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UK PENSIONS REGULATOR CONSULTS ON POLICY FOR NEW CRIMINAL SANCTIONS: SOME COMFORT FOR LENDERS?

The Pensions Regulator has published a consultation on its draft policy (the "Policy") which sets out the approach it will take in the investigation and prosecution of the new criminal offences introduced by the Pension Schemes Act 2021. While the Policy helpfully provides some indication as to how the Pensions Regulator intends to use its new powers (which includes examples in a lending context of where the Regulator does not intend to use them), there remain uncertainties and gaps. In this briefing, we consider the Policy and what comfort it may offer lenders. But while the guidance is helpful, its non-binding nature, combined with statements indicating that the Regulator is to a certain extent reserving its position (the Policy outlines circumstances where the Regulator will not "usually" prosecute) and the lack of guidance from other prosecuting authorities mean that lenders cannot ignore the risks.

Key issues

- The Pension Schemes Act 2021 introduces a new criminal offence in relation to defined benefit schemes for anyone engaging in conduct that detrimentally affects scheme benefits
- The new offence is anticipated to come into force on 1 October 2021
- The Pensions Regulator is consulting on its draft policy setting out how it will use its new powers. The consultation closes on 22 April 2021
- Lenders may be able to derive some comfort from the policy

BACKGROUND

The Pension Schemes Act 2021 (the "Act") introduces a new criminal offence in relation to defined benefit pension schemes for anyone 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). The new offence is not yet in force, but indications are that it may come into force on 1 October 2021 and it is not expected to have retrospective effect (although evidence of intention to engage in conduct before this date may be taken into account).

In our previous briefing note, we noted the key concerns for lenders arising out of the new offence. In the absence of specific exceptions for lenders and lending transactions, lenders will look to the Policy for guidance on whether they could potentially be in the frame when dealing with a borrower group with a defined benefit pension scheme.

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) 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; (b) they knew or ought to have known that the course of conduct "would" have that effect; and (c) they did not have a "reasonable excuse" for engaging in such conduct.
Penalty	A maximum custodial sentence of up to 7 years and/or a fine (unlimited) or new civil penalty up to £1m.

THE POLICY

Scope: the Policy helpfully confirms upfront that the new offence is aimed at the more serious intentional or reckless conduct already within the scope of the Regulator's existing Contribution Notice powers, which are part of the Regulator's moral hazard powers under the Pensions Act 2004 and which lenders will be familiar with and for which a clearance regime operates. This reflects the Regulator's understanding of the Government's policy intent that there is no intention to change the type of behaviour investigated or to instigate a fundamental change in commercial norms and accepted standards of corporate behaviour in the UK. This is to be welcomed. While the offence must be proved on a criminal burden of proof and this burden rests with the Regulator (or other prosecuting authority) to establish, the threshold for meeting the test may not be as high as intended given that in theory there are many circumstances in which an act may detrimentally affect the "likelihood" of scheme benefits being received (e.g. taking on additional company debt, speculative/poor investment decisions) and the reference to detriment could itself be interpreted widely as meaning forms of detriment other than financial detriment (e.g. administrative failures).

Status: the Policy is not legally binding. It will also evolve over time as the Regulator 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 notes that prosecution of the new offence can also be instituted by the Secretary of State or by or with the consent of the Director of Public Prosecutions. The Policy also states that it may not reflect the interpretation of these other bodies or their approach to investigation or prosecution of the new offence. It is unfortunate that the Policy does not represent common and complete guidance.

Material detriment: the new offence is drafted extremely widely – many activities will cause a "material detriment" to a pension scheme and the offence could, in principle, capture common lending activity e.g. taking security from a group with a defined benefits pension scheme or enforcing such security.

When assessing material detriment, the Policy indicates that the Regulator will consider the same factors as it would when looking at a Contribution Notice (CN) on grounds of material detriment. The Policy also advises that the Regulator would not expect to use its new criminal sanction powers where a person could establish a statutory defence to a CN on material detriment grounds. This is useful colour on the factors at play but the absence of any express exceptions for lenders and the fact that the new offence can target 'anyone' means that lenders may have to rely on the reasonable excuse defence. Some comfort may be taken from the fact that the Policy states that its approach to prosecution would be 'in broadly the same circumstances' where they would seek a CN, noting however that there may be circumstances where the Regulator chooses not to pursue a CN, but seeks to consider prosecution (i.e. where the target of the CN has insufficient funds) because its effect as a deterrent would be in the public interest. This could provide some comfort for lenders if clearance has been granted under the CN regime and there has been no material non-disclosure of fact in the clearance application which would enable the Regulator to disregard the clearance.

The Policy also helpfully confirms that when considering what a person ought to have known, this is based on the circumstances as they were at the time of the act and not with the benefit of hindsight based on knowledge of what has happened since. This may be particularly important in a restructuring context, where decisions are often taken in the reasonable expectation that a particular outcome would benefit the business, including its ability to continue to trade and contribute to the scheme, but where ultimately circumstances could transpire that mean that this is ultimately not the case.

Reasonable excuse: noting that what amounts to a reasonable excuse in any particular case will ultimately be fact-specific, the Policy sets out three factors (see the text box) which will be significant in determining whether there is a reasonable excuse for the act or omission, together with examples of specific scenarios (including in the lending context) of where these factors would be at play.

