Hogan Lovells

New offences, penalties and powers for the Pensions Regulator: what employers and trustees should know

Updated August 2021 Pension briefing

HIGHLIGHTS

The passage of the Pension Schemes Act 2021 (the Act) into the statute books has received press coverage far beyond the usual pension industry commentary. New criminal offences and civil penalties, plus increased powers for the Pensions Regulator (tPR), have raised concerns not just among sponsoring employers of defined benefit (DB) schemes but also from those with a wider relationship with these employers, such as group parent companies and the employer's lenders.

In particular:

- The Act creates new criminal offences, some punishable by up to seven years' imprisonment, plus a new civil financial penalty of up to £1m.
- The circumstances in which tPR can issue a contribution notice (CN) requiring funding to be made to a DB scheme will be widened.
- tPR will have increased powers to demand information, inspect premises or require an individual to attend an interview.
- The notifiable events regime, requiring tPR to be told of specified events, will be extended.
- The scheme specific funding regime will be strengthened, with a new requirement for trustees to prepare a "funding and investment strategy".

Most provisions are not yet in force. tPR has recently consulted on a draft policy on how it will approach investigation and prosecution of the new criminal offences. Following consultation, final regulations have been issued in relation to the new employer resources test and tPR's extended information gathering powers (please see below). We expect consultation on further draft regulations and guidance before tPR's new powers have effect.

This note explains the various changes made by the Act and explores some of the implications for employers, trustees and others.

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- New criminal offences and penalties
- Contribution notices
- Notifiable events
- Information gathering powers
- Scheme funding

This does not cover other changes provided for by the Act, which include: the introduction of collective defined contribution (CDC) arrangements; the establishment of pension dashboards; power to make regulations imposing new requirements relating to climate change; and amendments to the individual transfer regime to help combat pension liberation fraud.

WHEN IS THE ACT IN FORCE?

The Act received Royal Assent on 11 February 2021 but is not yet in force, apart from creating powers to make regulations.

When various provisions of the Act will have effect has been the subject of much speculation and, in particular, has raised concerns that tPR's new powers could be applied retrospectively to actions occurring before the Act is in force.

The Act itself is silent on the subject of retrospectivity. However, the Pensions Minister gave some clarity in January this year in an answer to a Parliamentary question. According to the Minister:

- tPR will consult with the pensions industry and then issue guidance on the use of the new criminal sanction powers. (At the time of writing, tPR has issued its draft policy on investigation and prosecution of criminal offences for consultation.)

- The aim is for other powers in Part 3 of the Act which require details to be set out regulations to be available to tPR by autumn 2021. These powers concern:
  - offences in relation to the avoidance of employer debt;
  - extension of the notifiable events regime;
  - information gathering, including powers for tPR to interview and inspect premises; and
  - offences of providing false or misleading information to tPR or trustees.
- Two areas which are also covered by Part 3 of the Act but which do not require regulations are:
  - the new civil penalty of up to £1m; and
  - tPR's extended powers to issue a contribution notice (CN).
- The Minister also confirmed that no provisions in Part 3 of the Act will be retrospective. The criminal sanctions and the information gathering powers will apply to schemes where the act occurs, or a series of acts commences, after the powers come into force.

NEW PENALTIES

The Act creates significant new offences and penalties. Most are aimed at strengthening tPR's ability to safeguard accrued rights in defined benefit (DB) schemes. However, the new financial penalty under section 88A may be imposed in relation to both DB and defined contribution (DC) schemes.

On 11 March 2021, tPR issued consultation on its draft policy on the investigation and prosecution of the new criminal offences. tPR points out that prosecutions of the new offences may also be brought by the Director of Public Prosecutions or the Secretary of State, and that tPR's policy may not reflect the approach of these other bodies.

Section 88A: new financial penalty up to £1m

New section 88A of the Pensions Act 2004 (PA04) will enable tPR to impose a financial penalty (a **"section 88A penalty"**) of up to £1 million where it is satisfied that, by reason of an act, section 88A applies to a person. A section 88A penalty may be imposed on individuals as well as on corporate bodies.

Regulations may increase the upper limit for a penalty above £1 million.

