

# Pension Schemes Act 2021:

## A guide on implications for corporate activity

### Introduction

The Pension Schemes Act 2021 (the **Act**) received Royal Assent on 11 February 2021. It introduces wide-ranging changes that will affect not only employers and trustees of defined benefit (**DB**) schemes, but potentially third parties engaging with them, such as banks and trade unions, and professional advisers to DB pension schemes.

In this briefing, we focus on the boost to the Pensions Regulator (**tPR**)'s armoury of moral hazard powers:

- There will be a new criminal offence for anyone engaging in activity with a materially detrimental impact on scheme benefits. A person found guilty could face an unlimited fine and up to seven years in jail. Alternatively, a civil penalty of up to £1 million could be imposed.
- Two new tests have been brought in for imposing a contribution notice.
- Employers will have to notify tPR in advance of more types of corporate activity.
- TPR's information-gathering powers are also strengthened.

Full regulations and guidance from tPR, clarifying the scope of the new powers, are awaited. TPR has published a consultation on how it plans to use its new criminal sanctions, with responses requested by 22 April 2021, and a further consultation on proposed regulations to govern contribution notices and information gathering powers, with responses requested by 29 April 2021.

To access our table summarising the new powers, [click here](#)

### What type of activity could be caught?

M&A activity, payment of special dividends, company borrowings (particularly where security is granted to a lender), solvent and insolvent restructurings and investment activity could all be caught by the new powers.

Potential lenders and investors are also likely to have more concerns when engaging with businesses that have defined benefit schemes in place.

## Why change?

In the government's view, whilst the existing regime was generally fit for purpose:

- Parts of the regime did not sufficiently deter "wrongdoing" that puts pension scheme members' savings at risk.
- Some gaps in the legislation needed plugging.

According to the government, the changes would assist tPR's ambition to be a "clearer, quicker, tougher" regulator.

## The two new contribution notice tests – a closer look

The Act introduces the following two new tests for the imposition of contribution notices, requiring the recipient to pay a specified amount into a DB scheme:

Test	Criteria	Defence
<b>Employer insolvency test</b>	If someone commits an act or omission that, had the employer gone into insolvency immediately afterwards, would have materially reduced the Section 75 debt recovered by the scheme, then tPR has the power to impose a contribution notice on that person. <sup>1</sup>	The potential recipient may have a defence if they can show that they gave due consideration to the impact of the act or failure to act in advance and:  a. concluded that there was no material reduction in the recoverable debt / employer resources <sup>2</sup> ; or  b. provided appropriate mitigation to the scheme.
<b>Employer resources test</b>	This test looks at the employer's resources measured, according to the proposed approach <sup>3</sup> , on a "normalised profitability" basis before tax, removing non-recurring or exceptional items for greater certainty.	Clearance from tPR will be available.

<sup>1</sup> A Section 75 debt is the most conservative measure of the deficit in a DB pension scheme. It assumes that the scheme's liabilities have been secured with an insurance company.

<sup>2</sup> The meaning of "employer's resources" will be spelt out in regulations.

<sup>3</sup> DWP proposes this approach in its consultation on the employer resources test published on 18 March 2021.

## **Potential implications of the new powers**

### ***More parties could be caught***

Under the existing powers, employers participating in DB schemes, and persons “connected” or “associated” with them<sup>4</sup>, such as other companies in the group and their officers, are within scope. Generally, trustees of DB schemes are not (unless they acting in their capacity as officers of the company).

The new powers will, however, apply to any “person”. This could mean that trustees of DB schemes, lenders, advisers to the trustees and employers (including legal advisers) and, to some extent, insolvency practitioners may be caught. It seems from the debate in Parliament that even trade unions are not necessarily exempt. However, the Act explicitly exempts insolvency practitioners from the scope of the new criminal and civil penalties.

This is likely to be a real game changer and represents a deliberate policy intention of the government. During parliamentary debate, the government stated clearly that any restriction of the persons potentially within scope of the new powers would create a “loophole”. Where the elements of an offence are met, no matter who has committed it, tPR should be able to respond appropriately.

### ***Less room for long/medium-term impacts of corporate activity to be taken into account***

- The new insolvency test does not take into account the actual likelihood of an insolvency. So, the corporate activities of businesses which are not in financial difficulty will still be considered under this new power on the basis that an actual insolvency-type event had occurred immediately after the act or omission in question.
- The resources test looks at the reduction in the value to the employer, but not the potential gains/returns of any activity for the pension scheme.
- The likely impact is that the potential medium- and long-term benefits to the employer group and the pension scheme of any corporate activity are unlikely to be taken into account when determining whether a contribution notice is to be imposed.

<sup>4</sup> “Connected” and “associated” have the meanings given to them under the Insolvency Act 1986.



