The trust should be abolished as the basis of pension scheme

Business

Following the discovery of the misappropriation of around £ 453 million from the pension funds of Mirror Group Newspapers and Maxwell Communications Corporation employees, discussion occurred over the appropriate method for regulating pension trusts. There was significant public concern over the abuse of pension funds and the loss to employees of their pension rights. The Pension Law Review Committee produced the Goode Report in which it recommended the retention of the law of trusts to govern pension funds while also proposing various safeguards to protect the rights of beneficiaries.

Trust law has traditionally been favoured as a foundation for pension schemes as opposed to contract as it creates equitable rights for the beneficiaries. This means that the trustee must keep trust property separate from private property and if the trustee becomes bankrupt, the trust assets are not available to creditors. Furthermore, beneficiaries have an equitable right to trace (Hayton 1993) The majority of the proposals contained in the Goode Report were implemented by the 1995 Pensions Act.

The general principles of trust law therefore govern the management of pension trusts, subject to certain exceptions, as outlined below, which are intended to safeguard the interests of employees. In particular, trust law is supplemented by duties of disclosure and fiduciary duties in addition to statutory regulations relating to professional advice, delegation of discretions and minimum funding requirements. The trustees of pension schemes owe particular fiduciary duties to the members of such schemes.

There are duties of undivided loyalty to beneficiaries, a duty to prudently preserve trust assets and a duty to exercise fiduciary powers responsibly.

These fiduciary duties help to prevent the balance in the relationship between employer and employee, which exists behind the trust, from being tilted in favour of the employer and will also help to prevent the undesirable investment of pension funds in the employer's business. Essentially, the trustees must always act in the interests of the beneficiaries.

The position of the employee is further strengthened by the characterisation of apparent personal powers conferred on the employer as fiduciary powers. For example, the classification of a power of appointment in favour of members as fiduciary has prevented the surplus in a trust from going to the employer's creditors (Mettoy Pension Trustees Ltd v Evans [1990]) Furthermore, it has been held that the implied duties in the contractual relationship between employer and employee may also be applied to the trust relationship.

Accordingly, the implied contractual obligation of good faith between employer and employee has been held to apply to the exercise of the powers and rights of the employer under the trust (Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd[1991]). This clearly places members of pension schemes in a more advantageous position than the beneficiary in an ordinary trust. The 1995 Act created the Occupational Pensions Regulatory Authority (Pensions Act 1995, s. 1). This has powers concerning the appointment and removal of trustees and can impose financial penalties on trustees for breach of their duties.

Furthermore, it may apply for an injunction or for restitution to restrain or remedy misappropriation. Provisions are contained in the 1995 Act

concerning the constitution of trustees. This is clearly in contrast to the normal rules relating to trustees of other types of trusts. The rules are essentially concerned with the protection of employee interests. Accordingly, the trustee body must contain representatives of scheme members (" the member-nominated trustees").

The trustees are expected to organise the selection of the member-nominated trustees, of which there must normally be at least two and who must constitute a minimum of one third of the number of trustees. In the case of a trustee which is a company connected with the employer, the member-nominated trustees become member-nominated directors. A further exception to the general principles of trust law allows a person to be both a trustee and a beneficiary.

According to section 39 of the Pensions Act 1995, no rule of law that a trustee may not exercise the powers vested in him so as to give rise to a conflict between his personal interest and his duties to the beneficiaries shall apply to the trustee of a trust scheme, who is also a member of the scheme, exercising the powers vested in him in any manner, merely because their exercise in that manner benefits, or may benefit, him as a member of the scheme". Further protection for the employer exists in the rule that a trustee who is independent of the employer is to be appointed in the event of the employer's insolvency.

Greater powers to disqualify a person from being a trustee exist, in comparison with those relating to the trustees of ordinary trusts. Section 29 sets out the categories of person who are disqualified from being a trustee.

Furthermore, the Authority has the power to disqualify a person who has previously been removed as a trustee for misconduct or mismanagement where the Authority believes that it is not desirable for him to be a trustee of any occupational pension scheme.

The 1995 Act also provides an exception to the general rule that trustees (with the exception of those of charities) must act unanimously where the trust instrument does not provide otherwise. In an occupational pension scheme, however, majority decisions are acceptable unless the trust scheme provides otherwise. This measure will ease the smooth running of the schemes. Protection to employees is however, afforded, by the rule that trustees must, as far as reasonably practicable give notice of occasions at which decisions may be taken to each trustee.

