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Judge blocks changes to future accrual

A ruling of the High Court in England and Wales has effectively (pending appeal) prevented cost-saving changes to future-service benefits under a pension scheme, unless its active members agree.[1] The case hinged on the particular words used in the scheme's amendment rule, especially the interpretation of the members' 'interests'. The judge rejected the suggestion that a cost-cutting change made in compliance with the rule would be an improper use of the trustee's power.

Background

The employer contribution rate in the BBC Pension Scheme had tripled since 2010, to 42.3% of pensionable salary. The BBC had already (though not without controversy[2]) changed employees' contracts to limit the extent to which pay rises would be pensionable, but was exploring the options for reducing future-service costs further—all the way up to ceasing accrual (no decision has been made, and no specific proposals put forward). It asked the Court questions about the limits of the amendment power in the Scheme rules.

Scheme amendment power

The amendment rule gives the trustee power to make changes, with the consent of the employer. However, it says that no alteration can apply to active members whose 'interests' are affected, unless

1. the scheme actuary certifies either that
    a. there is no substantial prejudice to their interests, or
    b. substantially equivalent benefits are being provided; or
2. a majority of the active members approve.

Judgment

The case turned on the meaning of 'interests', and in particular whether, as the BBC sought to argue, it covered only accrued rights. The judge said that the ordinary meaning of 'interests' in the context of active membership did not suggest that it was confined to past-service benefits. He said that

[1] *BBC v BBC Pension Trust Ltd & Another* [2023] EWHC 1965 (Ch).
[2] *Bradbury v BBC* [2017] EWCA Civ 1144.

> 'a natural focus... is on the position the Active Members have... prior to the proposed amendment, compared to their intended position if the proposed amendment... comes into effect.'

If their positions would be different, 'then it seems... inescapable that their *interests* are *affected'* (emphasis in original).

The judge made a distinction between the BBC Scheme rule's reference to 'interests' and another case in which the discussion was about 'rights'.[3] To him, 'interests' suggested 'a broader scope of protection', and more naturally covered the effects of an intended change on the terms of future benefit accrual.

There was also a question about whether the trustees would be using the amendment power for a proper purpose if (hypothetically) they changed the terms of future accrual. The argument there was based on the British Airways case, as a result of which trustees were prevented from introducing new pension increases, because (said the Court) their role did not extend to benefit redesign, which was more properly the prerogative of the sponsoring employer.[4]

The judge rejected the parallel with British Airways, because in that case the trustees had shifted the balance of power between themselves and the sponsor, against its interests. That was not so in the BBC case, where the amendment power was exercisable only with the consent of the employer. So, rather than '*arrogating to itself a responsibility falling exclusively within the domain of the employer... it would be giving effect to the wishes of the employer*.' Moreover, the very purpose of the amendment power was to permit alterations that complied with the stringent safeguards build into it.

The employer in this case seems to be caught between a rock and a hard place, and will no doubt be carefully considering its options: including the prospect of winning on appeal.

The ruling may also put a question mark over the outcome of the preceding litigation over the BBC's cap on increases to pensionable salary. Although it was about a contractual change, part of the successful argument seemed to be that the employer could have accomplished the same thing using an earlier rule amendment. Members may now be wondering how that wasn't substantially prejudicial to their interests (the validity of the actuary's 'no substantial prejudice' certification wasn't put at issue in the 2010 proceedings, and the Court of Appeal didn't feel equipped to look behind it).

Stopgap additions to DC guidance

The Pensions Regulator reported updates to its Code of Practice for defined contribution (DC) schemes, as well as the guidance on investment governance and communication and reporting for DC trustees. The documents now cover forthcoming governance and disclosure requirements, intended to promote greater consideration of illiquid assets.

Trustees are obliged to describe their policy on illiquids in the statement of investment principles (SIP) for their default investment arrangement. The requirement takes effect on the first occasion on which the default SIP is revised after 1 October 2023, and by 1 October 2024 at the latest.

Effective for the first scheme year to end after 1 October 2023, trustees must also provide detailed asset-allocation information for their default arrangement in their annual governance (Chair's) statements. The asset-allocation details must be made publicly available, free of charge, on a website.

The Regulator also mentions new Chair's-statement and website disclosures about performance-based fees, which came into effect from the first year-end after 6 April 2023.

The new requirements are subject to statutory guidance from the Department for Work and Pensions.

The Regulator hasn't updated the main body of Code of Practice No. 13, just inserted a lengthy note into its preamble pending the publication of the General Code, which will one day soon(-ish) supersede CoP13 and several of its siblings.