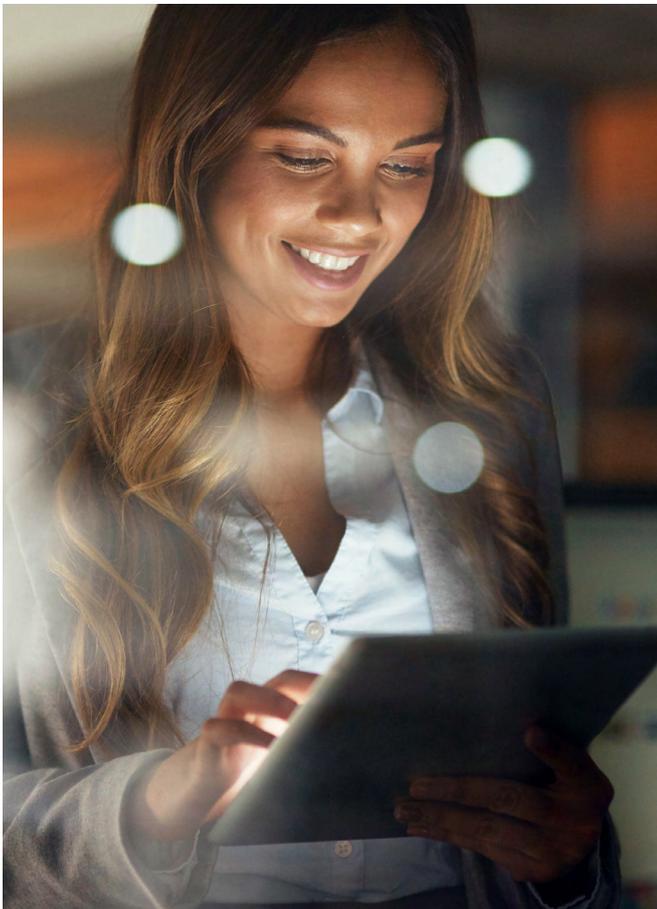
## Uncertainty

Much of the detail as to the scope of the new powers is expected to be clarified under regulations and guidance from tPR. Until these are available, considerable uncertainty will persist as to the scope of the powers.

The new contribution notice powers are subject to a materiality threshold. A lot may turn on what tPR considers to be material.

## More applications for tPR clearance

- The uncertainty as to the new powers is also likely to result in an increase in clearance applications to tPR.
- In particular, scheme advisers may be more reluctant to “take a view” on the extent to which the new powers may be engaged, given the risk of criminal sanctions. The statutory defence is likely to be key here.
- Where the employer (group) provides mitigation to the pension scheme, we think that there is unlikely to be much change in the current practice of not also seeking clearance from tPR in relation to a corporate transaction.



## Early engagement by corporates with scheme trustees

Given the criminal sanctions, DB sponsors will be keen to engage with scheme trustees at an early stage of any corporate activity where the moral hazard powers could be used.

## Trustees and employers should keep risk of tPR powers being engaged under review

Trustees (who would now be within the scope of the new powers) and employers will need to ensure that the risk of the new powers being engaged is kept under review.

## New notifiable events and need to provide a statement

There will be further requirements on employers to notify tPR in advance of certain events, to be set out in regulations. These are expected to include:

- the sale of a material proportion of the business or assets of a scheme employer that has funding responsibility for at least 20% of the scheme’s liabilities. Most TUPE / business transfers will now therefore have to be notified in advance to tPR; and
- granting security on a debt to give it priority over the debt owed to the scheme.

The notification will need to be accompanied by a statement of intent, setting out a description of:

- the event;
- any adverse effects it has on the pension scheme;
- any steps taken to mitigate such adverse effects; and
- what has been communicated with the trustees or managers in connection with the event.

The parties responsible for notifying these events to tPR have been expanded to include:

- other companies in the employer’s corporate group;
- directors; and
- potentially, a director’s spouse or civil partner.



This is in contrast with the scope of the reporting duty under the current notification regime, which only applies to the scheme's trustees and managers.

The Act also requires scheme employers to provide copies of the notification and accompanying statement to the trustees.

The impact of the amendments will likely result in additional and earlier engagement with scheme trustees and tPR, allowing trustees to intervene in potentially concerning corporate activity before it is concluded. There are also new criminal and civil sanctions for non-compliance with the notification requirements.

### **Further information-gathering powers**

The Act enhances tPR's information-gathering powers. In particular, to: (a) require individuals to attend an interview; and (b) permit tPR to enter and inspect premises. The Act also introduces new penalties for non-compliance with the information-gathering powers or for providing false or misleading information to tPR or the trustee.

