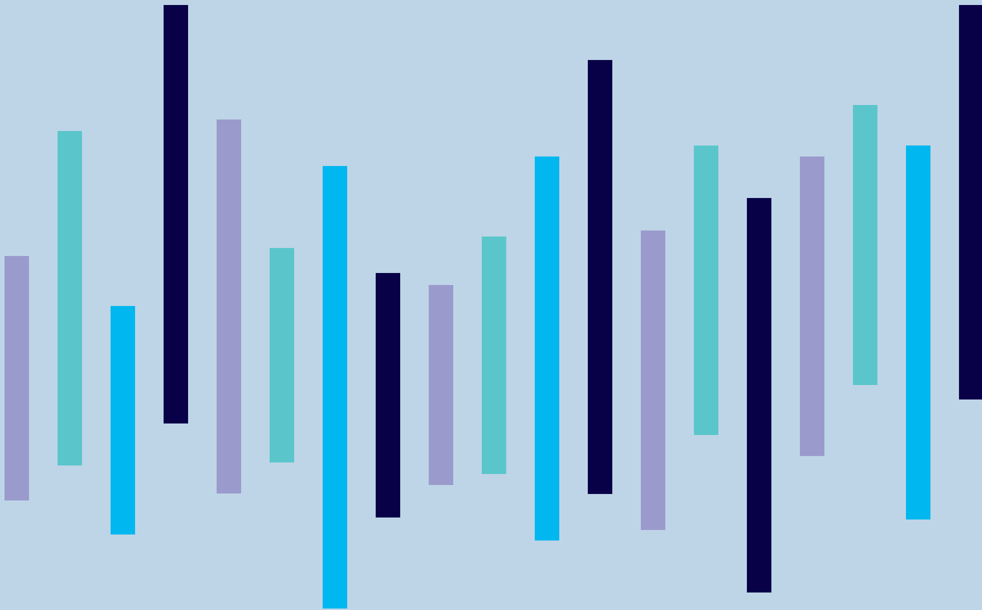
TaylorWessing

Pensions in Restructuring Survey Report

January 2021



2020 might provide answers to many political and economic issues, but it is not possible to see with perfect vision what the future holds for pensions in restructuring matters.

That was part of the conclusion to the report on Taylor Wessing's previous Pensions in Restructuring Survey; with hindsight, 2020 brought few answers and posed many questions.

Welcome to the results of Taylor Wessing's fifth annual Pensions in Restructuring Survey

We carried out our fourth annual survey against a background of the collapse of several household names. The past year, leading up to our fifth annual survey, has seen the high street continue to suffer, along with the hospitality and entertainment sectors, as the economy has reeled under the effects of Covid-19.

The economy now, post-Brexit, has to acclimatise to new trading relationships and there has been, and will be, significant new legislation on both restructuring and pensions matters to throw into the mix. It is difficult to imagine much more challenging circumstances for pensions in restructuring activity.

Now in its fifth year, this time our survey was carried out at a special event attended by experts in the field, including professional trustees, insolvency practitioners, covenant advisers, actuaries, benefit consultants, and lawyers.

Attendees had the opportunity to submit their responses to the survey and to debate the questions in more depth. It yielded some interesting results.

We focused on three broad issues:

- what the proposed new and extended powers for The Pensions Regulator (TPR) might mean for pensions in restructuring activity
- whether the Corporate Insolvency and Governance Act 2020 has upset the delicate balance between the interests of debtors and creditors
- what 2021 might have in store for pensions in restructuring activity.

The sense in the virtual room was one of uncertainty and concern about what the new legislation might mean in practice, when added to the mix of challenges already resulting from Covid-19 and Brexit. That was reflected in the answers to our survey explained in this report.

With so much more information expected to come its way, the simple question is: will TPR be able to cope?

New Regulator powers create uncertainty

New offences, new worries

The headlines in relation to the Pension Schemes Bill have been captured by the proposed new criminal offences. In particular, it is proposed that an offence will be committed if anyone, other than an Insolvency Practitioner, acts or fails to act:

- to prevent a s.75 debt arising, to reduce the amount of any such debt, to prevent recovery of any such debt or to compromise or otherwise settle it, with the intention of producing any such effect, or
- in a manner that detrimentally affects in a material way the likelihood of accrued scheme benefits being received, and the person knew or ought to have known that the act or failure would have such effect,

and in either case, without reasonable excuse.

The range of people who are within the ambit of the new offence is almost all-encompassing and there is scope for many different activities to produce, or contribute to, one of the prescribed effects.

There was concern amongst our participants that behaviours would be viewed with the benefit of hindsight and that Parliamentary or media pressure might influence how such behaviours are viewed by TPR. Further, there was a concern that this might dissuade purchasers from entering into deals that would otherwise have rescued businesses.