[3] *Wedgwood Pension Plan Trustee Ltd v Salt* [2018] EWHC 79 (Ch).
[4] *British Airways Pensions Trustees Ltd v British Airways plc* [2018] EWCA Civ 1533.

Public sector news

LGPS local valuations

The Local Government Pension Scheme (LGPS) Advisory Board for England and Wales published an overview of the 2022 local valuations. Compared with the position at the 2019 valuations, the average funding level has increased from 98% to 107%, with all Funds reporting an improvement (aggregate funding has gone from a £5.9bn deficit to a £22.1bn surplus); total membership has increased from 6.2m to 6.6m; and the average primary employer contribution rate has increased from 18.6% to 19.8% of payroll per annum, whilst the average total contribution rate has decreased from 22.9% to 21.1%.

Benefit statement guidance

The Regulator has issued some guidance for public sector scheme managers about their benefit statements for the next couple of years. The message is that they should take care not to provide confusing information to members who are affected by the *McCloud* remedy and are therefore in line for both annual benefit statements and remediable service statements (the remedy works differently in the LGPS, which will not produce remediable service statements). Whilst not offering a free pass for missed statement deadlines, it acknowledges the challenges that scheme managers face, and says that it will take a risk-based, practical approach to breaches from 2023 to 2025.

McCloud tax implications

His Majesty's Revenue and Customs (HMRC) has published another Public Service Pensions Remedy Newsletter, about the accommodations being made within the pensions tax legislation for the remedy for *McCloud* discrimination. Subjects include a separate reporting framework for annual allowance charges in the 2022/23 tax year, extension of 'scheme pays' to fully retired members, an extended deadline for applications for repayment of overpaid tax, the implications for members with pensions in payment arising from voluntary contributions, and the treatment of lifetime allowance excess lump sums (LAELS) that turn out (because of the remedy) not to have been LAELS after all.

HMRC has also updated its lifetime-allowance protection guidance for members, to cover public-sector scheme members who may find themselves, retrospectively, in the market for fixed or individual protection (2016) as a consequence of the remedy for *McCloud* discrimination; or who lost their protection because of the *McCloud* remedy and may now be able to reinstate it.

Updated cost-cap directions

The Treasury has published replacement Valuations & Employer Cost Cap Directions for the public sector schemes, which will govern the 2020 valuations at the national level. The 2023 Directions take account of previously announced reforms to the cost-control mechanism[5] and updated assumptions.

The Government Actuary's opinion on the Directions indicates that the provisional results from the 2020 actuarial valuations would generally predict increased employer contribution rates, but no changes because of the cost control mechanism.

Employers entitled to surplus remaining after buy out

The Inner House of the Court of Session in Scotland has agreed that a trustee was entitled to enter into arrangements to return post-buy-out surplus to the scheme's participating employers.[6] The scheme's rules were silent on what was to be done with any remaining assets, and prohibited any alteration to permit payments to the employers whilst the scheme was ongoing. As part of the arrangements, the trustee and employers agreed to use some of the surplus to augment member benefits.

The scheme has been closed to new members since 2004, and to defined benefit (DB) accrual since 2016. Past DB accrual has been funded all but entirely by the sponsoring employers. The trustee now finds itself in the position of being able to de-risk by buying out the DB liabilities with an insurer. Not only that, but the value of the scheme assets is expected to exceed the estimated cost of buy out and expenses of wind up.

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[5] Making it 'reformed-scheme only'; widening the corridor within which costs can diverge without necessitating benefit or member-contribution changes'; and introducing an economic check, so that benefit or contribution changes are only made when they are in line with the long-term economic outlook.
[6] *Re abrdn (SLSPS) Pension Trustee Company Ltd* [2023] CSIH 31.

Unsurprisingly, perhaps, the scheme's participating employers are co-operating in the arrangements for de-risking and return of surplus. However, the trustee also obtained their agreement to apply some of the surplus toward extra defined benefits for the members, and the transformation of a discretionary pension increase power into guaranteed inflation linkage.

The parties were reluctant to proceed with the planned de-risking transactions without clarity on the proper destination for the surplus. Accordingly, it asked the Court whether:

- its decision to enter into the arrangements with the employers is one that it is entitled to make, given the scheme rules and its fiduciary duties;
- the residual assets would be the subject of a 'resulting trust'; and
- the resulting trust would operate only in favour those employers participating immediately before the date when accrual ceased, and only after the buy out is completed and provision made for the expenses of wind up.