### **Are the new powers retrospective?**

Whilst this is not spelt out in the Act, the pensions minister, Guy Opperman, has confirmed that none of the provisions concerning the moral hazard powers 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.

That said, when considering if it is reasonable to impose contribution notices under the new powers, it is not clear whether tPR can look back to conduct or events prior to the date of the Act coming into force.

## Summary of tPR's new enforcement powers

### 1. The two new contribution notice tests

Test	Criteria	Defence
<b>Employer insolvency test</b>	If someone commits an act or omission that, had the employer gone into insolvency immediately afterwards, would have materially reduced the Section 75 debt recovered by the scheme, then tPR has powers to impose a contribution notice on that person. <sup>5</sup>	Potential recipient may have a defence if they can show that they gave due consideration to the impact of the act or failure to act in advance and:  a. concluded that there was no material reduction in the recoverable debt/ employer resources <sup>6</sup> ; or
<b>Employer resources test</b>	If, in relation to an act or omission, tPR is of the opinion that the act or omission "reduced the value of the resources of the employer" and the reduction was material relative to the amount of the estimated Section 75 debt in relation to the scheme.	b. provided appropriate mitigation to the scheme.  TPR clearance available.

### 2. New notifiable events and providing statement of intent to tPR

New notifiable events
<p>There will be further requirements on (a) employers (b) other companies in the employer's corporate group (c) directors (and potentially also a director's spouse or civil partner) to notify tPR in advance of certain events. The new notifiable events to be set out in regulations are expected to include:</p> <ul style="list-style-type: none"><li>• the sale of a material proportion of the business or assets of a scheme employer that has funding responsibility for at least 20% of the scheme's liabilities;</li><li>• granting security on a debt to give it priority over the debt owed to the scheme.</li></ul> <p>Scheme employers will have to provide copies of the notification and accompanying statement to the trustees.</p>
Statement of intent
<p>The notification to tPR will need to be accompanied by a statement of intent, setting out a description of: (a) the event; (b) any adverse effects it has on the pension scheme; (c) any steps taken to mitigate such adverse effects; and (d) what has been communicated with the trustees or managers in connection with the event.</p>

### 3. Further information-gathering powers for tPR

The Act enhances tPR's information-gathering powers. In particular, to: (a) require individuals to attend an interview; and (b) permit tPR to enter and inspect premises.

<sup>5</sup> A Section 75 debt is the most conservative measure of the deficit in a DB pension scheme.

It assumes that the scheme's liabilities have been secured with an insurance company

<sup>6</sup> The meaning of "employer's resources" will be spelt out in regulations.

#### 4. New civil and criminal penalties

Action	Target	Criteria	Limits and defences	Sanctions
<b>Avoidance of an employer debt</b>	Any person	<p>Any act or failure to act intended to prevent the recovery of the whole or any part of a Section 75 debt (including any contingent amount).</p> <p>This includes preventing such debt from becoming due, compromising the amount of the debt, or reducing the amount of a debt that would otherwise become due.</p>	The offence is fault-based because there must be an intention to avoid a Section 75 debt. A “person” must have a reasonable excuse for their actions.	Criminal offence. Seven years’ imprisonment or an unlimited fine.
<b>Conduct risking accrued scheme benefits</b>	Any person	Any act or failure to act that detrimentally affects in a material way the likelihood of accrued scheme benefits being received where the person knew, or ought to have known, that such a course of action would be likely to have that effect.	The offence is not fault-based because there is no need to prove any intention to risk accrued scheme benefits (person had to know, or ought to have known, that the action they took would have had the prohibitive result). A “person” must have a reasonable excuse for their actions.	
<b>Providing false or misleading information about a notifiable event</b>	Scheme employer and any person connected or associated with it	Knowingly or recklessly providing tPR with information which is materially false or misleading in relation to duties under the existing notifiable events regime.	Scheme is fully funded on the Pension Protection Fund (PPF) basis (i.e. the funding basis sufficient to ensure the scheme is able to pay PPF level of benefits) and other conditions are met.	Criminal sanctions: Fine or imprisonment for up to two years.
<b>Failing to notify tPR of a notifiable event</b>	Scheme employer and any person connected or associated with it	Failing to comply with the notification requirements under the notifiable events regime.		Civil fine up to £1 million.
<b>Failure to comply with a contribution notice</b>	Any person	Where a contribution notice is issued to a person and the person fails to pay the debt due by virtue of the contribution notice.	A “person” must have a reasonable excuse for their actions.	Criminal offence carrying an unlimited fine or civil fine up to £1 million.
<b>Providing false information to trustees or to tPR</b>	Any person	Person knowingly or recklessly provides information which is “false or misleading in a material particular” to the trustees or tPR.	A “person” must have a reasonable excuse for their actions.	Civil fine up to £1 million.

## KEY CONTACTS



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