Where a section 88A penalty could be imposed on a corporate body and the act in question was done with the consent or connivance of:

- a director, manager, secretary or other similar officer (or someone purporting to act in that capacity); or
- a member (where the corporate body is managed by its members),

a section 88A penalty may be imposed on that person instead of on the corporate.

Similarly, a section 88A penalty may be imposed on a partner of a Scottish partnership.

No section 88A penalty may be imposed on a person who has already been convicted of an offence or required to pay a penalty under section 10 Pensions Act 1995 in respect of the same act, or who is currently subject to criminal proceedings.

To impose a section 88A penalty, tPR must issue a notice specifying the amount of the penalty and giving at least 28 days for it to be paid.

Glossary

Contribution notice (CN): a notice issued by tPR requiring the recipient to make an immediate financial contribution to a defined benefit (DB) scheme.

Financial support direction (FSD): a direction issued by tPR requiring the recipient to put financial support in place in relation to a DB scheme (which could be a financial contribution, or a guarantee/contingent asset).

Clearance: parties concerned about intervention by tPR may apply for clearance which, if granted, provides comfort that it will not exercise its powers to issue a CN or FSD in relation to a particular transaction. Clearance is usually only granted if the scheme trustees support the application and if either there is no weakening in the employer covenant, or "mitigation" is provided to offset the reduction in the covenant.

Section 75 debt: a DB scheme's section 75 debt (under section 75 of the Pensions Act 1995) is the difference between the value of its assets and the value of the liabilities, calculated as if the benefits were being bought out with annuities from an insurance company.

Avoidance of employer debt: new imprisonable offence and section 88A penalty

Avoidance of a section 75 debt (please see the box below) will be an offence, punishable by imprisonment for up to seven years and / or an unlimited fine.

A person may commit this offence by doing an act (or failure to act) or engaging in a course of conduct which:

- prevents the recovery of the whole or part of a section 75 debt which has become due;
- prevents a section 75 debt becoming due;
- compromises or settles a section 75 debt; or
- reduces the amount of a section 75 debt which would otherwise become due.

However, an offence will only be committed if:

- the person intended the act or course of conduct to have one of the above effects; and
- the person did not have a reasonable excuse.

Alternatively, tPR may impose a section 88A civil penalty of up to £1m for avoidance of employer debt, in circumstances similar to the conditions for the new offence of avoiding an employer debt described above, provided that the "main purpose" test is met and any failure to act is *"deliberate"*. In relation to a section 88A penalty, this means that the main purpose (or one of the main purposes) of the act or deliberate failure to act was to have one of the impacts on a section 75 debt set out above.

A section 88A penalty may also be imposed on someone who *"knowingly assists"* in the act or deliberate failure to act.

Reminder: when is a section 75 debt payable?

Each sponsoring employer participating in a DB scheme has a potential (contingent) liability to pay a "section 75 debt".

A sponsoring employer's section 75 debt is its share of the scheme's overall section 75 debt, determined broadly by reference to the value of the benefits built up by the employer's own employees compared to the value of the total accrued benefits under the scheme. An employer's section 75 debt will include its share of any "orphan liabilities" (liabilities in respect of any members whose employer no longer participates in the scheme and where the former employer has no ongoing obligation to pay contributions).

A sponsoring employer's 75 debt will become due when:

- the scheme goes into winding-up;
- the employer becomes insolvent (or goes into solvent winding-up); or
- where a scheme has multiple employers, one of the employer stops employing active members (employees currently earning pension benefits) when the scheme continues to have active members employed by other employers.

Conduct risking accrued scheme benefits: new imprisonable offence and section 88A penalty

Risking accrued DB benefits (please see the box below) will be an offence, punishable by up to seven years' imprisonment and / or an unlimited fine.

A person may commit this offence by doing an act (or failure to act) or engaging in a course of conduct which *"detrimentally affects in a material way the likelihood of accrued scheme benefits being received"*.

However, an offence will only be committed if:

- the person knew, or ought to have known, that the act or course of conduct would have that effect; and
- the person did not have a reasonable excuse.

When deciding whether the *"material detriment"* test above is met, tPR expects to adopt the same approach as when it considers issuing a CN on grounds of material detriment (please see below), and to take account of factors set out in legislation, its Code of Practice and guidance.

