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For the attention also of Pete Serle at the Department for Work and Pensions

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1 INTRODUCTION

1.1 This document has been produced in the context of the Pension Schemes Bill 2019-20 (the "Bill") which was published on 16 October 2019. The Bill was first introduced into the House of Lords and received its first reading on 15 October 2019. Although the 2017-2019 Parliament dissolved at the end of the 2019 Session, the Bill was re-introduced into the House of Lords on 7 January 2020 in substantially the same form as the original Bill. We are making these comments on the Bill as re-introduced.

1.2 The Bill contains a number of provisions which have the potential negatively to impact financially distressed businesses and genuine attempts to restructure those businesses for the benefit of all stakeholders (including the beneficiaries of a pension scheme). This is why the City of London Law Society (CLLS) Insolvency Law Committee and the Insolvency Lawyers Association's Technical Committee have decided to write to you formally.

1.3 By way of background, the ILA provides a forum for approximately 500 full, associate, overseas and academic members who practise restructuring and insolvency law. The membership comprises a broad representation of regional and City solicitors, barristers, academics and overseas lawyers. The Technical Committee of the ILA is responsible for identifying and reporting to members on key developments in case law and legislative reform in the insolvency and restructuring arena.

1.4 The CLLS represents approximately 17,000 City lawyers, through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. The CLLS Insolvency Law Committee, made up of solicitors who are expert in the field, has prepared the comments below in response to the Consultation. Individuals and firms represented on this Committee are set out in the Appendix.

1.5 We have limited our comments below to those that are of specific relevance to insolvency and restructurings – rather than to those involved in pensions law more broadly. We have also kept our comments to a high level but would be happy to discuss or expand on any of the comments made in this response, if requested.

2 SUMMARY

2.1 For companies that are in distress, the issues we have highlighted below, particularly in any negotiations with trustees, are compounded. The way in which the new offences are framed could disincentivise responsible directors and other stakeholders to pursue a turnaround plan or a pension scheme compromise that could ultimately benefit the pension scheme, instead making it more likely that directors will file for insolvency rather than risk personal criminal liability by continuing to trade.

2.2 We are also concerned that the proposed expansion of the grounds for the Pensions Regulator ("tPR") to issue contribution notices under its "moral hazard" powers would have a similar impact on distressed companies as the new criminal offences.

3 Criminal offences[1]

3.1 The Bill proposed three new offences which could have detrimental consequences for companies in distress and their pension schemes. For the purposes of this response, we are not addressing the proposed new section 40A of the Pensions Act 2004 – *Offence for failure to comply with a section 38 contribution notice*.

3.2 The first offence of "risking accrued scheme benefits" applies where any person engages in an **act or conduct that they knew or ought to have known would have a "materially detrimental effect" on a defined benefit pension scheme**.[2]

3.3 Directors of a distressed employer may need to make decisions for the employer to continue trading rather than filing for insolvency because they consider that the prospects of securing a restructuring for the benefit of all stakeholders, including the pension scheme, are reasonable. Those decisions may include expending resources to continue trading and could reduce the amount ultimately available to the pension scheme if the restructuring is not successful. Under the terms of the current draft legislation, such decisions could fall within the scope of the offence of "risking accrued scheme benefits".

3.4 Whilst a person will not be committing the offence if they had "reasonable excuse" for the act or conduct, without further clarification in the legislation this is unlikely to provide sufficient comfort for directors of distressed companies that they will be protected from criminal liability. The test appears to be subjective and context-dependent; even interpretation in guidance may be considered insufficient for reliance for individuals where criminal liability is at stake. Directors may therefore be more likely to take the view that they should cease trading rather than run the risk of facing a fine and/or up to seven years in prison if they decide to continue trading.