In relation to the first factor, an example is given of ordinary business activity conducted on arm's length terms by an unrelated party, such as a lender refusing, revising or terminating a lending arrangement, where the purpose of the act was unrelated to the scheme. While this is helpful clarification in

Reasonable excuse – 3 factors

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

relation to ordinary business activity, some colour would be helpful on what is meant by "the purpose of the act was unrelated to the scheme". For example, lenders, acting properly, should be able to take into account liabilities under a pension scheme when deciding whether to continue to lend or not, as any deficits to the scheme will be a consideration in their ordinary risk and credit assessment.

In relation to the third factor, the Policy confirms that the Regulator "won't generally expect someone to pursue an alternative that means unreasonably disregarding their interests". The example is given of a lending syndicate being asked to lend further sums and declining to do so, thus triggering an insolvency process. While the syndicate may be aware that this will be the result of refusing to lend and that lending would avoid or reduce the detrimental impact, the Policy confirms that they would not be expected to do so if it was materially against their interests based on a reasonable assessment. Again this example is helpful for lenders in terms of their ordinary lending activities, although what is unreasonable is open to interpretation. Some concerns from a lenders' perspective have also been raised regarding the need to disclose evidence of their lending decisions including legal advice as the Policy states that the Regulator will expect those under investigation to put forward sufficient evidence to provide them with a reasonable excuse.

Lenders may also be able to derive comfort from another example which is where the employer raises debt with prior ranking security to that of the scheme or with a yield that is higher than conventional bank debt, where the new debt is critical for the survival of the business, there is no less onerous source of finance available and the continuation of the employer is a better outcome for the scheme than its insolvency. Even this example could benefit from further clarity to confirm that where rescue finance is provided to the company on commercial terms and where it is simply a condition of the rescue finance that security is required (i.e. to reflect the added risk), it ought not to render a lender susceptible to a criminal sanction for protecting its own commercial interests. Practically speaking, it may also be difficult for a lender to satisfy itself that there is 'no less onerous' finance available.

Also in a restructuring and distressed context, while insolvency practitioners are exempt in the context of formal insolvency proceedings from risk of prosecution under the new offence, there is no guidance in the Policy specifically dealing with pre-insolvency scenarios, where insolvency practitioners often act in an advisory capacity before they take any formal appointment. Such situations are most likely to be impacted by the new offence. It would be very unfortunate especially in the current economic climate if directors were reluctant to explore rescue opportunities with financial advisers and other professional advisors and were unable to do so, due to the enhanced risks introduced by the new offence. While some comfort may be taken from the Policy comments regarding professional advisors acting in accordance with ordinary professional rules and standards and who ought not to be caught, a recognition of the special circumstances that arise in a distressed scenario would be welcomed.

The Policy also notes that proposing or acting in accordance with a scheme authorised by a court under Part 26A of the Companies Act 2006 (CA 2006) could satisfy the "act" and "intention" elements of the new offence, but confirms the Regulator is likely to consider the fact of the court sanction a reasonable excuse, although this does not affect recourse to a Contribution Notice or Financial Support Direction in these circumstances. While this is useful confirmation in relation to a Part 26A scheme (albeit that "likely" is not as definitive as lenders might like), it seems to suggest that the Regulator may be in a position to undermine the court's role in sanctioning a scheme. It also leaves other restructuring processes such schemes under Part 26 of the CA 2006 which are often used in a restructuring context (and also sanctioned by the court) in limbo. Further clarification would be welcomed. We assume that company voluntary arrangements and administrations (including pre-packs) are also intended to fall under the insolvency practitioner exemption, but even this is not entirely clear as the exception could be interpreted to be limited to the insolvency practitioner and not the insolvency processes. The narrower interpretation could therefore result in the process itself being undermined, creating further uncertainty.

Clearance: The Policy confirms that there is no bespoke clearance procedure for the new offence. Although as mentioned above, clearance granted in respect of a transaction that falls under the CN regime may be of some assistance in certain cases and indicate that the Regulator may be unlikely to pursue a prosecution. Regardless of whether a given action is subject to clearance, parties may want to approach the Pensions Regulator for informal comfort, but the guidance gives no steer as to whether such comfort would be given.

WHAT DOES THIS MEAN FOR LENDERS?

The wide scope of the new offence combined with the severe penalties mean that there is some level of risk for anyone dealing with a group with a defined benefit pension scheme. The Policy is helpful in providing some much needed colour on how the Pensions Regulator views the new offence and confirming the Pensions Regulator's view of the policy intent of targeting egregious behaviour rather than ordinary business activity. However, its legally non-binding nature may limit the reliance which can be placed on it, which is exacerbated by the absence of a clearance procedure. It's also not clear when either the Secretary of State or Director of Public Prosecutions might be expected to pursue a prosecution (particularly if the Pensions Regulator has decided not to do so). It is also clear that lenders will need to rely on the defence of reasonable excuse in the absence of any exceptions to what constitutes material detriment. While the examples are helpful in this regard in relation to normal lending activity, whether they will provide lenders with sufficient comfort remains to be seen. As mentioned above there are also some gaps in the scenarios covered, notably for lenders in a restructuring and insolvency context.

WHAT'S NEXT?

The consultation runs until 22 April 2021 and provides the opportunity to input into the Policy. For lenders, further examples would be helpful, particularly in relation to restructurings bearing in mind the rescue culture and the government's aim to facilitate the support of companies in financial distress at an early stage. In terms of the existing examples, some further detail would be helpful e.g. comfort around lenders considering the pension scheme when deciding whether to continue lending. In addition to the examples, some clarity on cases where clearance has been sought under the CN regime in relation to transactions involving lenders and granted or where the Regulator has been kept fully informed and consulted might also assist lenders. Fundamentally, bolstering the Policy in any way can only help lenders in getting comfortable with the new offence and its implications for lending activities.

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