Hogan Lovells

Recent developments in pensions

Hogan Lovells Pensions Team

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The new single code of practice: implications for trustees

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Single Code of practice – why?

Code of practice	Code in force	Part of new code
01: Reporting breaches of the law	April 2005	✓
02: Notifiable events	April 2005	×
03: Funding defined benefits	July 2014 (GB) July 2015 (NI)	×
04: Early leavers	May 2006	✓
05: Reporting of late payment of contributions to occupational pension schemes	September 2013	✓
06: Reporting of late payment of contributions to personal pension schemes	September 2013	✓
07: Trustee knowledge and understanding (TKU)	November 2009	✓
08: Member-nominated trustees/member-nominated directors – putting arrangements in place	November 2006	✓
09: Internal controls	November 2006	✓
10: Modification of subsisting rights	January 2007	×
11: Dispute resolution – reasonable periods	July 2008	✓
12: Circumstances in relation to the material detriment test	June 2009	×
13: Governance and administration of the occupational trust-based schemes providing money purchase benefits	July 2016	✓
14: Governance and administration of public service pension schemes	April 2015	✓
15: Authorisation and supervision of master trusts	October 2018	×

tPR draft single code of practice

- Consultation ends 26 May 2021
- (Currently) 51 topic-based modules
- 5 sections:
  - Governing body (most new things here)
  - Funding and investment (nothing on funding…will be incorporated later)
  - Administration
  - Communication and disclosure
  - Reporting to tPR
- Expectations at standard “appropriate for any well-run scheme”
- Various exemptions for small schemes (under 100 members) but recommended to comply anyway

Board structure and activities

- **Recruitment**
  - Trustees to have processes for exercising any powers in recruiting / appointing members
  - Include: gaps in skills/competencies; succession plan; assessment of fitness and propriety of candidates; resignation and removal policy

- **Meetings and decision-making**
  - Effective system of governance: in “most cases” will need to meet quarterly
  - “*Create a process for rescheduling postponed meetings*”; who is responsible for agenda and who is consulted in its development; setting expectations of trustees on preparation for meetings
  - Consider publishing board papers, agendas, minutes (redacted if appropriate)

Remuneration policy

- Applicable to all persons who effectively run the scheme; carry out key functions; or whose activities materially impact scheme's risk profile
- Explain decision-making process for the levels of remuneration and why these are considered to be appropriate
- Review at least every three years – but in most cases annually will be appropriate
- Publish on website or otherwise make available to members

Managing advisers and service providers

- Follow tPR's expectations for processes for selection, appointment, management and replacement
- Written policies for appointments, reviewed at least every 2 years
- Regularly assess performance against agreed KPIs and SLAs; record outcomes and track progress
- Periodically review the market

Continuity planning

- Should have resilient business continuity plan (BCP) that sets out key actions in case a range of events occur that impact the scheme's operations
- Prioritise scheme activities in the event of the BCP being triggered, for example pensioner payments, retirement processing and bereavement services
- Set out roles and responsibilities within the BCP, and agree these with service providers
- Ensure advisers and service providers have a BCP

Own risk assessment

- Schemes should carry out own risk assessment (ORA) of their system of governance
    - Assessment of how well governance systems are working, and the way potential risks are managed
    - Document how assessed effectiveness of each policy/procedure and whether consider it to operate effectively

- ORA is a "*substantial process*" and "*the first such exercise may be a significant piece of work*". However, it should "*not be perceived as an item of tick-box compliance, or an unnecessary burden*"

- ORA should be recorded – tPR may ask to see them…

- Document first ORA within 12 months of date code in force

- Subsequent ORAs annually or if material change in risks

Stewardship

- Trustees should understand investment managers stewardship policies and have process for monitoring and reviewing them
- Identify and account for the systemic risk of climate change in decisions made about the scheme's investment and funding
- Consider co-operation with other institutional investors in engaging with investee companies on ESG issues
- Seek to follow, where appropriate, the Financial Reporting Council's UK Stewardship Code

Cyber

- Have a cyber-security policy
- Assess vulnerability of the scheme to a cyber incident
- Consider accessing specialist skills and expertise to understand and manage the risk
- Receive regular reports from service providers on cyber risks and incidents

Takeaways

- Increased governance obligations in particular - perhaps a “compliance with code” document/policy
- Regulator recognises the different policies “*should be proportionate to size, scale, nature and complexity of scheme activities*”
- Continuing the incentives for aggregation of schemes / increasing role for professional trustees
- tPR will start a rolling programme of reviewing their guidance
- Good idea…?