Alternatively, tPR may also impose a section 88A penalty, in similar circumstances to the conditions for the new offence of conduct risking accrued scheme benefits. However:

- a section 88A penalty may only be imposed in relation to a failure to act if the failure was *"deliberate"*; and
- a section 88A penalty may also be imposed on someone who *"knowingly assists"* in the act or deliberate failure to act.

What are accrued rights?

For the purposes of the new offence and financial penalty, rights to accrued benefits:

- mean rights which have accrued by the time of the act, failure to act, or the end of a course of conduct (the *"relevant time"*);
- are rights calculated as if the member left pensionable service on or before the relevant time; and
- do not include compensation from the Pension Protection Fund (PPF) or Financial Assistance Scheme (FAS).

New criminal offences: tPR's approach to investigation and prosecution

tPR has set out its approach to investigation and prosecution of the new criminal offences in a draft policy, issued for consultation in March 2021.

- tPR will be guided by its understanding that the new offences were *"not intended [by the government] to achieve a fundamental change in commercial norms or accepted standards of corporate behaviour in the UK"*. Instead, the policy intent was for the new offences to punish (and deter) the abandonment of a DB scheme without appropriate mitigation; or other unfairness in the treatment of the scheme.
- It will be for the prosecution to prove that the target did not have a *"reasonable excuse"* for the act or omission (please see below).
- Professionals, acting in accordance with their professional duties, conduct, obligations and ethical standards are likely to have a *"reasonable excuse"* and so not be liable for a criminal offence.
- Whether tPR decides to issue a CN or prosecute a criminal offence (or both) will be guided by the efficient use of its resources. Where a target's resources mean that any recovery under a CN would be low, tPR may still decide it is in the public interest to prosecute.
- Other factors tPR will consider when deciding whether to initiate or continue a criminal investigation include:
  - the extent of communication and consultation with the pension trustees;
  - compliance with any statutory duty to notify tPR of certain events; and
  - openness and timeliness of communication with tPR.
- tPR considers it may take into account evidence from before the criminal offence provisions are in force (widely expected to be on 1 October 2021), for example if the evidence demonstrates a person's intention.
- Where appropriate, discussion with tPR will take the form of an interview under caution, conducted in compliance with the Police and Criminal Evidence Act 1984.

New penalties: implications for employers, trustees and others

The circumstances in which the new offences of avoidance of employer debt or conduct risking accrued scheme benefits might be committed (or a section 88A penalty imposed) are wide-ranging and include:

- preventing a section 75 debt becoming due by arranging for a ceasing employer in a multi-employer scheme to continue to employ at least one active member (thus avoiding an employer-cessation event);
- reducing the amount of a section 75 debt which would become due from an employer in a multi-employer scheme, through use of an apportionment arrangement or other statutory mechanism (carried out in accordance with the relevant legislation);
- regular corporate activity such as: payment of dividends; share buybacks; taking on of secured debt with higher priority than the pension trustees; restructuring; or mergers and acquisitions.

There are specific exemptions from both offences (or section 88A penalties) for insolvency practitioners, but not for other professionals. Potentially, an offence could be committed not just by a sponsoring employer but also by its parent company, trustees if they agree to the conduct, and others who might have *"aided and abetted"* the commission of the offence.

There is no limitation period applicable to the criminal offences, meaning that a prosecution could be brought at any future time. In contrast, a CN may only be issued if tPR issues a warning notice to the target within six years of the target's act (or failure to act).

A number of industry bodies (many of whom Hogan Lovells is actively involved with) have expressed concern about the potential breadth of these new offences.

Reasonable excuse: who must show what?

The new offences will only be committed if the person *"did not have a reasonable excuse"* for the act or failure to act. In debates in Parliament, the government made clear that the prosecutor must prove that the person had no reasonable excuse. In other words, not having a reasonable excuse is a necessary part of the offence (rather than being a defence – which would have to be claimed and evidenced by the person accused). If the prosecutor cannot prove beyond reasonable doubt that the accused person did not have a reasonable excuse, then no offence is committed.

