Hogan Lovells

Pensions: new notifiable events – what corporates (and their lenders) should know

November 2021

Pension briefing

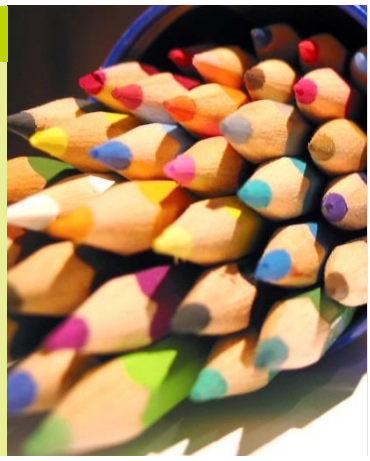
HIGHLIGHTS

A requirement to tell the Pensions Regulator (tPR) about certain events ("notifiable events") has long been part of tPR's armoury in its ongoing campaign to strengthen funding of defined benefit (DB) pension schemes.

Going forward, corporates will need to alert tPR at a much earlier stage in some proposed transactions. The notification requirement will be extended to include sale of a sponsoring employer's business and granting security over the employer's assets (or the assets of its subsidiaries). The new requirements will apply not just to the employer itself, but also to those who are associated or connected with it.

Those in breach of the requirements will be liable to a new financial penalty of up to £1m.

This note explains the new requirements and explores the implications for corporates and their lenders.



IN A NUTSHELL: WHAT'S CHANGING?

The existing notifiable events regime is being significantly strengthened in the following ways:

- Making the sale of a "material proportion" of an employer's business a notifiable event;
- Creating a new notifiable event of granting (or extending) a "relevant security" over an employer's assets;
- Requiring earlier notification of a decision to relinquish control of an employer or of receiving a bid for an employer company;
- Introducing the concept of a "decision in principle" and requiring notification of the above events at a much earlier stage (in addition to a second notification at a later stage of negotiations); and
- Imposing notification requirements on a sponsoring employer's corporate group and on any other associated or connected person.

The DWP has recently consulted on draft regulations to implement the changes. Other changes to increase the powers of the Pensions Regulator (tPR) in relation to defined benefit (DB) schemes came into force on 1 October 2021. We anticipate that changes to the notifiable events regime will have effect from 6 April 2022 or, potentially, earlier.

What is a "decision in principle"?

A "decision in principle" means a decision before any negotiations or agreements have been entered into with another party.

THIS NOTE EXPLAINS

- What are the new notifiable events?
- What action is required?
  - Stage 1: notify when decision in principle is reached
  - Stage 2: notify when main terms are proposed
- The implications for corporates and their lenders

WHAT ARE THE NEW NOTIFIABLE EVENTS?

First new notifiable event: intended sale of material proportion of a sponsoring employer's business or assets

- A "decision in principle" by a sponsoring employer to sell a "material proportion" of its business or assets will be a new notifiable event. A decision to transfer legal or beneficial ownership other than on sale will also be caught.
- A "material proportion" of the sponsoring employer's business will be a proportion that accounts for more than 25% of the employer's annual revenue.
- A "material proportion" of the sponsoring employer's assets will be more than 25% of the gross value of the employer's assets.
- The employer's annual revenue or value of assets should be taken from its most recent annual accounts (or its accounting records, if it is not required to file accounts). For this purpose, "assets" does not include money.

- When deciding whether the "material proportion" threshold is met, any other disposals made or agreed in the previous 12 months should be included.

Second new notifiable event: intended grant or extension of a "relevant security" over a sponsoring employer's assets

- The second new notifiable event is:
  - a "decision in principle" by a sponsoring employer to grant or extend a "relevant security" over its assets; and
  - which would result in the secured creditor ranking above the pension scheme trustees on the employer's insolvency.
- A "relevant security" is a security granted or extended by:
  - the employer (please see next bullet); or
  - one or more of the employer's subsidiaries, comprising more than 25% of either the employer's consolidated revenues or its gross assets (excluding money).
- It is not clear whether the 25% threshold is also intended to apply to a security granted or extended by the employer. The consultation document was amended part-way through the consultation period, but unfortunately its intended meaning remains ambiguous.
- A "relevant security" will include a fixed charge or a floating charge over assets of the employer or the employer's group, or an all assets floating charge which gives the charge-holder the right to appoint an administrator.
- Refinancing an existing debt (except where this involves granting a fixed or floating charge), security over specific chattels, or vehicle finance will not be a "relevant security".
- More information is expected from tPR in a code of practice and guidance.

Third (amended) notifiable event: relinquishing control of an employer

- The current notifiable event of deciding to relinquish control of an employer company will be amended so that the following will be notifiable events:
  - a "decision in principle" by a controlling company to relinquish control of the employer; or
  - receiving an offer to acquire control of the employer, where a "decision in principle" to relinquish control has not been made.

Background: what is the notifiable events regime?