New criminal offences: the Regulator's approach to investigation and prosecution

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The new offences

- Introduced by Pension Schemes Act 2021
- Not yet in effect
- Regulations and Regulator guidance will provide more detail
- tPR consulting on policy for prosecution of criminal offences (closed 22 April 2021)
- Prosecutions can be brought be tPR, Secretary of State or DPP
- Minister has confirmed new CN powers and criminal offences won't be retrospective but tPR's draft policy suggests evidence from before commencement could be relevant to investigation

Crimes & penalties

New offence of avoiding employer debt:

- Person (except an insolvency practitioner) engages in conduct (including failure to act) which prevents recovery of a s75 debt; prevents a s75 debt becoming due; reduces the amount of a s75 debt etc; AND
- Person intended the act to have this effect; AND
- Did not have a reasonable excuse

New offence of risking scheme benefits

- Person (except an insolvency practitioner) engages in conduct (including failure to act) that detrimentally affects in a material way the likelihood of accrued DB benefits being received; AND
- Person knew or ought to have known the conduct would have this effect; AND
- Did not have a reasonable excuse

Can also cover anyone who helps or encourages this conduct

Penalties in both cases:

- Criminal: unlimited fine, or prison term of up to 7 years
- Civil: fine of up to £1 million

Crimes & penalties

New offence of failing to comply with contribution notice

- Criminal: unlimited fine

New offence: Notifiable Events; inspection of premises and interviews

- Criminal: knowing/reckless provision of materially false or misleading information: unlimited fine or imprisonment up to two years
- Civil: breach of statutory duties: Penalties up to £1m; daily escalating penalty of up to £10k per day

New penalty: knowing/reckless provision of materially false or misleading information to a DB trustee

