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UK Pensions Briefing

The Pensions Regulator's draft policy on its new criminal powers

April 2021

The Pensions Regulator is consulting on a draft policy which outlines how it intends to investigate and prosecute the two key criminal offences which were created by the Pension Schemes Act 2021 (the Act) and are expected to come into force from October 2021. These are the offences of avoiding employer debt and putting scheme benefits at risk. Conviction for either offence is punishable by up to seven years in prison and/or an unlimited fine.

Why is this policy needed?

As we outlined in a recent briefing on the Regulator's stronger powers, the wide drafting of these new criminal offences brings uncertainty as it has the potential to capture ordinary corporate business activities. The Regulator recognises this in the consultation. The policy is an attempt to clarify when companies and individuals can expect to be at risk of prosecution.

There is a defence of "reasonable excuse" for the new offences, but the Act does not explain what that means. The Regulator's new draft policy attempts to do so.

Does the policy remove the areas of uncertainty?

Not as currently drafted. The policy gives some helpful illustrative examples and outlines some principles for use of the powers, but plenty of grey areas remain.

While the examples given in the draft policy are helpful, they are arguably not particularly challenging or nuanced. However, this may be deliberate: the challenge for the Regulator is to strike a balance between providing reassurance and not unnecessarily limiting its discretion.

Norton Rose Fulbright LLP intends to respond to the Regulator's consultation on the policy before it closes on April 22, 2021. The policy is expected to be finalised by the autumn.

When does the Pensions Regulator expect to prosecute?

The Regulator explains that the new offences are not intended to fundamentally change the standards of corporate behaviour in the UK and that it does not expect the introduction of the offences to change the type of behaviour it investigates. Rather, the new prosecution powers give it more options when responding to serious cases.

The Regulator understands the powers to be aimed at enabling it to punish the more serious intentional or reckless conduct of the type that was already within the scope of its "Contribution Notice" powers (i.e. the power to require certain companies or individuals connected with an employer of a defined benefit (DB) pension scheme to pay money to the scheme). The policy also states that the Regulator would expect to consider a case for prosecution in broadly the same circumstances that it would consider seeking a Contribution Notice.

Given that the Regulator has only rarely used its Contribution Notice powers to date, this is broadly reassuring. However, it is still a wider view of what the powers are for than the Government's original intention (as set out in the [2018] White Paper) that they should be used to punish *"wilful or grossly reckless behaviour".*

The Regulator could pursue both a prosecution and a Contribution Notice in parallel but may also decide to prosecute without seeking a Contribution Notice or vice versa. This will depend on factors such as the target's resources and the public interest.

The Regulator does not explain when it would look to use its other new power to impose civil fines of up to £1 million either in preference to, or alongside, pursuing a criminal prosecution or a Contribution Notice.

Examples of cases which the Regulator considers may be appropriate to prosecute are where:

- The primary purpose of the conduct is the abandonment of a scheme without provision of appropriate mitigation.
- Significant financial gains have been unreasonably made to the detriment of a scheme.
- There has been some other unfairness in the treatment of a scheme.
- The trustees, the Regulator and/or the Pension Protection Fund have been misled or not appropriately informed.

What is a "reasonable excuse"?

Given the wide drafting of the criminal offences and the wide range of everyday activities that could be caught by it, the most important part of the policy is what will count as a "reasonable excuse". An offence will only be committed if a person does not have a reasonable excuse.

The policy explains that the legal burden of proof will be on the prosecution to establish the absence of a reasonable excuse. This is a potentially onerous requirement; however, the Regulator does not interpret this to mean it will need to identify and disprove every possible excuse which a person could raise. Instead, it will expect those investigated to put forward a positive, evidenced case.

The Regulator expects the basis for any reasonable excuse to be clear from contemporaneous records such as meeting minutes, correspondence and written advice notes. This is of immediate significance given that the policy also states that evidence from a time before these new powers come into force may be used in the investigation or prosecution of actions occurring after that point.

