

**FINANCIAL MARKETS LAW COMMITTEE**

[www.fmlc.org](http://www.fmlc.org)

**c/o BANK OF ENGLAND**

**Threadneedle Street**

**London**

**EC2R 8AH**

*CHAIRMAN – LORD BROWNE-WILKINSON*

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David Norgrove  
Chair of the Pensions Regulatory Board  
Napier House  
Trafalgar Place  
Brighton  
BN1 4DW

I refer to a meeting held recently between some of the members of the FMLC Issue 104 Working Group on the Pensions Act 2004 and amongst others, Louise Inward of the Pensions Regulator and Richard Farr, adviser to the Pensions Regulator.

One point discussed at that meeting concerned the ambit of Section 435 of the Insolvency Act 1986, when used in the context of the contribution notice and financial support direction provisions of sections 38-51 of the Pensions Act 2004. In particular concern has been expressed about its implications for those taking security over shares in a company, which may itself be an employer or which directly or indirectly hold shares in a company, which is an employer under a defined benefit pension scheme. The FMLC Working Group's concern is that, unless clear guidance can be given on the point at issue, there may be an adverse impact on lenders' willingness to lend to companies with direct or indirect association to a final salary or other defined benefit pension scheme.

In summary the legal concern is as follows:-

Contribution notices can be issued to a person if (amongst other things) the person was "connected with, or an associate of, the employer". Again financial support directions can be issued to a person who "is, at the relevant time, connected with or an associate of the employer".

The meanings of "connected person" and "associate" are by reference to sections 249 and 435 respectively of the Insolvency Act 1986.

Section 249 of the Insolvency Act 1986 provides (amongst other things) that a person is connected with a company if, "he is an associate of the company". "Associate" has the meaning given by section 435 of the Insolvency Act 1986.

Section 435(6) of the Insolvency Act 1986 states (amongst other things) that a company is an associate of another company "if the same person has control of both ..." and section 435(7) states (amongst other things) that, "a company is an associate of another person if that person has control of it ..."

Section 435(10) of the Insolvency Act 1986 states (amongst other things) that, "a person is to be taken as having control of a company if he is entitled to exercise, or control the exercise, of one third or more of the voting power at any general meeting of the company or of another company which has control of it".

When taking security over shares (whether by way of legal or equitable mortgage) it is common practice for the chargor to agree, that upon the occurrence of a specified event (usually an event of default occurring or the underlying debt obligations being accelerated), the chargee may, at its discretion (in the name of the chargor or otherwise and without any further consent or authority from the chargor) exercise (or refrain from exercising) any voting rights in respect of the shares. At the meeting concerns were raised that there may be circumstances where a party holding security had not in fact taken any steps (by virtue of its entitlement to exercise or control the exercise of one third or more of the voting power at any general meeting of the company or of another company which has control of it) actually to exercise control yet nonetheless would technically be capable of being made subject either to a contribution notice or to a financial support direction.

Concern was particularly expressed in two situations:

first where the entitlement to exercise control had not vested, for example because no event of default or other specified event had occurred,

secondly where, although the condition to exercise had been satisfied, for example the event of default or other specified event had occurred, nevertheless no directions had actually been given through exercise of the voting rights with regard to control.

Lousie Inward explained at the meeting that she did not think it would be reasonable, in circumstances where control of the share security had not actually been exercised by directing either how the shares should or should not be voted, for the Regulator either to impose any liability under a contribution notice issued under section 38 on those holding or entitled to the share security or to impose the requirements of a financial support direction under section 43 on those holding or entitled to the share security.

Louise Inward also explained that if I wrote to you on the issue you would be able to confirm this in reply to my letter.

I should accordingly be most grateful to receive your confirmation on this point.

It would also be helpful, if such confirmation can be given to know whether future editions of the Regulators Guidance on Clearance could contain a statement on the point.

**Nicolas Browne-Wilkinson**