3.5 The second offence applies where any person commits an act that **prevents the recovery of a section 75 debt** due to a defined benefit pension scheme or otherwise **compromises or settles such a debt**.[3] This offence would catch arrangements permitted under legislation such as regulated apportionment arrangements which have been used by companies in distress to manage a section 75 debt. It would also apply to compromises of employer debts through company voluntary arrangements or to compromises outside the Pension Protection Fund ("PPF") where benefits above PPF levels are provided. This offence could apply to both employers in distress and to trustees that use statutory mechanisms to compromise a section 75 debt. It also applies to acts that prevent the occurrence of a relevant event under section 75(4C) of the Pensions Act 1995 on which a debt is contingent, again potentially catching

[1] These can be found in clause 107 of the Bill
[2] To be inserted as section 58B of the Pensions Act 2004
[3] To be inserted as Section 58A of the Pensions Act 2004

legitimate restructuring activity. Again "reasonable excuse" may provide little comfort to such employers or trustees, particularly as there are no details of how this would operate in practice.

3.6 The civil penalty provisions (to be inserted as sections 58C and D) include within their scope as parties to an act or failure any persons who knowingly assist in the act or failure. In addition, section 309 of the Pensions Act 2004 creates potential personal liability where an act by a body corporate is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, a director, manager, secretary or other similar officer etc. and thus the net of potential liability is spread very widely, subject only to the defence of 'reasonable excuse'.

3.7 We wish to highlight the following concerns about each of these offences:

(a) The criminal sanctions of up to seven years in prison risk undermining the rescue culture – which would have a detrimental impact on restructurings more generally, and goes against the government's aim to improve the insolvency system to support companies in financial distress[4] in line with global trends to facilitate restructurings at an early stage.

(b) In contrast to the "moral hazard" powers of tPR, these new offences would apply to **any person** (rather than just to parties connected with the pension scheme employer). This means they could apply to acts of third parties, including banks considering lending to a corporate with a defined benefit pension scheme, companies wishing to buy a business out of a group with a defined benefit scheme and other commercial counterparties (such as suppliers) dealing with groups with such schemes.

The offences could also apply to professional advisers, even where the advice is provided to a statutorily-sanctioned arrangement such as a company voluntary arrangement, see above. We note that there is a carve out for the criminal offences of avoidance of employer debt or conduct risking accrued scheme benefits if the act or conduct in question reflects the person's functions as an insolvency practitioner.[5] This does however not reflect the reality that insolvency officeholders are engaged from the outset of a restructuring in the structuring of the deal and will be engaged at a much earlier point in time than when the official appointment occurs. At that earlier stage, the relevant practitioners will be acting in a broader, financial advisory, role as against the narrower capacity of insolvency officeholders. Additionally, it is often impossible to say, at the outset of a particular transaction, whether formal insolvency proceedings will be required as part of that transaction, or whether the parties may reach a consensual restructuring outside the formal insolvency framework.

Insolvency practitioners will therefore be concerned and wish to have some comfort that their advice in the lead up to any insolvency will not expose them to the risk of criminal liability. This, together with the fact that there is no carve out for other professional advisers, such as lawyers, will make it harder for a distressed corporate to obtain proper advice. The easy availability of such advice is especially crucial to preserve value and jobs during the restructuring process.

To give some hypothetical examples, suppose that a corporate has asked for an additional short-term lending facility to tide it over during a restructuring process. The lenders may consider providing such funding but, due to the relative risk of return may ask for security to be provided. This security may rank ahead of the pension scheme – if the restructuring is ultimately not successful, will the lenders be considered to be criminally liable as they knew that a failed restructuring would be detrimental to the pension scheme?

On its face the lenders will commit a criminal offence unless they can be said to have acted with reasonable excuse, but how are lenders to assess such "reasonable excuse"?

[4] See Insolvency and Corporate Governance – Government Response issued on 26 August 2018 here
[5] To be inserted as section 58A(4) and section 58B(8) of the Pensions Act 2004

Is a lender's pure commercial interest in not providing the loan without first obtaining additional security a reasonable excuse? What about the situation where a lender has existing security and permits a company in distress to draw down on an RCF to attempt a successful restructuring? The lender in these circumstances again knows that if the restructuring were to fail, the company's exposure to the lender is increased. This is likely to have an adverse consequence for the pension scheme. Is the lender criminally liable for having permitted the drawdown? Concerns about such a risk may well make third parties, such as banks who are critical to the success of a restructuring, reluctant to participate in it.

(c) Finally, the Bill lacks any specific safe harbour provisions, although it does say that no offence will be committed if there is "reasonable excuse" for the conduct. We have explained above our concerns about the uncertainty as to how the "reasonable excuse" would operate in practice.