The general principles of trust law have been applied to the management of investments in occupational pension schemes. The 1995 Act, however, introduces special rules relating to pension trusts. Firstly, the trustees are given the right to make any investment as if they were absolutely entitled to the assets, subject to any limitations placed upon this power in the occupational pension scheme itself. A written statement of the principles which determine investment policy is to be prepared and maintained.

This should include details of risk and expected return in addition to the social, environmental and ethical factors which impact investment decisions. There is also a duty to obtain professional advice and to consult the employer before making or revising this statement. (Hanbury and Martin, Modern Equity) Control is exerted over investment decisions by the statutory

requirement that trustees have regard to the need to diversify investments and to the suitability of the scheme of investments, of the description of investment proposed and of the investment proposed as an investment of that description (Pensions Act 1995, s. 6(2)).

Suitable advice is to be obtained on investments and the trustees have a duty to exercise their powers in order to give effect to the principles set out in their policy statement, so far as this is reasonably practicable. These duties must be complied with: failure to do so can lead to a financial penalty or removal. It should also be noted that the trustees of a pension trust are not subject to the statutory duty of care under the Trustee Act 2000 in the exercise of their investment powers.

As an exception to the general rule prohibiting delegation of the exercise of a trustee's discretion without authority, the trustees of pension trusts are permitted to delegate investment decisions to a fund manager who is authorised to carry out investments under the Financial Services and Markets Act 2000 (Pensions Act 1995, s. 34(2)). This measure was necessary to resolve difficulties which had occurred over the delegation of such decisions.

The trustees also have the option of delegating these decisions by power of attorney, or to a fund manager who does not have the necessary authorisation under the Financial Services and Markets Act 2000 or, subject to any limitations contained in the occupational pension scheme, to authorise two or more of the trustees to make investment decisions on behalf of all the trustees. A delegation to a fund manager authorised under

the FSMA 2000 absolves the trustees of responsibility for his acts or defaults provided they have taken all reasonable steps to satisfy his execution of duties competently and in accordance with statutory duties.

In contrast where the trustees delegate in any of the three other methods outlined, they will be liable for ay breach caused by the acts or defaults of the person to whom the power has been delegated in the exercise of that discretion. Liability for the acts or defaults of the unauthorised fund manager may be excluded or restricted by an instrument or agreement where the trustees have taken all reasonable care to satisfy themselves that he has appropriate knowledge and experience, is acting competently and in accordance with statutory duties.

There is clearly, therefore, an incentive for trustees to be diligent in making any delegations, an incentive which should help to safeguard the interest of the members of the pension scheme. The interests of scheme members are protected in the event of the employer's liquidation through the restrictions placed upon investments in the employer's business. At present, only five per cent of the fund assets may be invested in the employer's business (Pension Schemes Act 1993, s. 112).

The trustees or managers of the scheme must ensure that such restrictions are complied with, the penalty for failure to do so is a fine or removal. In addition, where the trustee or manager has agreed to the investment, an offence will be committed. The value of the assets of the occupational scheme is not to be less that the total amount of its liabilities. This rule is

intended to ensure regular monitoring of the schemes assets and to identify and prevent funding inadequacies (Hanbury and Martin).

Valuations are to be obtained at regular intervals (Pensions Act 1995 s. 57). A certificate from the actuary is necessary, stating the adequacy of current contributions. If they are found to be inadequate for securing minimum funding, a further valuation is to be made within six months. Where the actuarial report reveals that assets are below ninety per cent of liabilities, the employer has one year in which to increase assets to ninety per cent-failure to do so will result in the trustees having to inform the authority and scheme members.

The normal penalties of a fine or removal apply to trustees who fail to take all reasonable steps to ensure minimum funding rule is satisfied. The usual duty for trustees to provide information to the beneficiaries of a trust is applicable in cases involving pension trusts. Furthermore, trustees of occupational pension schemes must make copies of certain documents, including audited accounts, actuarial valuations and certificated relating to the minim funding requirement, available for members and other specified persons to inspect.

Case law suggests that members may be able to challenge investment policies and decisions alleged to have been taken without significant consideration of employee interests or on the basis of improper considerations Cowan v Scargill [1985]. Armed with sufficient information concerning the exercise of the trustees' powers, members may challenge the way in which the trustees' duties are executed.

In the case of an ongoing scheme, as opposed to one which has been wound up, employees have no right to an actuarial surplus but do have a reasonable expectation that the employer, in managing it, will respect the duty of good faith owed to employees Jefferies v Mayes [1999]. Restrictions on payment to the employer from an approved ongoing scheme require that any power conferred by the scheme on persons other than the trustees to make payments to the employer may only be carried out by the trustees.