However, tPR makes clear in its draft investigation and prosecution policy that it expects those it investigates to explain their actions and to put forward evidence of any matters which might constitute a reasonable excuse. In particular, it expects the reasons behind particular action (or inaction) to be well documented, including consideration of alternative approaches and any assessment that no material detriment would arise.

When assessing whether a person has a reasonable excuse, tPR considers three factors to be significant:

- Whether the detrimental effect was an *"incidental consequence"* of the act (or omission), or a *"fundamentally necessary step to achieve the person's purpose"* (please see the box below). The more the detriment is incidental, the more likely the person would be to have a reasonable excuse.
- The adequacy of any mitigation to offset the detrimental effect, approached in a similar way to tPR's assessment of mitigation in clearance cases.
- Where there was no (or inadequate) mitigation, was there a *"viable alternative"* which would have avoided or reduced the detrimental effect? For example, there may be no viable alternative where new secured debt is critical to the employer's survival and the continuation of the employer is a better outcome for the scheme than the employer's insolvency.

tPR makes clear that it expects pension schemes to be treated fairly, but it does not expect persons to pursue an alternative which would unreasonably disregard their own interests.

Examples : incidental or fundamental ?

- **Incidental**: harm to the employer's business is caused by ordinary commercial activity on an arm's length basis, such as a lender withdrawing a lending agreement, or a customer taking its business elsewhere.
- **Incidental**: the employer's business is disrupted by industrial action, or by the protests of a pressure group against the employer's activities.
- **Fundamental**: termination of a contract by a key supplier, with the intention of causing the employer's insolvency and enabling the supplier's subsequent purchase of the employer's business, without taking on the pension liability.

Would clearance help?

The clearance regime applies only in relation to issuing by tPR of CNs and FSDs (please see the Glossary above) and tPR expects clearance applications to be made only by persons who could be subject to a CN or FSD.

While the scope of the clearance regime does not extend to the new criminal and civil penalties, it should be difficult for tPR to convince a court that a person had no reasonable excuse for an act (or failure to act) in respect of which it had previously given clearance.

We therefore anticipate that tPR will see an increase in clearance applications.

Failure to comply with a contribution notice: new offence and section 88A penalty

The Act introduces a new requirement for a CN (please see the Glossary above) to specify a date by which the amount specified in the CN must be paid.

A recipient of a CN who fails, without reasonable excuse, to pay the debt due under the CN by the specified date:

- will be guilty of an offence, punishable by an unlimited fine; or
- may be given a section 88A penalty of up to £1m.

Implications of criminal prosecution for employers, trustees and others

In the case of criminal sanctions, it will be for tPR, the Secretary of State or the Director of Public Prosecutions to decide whether to instigate proceedings. A trial would take place either before magistrates or, on indictment, before a jury.

In contrast, many of tPR's regulatory functions (including the power to impose a civil penalty under section 10 of the Pensions Act 1995 or a new section 88A penalty) are exercised by tPR's Determination Panel, made up of experienced individuals who operate independently of tPR. Civil cases concerning pension schemes are usually heard in the Chancery Division of the High Court, with the parties represented by senior barristers who have significant experience in trusts and pension law.

While there will be no criminal liability unless the person did not have a "reasonable excuse", this will be of small comfort to companies and individuals faced with making decisions about corporate restructurings and other legitimate corporate activities, especially where a course of action involves a degree of risk. What is considered a reasonable excuse in relation to an act (or failure to act) will depend on the particular situation. Magistrates and jurors will not usually have experience of running pension schemes or large companies – but criminal liability will hinge on their view of whether there is a reasonable excuse for a course of action.

CONTRIBUTION NOTICES

The circumstances in which tPR may issue a CN (please see the Glossary above) will be extended. A new **"employer insolvency test"** and an **"employer resources test"** will be introduced, and tPR may issue a CN where either of the new tests is met in relation to a person's ("target") act or failure to act.

tPR may only issue a CN (in respect of any test) where:

- it believes it is reasonable to do so, taking into account specified considerations; and
- it issues a warning notice in respect of the CN within six years of the act or failure to act.

Reminder: when may tPR (currently) issue a CN?