An independent expert was appointed to the role of court reporter, as a cost-effective way of establishing the facts of the case and to confirm that there was no impropriety about the proposed arrangements. He confirmed that (amongst other things) the trustee had power under the rules to wind up the scheme and secure benefits through buy out, that there was no conflict of interest, and that each side in the negotiations had 'fought its corner'.

Judgment

The Court agreed with the reporter's view that the decision to enter into the proposed arrangements was something that a reasonable trustee could do. The trustee had sought advice from experts, and taken all material considerations into account. The overall outcome would be to members' benefit.

The Court agreed that the remaining surplus would be held in a 'resulting trust' in favour of those employers that were participating at the time when accrual ceased.[7] Ordinarily, past participants would also have been entitled to share in the surplus, but in this case the scheme rules excluded that.

As noted above, the scheme had been largely non-contributory from its members' point of view, although some had for a brief period paid to obtain or retain extra benefits. The Court said that the character of those contributions was different from that of the participating employers. The members' purpose was to obtain extra benefits, and that purpose had been achieved (and then some, because of the augmentations agreed as part of the negotiations with the employers). That was contrasted with the purpose behind the employers' contributions, which was to fund the scheme and meet any deficit that arose from time to time. It was not part of their purpose to produce the surplus that had arisen as a consequence of the trustee's investment choices. Provided that the trustee had gone about its decision-making in the right way, the Court would not interfere with the trustee's decision to augment benefits across the board rather than expend a disproportionate part of the surplus trying to calculate who ought to benefit and by how much.

Finally, the Court agreed that the surplus would not emerge until the benefits had been secured and the expenses of winding up were met.

There were some case-specific aspects to the judgment, but it's good to see the Court's pragmatic approach—made easier, no doubt, by the trustee's careful attention to the issue, and success in negotiating a positive outcome for the members.

[7] The resulting trust recognized the 'radical beneficial interest' of the person who had established a trust in any surplus that remained once the purposes of that trust had been fulfilled.

The reasonableness & size of contribution notices

The Upper Tribunal has rejected an appeal against a contribution notice issued to a former company director who was a party to a series of acts that led to a family member being paid over £3.6m from the proceeds of a joint venture, at a time when the company pension scheme's financial position was fast declining.[8] The decision has some interesting things to say about the 'reasonableness' test that the Regulator needs to conduct before imposing a contribution notice, and the limits on the contribution that can be demanded by the Regulator.

The former director was a party to an agreement under which the scheme's principal employer waived its entitlement to the proceeds from the disposal of shares in a joint venture company owned by a subsidiary that was also a statutory employer. The sale proceeds went to another company (not a statutory employer) that held its assets on behalf of the director's nephew. The principal employer later entered into creditors' voluntary liquidation, at which point the scheme began the process of assessment by the Pension Protection Fund, with a buy-out (section 75) deficit of around £5.85 million.

The Regulator's Determinations Panel concluded that the actions of the former director and his nephew were materially detrimental to the likelihood of scheme members receiving their full benefits. The resulting contribution notice was originally for £3,688,108, reflecting the proceeds from the sale. It was issued against the former director and the nephew, jointly and severally. However, the nephew subsequently reached a settlement with the Regulator, so the appeal related solely to the contribution notice against the uncle, and the Regulator asked for half of the original amount, plus interest.

The Tribunal upheld the Determination Panel's decision. On the issue of reasonableness, it said that particular weight should be given to the first three of the eight considerations listed in the legislation: degree of involvement, relationship with the scheme employer, and involvement with the scheme. It said that the case becomes even stronger if the target of the contribution notice also benefited from the detrimental act(s). In this instance, the Tribunal thought that the former director's conduct was so unreasonable that all of the other factors would have had to point very clearly in the opposite direction for him to have a sensible case against the contribution notice. They did not, so that his—not very well substantiated, in the Tribunal's opinion—claim to an ascetic lifestyle in accordance with his religious principles did not get him off the hook.

On the subject of the amount of the contribution notice, the Tribunal said that (contrary to remarks made in an earlier ruling[9]) it is not necessary for the Regulator to limit the maximum amount to the loss suffered by the scheme as a result of the detrimental act. Once the Regulator had established that the act had caused material detriment, the only constraint on the contribution notice was that it could not exceed the estimated section 75 debt due to the scheme. It was reasonable, given the '*aggravating factors*' in this case, for the Determinations Panel to set the amount by reference to the sale proceeds; however, as it happened, the Tribunal *did* think that the amount was representative of the loss to the scheme, because it would otherwise have been available to fund the benefits due to members.