Furthermore, this power is to be exercised pursuant to Revenue-approved proposals to eliminate excessive surplus and is controlled by rules such as that requiring the trustees to be satisfied that the proposed exercise of the power is in the interests of members and that annual increases in pension rates have occurred. The fact that these conditions have been fulfilled must, in certain cases, be confirmed by the regulatory authority. The issue of a shortfall or excess of assets does not arise in money purchase schemes as benefits are defined and depend on the performance of investments.

Assets are to be used to discharge liabilities to members. This must occur in a specified order, for example, liability for pension increases is the final liability to be discharged (Pensions Act 1995, s. 73). The Act provides for different ways to discharge liabilities; these include transferring credits to other schemes, transfer to particular personal pension schemes or the purchase of annuities. In the event of insufficient assets to discharge all liabilities, the shortfall becomes a debt owed by the employer to the trustees.

Schemes generally provide for the distribution of any surplus assets. Where this does not exist, common law rules will be applicable. The application of such rules can be seen in the Privy Council case of Air Jamaica Ltd v Charlton. A pension scheme was discontinued and a purported amendment providing for payment of surplus to the employer was held to be void. The surplus was therefore held on resulting trust for the employer and the members. The employer would be a beneficiary as to half, as would the members, in proportion to their contributions.

Accordingly, the decision in Davis v Richards & Wallington Industries Ltd that any shares of the members would become Crown property as bona vacantia was wrong. The decision of Scott J in this case had been incorrectly based on an analysis of intention and the conclusion that the members must have intended to exclude a resulting trust for tax purposes was therefore wrong. The 1995 Act further provides that where a scheme allows for the employer or trustees to distribute assets to the employer on the winding-up of the scheme, this power is only to be exercised after all liabilities have been fully discharged and pension rates increased.

In some situations, confirmation of compliance with these requirements must be obtained from the regulatory authority (Pensions Act 1995 s. 76). In certain cases, the scheme will prohibit distribution to the employer. In such circumstances pension rates must be increased and additional benefits provided to members before the trustees may distribute any surplus to the employer. The usual sanctions of a financial penalty or removal of trustees

apply. A compensation scheme was created by the 1995 Act to alleviate the hardship suffered by employees when a misappropriation of funds occurs.

An employee makes an application to the Pensions Compensation Board, which was set up by the Act. This may be done where the value of assets in an occupational pension scheme has diminished and reasonable grounds exist for believing that the reduction was the result of misappropriation. In the case of a salary related scheme, the reduction must mean that assets total less that ninety per cent of liabilities whereas for a money-purchase scheme the assets must have reduced to less than ninety per cent of their pre-offence value.

The employer must be insolvent, a rule which would have prevented relief being granted to the victims of the Maxwell funds and is somewhat narrower than the proposals contained in the Goode Report. A member has twelve months to make an application, from the date of insolvency or, if later, the date on which the scheme's auditor knew about the reduction in assets. Compensation is not to be greater than the shortfall or, for salary related schemes, than the sum necessary to ensure that assets equal ninety per cent of liabilities.

In accordance with the objective of ensuring a retirement income for members, interests under an occupational pension scheme may not be assigned, surrendered, charged or the subject of a right to set-off. Where rights are surrendered or assigned for the benefit of a widow, widower or dependent, limited exceptions permit a charge or set-off by the employer. In the event of a member's bankruptcy, pension rights are not regarded as part

of the bankrupt's estate for the purpose of the Insolvency Act 1986 and are therefore not available to creditors.

To the extent that pension contributions were excessive and unfairly prejudiced creditors, a court may order them to be recovered by the trustee in bankruptcy. The law of trusts will continue to form the basis of the law governing occupational pension schemes. This allows for flexibility and for beneficiaries to have equitable proprietary rights. Further measures are necessary in order to ensure the smooth-running of pension schemes and the protection of members' interests. The recommendations contained in the Goode Report demonstrate a concern to increase the security of the benefits of members of an occupational scheme.

The recommendations needed to be accepted by employers, as recognised by the Committee. It has been suggested that the government was more concerned not to burden employers than to make benefits secure. Drastic measures would have led to an abandonment of occupational pension schemes by employers, a move which would not have been in the public interest. Changes in the law relating to these schemes were tailored accordingly. The current law therefore reflects a compromise between the protection of employee interests and the reluctance to impose too onerous obligations upon the employer.