4 Expansion of moral hazard powers[6]

4.1 We are also concerned that the addition of two new grounds to the circumstances where tPR has power to issue a contribution notice under section 38 of the Pensions Act 2004 (the "PA 2004") may lead companies to file for immediate insolvency rather than attempting a restructuring that may ultimately benefit the pension scheme.

4.2 These new grounds are:

(a) **Employer insolvency test**. This test will be met where there is a deficit and there is an act or failure to act which materially reduces what the pension scheme would have recovered from the employer if there had then been an immediate insolvency.[7]

(b) **Employer resources test**. This test will be met if tPR takes the view that the act or failure reduced the value of the employer's resources, and that the reduction was material compared with the buy-out deficit.[8]

4.3 Whether a restructuring ultimately is successful will be a question of hindsight and if it fails, there is a risk that the pension scheme will recover less than if there had been an immediate insolvency at an earlier point in time. It may result in the directors of a company preferring to file for immediate insolvency and increase the risk of the company entering the PPF, rather than risk an unsuccessful restructuring and civil as well as criminal sanctions arising in consequence. This may be value destructive both for the company's creditors more broadly as well as depriving the company (and the pension scheme) of the chance of turning the situation around. It also diminishes the value of tried and tested approaches – for example, where a defined benefit employer sells a business and the proceeds are partly distributed, a parent company guarantee or other security could mitigate any potential detriment to the scheme; but these structures would not eliminate the reduction in the employer's resources and therefore the parties would be at risk of tPR taking the view that it remained reasonable to impose liability for the act, even though by current standards appropriate mitigation had been put in place.

4.4 In addition, the ability to establish a defence to these new grounds is limited by the requirement that in each case the directors must, having regard to all the relevant circumstances of which they are aware or ought reasonably to be aware, reasonably conclude that the act or failure to act **would not** have the relevant negative effect. Thus the risk of a contribution notice could result in companies filing for immediate insolvency rather pursuing a restructuring that could ultimately benefit the pension scheme.

4.5 As with the offences considered above, the parties to an act or failure to act include anyone who knowingly assists in the act or failure to act. In relation both to the new offences and the new

[6] These can be found in clause 103 of the Bill
[7] To be inserted as sections 38C-D of the Pensions Act 2004
[8] Section 38E-F

contribution notice tests, there is also concern about possible retrospectivity, due to suggestions that references in the White Paper may be taken to have put individuals 'on notice' of issues that are only now being clarified in draft legislation.

5 Pensions Regulator notifications

5.1 The Bill introduces a new requirement to notify tPR of certain corporate activity and to provide statements to tPR about the impact of that activity on the defined benefit pension scheme – essentially setting out what the transaction is, whether there is an adverse impact on the pension scheme, what mitigation is proposed and whether there has been trustee engagement.

5.2 For companies in distress, these new notification requirements could be particularly problematic:

(a) The Bill does not provide any details on the specific events requiring notification and a statement that these will be set out in regulations and tPR directions. However, it is expected that the events will include (i) change of control of an employer, (ii) sale of material assets and (iii) granting security which ranks ahead of the pension scheme.

(b) The timing of notifications, particularly if notification is required before a transaction takes place, could delay actions that needed to be taken in order to preserve value and employment. Such risk of delay will need to be addressed in any regulations that set out the detail of the notification requirements.

5.3 In addition, where a company in financial distress needs to borrow new money in order to give a restructuring a chance of success, the notification requirements may be triggered – as it may be a condition of any lender providing new money that the company grants security which may rank ahead of the pension scheme.

5.4 We are therefore concerned that any notification requirements should not apply a blanket "one size fits all" rule, and in particular, that they do not hinder any chances of financially distressed companies restructuring successfully, particularly as companies that fail to comply with the new notification requirements will risk facing a significant civil penalty.

If you have any queries, please contact the Chair of the City of London Law Society's Insolvency Law specialist Committee, Jennifer Marshall, at jennifer.marshall@allenovery.com in the first instance.

10 January 2020

Appendix 1

The members of the City of London Law Society Insolvency law specialist committee are herewith:-

http://www.citysolicitors.org.uk/clls/committees/insolvency-law/insolvency-law-committee-members/