Regulator revises superfund guidance

The Pensions Regulator has published a blog post announcing changes that it has made to its guidance for both those setting up and running defined benefit (DB) superfunds and trustees and employers considering transferring to one.

The amendments to the guidance include the dimensions of the 'gateway' though which schemes are expected to pass when entering a superfund, changes to the funding expectations for superfunds, the bar for profit extraction, and the assessment process. The updated guidance follows the Department for Work and Pensions (DWP) announcement that it intends to develop a permanent superfunds legislative regime.[10]

The gateway principles have been updated so that schemes that could afford to buy-out benefits, but are unable do so because they are cannot 'access' buyout (e.g. because an insurer has declined to quote on a scheme) should be allowed to transfer to a superfund. The timescale for which the gateway principles are deemed to be satisfied for has now been extended from one month to nine months.

[8] *Shah v The Pensions Regulator* [2023] UKUT 00183 (TCC).
[9] *Re Bonas Group Pension Scheme* [2011] UKUT B33 (TCC).
[10] <www.hymans.co.uk/insights/research-and-publications/publication/current-issues-august-2023/>.

The Regulator has also published an account of its discussions with the industry, which helped inform the revisions to the guidance.

We welcome the update to the guidance. As the Regulator says, while this market has great potential to make a difference to member outcomes by establishing another route to secure full benefits, it has yet to fully take off.

A running theme of these latest documents appears to be a clear desire to have a superfund regime that works for both members and providers. There's also a recognition that, for this market to truly flourish, the framework must allow for significant differences in pricing between insurers and superfunds.

Updated guidance on deferral of connection to dashboards

The Department for Work and Pensions (DWP) has updated its guidance for trustees and pension scheme managers on how to apply to defer connection to the pensions dashboards infrastructure.

The DWP has revised its guidance to reflect amendments[11] to the dashboards legislation[12] that introduce a single deadline of 31 October 2026 by which all relevant occupational pension schemes will be required to connect to the dashboards system. The staging timetable that was previously set out in the legislation has been repealed and a new timetable will be set out in statutory guidance, which is to be developed by the DWP in consultation with the Pensions Dashboards Programme and the regulators.

The updated guidance explains the very limited circumstances in which an application may be made to the DWP to defer connection. In essence, the option to agree a later deadline will only be available when the trustees or managers have a standing commitment to change their administrator, and meeting the standard connection deadline would be disproportionately burdensome or would put members' personal data at risk. The revised guidance says that the application, which now must relate to events before 9 August 2023, has to be submitted by 8 August 2024, and can only be in respect of a request to defer connection beyond 31 October 2026. As before, the deadline can only be extended for up to 12 months.

Killing the golden goose

The High Court in England and Wales has approved a trustee's decision to put its scheme's ailing sponsors into insolvency proceedings.[13] The trustee was concerned that otherwise 'scheme drift' would continue to worsen its already poor funding position.

The litigation & litigants

Trustees may seek judicial blessing when they propose to take a particularly momentous decision, if they desire obtain reassurance that it would be a proper exercise of their powers. The court's role is limited: it will consider whether the trustees have properly arrived at their decision, if it is one that reasonable and correctly informed trustees could make in the circumstances, and that it is not impaired by conflict of interest.

In this case, the hearing was held in private, on the grounds that publicity would have defeated the object of the exercise, and that it was necessary to secure the proper administration of justice. The same confidentiality considerations had led the Court to appoint a pensions lawyer to represent scheme beneficiaries in whose interests it was that the decision was not approved. She was joined as a defendant by the Pension Protection Fund (PPF)—although in the event she could come up with no credible grounds for opposing the trustee's decision, and the PPF strongly supported it. The scheme's principal employer and the Pensions Regulator were both invited to participate but had declined to do so.

Sorry state of affairs

Under the rules of the scheme, the only way for the trustee to wind up the scheme without the principal employer's cooperation was if the principal employer became insolvent. The Regulator could have ordered it, but in the absence of sponsor insolvency the scheme would not have been eligible for entry into the PPF.

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[11] *The Pensions Dashboards (Amendment) Regulations 2023*, SI 2023 No.858.
[12] *The Pensions Dashboards Regulations 2022*, SI 2022 No.1220.
[13] *BRASS Trustees Ltd v Goldstone & Anor* [2023] EWHC 1978 (Ch).