At present, tPR may issue a CN if it is of the opinion that:

- the *"material detriment"* test is met in relation to the target's act or failure to act; or
- the main purpose or one of the main purposes of the act or failure to act was to:
  - prevent the recovery of the whole or part of a section 75 debt; or
  - prevent a section 75 debt becoming due, compromise or settle a section 75 debt, or reduce the amount of a section 75 debt which would otherwise become due.

Broadly, the material detriment test will be met if tPR considers that the target's act (or failure to act) has "*detrimentally affected in a material way the likelihood of accrued scheme benefits being received*".

A person who *"knowingly assists"* in an act or failure to act may also be subject to a CN.

New employer insolvency test

The employer insolvency test will be met if tPR considers that immediately after the target's act or failure to act (the *"relevant time"*):

- the value of the scheme assets was less than the amount of the liabilities (as estimated by tPR, on the section 75 debt basis); and
- if a section 75 debt had fallen due from the employer, the target's act (or failure to act) would have materially reduced the amount of the debt likely to be recovered by the scheme.

The new test may also be met by a series of acts, or failures to act.

Employer insolvency test: defence

tPR must not issue a CN in relation to the employer insolvency test where the target meets Conditions A to C below or, alternatively, can rely on Condition D.

- **Condition A:** before becoming a party to the act (or failure to act), the target gave *"due consideration"* as to how, if a section 75 debt became due from the employer immediately after the relevant time, the act or failure might materially reduce the amount of a section 75 debt likely to be recovered. Giving *"due consideration"* for this purpose means taking such steps as a reasonably diligent person would have done;
- **Condition B:** the target took all reasonable steps to eliminate or minimise the potential for the act (or failure to act) to have such an effect (where relevant); and
- **Condition C:** having regard to all relevant circumstances, it was reasonable for the target to conclude that the act (or failure to act) would not materially reduce the amount of section 75 debt likely to be recovered.

The target will also have a defence if tPR is satisfied that immediately after the relevant time the value of the assets was at least equal to the value of the liabilities (**Condition D**). (The Act does not set out on what basis the values of the assets and liabilities are to be determined for the purposes of Condition D but it is likely to be the section 75 debt basis).

New employer resources test

The employer resources test will be met if tPR considers that:

- the act (or failure to act) reduced the value of the sponsoring employer's resources (determined in accordance with regulations); and
- that reduction was a *"material reduction"* relative to the amount of the estimated section 75 debt which would be due from the employer on a winding up, calculated as at the time immediately before the act (or failure to act).

The new test may also be met by a series of acts or failures to act.

Following consultation, the DWP has confirmed that an employer's resources for the purpose of the new test means the employer's profits before tax (PBT), adjusted to exclude the effects of non-recurring or exceptional items. It will be for tPR to decide:

- whether an item is non-recurring or exceptional;
- the value of any non-recurring or exceptional items; and

- the effect of the act or failure to act on the employer's resources.

The pension industry has raised concerns that the new test lacks clarity, in particular around what non-recurring or exceptional items tPR will exclude when calculating an employer's PBT, and how tPR will assess whether a reduction in the employer's resources is "material". The Association of Consulting Actuaries (ACA) has pointed out that where a scheme is well funded (with a low potential section 75 debt) a reduction in employer resources would be a higher percentage of the potential section 75 debt (and so, on a simplistic basis, more "material") than the same reduction in relation to the potential section 75 debt if the scheme were less well funded.

Employer resources test: defence

tPR must not issue a CN in relation to the employer resources test where the target can demonstrate that it meets Conditions A to C above, except that *"due consideration"* must be given to the extent to which the act or failure to act might reduce the value of the employer's resources relative to the amount of the estimated section 75 debt.

There is no Condition D defence in relation to the employer resources test.

Code of practice

tPR will be required to explain the circumstances in which it expects to issue a CN in relation to the employer resources test or the employer insolvency test in a code of practice. A draft code and code-related guidance was issued for consultation in May 2021.

NOTIFIABLE EVENTS

Part 3 of the Act includes amendments to the requirements to notify certain events to tPR.

New notifiable events requirement

A new section 69A will be inserted in the Pensions Act 2004, applicable (broadly) to defined benefit (DB) schemes.

