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Sixty second summary

Insolvency-law changes affect DB schemes

The *Corporate Insolvency and Governance Bill 2019-21* aims to help businesses avoid insolvency during the current period of economic uncertainty.[1] However, some of the reforms that it would make to insolvency law would be permanent, and may adversely affect the standing of defined benefit (DB) pension schemes.

Insolvency reforms

Although the Bill is described as a response to the COVID-19 crisis, some of its reforms have been under discussion since long before the SARS-CoV-2 outbreak. It has been described as the biggest shake up of UK insolvency law for over 30 years[2], with some of the key measures, in as far as they could impact DB pension schemes, summarized below.

Moratorium on legal activities

The Bill makes provision for a 20-business-day moratorium (extensible to 40 business days), intended to provide financially distressed companies with breathing space in which to attempt a rescue. During the moratorium a 'payment holiday' will be in force such that the company's creditors would be unable to enforce debts, crystallize charges, or instigate corporate wind-up proceedings. The company itself would be subject to restrictions on its ability to obtain credit, grant security, enter into certain market contracts, settle debts or dispose of property. These matters would be subject to supervision by a '*monitor*' (an insolvency professional) and, in some circumstances, the courts. There are some short-term relaxations to the moratorium-eligibility criteria that would apply for the duration of the coronavirus outbreak.

The class of '*pre-moratorium debts*' for which a company would thereby obtain a payment holiday excludes (amongst other things) '*debts or other liabilities arising under a contract or other instrument involving financial services*'. This category appears to cover a range of financial arrangements including lending, securities, commodities, futures, and swaps. There would be a separate exclusion (that is, no payment holiday) for '*wages or salary arising under a contract of employment*', a category that includes occupational pension scheme contributions; however, it is not clear at all clear that it covers the employer contributions, and even less clear that it extends to deficit recovery contributions.

The potential threat here is that, if a moratorium is followed by insolvency proceedings or restructuring (see below), unsecured bank and financing debt will have 'super priority' (notwithstanding any agreement that the trustees might have reached with the company for *pari-passu* treatment with lenders), leaving less available for other creditors, including pension scheme trustees. Meanwhile, any security over employer assets that the trustees have negotiated as part of their funding and risk-management activities might be unenforceable at the time when it is most needed.

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[1] <services.parliament.uk/Bills/2019-21/corporateinsolvencyandgovernance.html>.

[2] *UK Government plans radical changes to UK insolvency regime*, 21 May 2020, Herbert Smith Freehills LLP <hsfnotes.com/pensions/2020/05/21/breaking-uk-government-plans-radical-changes-to-uk-insolvency-regime>.

New restructuring plan (AKA '*cross-class cram down*')

There would be a new sort of court-sanctioned restructuring mechanism capable of overriding the objections of dissenting creditors if they are considered unlikely to be financially disadvantaged by the plan.

Neither the new restructuring mechanism nor the proposed moratorium would count as an 'insolvency event' for the purposes of the pensions legislation. That is to say, they will not trigger the calculation and establishment of 'section 75' employer debts, or the intervention of the Pension Protection Fund (PPF). It is unclear what class the trustees will occupy for the purposes of the vote on the restructuring proposals, or how much sway they will have.

***Pro tempore* measures**

There are also temporary suspensions on the ability of creditors to use statutory demands as the basis for winding up proceedings if the pandemic has prevented a company from paying its debts, and on the 'wrongful trading' rules. Both suspensions would expire one month after the Bill receives Royal Assent, unless extended by the Government.

Parliamentary debate

The Bill had its Second Reading in the House of Lords on 9 June 2020.[3] The potential adverse effects on pension schemes was raised numerous times, most notably by Baroness Drake, Baroness Warwick, and Baroness Altmann, who talked about the problem of bank finance debt enjoying effective super-priority, and the implications of the moratorium and restructuring not counting as insolvency events for pension purposes (effect of separate legislation that would shift HMRC up the priority rank[4] was also mentioned).

To these pensions points, Lord Callanan replied on behalf of the Government that—

> *If an employee is not a creditor or shareholder of the company, they cannot be included in a restructuring proposal. The interaction between pensions legislation and insolvency legislation gives rise to some extremely complicated issues, and the Government are working closely with key stakeholders to determine any implications for the Pension Protection Fund, the Pensions Regulator and pension schemes more generally.*

This is a highly specialized area and trustees will need specialist legal and covenant advice about the potential repercussions for their DB schemes. Overall, the implication is that a distressed scheme sponsor could undergo a restructuring process that might end up placing the trustees in a worse position, there being nothing that they can do to protect their interests while it happens. It might, however, mean that companies avoid otherwise-inevitable insolvencies, so that schemes emerge from the crisis with sponsors that are stronger and in a better position to manage their pension funding obligations.

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3 <hansard.parliament.uk/lords/2020-06-09/debates/A98B8D47-41B2-4479-94A2-63B4CBBAE0B2/CorporateInsolvencyAndGovernanceBill>.

4 Clause 95 of the current *Finance Bill*. For a brief summary, see '*Unpaid tax prioritised in sponsor insolvencies—to the detriment of pension schemes*', in *Current Issues* September 2019 <www.hymans.co.uk/media/uploads/Current_Issues_-_September_2019.pdf>.