Published on *The National Law Review* https://natlawreview.com

The Geometry and Trigonometry of the Corporate Insolvency and Governance Act – What Is the Final Pensions Angle?

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If you are going round in circles trying to figure out the final shape of the new insolvency legislation, read this blog which takes a look at the impact the final amendments made to the legislation will have in the pensions sphere.

The Corporate Insolvency and Governance Act 2020 (the Act) received Royal Assent on 25 June 2020, with most provisions coming into force on 26 June 2020. In earlier blogs we covered the pensions angles of the new moratorium provisions and restructuring process that were proposed as part of the Bill, while our restructuring colleagues blogged more generally on the provisions of the Bill.

In our blogs we noted that the legislation, as originally drafted, resulted in some interesting tangents for pension schemes. Fortunately, some of the most detrimental proposals were modified at the final stage, reducing the degree of impact on pension schemes and introducing additional rights for The Pensions Regulator (TPR) and the Pension Protection Fund (PPF).

Critically, it remains the case that neither a moratorium nor a restructuring plan will be an “insolvency event” for the purposes of triggering the section 75 debt regime or a PPF assessment period.

What Were the Key Changes from a Pensions Perspective?

Finance Debt Super-priority Risk Averted

One of the key concerns within the pensions industry centred around the structure of the moratorium period and the ability of banks to “accelerate” bank debt during a moratorium period. This is where the act of entering into a moratorium period could trigger default clauses in banking facilities, effectively allowing the company’s bankers to call in all of the debt owed to the bank – including unsecured debt such as overdraft facilities.

The impact for a defined benefit pension scheme in a subsequent employer insolvency scenario could have been huge. This is because if winding up proceedings against a company commence within 12 weeks of the day after a moratorium period ends, certain debts gain “super-priority” status. Under the original drafting of the legislation, accelerated bank debt would have been granted “super-priority” status, thus ranking unsecured bank debt, which would have otherwise ranked equally with unsecured pension scheme debt, ahead of the pension scheme. This might have left pension schemes (and the PPF) empty handed in the event of the employer's insolvency.

Under the final form of the legislation, debt under financial services contracts, such as banking facilities, which is accelerated during a moratorium period does **not** gain "super-priority" status and unsecured bank debt would not rank ahead of unsecured debt owed to the pension scheme. This puts the pension scheme back on a more equal footing with other unsecured creditors.

Additional Powers for TPR and the PPF

After much debate within the House of Lords in particular, TPR and the PPF now have certain information rights and the ability to participate in certain proceedings to the same extent as pension trustees.

In relation to the moratorium process, the insolvency practitioner (called a monitor) must notify TPR and the PPF when a scheme employer of a defined benefit pension scheme enters a moratorium period. The monitor must also inform TPR and the PPF if there is an extension to the moratorium period, a change of monitor and when the moratorium period ends. During the moratorium period, the PPF will have the same rights to challenge the monitor and company directors as the pension trustees would have.

The Act enables regulations to be brought in that would grant the PPF the power to exercise certain rights as creditor that the pension trustees would have during a moratorium period. This power might be exercisable in addition to the trustees' rights or to the exclusion of the trustees' rights as creditor.

In relation to the restructuring process, where a compromise is proposed and the company is or has been an employer of a defined benefit pension scheme, any notice that is required to be sent to a creditor must also be sent to TPR and the PPF.

The Act enables the introduction of regulations that would allow the PPF to exercise the rights of the pension trustees as creditor on a restructuring plan, either to the exclusion of the trustees or in addition to those rights exercisable by the trustees. This would allow the PPF to vote on any proposed compromise agreement.

What Next for Pension Trustees?

Despite the last minute changes to the text of the legislation, the Act introduces some radical changes that alter the balance between the employer and pension trustees. In particular, company directors' new ability to initiate a moratorium without reference to scheme trustees (which strips away trustees' leverage and enforcement rights) will be a very real concern for trustees of schemes linked to financially distressed companies, especially in sectors hardest hit by COVID-19. This could initiate something of an "arms race" between trustees and companies – can trustees make a statutory demand and initiate company winding-up proceedings; or trigger wind-up of the scheme under the rules before a moratorium begins? Some clients are already actively thinking this through, although for those considering serving a statutory demand or presenting a winding up petition it is also worth noting that the Act places temporary restrictions on these until 30 September 2020, which may prevent that.

Save for the reversal of the finance debt "super-priority" point discussed above, all of the pensions implications of a moratorium based on the draft Bill hold good under the Act. By way of brief reminder:

- There is a significant risk of confidentiality conflicts for company directors and senior executives who are also trustees.
- Trustees and companies should check scheme rules to see if a moratorium might trigger scheme wind-up and hence the section 75 debt regime.
- Deficit recovery payments to defined benefit schemes will not have to be paid during a moratorium. Trustees should consider any cashflow implications and making claims under applicable guarantees.
- Future service contributions to occupational pension schemes must continue. The Act is unclear if this applies to personal pension schemes too.
- Trustees won't be able to enforce security or take legal action against the company during the moratorium.
- Trustees with fixed charges may find them being challenged.
- Trustees may wish to check in with their covenant adviser to see if the Act changes their view of the covenant.
- The PPF may review the levy credit it gives for contingent assets and update its standard form documents.

For more detail on these points see our previous moratorium blog.

The key changes in the final version of the Act relate to the requirement for the PPF to be involved in restructuring plans, even though a restructuring plan does not trigger a PPF assessment process. Again, the comments in our previous blog hold good. By way of brief reminder:

- If there are conflicted company executive trustees, thought may need to be given to the skills and composition of the remaining board, including the possible appointment of an independent trustee. This will in part depend on whether the PPF will be given exclusive power to exercise the trustees' creditor rights, or joint power.
- The value of the trustees' claim in a restructuring plan will be critical. Will it be the section 75 debt or (bearing in mind a restructuring plan does not trigger the section 75 debt regime) just the value of any outstanding contributions (if any)? This may come down to the idiosyncrasies of scheme rules.
- If the restructuring plan follows a moratorium, this could significantly impact the trustees'/PPF's leverage in any negotiations.
- As the PPF will now be involved in any restructuring plan, the risk of trustees agreeing deal terms which render their scheme ineligible for entry in to the PPF would appear to have abated.

Again, for more detail on these points, see our earlier restructuring blog.

More generally, all trustees should take note of the new possibilities introduced by the Act and consider if any additions are required to their risk registers. One of the key strategic implications of the Act is likely to be trustees looking to take security and gain greater control of scheme wind-up triggers. It will also be an additional consideration for trustees faced with deficit contribution deferral requests.

National Law Review, Volume X, Number 188