It was noted, however, that the requirement that the person at issue acted, or failed to act, without reasonable excuse is part of the offence, rather than a defence, and so it will be for the prosecutor to prove that there was no such excuse. Further, all elements of the offence will have to be made out beyond reasonable doubt.

TPR is to produce guidance on the offences. The understandable expectation was that this would be considered carefully by all involved with defined benefit pension schemes, to get a valuable insight

into how TPR views the new offences and the approach that it will adopt in relation to them.

Information overload

Whilst the new offences caused concern, the sense was that, in the vast majority of cases, the bigger question will be whether TPR will have the resources to respond in a timely and effective manner, to ensure that deals to save stressed and distressed businesses are not hampered. This is as a result of the expected significant rise in information that those involved with defined benefit pension schemes will provide to TPR.

There are proposed extensions to the events that must be notified to TPR. Based on the White Paper that led to the Bill, they are expected to include whenever a defined benefit (DB) pension scheme employer:

- grants security in priority to the pension scheme and/or
- sells a 'material proportion' of its business or assets, where the employer has responsibility for funding 20% or more of the liabilities of the scheme.

There will also be the new declarations of intent that pension scheme employers and certain other persons will have to provide to TPR and the trustees where notice is to be given of certain events. The details are awaited, but it is assumed that the events will include where the employer grants security and where the employer is sold or it sells its business or assets.

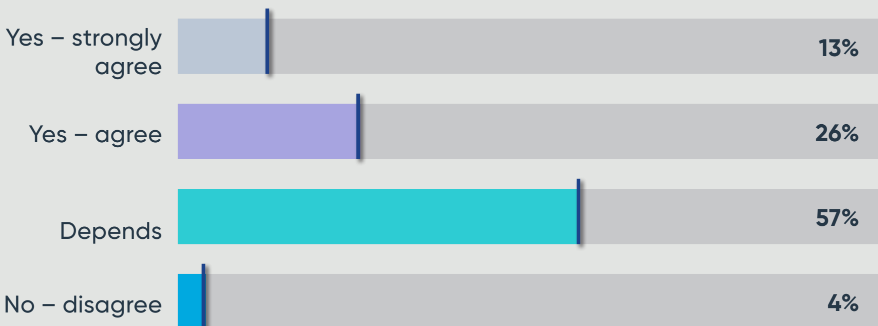
There was also concern over the planned extensions to TPR's contribution notice powers. In particular, there was concern about the new 'before and after test', in relation to the effects on (i) insolvency outcomes and (ii) employer resources, relative to the size of the employer's s.75 debt liability. The concern was that it will be difficult for parties to take a view on 'short-term pain in the interests of long-term gain' for the pension scheme, as has been reasonably common until now. The sense, therefore, was that there would be an increase in the amount of clearance applications made.

With so much more information expected to come its way, the simple question is: will TPR be able to cope?

Specifically, we asked,

“Will the new and extended powers that are to be conferred on The Pensions Regulator under the Pension Schemes Bill hamper the chances of deals to save distressed businesses that participate in a defined benefit pension scheme?”

The uncertainty noted above was seemingly behind the significant proportion of our participants who considered that the answer will depend on how TPR uses its powers. The full results are below.



Is there a level playing field?

It has been a hallmark of the UK's vaunted restructuring and insolvency regime that it is finely balanced and achieves a fair outcome for stakeholders. Other countries have tried to copy it, partly for the benefits to their economies of the regime and partly to attract foreign businesses to utilise their systems and professionals for restructurings (something known as 'forum shopping').

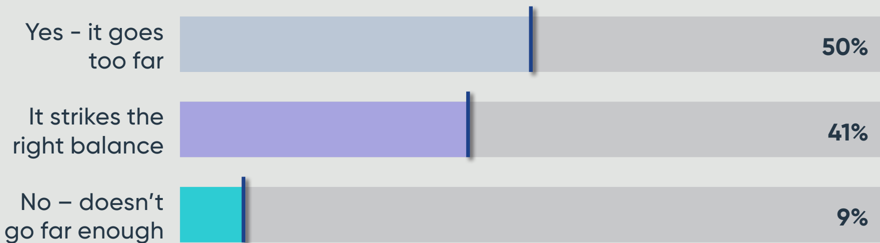
If anything, the UK regime was considered to be one of the most pro-creditor (in particular, secured creditor) systems in the world, for example through processes that could compromise unsecured creditors but not secured creditors and the secured creditors having veto rights on the identity of any administrator. Yet, the regime achieved equilibrium with provisions which nevertheless gave companies flexibility that are denied in other countries, for example comparing the flexible concept of 'wrongful trading' with its subjective test against the German system which makes it a criminal offence for a director to fail to file for insolvency within 21 days of being unable to pay debts.