The notifiable events regime (under section 69 of the Pensions Act 2004) is intended to provide an early warning system to alert the Pensions Regulator (tPR) of corporate events which may have a significant detrimental impact on the ability of a sponsoring employer to support its defined benefit (DB) pension scheme, or scheme events which may adversely affect the scheme's ability to pay benefits.

The notifiable events requirements apply in relation to DB schemes eligible for protection from the Pension Protection Fund (PPF) – broadly, private sector occupational DB schemes.

Notifiable events may be scheme-related (notifiable by the pension trustees) or employer-related (notifiable, at present, by the employer).

tPR Code of Practice 2, issued in 2005, concerns notifiable events. It makes clear that employers should be aware of the notifiable events requirements and have a procedure which enables identification and notification to occur.

Existing employer-related notifiable events

- A decision by a controlling company to relinquish control of the employer company (or the relinquishing of control without a decision being taken);
- A decision by the employer which will (or is intended to) result in a section 75 debt which is or may become due to the scheme not being paid in full;
- The employer ceasing to carry out business in the UK (or deciding to do so);
- A breach of one of the employer's banking covenants (except where the lender agrees not to enforce the covenant);
- Conviction of one of the directors of the employer for a dishonesty offence.

What is a section 75 debt ?

A section 75 debt (under section 75 of the Pensions Act 1995) is a debt due from the sponsoring employer to the pension trustees. An employer's section 75 debt will become due when:

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

The amount of a section 75 debt is the difference between the value of the pension scheme assets and the value of the liabilities, calculated as if the benefits were being bought out with annuities from an insurance company.

WHAT ACTION IS REQUIRED?

STAGE 1: NOTIFY WHEN "DECISION IN PRINCIPLE" IS REACHED

tPR must be told when a "decision in principle" is reached to proceed with one of the three notifiable events described above.

Stage 1: who must notify tPR?

- The stage 1 notification requirement falls on the sponsoring employer in relation to the DB scheme.
- The notice must be given in writing, as soon as reasonably practicable after the employer becomes aware of the notifiable event. What is reasonably practicable will depend on the circumstances but tPR considers that in all cases this implies urgency.
- tPR Code of Practice 2 explains that when the employer is a company, the individuals who give effect to the legal personality of the company will be responsible for notification. It comments that employers may wish to channel notifications through one individual, such as the company secretary.
- Although there is no legal obligation to notify the trustees at this stage, we expect that tPR would want the trustees to have been informed.

Stage 1: exception where scheme is fully PPF funded

tPR has issued directions which release an employer from its obligations to notify a decision by the controlling company to relinquish control of the employer provided that:

- the scheme is fully funded on the PPF basis; and
- the trustees have not had to report non-payment of employer contributions in the previous 12 months.

As the directions are worded, there is nothing to suggest that the exemption won't continue to apply after this notifiable event is amended by the current draft regulations.

STAGE 2: NOTICE AND "ACCOMPANYING STATEMENT" UNDER NEW SECTION 69A OF THE PENSIONS ACT 2004

Stage 2: what are section 69A notifiable events?

- The three section 69A notifiable events are similar to the Stage 1 notifiable events above, except that section 69A will apply where "main terms" have been proposed:
  - The intended sale by the employer of a "material proportion" of its business or assets (as defined above), in respect of which "main terms" have been proposed;
  - The intended grant or extension of a "relevant security" over the employer's assets (as defined above), in respect of which "main terms" have been proposed, and which would result in the secured creditor ranking above the scheme trustees on the employer's insolvency; and
  - Where the employer is a company, a controlling company deciding to relinquish control of the employer where "main terms" have been proposed, or the actual relinquishment of control of the employer (where this is done without a decision to do so being taken).
- The draft regulations do not define "main terms".

Stage 2: who must notify tPR (and the trustees)?

The requirement to notify at stage 2 applies to:

- the employer; and
- any person connected or associated with the employer.

A company or individual which is connected or associated with the employer will not have to notify tPR at stage 1 but could fall within the notification requirements at stage 2.

The notice must be given in writing, as soon as reasonably practicable after becoming aware of:

- the section 69A notifiable event;
- a "material change" (please see below); or
- the section 69A notifiable event not going ahead.

A copy of the notice and accompanying statement must also be given to the pension trustees.

What must a section 69A accompanying statement include?

An accompanying statement must include descriptions of the following:

- the notifiable event and the main terms proposed;
- any adverse effects on the pension scheme;
- any adverse effects on the sponsoring employer's ability to meet its legal obligations to support the scheme;
- any steps taken to mitigate these adverse effects; and
- any communication with the trustees about the notifiable event.

Notice of "material changes"

Notice and an accompanying statement must also be given to tPR and the pension trustees if there is a "material change" in a section 69A notifiable event, or in its expected effects. For this purpose, a "material change" will be:

- a change in the terms of the intended section 69A notifiable event; or
- a change in the steps taken to mitigate any adverse effects of the section 69A notifiable event.

Notice that notifiable event not going ahead

tPR and the pension trustees must also be given notice if a section 69A notifiable event is not going to, or does not, take place.

