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The Pension Schemes Act 2021 – Implications for lenders

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By Tom Farrell

The Pension Schemes Act was introduced following the failures of the BHS and British Steel pension schemes with the intention of strengthening the powers of the Pensions Regulator and introducing new criminal sanctions. The Act introduces two new offences under which criminal liability can extend to third parties, which will include any lender who makes a loan to an employer with a defined benefit pension scheme.

The new offences comprise:

1) Committing an act that prevents a pension scheme from recovering all or any part of a Section 75 Debt from the employer, with the intention that such act would have that effect.

   A s75 debt is payable by a company directly responsible for funding the pension scheme and is calculated by reference to the cost of purchasing an insurance policy to provide the benefit. Such a debt can arise on the insolvency of the employer and the winding up of the pension scheme, or when the employer otherwise leaves the group.

2) Engaging in action or conduct that detrimentally affects, in a material way, the likelihood of accrued scheme benefits being received, with the knowledge that such act or conduct would have that effect.

These offences carry potential criminal sanctions of an unlimited fine or up to seven years imprisonment. Lenders who make loans to borrowers who have defined benefit pension schemes should therefore be alive to the fact that there is the potential for criminal liability under these offences although, as outlined below, where a lender's conduct falls within the scope of the offences, it will generally be an adequate defence if a lender is acting in its best commercial interests.

The offences will not apply where the relevant party has a "reasonable excuse" for acting in the way that it did. Although the Act itself does not specify what constitutes a reasonable excuse, the Regulator has issued a policy which provides guidance on this point and lists three factors which the Regulator considers to be significant in assessing whether the party did indeed have a reasonable excuse:

- the extent to which the detriment to the scheme was an incidental consequence of the act or omission;

- the adequacy of any mitigation provided to offset the detrimental impact; and
- where no, or inadequate, mitigation was provided, whether there was a viable alternative which would have avoided or reduced the detrimental impact.

The Regulator has also made clear that the new powers are intended to address only the most egregious conduct and that it is not the intention to interfere with ordinary, commercial activity. A lender acting in its own commercial interests is therefore unlikely to fall foul of the regime where any detrimental impact on the pension scheme is incidental to actions taken by the lender.

Examples of steps taken by lenders which may be detrimental to a pension scheme but where the lender is nevertheless likely to have a reasonable excuse for acting in such a way may include:

- taking or enforcing security, with the result that the lender ranks ahead of the pension scheme on the insolvency of the employer;
- terminating or varying a lending arrangement, where the objective is unrelated to the pension scheme (for example, where a lender makes a commercial decision to no longer lend into a particular sector); or
- deciding not to lend because the pension scheme could cause the borrower's insolvency, for example where the trustees have the power to wind up the pension scheme and trigger a s75 debt.

The risk of prosecution is therefore low where the lender is acting in furtherance of its own commercial interests and the onus is on the Regulator to demonstrate that a lender does not have a reasonable excuse. Lenders may, however, wish to further protect themselves and mitigate any risk by ensuring that they have fully considered all relevant factors and have reached the firm conclusion that there is a reasonable excuse for taking the actions in question. Such mitigating steps could include:

- Carefully considering the financial health of the borrower before providing funding. It follows that, if the borrower is on a strong financial footing at the time of the financing, there will be a lower risk of the Regulator seeking to take action in connection with the pension scheme.
- Carrying out due diligence on the funding position of the pension scheme and taking specialist advice if necessary.
- Considering how the proposed lending will affect the position of the scheme trustees. For example, have the scheme trustees obtained any security from the Borrower?
- Ensuring that the scheme trustees are aware of the proposed financing and have expressed a view on how such financing may affect the scheme. If the trustees have given their express approval to the financing, this may further lower the risk of regulatory action.
- Accurately recording any decisions to lend, so as to provide documentary evidence that all relevant factors have been carefully considered in reaching the conclusion that there is a reasonable excuse.