Section 69A will require an *"appropriate person"* to notify tPR of:

- a prescribed notifiable event (including a failure to act) in relation to the employer;
- a material change (as defined in regulations) in a notifiable event, or in the expected effects of a notifiable event in relation to the employer; or
- the non-occurrence of a notifiable event in relation to the employer.

The Explanatory Notes issued alongside the Act state that the obligation to notify the non-occurrence of a notifiable event only applies where tPR has already been notified of the event. However, this is not clear on the face of the Act.

What will be a "notifiable event" under section 69A?

A *"notifiable event"* for the purposes of new section 69A will be defined in regulations.

According to the February 2019 response to consultation, there will be two new employer-related notifiable events:

- sale of a material proportion of the business or assets of a scheme employer which has funding responsibility for at least 20% of the scheme's liabilities; and
- granting security on a debt to give it priority over debt to the scheme.

What constitutes a *"material proportion"*, *"funding responsibility"* and *"scheme liabilities"* (for the purposes of the 20% test) should be set out in regulations, backed up by guidance from tPR to avoid uncertainty for businesses.

It is worth noting that not all granting of security will place pension trustees in a worse position – for example, security given on the refinancing of existing debt on identical terms.

Who is an appropriate person?

An *"appropriate person"* for the purposes of section 69A will mean each of the following:

- the scheme employer;
- a person connected with the employer;
- an associate of the employer; and
- a person of a prescribed description.

Section 69A duties will therefore apply also to other companies in the employer's corporate group, as well as to directors and, potentially, to a director's spouse/civil partner and certain other relatives (plus to any other persons prescribed in regulations).

In contrast, only scheme employers and the trustees or managers are subject to the current notification requirements under section 69 (there is power for regulations to apply section 69 to other persons, but this has not been used).

To avoid multiple notifications of the same event, it would be sensible for regulations or guidance to allow the notification requirement to be treated as being satisfied when one of the appropriate persons has given notice of the notifiable event on behalf of all the appropriate persons.

Background: what is (currently) an employer notifiable event?

Employer notifiable events under the current section 69, are:

- a decision by the employer to take action which will (or is intended to) result in a debt due (or which may become due) to the scheme not being paid in full;
- the employer ceasing to carry out business in the UK (or a decision that the employer will cease carying out businss in the UK);
- an employer's breach of a banking covenant (except where the lender agrees not to enforce the covenant);
- relinquishing control (or deciding to relinquish control) of the employer;
- the conviction of a director (or partner) of the employer for a dishonesty offence.

The government has said that it intends to remove wrongful trading from the current list of notifiable events.

Accompanying statement

Notice of a notifiable event, or of a material change in a notifiable event, must be sent with an *"accompanying statement"* containing prescribed information, including a description of:

- the notifiable event;
- any adverse effects of the event on the scheme;
- steps taken to mitigate the adverse effects; and
- any communication with the trustees or managers about the event.

When must notification be given?

The notification must be given:

- as soon as reasonably practicable after the appropriate person becomes aware of the notifiable event, material change, or non-occurrence of a notifiable event; and
- if required by regulations, at least a prescribed period before the notifiable event or material change.

At the same time as providing the notification and accompanying statement to tPR, the appropriate person must give copies of these to the trustees.

In consultation the DWP proposed bringing forward the time at which notice of certain events should be given, such as to the agreement of heads of terms. Concerns were raised that "heads of terms" is not sufficiently well-defined and would not be helpful as a trigger for notification. In response, the government said that it intends to assess the impact on business of the proposed changes.

Will there be any exceptions?

tPR may direct that the section 69A notification requirement will not apply in certain circumstances.

tPR has a similar power in relation to the existing requirements under section 69 and has used this to provide that certain events need not be notified where the scheme is at least fully funded on the Pension Protection Fund (PPF) basis and other conditions are met.

It would be logical for tPR to make similar exemptions in relation to the new notification requirements but whether it will do so remains to be seen.

Penalties for non-compliance

Knowingly or recklessly providing tPR with information which is materially false or misleading in relation to duties under the existing section 69 or new section 69A will be a criminal offence under section 80, punishable by a fine or by imprisonment for up to two years.

Civil fines of up to £1m under new section 88A may be imposed on a person who, without reasonable excuse, fails to comply with the requirements under section 69A. Section 88A will also apply to failure to comply with section 69.

