the watchful gaze of TPR," Squire Patton Boggs partner, Matthew Giles, says.

Impact

For Amin, the new criminal offences could potentially have "significant and far-reaching implications to the UK pension system as we know it".

For example, she says, it leads to questions such as whether a lender requesting additional security to support an increased lending facility for a struggling company with a DB scheme come under the potential scope of the offence, or if a director signing off a dividend is at risk of the offence if a cash contribution is not made at the same time to the DB scheme on what TPR would consider to be an equal footing.

While the prospect of criminal offences is causing the most attention, the two new Contribution Notice Tests will potentially be more significant in terms of their impact, Amin adds.

"For example, it is likely any material restructuring or dividend decision will need to be tested in detail against the new requirements. In some cases, what has previously been considered normal business activity will now breach the requirements, and the sponsor may need to agree mitigation with the trustees of the scheme," she says.

"This could add to board governance costs, because a wider range of corporate activity will need to be considered through the pensions lens, requiring trustees to be involved sooner than usual in the process and for it to be demonstrated that they have balanced the needs of the business with the needs of the pension scheme – which may mean that corporate options will be more constrained than in the past."

Pensions becoming a more focal issue in corporate actions appears to be a primary objective of the legislation, but, Hartley warns, "otherwise beneficial proposals could become uncommercial if pension issues cannot be addressed swiftly and pragmatically. Over time, this could lead to more business failures".

This constraint could also be problematic as the impact of the Covid-19 crisis has illustrated the need for employers to be able to take quick actions in unprecedented circumstances, Dabrowski says.

"The act could result in employers and trustees being afraid to take necessary steps to do what's best for the business and pension scheme in the long run due to fear of falling foul of the offences, or for normal activities to be mired in unnecessary compliance, or simply to stop altogether. There is also the quite real risk that it will deter people from wanting to be trustees."

Independent Trustee Services director, Nita Tinn, agrees that the criminal sanctions will impact the ability to attract and retain both company-appointed and member-nominated lay trustees, "with many likely to be deterred from taking on the role, especially as criminal sanctions are not generally possible to insure against"; the result being an increased need for professional trustees.

Another potential area of impact is with mergers and acquisitions, Aon partner and head of UK retirement policy, Matthew Arends, warns.

"Without the associated regulations, it is unclear what events will need notification and when. But one reading is that companies will have to notify TPR and trustee boards very early in the process of considering corporate transactions. Large companies are sometimes juggling tens or hundreds of potential transactions simultaneously, most of which will never be followed through, so this could be a very significant additional burden on companies – and their trustee boards, who will need to assess the information provided – for little actual improvement in the running of the pension scheme. It also raises material questions about confidentiality of sensitive information. A pragmatic approach is needed," he says.

Approach

Both TPR and the DWP stress that a pragmatic approach will indeed be implemented.

Speaking at the PLSA Investment Conference last year, Pensions Minister, Guy Opperman, said: "I recognise that there are concerns amongst some about the scope of these offences, however I want to just clarify and take the opportunity to highlight that it is the conduct that we are focusing on here.

"It is only an offence if the person intended to harm the scheme, or should've known that the conduct would have that effect, and they have no reasonable excuse for their actions. It is important that where these offences have been committed, the regulator can respond appropriately, no matter who has committed them.

"It is not the government's intention to interfere with routine business activities. We want to improve protections for members, whilst being proportionate to business, you will all understand that this was bought in following the actions of Philip Green.

"These are the people that we are focused upon."

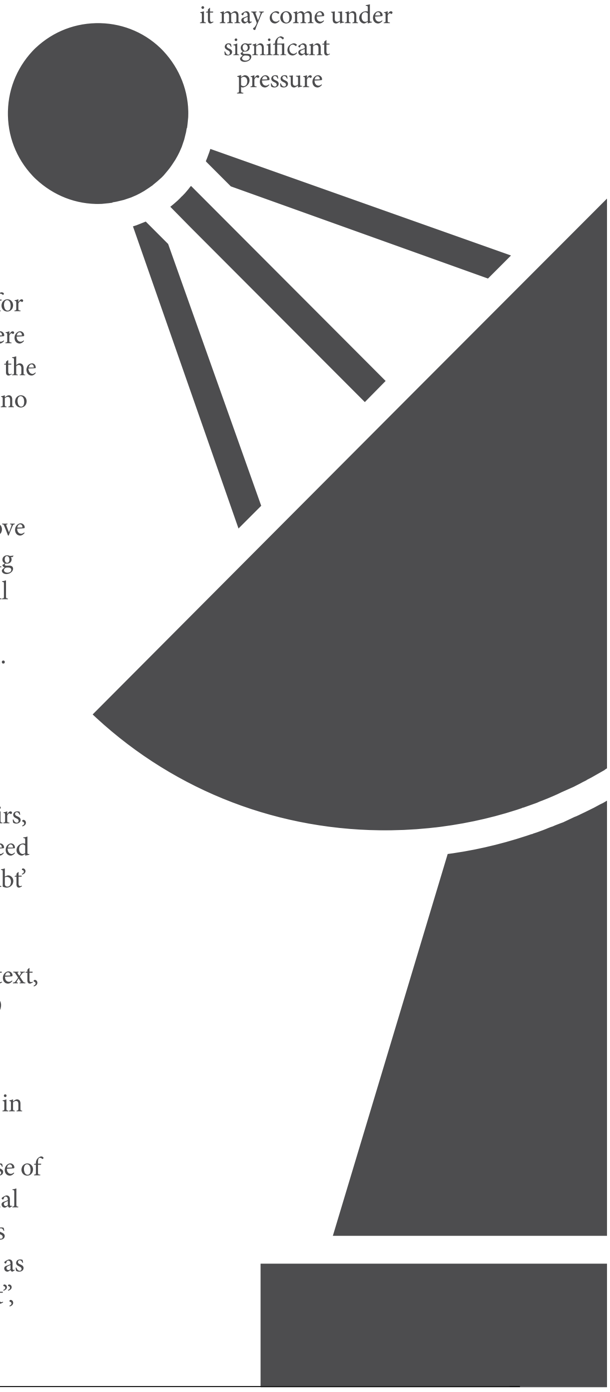
In last month's *Pensions Age*, TPR executive director of regulatory policy, analysis and advice, David Fairs, highlighted how criminal offences need to be proved 'beyond reasonable doubt' – "a high threshold for a prosecuting authority such as TPR to meet".