IMPLICATIONS FOR CORPORATES AND LENDERS

Penalties for breach

From 1 October 2021, tPR has power to impose a financial penalty of up to £1m for breach of the notifiable events requirements, unless the person had a reasonable excuse for the breach. (Previously, tPR could impose a penalty of up to £50,000 – so this is a significant strengthening of its deterrence powers.)

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.

Stage 1: what is a "decision in principle"?

- The question arises of how formal a decision must be to qualify as a "decision in principle". Could a discussion over coffee between a couple of directors about a potential sale count?
- It seems clear that a "decision in principle" is intended to catch a decision to explore whether a sale (or finance arrangement) can be agreed on acceptable terms – in other words, long before a final decision to sell (or take secured finance) is made.
- The risk for corporates is that a decision to explore a potential sale or financing may be taken by decision makers in a parent or other group company who are unaware that this could count as a "decision in principle" and so trigger the requirement to notify tPR.
- Similarly, an exploratory offer to buy an employer may be made to individuals in the employer's corporate group who do not realise the consequences under the notifiable events regime.
- Depending on the particular corporate structure, the employer may not be aware if a decision in principle is made by its parent (or an offer to acquire control made to the parent). At stage 1, it is the employer who has to notify tPR, meaning that the notification requirement will not be triggered until the employer becomes aware of the notifiable event.
- It is not clear how receipt of an "offer to acquire control of the employer company" will work in relation to a listed company (which will also be subject to the requirements of the Takeover Code).
- The risk of inadvertent triggering of the notification requirements will be even greater where decision makers are based outside the UK.

Inadvertent triggers: what can corporates do?

- To protect against inadvertent triggering of the stage 1 notification requirement, a corporate could adopt a policy that a "decision in principle" falling within the requirements may only be taken by the board of directors of the parent company (or by other specified individuals).
- Key individuals such as the company secretary, the general counsel and the head of treasury should be made aware of the notification requirements and should be alert to situations in which an obligation to notify may arise.
- It would be helpful if the draft regulations were amended to specify that an offer must be made to the controlling company's board. To give an extra layer of protection, a corporate could adopt a policy that an expression of interest in assuming control of a subsidiary will only be considered an "offer" if it is made to the board of the parent (or other controlling) company.

A multitude of notifications?

Inevitably, some or many of these explorations will result in a proposed sale or financing being abandoned. Notification of "decisions in principle" in these cases will create additional work for corporates – but also for tPR as it will need to process and assess each notification.

Stage 2: when are main terms "proposed"?

The proposal of main terms may take place (and the requirement to notify under section 69A be triggered) at a point where the proposed transaction is still far from a done deal.

For example, in an auction process the seller may issue a proposed sale and purchase agreement (SPA) – with the expectation that would-be buyers will submit a mark-up of the SPA with their amendments to the proposed terms alongside their bid. Our understanding of the regulations as currently drafted is that the issue of the seller's first version of the SPA will trigger the new section 69A requirements.

Stage 2: change in main terms

Under the draft regulations, any change in the proposed terms of a transaction would count as a "material change" and so trigger a further requirement to notify tPR and submit an accompanying statement.

This requirement appears unworkable and would impose significant additional burdens on business, with little or no benefit to the pension scheme. For example, would each mark-up of the SPA by potential bidders count as a material change?

An approach more focussed on changes which are likely to have a material impact on the pension scheme would lessen the burden on companies and on tPR alike.

POSITION OF LENDERS

Do lenders have to notify?

Lenders will only be subject to the section 69A notification requirements if they are associated or connected with the employer. A lender will usually only become associated or connected if it gains control of an employer following the employer's default under the terms of its financing arrangements.

Lenders should already be alive to the risk of falling within the scope of tPR's moral hazard powers if they become associated or connected to a sponsoring employer of a DB scheme. For several years we have advised our lender clients to ensure that they do not automatically become associated or connected with the employer if it breaches a banking covenant.

Notification by borrowers

An employer must already notify tPR if it breaches one of its banking covenants, except where the lender agrees not to enforce the covenant. However, since 1 October 2021 the maximum penalty for non-compliance has increased from £50,000 to £1m.

Lenders are also likely to be concerned if a company to which it lends becomes subject to a fine of up to £1m for failing to notify tPR of secured lending. It is not only the size of that fine: the lender may be exposed to related adverse publicity through no fault of its own. Lenders may want to amend their standard representations and warranties to include confirmation that any notifications to tPR required by the Pensions Act 2004 have been made.

Replacement of existing security

As currently drafted, a refinancing which involves granting a fixed or floating charge will trigger the notification requirements – even where the security is granted on the same (or essentially the same) terms as existing security.

Refinancing an existing debt is excluded from the definition of "relevant security" – so the drafting which catches replacement of existing security may be an error.

HOW WE CAN HELP

We will be pleased to advise you on whether (and when) you may need to notify tPR under the new requirements. Through our active participation in the pension industry and involvement in some of the highest profile cases involving DB schemes, we can give you an informed view on tPR's approach and how that develops following the tightening up of the notifiable events regime.

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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