Code of practice

tPR will be required to cover the notification requirements under the new section 69A in a code of practice.

Given the serious sanctions for non-compliance, it is to be hoped that tPR gives clear indication and examples of the events which should be notified and of the information expected in the accompanying statement.

INFORMATION GATHERING POWERS

As expected, the Act significantly increases tPR's powers to obtain information from individuals and businesses.

Power to interview

tPR will be able to require individuals to attend an interview to answer questions and provide explanations on matters which are relevant to the exercise of tPR's functions.

The scope of the interview power is wide-ranging, and may be applied to:

- a trustee or manager of an occupational or personal pension scheme;
- a professional adviser in relation to an occupational pension scheme;
- an employer in relation to an occupational pension scheme;
- an employer which makes direct payments to a personal pension scheme in relation to its employees; or
- any other person tPR considers holds, or is likely to hold information relevant to the exercise of its functions.

tPR must give notice to the intended interviewee, setting out the time and place of the interview; the matters on which the person interviewed will be expected to answer questions or provide explanations; plus other matters prescribed in regulations. Following consultation, the prescribed requirements include that the notice must also explain how the interview process will be conducted and that the interviewee has the right to be represented at the interview.

Failure, without reasonable excuse, to attend an interview, answer a question or provide an explanation as required will be an offence, punishable by an unlimited fine.

The Act will also repeal section 72(1A) of the Pensions Act 2004, which currently prohibits tPR from requiring a person to give information which might incriminate the person or the person's spouse or civil partner. It is not yet known whether section 72(1A) will be repealed at the same time as the new criminal offence provisions come into force, or on another date.

Inspection of premises

tPR's existing power will be extended to permit it to enter and inspect *"premises liable to inspection"* to investigate whether:

- there are grounds for issuing a CN or FSD (please see the Glossary above) in relation to an occupational pension scheme; or
- requirements of specified pension legislation are being, or have been, complied with in relation to an occupational or personal pension scheme.

The inspection of premises may be carried out at any reasonable time.

What are *"premises liable to inspection"*?

For the purposes of this power, tPR may currently only enter premises if its inspector has reasonable grounds to believe that:

- scheme members are employed there;
- documents relevant to scheme administration are kept there; or
- the administration of the scheme, or work connected with scheme administration, is carried out there.

As amended, tPR will also be able to inspect premises where its inspector has reasonable grounds to believe that:

- documents relevant to the administration of the business of a scheme employer are kept there;
- the administration of a scheme employer's business, or work connected with that administration, is being carried out there; or
- in relation to a sponsoring employer of a DB scheme, documents relevant to a change of ownership of the employer, or of a significant asset of the employer, are being kept there.

These amendments represent a significant expansion of tPR's powers, both in terms of the premises which may be inspected and the purpose of an inspection. Current powers are restricted to checking whether legislative requirements are being met. As amended, tPR will be able to enter business premises and investigate commercial matters, such as share or asset sales or other activity, which may impact the employer's covenant and, therefore, the likelihood of accrued benefits being paid by the scheme.

The changes also throw open the possibility that advisers' offices may be inspected, where the advisers hold documents relevant to sales and acquisitions which might give tPR cause to issue a CN or FSD. Legal advice is exempt from inspection or disclosure – but advice from other advisers, such as covenant advisers or the scheme actuary, is not so protected.

Inspection of premises: who is an employer?

For the purposes of tPR's power to inspect premises, an "employer" will:

- include a former employer of an occupational pension scheme; and
- have the meaning given to "employer" for the purposes of the particular legislation under consideration.

Information powers: fixed penalties

tPR may issue a fixed penalty to a person it considers has:

- failed to comply with a notice to provide information or attend an interview;
- failed to comply with a requirement under tPR's power to inspect premises; or
- prevented or hindered an inspector exercising tPR's information gathering powers.

In a consultation response issued in June 2021, the DWP confirmed that the fixed penalty rate will be £400.

Information powers: escalating penalties

tPR may also impose an escalating penalty for failure to comply with a notice to provide information or attend an interview.