He also pointed out how the context, such as the challenges with Covid-19 and Brexit, would also be taken into consideration when determining the reasonableness of a person's conduct in relation to the new offences.

Giles anticipates a very limited use of TPR's new powers to institute criminal proceedings, as "the government sees the criminal sanctions mainly acting as a deterrent rather than a punishment", forecasting 0-5 criminal convictions per year (0-2 involving custodial sentences and 0-3 involving substantial fines).

"TPR is much more familiar with the civil sanctions that it has had in its armoury for many years, and with these having a lower burden of proof, we see these as continuing to be the weapon of choice for TPR," he adds.

Although the regulator is likely to be reluctant to use new powers, it may come under significant pressure



to make use of these new powers, particularly when the next high-profile corporate failure involving a DB scheme occurs, Brown warns.

"Therefore, even if the regulator shows restraint external pressures may force it to act, particularly as these powers have been introduced in response to a perception that the regulator has not been tough enough historically."

Meanwhile, SPP president, James Riley, says that it is "very well to say that everything will be ok and just for very bad behaviour but that is not what the law says". Attitudes may change how the courts interpret this act over time, he states, giving the example of how the Human Rights Act has evolved in court from its initial interpretation.

"No one is expecting TPR behaviour to materially change overnight, but there is a tail risk for the industry and for companies that are not part of the industry, such as investors and banks," he says.

Guidance

While Hartley believes that the criminal sanctions "are more a deterrent for egregious behaviour than a likely normal course of action, clear guidance is needed to avoid unnecessary corporate disruption".

This guidance is on its way, with Fairs stating in February's *Pensions Age* that "TPR will work closely with all stakeholders, including through consultation, to produce guidance on the criminal offences".

However, while people are keen to see the guidance, it is important to remember that guidance is not legislation or regulation; "it is not as powerful as the law", Riley states.

In January, the government confirmed that TPR's additional powers will not be applied retrospectively and are expected to be available to TPR by autumn 2021.

Preparation

Even without guidance yet, there are still a number of ways pension stakeholders can prepare for the autumn.

"Despite the fact that these new powers are not expected to come into force until later this year directors, lenders and investors should have regard to them now when making decisions. This is because even though the regulator has indicated that actions and decisions taken prior to these new 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 that take place after that time," Brown says.

Hartley advises trustees and directors to seek training on the Pension Schemes Act, generally get their house in order and take appropriate advice to ensure a clear understanding of governance, funding, covenant and legal structure of their schemes. "Trustee boards should ensure they remain cognisant and mindful of changes to the scheme or covenant that could impact member benefits and if in doubt, take appropriate advice," he adds.

Directors' liability insurance should also be checked to ensure that it covers the various risks including the new civil financial penalty, Amin suggests.

"CFOs and boards will also need to review corporate governance processes for certain activities (likely to include at least refinancing, dividends and restructuring) to ensure that the pension scheme is considered earlier in the decision-making process and that there is an appropriate audit trail. This is likely to be needed throughout a large organisation, and not just a group board level," she says.

Despite the discussions around the scope and impact of TPR's new powers, a February 2021 webinar survey from Sackers found 43 per cent of pension trustees and employers had no concerns about the regulator's powers.

It also found that 40 per cent of respondents were mildly concerned, while just 17 per cent said they were either very or extremely concerned by the changes.

The DWP and TPR will likely be pleased to see such low levels of concern, despite the industry discussions as to the scope and impact of the new powers. After all, the changes are intended to be to the benefit of pension schemes and ultimately members, not to cause fear about well-intentioned actions.

It may also bring about unintended benefits, such as mitigating concerns arising from the reforms to the UK insolvency regime that were introduced last summer by the Corporate Insolvency and Governance Act 2020, Brown says.

"At the time there was considerable concern that the new corporate moratorium and restructuring plan could reduce the amount that DB schemes and the PPF stand to recover in an insolvency scenario. However, the threat of these new powers is likely to limit the use of those mechanisms where a distressed business has a DB scheme," she says.

According to Hartley, although there may be some headline- and attention-grabbing cases, the real benefit is likely to be an increased focus on pensions in the context of corporate activity, "which, alongside the changes to focus on longer-term journey planning, should give trustees of all schemes more influence to put schemes on a stronger financial footing and ultimately pay member benefits".

"We expect the increased powers to make pension scheme issues a key aspect of corporate events, which should ultimately result in better outcomes for pension schemes."

Written by Laura Blows