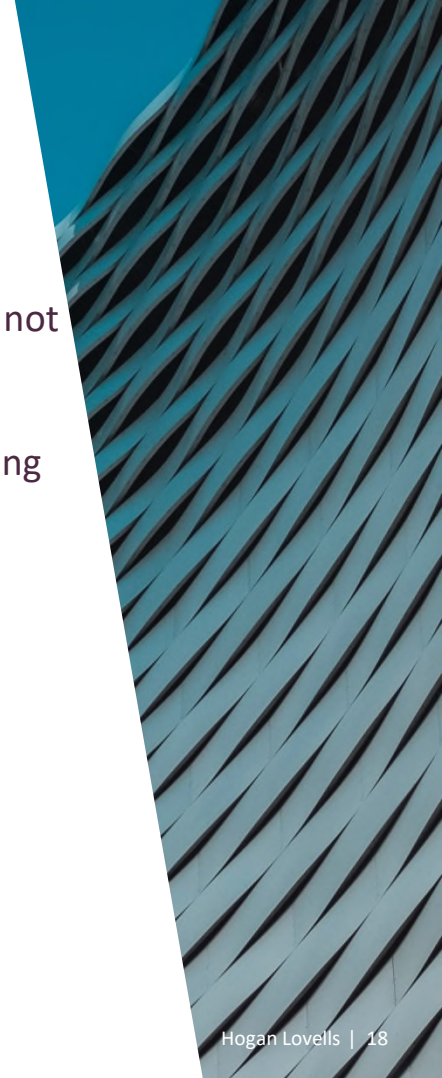
- Civil: Penalty of up to £1m

Draft policy: Selection for prosecution

- tPR's approach guided by HMG policy that offences not intended to achieve fundamental change to commercial norms
- Choice of CN or prosecution guided by efficiency; deterrent and warning to others
- Existing policy on prosecutions (June 2016) states tPR will consider and apply the Code for Crown Prosecutors (evidence test; public interest test)
- Selection of cases for prosecution:
  - Primary purpose is abandonment
  - Unreasonable and significant financial gain
  - Scheme treated otherwise unfairly
  - tPR or PPF have been misled or not informed
  - No limitation period (unlike a CN)
- Selecting an individual for prosecution:
  - Relationship, duties and proximity to employer, scheme and the act
  - Extent of involvement or influence
  - Benefits received
  - Expectation of significant decision making power but help and encouragement of decision makers could also be prosecuted

Examples of actions that might be prosecuted

- Sale of employer which benefits from a parental guarantee, where guarantee is not replaced and trustee is not told in advance
- Purchase of an employer, mismanagement of business, extraction of value leading to insolvency of employer
- Asset stripping of employer damaging covenant
- Engineering insolvency of employer, so business can be purchased without the scheme



Draft policy: Other comments

- **Other factors tPR may take into account**
  - Extent of communication and consultation with trustees
  - Compliance with statutory duty to notify TPR
  - Openness and promptness of communication with TPR

- **Fair, balanced and impartial; early engagement**

- **Evidence of intentions from before commencement date of offences can be taken into account**

Draft policy: Reasonable excuse

- tPR must prove beyond reasonable doubt there is no reasonable excuse for offences of avoiding employer debt and risking scheme benefits
- But defendant expected to explain reasons and provide evidence during investigation phase
- Assessment of reasonable excuse:
  - Incidental not fundamental
  - Adequacy of mitigation
  - If no mitigation, was there another route less damaging to the scheme?
  - How fairly was the scheme treated?
  - Benefits of action/inaction
  - A person is not expected to pursue paths that unreasonably disregard their interests
- Professional adviser acting in accordance with professional duties and ethical standards likely to have a reasonable excuse
- CIGA 2020 scheme could be an “act” but court sanction likely to amount to reasonable excuse (but might still consider FSD/CN)

Examples of reasonable excuse

Reasonable:

- Employer's business harmed by supplier or customer terminating a business relationship or lender terminating a loan where the purpose of conduct is unrelated to the scheme
- Employer's business affected by protest by pressure group opposed to employer's activities
- The employer's business is disrupted by employee industrial action
- Employer benefiting from wider group support sold to third party with some proceeds paid to the scheme and new group entities provide guarantees
- Employer grants security but on basis it is subordinated to scheme's claim
- Employer with well funded scheme, transfers cash to treasury but keeps a right to demand repayment
- Employer raises debt on expensive terms where no better deal was available and continuation of employer is better for the scheme than insolvency
- Lending syndicate refuses further debt in liquidity crisis triggering insolvency

Not reasonable:

- Supplier terminates contract to cause insolvency to buy the business without the scheme

Suggested steps to take in practice?

Create governance structures that give confidence that you will spot transactions that might be caught

- Identify the group of key individuals who would know about any transaction that might adversely affect a DB pension scheme and
  - Require them to consider impact on your DB schemes and any material adverse impact on the covenant of the counter-party if it sponsors a DB scheme
  - Ask them to assess whether the transaction is a notifiable event
- Remind them of the issue annually and update them on tPR regulatory updates and cases pursued

Talk to the trustee when there may be a relevant transaction

- Often required under any agreement to share information agreed with trustee (which often includes arrangements to protect confidentiality)
- tPR will take this into account when assessing actions
- Trustee's reaction and agreement to mitigation can provide reassurance

Create an audit trail

- Introduce a compulsory section for Board papers
  - showing impact on Scheme considered and whether Head of Pensions has been involved
  - commenting on if it is a notifiable event and whether event has been notified

Regulatory intervention: why the Regulator acted against the owners of Silentnight