The new Corporate Insolvency & Governance Act 2020 brings major changes to the UK regime that seek to replicate some of the more company (debtor) friendly features of the wildly successful Chapter 11 in the United States. Rushed through Parliament in the summer of 2020, in the midst of the pandemic and with relatively little consultation, a major concern is that the provisions (some, such as the suspension of wrongful trading, being temporary) tilt the playing field too much in favour of debtors.

Half of our participants think that the playing field is no longer level for creditors such as pension schemes. And whilst a significant minority felt it strikes the right balance, for half to feel the balance has been upset indicates a system in transition. And a system in transition brings unexpected and sometimes seemingly unfair outcomes.

We asked our participants,

"With the Corporate Insolvency & Governance Act introducing a Restructuring Plan with cross-class-cram-down, a stand-alone moratorium and a temporary suspension of wrongful trading, has the UK restructuring and insolvency regime become too debtor-friendly at the expense of creditors such as pension schemes?"



We think that this is partly a reflection of the magnitude of the new legislation, which introduces the most radical overhaul of the UK regime since 1986. But there is also a sense that the changes favour the debtor at the expense of creditors and that the natural evolution of the regime, with almost imperceptible balancing of interests through the courts and secondary legislation, has been left behind and that the new legislation is a moment of revolution.

If our participants are correct and the new system is too debtor-friendly, we are likely to be in for a few years of surprising outcomes from restructurings and insolvencies, as the stakeholders, courts and legislators try to navigate the regime in the search for a new equilibrium. We predict that there will be many more court challenges and appeals to higher courts as parties try to assert their rights as they had always recognised them to see whether, in the new regime, they have the same impact and carry the same value as before.

What will matter most in 2021?

Looking forward, we asked,

"What will be the most significant factor in determining how pension schemes of stressed and distressed employers fare in 2021?"

There are, of course, obvious factors that have caused disruption this year and are expected to do so again in 2021, most notably, Covid-19.

At the time of our survey, expectations were high for a vaccine, but the news about the new strain of the virus had not yet been released. Nevertheless, a significant proportion of participants considered that Covid-19 would be the most significant factor affecting how DB schemes of stressed and distressed employers will fare in 2021.

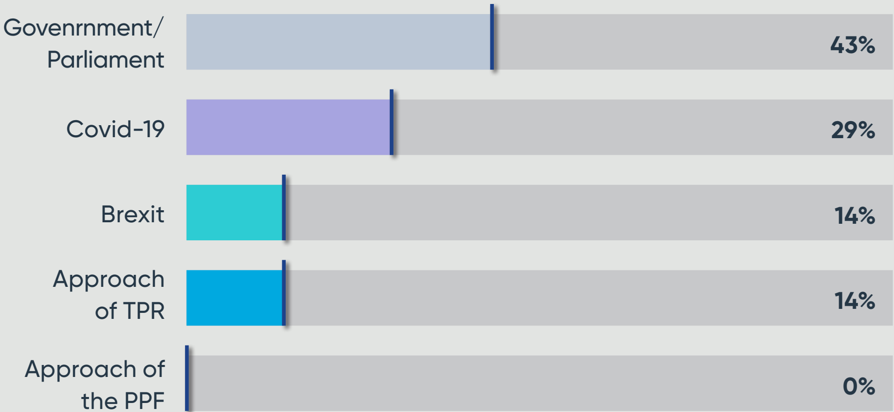
Another obvious factor that was considered significant is Brexit and the continued uncertainty as to the impact this will have on employer covenants.

Picking up the theme from an earlier question, some participants also considered that, ultimately, it will be how TPR uses its new powers that will have the biggest impact on how pension schemes of stressed and distressed employers fare, but the most likely, with 43% of the vote, was what the Government and Parliament do.

There is broad scope within "what the Government and Parliament do" to cover matters like:

- how the Government responds to developments, including how long it keeps measures in place to support the economy as a result of issues arising from Covid-19
- how the Government steers the economy through the first year post-Brexit
- the legislation that Parliament puts through, including what is expected to become the Pension Schemes Act 2021 early this year and whether we will see, during the year, a Bill in respect of so-called commercial consolidators or superfunds, which may provide increased legitimacy to such funds as an option for employers to bring an end to their DB liabilities
- the extent to which the Work & Pensions Select Committee, post Frank Field, flexes its muscles.

The full results are below.



There is no doubt that much remains to be resolved, as we see how the world emerges from the pandemic, what trade and political relations may be with the EU post-Brexit, and how the new legislative regimes will play out in practice for pensions in restructuring activity.

Conclusion

Our event ended on a positive note, with one participant offering the thought that the new legislation and dynamic circumstances bring with it an opportunity for creativity and collaboration that will hopefully see innovative responses to the challenges that stakeholders involved with DB pension schemes will doubtless face in 2021.

Having learned our lesson from last year, we do not intend to make any further predictions as to how the coming year may play out, other than to say that we are sure that there will be plenty to discuss in our sixth annual survey and look forward to working with you in the positive spirit highlighted above!

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