An escalating penalty will be calculated by reference to a daily rate. According to the DWP's June 2021 consultation response, the daily rate for an individual will be £200. For corporate bodies, the daily rate will start at £500 and will increase by £500 each day, to a maximum of £10,000 which will apply on the 20th and each subsequent day.

It is not clear whether an escalating penalty may be imposed in addition to a fixed penalty.

Providing false or misleading information to tPR or trustees: section 88A penalties

A section 88A penalty of up to £1m may be imposed on a person who *"knowingly or recklessly"* provides tPR or the trustee of a DB scheme with information which is *"false or misleading in a material particular"*.

tPR may impose this penalty where the misleading information is given:

- in purported compliance with certain statutory obligations; or
- where the person giving the information intends (or could reasonably be expected to know) that it would be used by tPR in exercising certain functions or by the trustee in its capacity as trustee of the scheme.

SCHEME FUNDING

The Act will also amend the current scheme specific funding regime applicable to DB schemes.

Funding and investment strategy

Trustees will have to adopt a **funding and investment strategy ("FIS")** for ensuring that benefits under the scheme can be provided over the long term, taking into account prescribed matters and principles.

The FIS must specify:

- the intended funding level as at the **"relevant date"** or relevant dates (using prescribed actuarial methods or assumptions if required); and
- the intended investments to be held on the relevant date or dates.

The employer's agreement to the FIS will be needed, except where the trustees have unilateral power to set contributions in relation to the scheme funding requirements.

More detailed requirements will be set out in regulations, including how the "relevant date" should be set and how often the FIS must be reviewed.

Changes made by the Act require a scheme's technical provisions (please see the box below) to be calculated in a way consistent with the scheme's FIS.

The requirement for employer consent to the FIS sits uneasily with the trustees' unilateral investment power, conferred by the Pensions Act 1995.

While some trustees have already adopted long term funding plans and have set triggers for future changes to the investment of scheme assets, the new requirements will put these measures on a more formal footing and may expose trustees to greater scrutiny from tPR if their strategy is unsuccessful.

Statement of strategy

As soon as reasonably practicable after determining (or revising) a scheme's FIS, the trustees must prepare a written **"statement of strategy"** setting out:

- the FIS (**"Part 1"** of the statement); plus
- the following matters (**"Part 2"** of the statement);
  - the extent to which the FIS is being successfully implemented;
  - where the FIS is not being successfully implemented, what steps are proposed to remedy the position, including details on timing;
  - the main risks in implementing the FIS and how these will be mitigated or managed;
  - reflections on any significant earlier decisions relevant to the FIS, including lessons learned which have or may affect other decisions; and
  - any matters prescribed in regulations.

The employer must be consulted when preparing or revising Part 2 of the statement of strategy but its consent is not needed.

The statement of strategy must be signed by the chair of trustees.

The requirement to report on how well the FIS is being implemented is similar to the existing requirement to include a statement on the implementation of the scheme's statement of investment principles (SIP) in the annual report. In addition, from 1 October 2020 trustees must also report on the implementation of their policy on the exercise of rights and engagement activities in relation to the scheme's investments.

Glossary: technical provisions

- A scheme's **"technical provisions"** means the value of assets needed to meet the scheme's liability to pay current and future benefits, calculated on an ongoing actuarial basis (that is, assuming that the sponsoring employer will continue to fund the scheme).
- Schemes must have a valuation on this basis at least every three years.
- The actuarial assumptions used when valuing the technical provisions are usually negotiated between the employer and trustees (unless the scheme rules give trustees unilateral powers) and must include an element of "prudence".
- This valuation is used to determine the level and duration of any contributions the sponsoring employer(s) must pay to the scheme (including contributions to make good any deficit).

Compliance

tPR may impose civil penalties under section 10 Pensions Act 1995 on trustees for failure to take all reasonable steps to secure compliance with the requirements for a FIS and a statement of strategy. A section 10 penalty may be up to £50,000 for a corporate body and up to £5,000 for an individual.

tPR may also require the trustees to revise their FIS in accordance with its directions.

CONTACT US

We would be pleased to speak to employers, trustees or other professionals who would like to discuss any of the issues covered in this note. For further information, please speak to your usual Hogan Lovells contact or one of the pension partners listed below.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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