The scheme actuary had estimated that, as at 31 December 2022, the scheme had liabilities of almost £70m and a deficit of over £28m on its scheme-specific funding basis. The principal employer had failed in its obligations toward the scheme since March 2020, owing it over £39m, including more than £8.5m (before interest) in unpaid contributions and expenses. The trustee painted a '*bleak picture*' of the employer's financial position, which the judge thought could very well understate the full extent of its problems. The employer had been '*generally unforthcoming*', drip-feeding information that gave a one-sidedly rosy portrayal of its prospects, whilst failing to inform the trustees about setbacks. It was clear to the judge that there was no likelihood of it meeting its obligations to the scheme.

The trustee gave evidence that the employer had '*survived the last couple of years almost entirely by taking on new debt*', that its directors were worried that it was becoming harder to justify continuing to trade, in light of their legal duties, and that that other creditors besides the scheme were 'shouting for payment'. The trustee also said that the employer had breached a negative pledge obligation, with the result that other creditors had been preferred over the scheme.

Scheme & PPF drift

The trustee was concerned about the effect of 'scheme drift', whereby the funding position worsens over time as benefits are paid out and administration expenses are incurred. It had felt obliged to take a conservative approach to investment in light of its assessment of the employer's covenant. It concluded that current pensioners were receiving payments at the expense of those whose benefits would become due later.

The Court also considered the issue of 'PPF drift'. As explained by the trustee's lawyer, the longer it took for the employer to suffer an insolvency event that would qualify the scheme for entry into the PPF, the greater the compensation that would be due, because more members would have reached normal pension age or have died. Moreover, ongoing administration expenses would continue to reduce the assets available to the PPF to offset that compensation, leaving the PPF (and its levy payers) to bear the burden of the ever-increasing shortfall. The scheme actuary had estimated that the extent of the scheme and PPF drift were each increasing monthly by six-figure amounts.

Judgment

The judge was satisfied that the test for court approval of the trustee's decision had been met. He concluded that the scheme's deteriorating funding position, the result of the sponsors' financial problems and conduct, had left the trustee in an '*unenviable*' and '*invidious*' position in which it felt that it had no alternative than to petition for the winding up of the companies to protect the interests of the members as a whole.

The trustee recognized the 'momentous consequence' of putting the employer into liquidation. The judge was satisfied that it had considered the financial circumstances, the consequences for members of allowing continued scheme drift, their duty to call in and protect the scheme's assets, and their obligation to protect scheme beneficiaries' interests. It had also taken appropriate advice.

As it turned out, the judge did not need to rule on the legitimacy of the trustee taking the availability of PPF compensation and the PPF's financial interests into account when exercising its powers in this case, because the trustee had concluded that its decision would be the same either way. However, the judge considered the judicial precedents on the (ir)relevance of the PPF's existence to trustee decision-making, and agreed that the trustee could not have used its existence to justify failing to take steps to staunch the bleeding (scheme drift).

The judge had little hesitation in giving his blessing to 'the nuclear option' in this case. Thank goodness that such extreme examples are, mercifully, quite rare. The succinct rehearsal of judicial precedents on the relevance of the PPF may also be of interest, even if they didn't come into play as things turned out.

And Finally…

There's mention earlier in this edition of *Current Issues* of the Regulator's General Code, whose coming hath been foretold in song and ancient prophesy. The gist is that *Il Regolatore* has published a revised edition of its DC Code of Practice, which—much to the 'dissapointment' of dozens of one-star reviewers on Amazon—is just the old version but with a new preface, nodding toward changes that start to have effect in October. It's a tacit acknowledgment that the One Code to Rule Them All (And in the Darkness—Of the Regulator's Website—Bind Them) won't reach Mount Doom in time.

Before they can enter into force, Codes must have lain before Parliament in draft form for forty days. And maybe forty nights too, depending on whether your 'baby left this town'.

AF is a bit hazy on what that means in practice: *before* Parliament—are they left outside? Maybe flicked through desultorily with tattered back copies of *Town & Country* and *Cosmo* in a waiting room? If they're stood on their ends instead of laid down, does that invalidate the process?

Anyway, the clock stops on this lying-in-state whilst Parliament is dissolved or prorogued, or when both Houses are adjourned for more than four days. We're just coming to the end of the six-week summer recess, and then Parliamentarians will be Coming Soon! To a Convention Centre Near You!, with the start of the three-week conference season (with only two weeks in between the two adjournments). The current session of Parliament is due to be prorogued (less painful and intrusive than it sounds) ahead of the King's Speech on 7 November 2023.

From which we must needs conclude that: (a) Parliament has hols to make school kids envious; and (b) holding one's breath whilst waiting for The Code of Codes would perhaps, for now, be medically unwise…

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