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Agenda

- Brief summary of the case
- Why was it significant?
- Why did tPR bring the case?
- Reflections
- Ramifications for the future

Summary of the case

- tPR sought the issue of CNs against U.S. private equity firm HIG
- HIG bought the Silentnight business out of administration in 2011
- That administration followed HIG having bought the secured debt that Silentnight owed its bank, Clydesdale, with the objective of acquiring the business free of certain liabilities (including the pension scheme). This was a "loan-to-own" strategy
- An RAA, then a CVA, was pursued, but negotiations with the PPF and tPR failed
- HIG made demands under its secured lending, triggering an administration
- Administrators (from KPMG) were appointed; HIG was the winning bidder

Why was it significant?

- Not many reported CN cases

- Unusual procedural history:
  - Two Warning Notices:
    - 2014 seeking £17.2m (later updated to £32.1m; the case being HIG bought the business at an undervalue)
    - 2016 seeking £96.4m (the case being HIG precipitated an unnecessary insolvency)
  - 2016: judicial review challenge by HIG
  - Very long investigation (tPR started investigating in 2011, and the matter was only referred to the Determinations Panel in March 2020). The case settled for £25m in early 2021

- Raised some very interesting questions, e.g.:
  - Can it be reasonable to impose a CN on a third-party buyer who had no prior responsibility for the scheme?
  - Is any "material detriment" suffered if the sponsoring employer was heading for insolvency in any event?
  - What principles govern the amount it is reasonable to award under a CN?

Why did tPR bring the case?

- It is (now) clear that tPR will investigate pre-pack administrations as a matter of course

- But tPR chose not to proceed in other pre-pack / PE cases. For example:
  - **Brintons**: Carlyle bought secured debt from Lloyds Bank in August 2011, and bought the business out of a pre-pack administration in September 2011
  - **Bernard Matthews**: Rutland made a profit of £13.9m in 2016 having previously provided £20m of funding at a 20% interest rate

- Moral hazard cases are highly fact-specific

- Resource allocation within tPR will, no doubt, be a factor: Silentnight was unusually lengthy and costly

Reflections

- Restructurings / insolvencies of sponsoring employers will almost inevitably cause tPR to think about investigating moral hazard action; pre-packs certainly will

- tPR doesn't like parties doing deals other than on terms tPR/PPF agree

- Moral hazard cases are a "blunt tool":
    - Can be very lengthy, expensive and complex
    - tPR sometimes struggles with taking consistent positions in different contexts

- Will tPR do things differently in future?
    - Closer liaison with trustees?
    - Stick to one WN?
    - Quicker process?

Ramifications for the future

- Silentnight was a high-profile case

- But, in our view, its significance is heightened because the question of what scope there is for restructurings of employers sponsoring DB schemes is highly topical, and is reinforced by a number of developments:
    - Pension Schemes Act 2021, particularly new criminal offences that overlap with CN powers
    - An anticipated increase in restructurings as COVID-inspired Government support is withdrawn
    - New restructuring tools under the Corporate Insolvency and Governance Act 2020 ("CIGA")
    - Tightening of regulations concerning pre-pack administrations

Looking forward

- **Clearance:**
  - Likely increase in clearance applications (will tPR increase resources to process them efficiently?)
  - Getting clearance can be challenging in distressed situations, as there is often a narrow window of opportunity to close a deal

- **Impact on rescue culture**:
  - Clearly there is now heightened regulatory risk for lenders/investors (and indeed advisors)
  - Will this have a chilling effect on restructurings where DB pension schemes are involved? Will job-saving restructuring/refinancing opportunities be lost?

- **tPR guidance is likely to be of little help to Trustees/employers/lenders**:
  - Understandable desire to maintain flexibility
  - The moral hazard jurisdiction was (and is) unusually broad in scope, and there remains little legal precedent to clarify how the regime works in certain respects
  - The supposedly moderating requirement of “reasonableness” in the statute in practice provides cold comfort: people can (and often do) have radically different views about what is reasonable in a given case

Any questions?

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