A key take-away for trustees, employers and others falling within the scope of the offences is to make sure to keep a paper trail of all key decisions that could affect the pension scheme and the reasoning behind them and to get into that habit now.

Although the Regulator will assess all relevant factors when considering whether a person had a "reasonable excuse", it considers the following three factors significant:

1. Incidental detriment – The degree to which any detrimental impact on the scheme was an incidental consequence of the relevant act or omission, as opposed to a fundamentally necessary step to achieving the person's purpose. For example, harm done to the employer's business because a supplier or customer terminates a business relationship or a lender refuses to lend could be considered incidental detriment.
2. Adequate mitigation – The degree to which adequate mitigation was provided to offset the detrimental impact. For example, the employer grants security to entities outside the direct covenant but subordinates it to the scheme's liabilities.
3. Viable alternative – Where no or inadequate mitigation was provided, whether there was a viable alternative which would have avoided or reduced the detrimental impact. For example, the employer raises debt with prior ranking security to that of the scheme, where the new debt is critical for the survival of the business and no less onerous source of finance is offered.

The extent to which the person under investigation openly consulted with the trustees and the Regulator before acting and whether or not they complied with the notifiable events regime will also be influential.

Is it acceptable for a person to take their own interests into account?

The policy suggests that it will be reasonable in many circumstances for a person to take their own interests into account, particularly where the impact of their conduct on the scheme is incidental.

The Regulator gives as an example a lender refusing to extend further lending to an employer, knowing this could trigger an insolvency. The Regulator would not expect them to lend *"if it was materially against their interests, e.g. if they assess there is a high risk of default..."*.

What is not clear from the current policy is the extent to which the Regulator would expect a person who has no legal obligations towards a pension scheme (e.g. a lender) to consider the scheme's interests when reaching a commercial decision. For example, would that person have to consider mitigation and viable alternatives (factors 2 and 3 above) if the impact of their actions on the scheme was only incidental? Arguably, the more incidental the consequence, the less reasonable it would be for the Regulator to expect someone to consider these points – or to consider the scheme at all.

Is it possible to get clearance for a course of action?

No, the policy confirms that clearance is not available in relation to the criminal offences.

There is no applicable limitation period in relation to prosecution under the new criminal offences (in contrast to Contribution Notices, where the Regulator only has a six-year "look-back" period). So in principle, a person can remain at risk of criminal prosecution indefinitely.

Given that Contribution Notices can be issued in very similar circumstances, if clearance is granted in respect of a Contribution Notice, it should follow that the Regulator will not use its criminal powers either. However, this is not confirmed in the policy.

Will a person who complies with this new policy be safe from prosecution?

Not exactly. Complying with the policy will help reduce the risk of a successful prosecution but will not entirely remove it.

While it is clear that the authors or the policy have tried to be as helpful as possible, offering several examples of what probably would and would not result in a prosecution, these are only examples and every case will be assessed on its own facts.

The Regulator is not the only prosecuting authority for these offences, which also include the Secretary of State and Department of Public Prosecutions in England and Wales, the Crown Office and Procurator Fiscal Service in Scotland and the Public Prosecution Service in Northern Ireland. The policy notes that these other authorities may have differing approaches and that it is ultimately the courts that will decide the correct interpretation of the new laws. We understand, however, that the Pensions Regulator is actively discussing its draft policy with the other authorities.

What are the main steps I should be taking to reduce the risk of criminal prosecution?

The importance of a careful paper trail cannot be understated. Trustees and employers should get in the habit now (if they are not already) of carefully documenting their decision-making process whenever corporate activity of any kind could negatively affect the pension scheme.

Trustees and employers should also review and keep updated their existing governance structures and policies in the light of this emerging policy and the new legislation to ensure all relevant corporate activity is properly considered at an early stage and by the right people. They will need to be familiar with the Regulator's policy, assess the transaction with the policy's principles in mind and consider whether it would be appropriate to engage with the Regulator in advance of the transaction.

Lenders and others who are less directly involved in decisions affecting DB pension schemes should also consider taking advice on their current governance and decision-making processes to minimise the risk of Pensions Regulator action.

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