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# **Pensions** Legal Update



# Pensions Bill

**Summary.** The Pensions Bill has been published.

**Background.** In December 2006, the Department of Work and Pensions published a White Paper setting out its proposals for personal accounts under the proposed national defined contribution scheme. The personal accounts scheme is expected to be established from 2012.

**Facts.** Key provisions in the Bill include:

- Framework legislation for personal accounts. The Pensions Bill enables the Secretary of State for Work and Pensions to establish this new pension scheme. The Personal Accounts Delivery Authority (established by the Pensions Act 2007) will have extended powers to oversee the establishment.
- The Pensions Bill also introduces requirements for employers to enrol employees automatically into a pension scheme (which may be the new personal account scheme or another scheme which meets minimum quantity requirements).
- Abolition of safeguarded rights (benefits derived from contracted-out benefits where pensions are shared on divorce) from an unspecified future date.
- Provision for revaluation of deferred pensions earned through service after an unspecified future date in line with price inflation with a 2.5% cap (rather than the current 5% cap).
- Provisions allowing compensation under the Pension Protection Fund to be shared on divorce or made the subject of a pension earmarking order.
- Provision for charging interest on late payment of Pension Protection Fund levies.

*Source: Pensions Bill as introduced into the House of Commons on 5 December 2007.* www.dwp.gov.uk/mediacentre/pressreleases/2007/dec/pens48-051207.asp

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# Scheme rules: drafting errors

**Summary**. The High Court has rejected the use of two alternative remedies to rectification in order to correct a drafting error in the scheme rules.

**Background**. A court order for rectification of a scheme rule requires a high standard of evidential proof (*Lansing Linde Ltd v Alber*).

Recent case law suggested the availability of two alternative remedies to that of rectification:

- To apply the rule developed from *re Hastings-Bass decd* (*[1975] Ch 25*). This applies where the effect of exercising a trustee discretion is different from what was intended by the trustees, and it is clear the trustees would have acted differently had they not failed to take into account considerations which they ought to have taken into account, or taken into account considerations which they ought not to have taken into account.
- To seek relief in equity from the consequences of a mistake. *(see for example Gibbon v Mitchell ([1990] 1 WLR 1304))*

The High Court has rejected the use of two alternative remedies to rectification in order to correct a drafting error in the scheme rules.

**Facts**. It was discovered that the rules of one of the pension schemes operated by S contained a drafting error in the early retirement rule for deferred members. A deferred member could draw an immediate pension at 60 (rather than 65) without suffering an actuarial reduction. Further, an employed member could also take advantage of the error in the rule and draw benefits unreduced from 60.

S considered making an application for rectification, but decided not to proceed. The reason for this was not disclosed to the Court, but it is assumed that there was insufficient evidence to support an application. S, therefore, sought to rely on two alternative remedies.

**Decision.** The court rejected the use of both alternative remedies.

Regarding the rule in *Hastings-Bass*:

- There should be no rectification by the back door. Rectification serves the purpose of substituting a corrected version of what a rule ought to have said. By contrast, successfully applying the rule in *Hastings-Bass* renders a rule void; it is not possible for the parties later to execute a deed of undertaking such that if a rule is made void by the courts they agree to apply the rule on the basis of what it ought to have said.
- The rule in *Hastings-Bass* is only available to trustees acting in accordance with a fiduciary duty, and the adoption of the definitive trust deed and rules in this case was essentially an act of the sponsoring employer not the trustees of the pension scheme.
- Although the trustees owed a fiduciary duty to members to ensure that definitive pension scheme documentation was put in place, the requirement to highlight to S errors which if not corrected worked to the members' advantage was not a relevant factor the trustees ought reasonably to have taken into account under the rule in *Hastings-Bass*.

Unless an order for rectification can be obtained, it will be difficult to get the court's approval to correct drafting errors in pension scheme rules.

In relation to the equitable remedy of mistake, the company could only set aside a deed on equitable principles if it had entered into the trust deed and rules voluntarily. This could not be the case where the scheme was established pursuant to contracts of employment of relevant members.

Finally, a counterclaim by the representative beneficiary attempting to improve the benefits of members was rejected.

**Comment.** Unless an order for rectification can be obtained, it will be difficult to get the court's approval to correct drafting errors in pension scheme rules.

*Case: Smithson & others v Hamilton [2007] EWHC 2900 (Ch).*

# Financial Assistance Scheme

**Summary.** The Department for Work and Pensions (DWP) has announced a series of extensions to the Financial Assistance Scheme (FAS).

**Background.** The Pensions Act 2004 introduced the FAS, which is intended to provide financial assistance to members of defined benefit pension schemes who have lost benefits because their pension scheme was wound up in deficit, usually as a result of employer insolvency. The FAS covers occupational pension schemes that commenced wind-up between 1 January 1997 and 5 April 2005 (the date when the Pension Protection Fund was introduced).

The DWP consulted on changes to the FAS in August 2007.

**Facts.** The extensions to the FAS provide for increases in the level of compensation and cover for members whose employers were still solvent when their scheme was wound up. The main changes are:

- Assistance will be increased for those affected, from 80% to 90% of their accrued pensions at the date their scheme began wind-up (subject to an annual cap of £26,000).
- Assistance payments derived from post-1997 accrual will be increased in line with inflation.
- Assistance will be paid from each failed scheme's normal retirement age (subject to a lower age limit of 60 years).
- People who are unable to work due to ill-health can apply for early access to payments from age 60.
- Members may be able to draw a tax free lump sum.
- Cover will be extended to people in schemes wound up by qualifying solvent employers. This is likely to apply to schemes that have wound up underfunded where a compromise agreement is in place, without which the employer would have become insolvent.

Source: DWP announcement, 17 December 2007, available at *www.dwp.gov.uk/mediacentre/pressreleases/2007/dec/pens51-171207.asp*.

The extensions to the FAS provide for increases in the level of compensation and cover for members whose employers were still solvent when their scheme was wound up.

# Scheme funding regime

Summary. The High Court has considered the construction of a scheme's employer contribution rule and how the new scheme funding regime applies.

**Background.** A was the principal employer of two defined benefit pension schemes (the schemes). These were multi-employer schemes in deficit and were subject to the new scheme funding regime under the Occupational Pension Schemes (Scheme Funding) Regulations 2005 *(SI 2005/3377)* (2005 Regulations). The employer contribution rules were the same in both the schemes.

The High Court has considered the construction of a scheme's employer contribution rule and how the new scheme funding regime applies.

Where employer contribution rates are determined by the actuary, without the agreement of the employer, the actuary has to provide an extra element of actuarial certification (the actuarial underpin) (*paragraph 9(5), Schedule 2, 2005 Regulations*).

**Facts.** The schemes had two employer contribution rules: Rule 12.1 dealt with future collective contribution rates and Rule 18.7.5 dealt with past service deficit collective contribution rates. Rule 18.7.5 provided that if the actuary's report disclosed a deficit, the employers shall collectively pay such amount (by lump sum or periodic payment) which will "...in the opinion of the Actuary restore the solvency of the Fund; *such amount to be paid by the Participating Companies in such proportions as the Actuary shall certify and within such period as the Trustees may, on the advice of the Actuary, agree with the Principal Company*."

A and the trustees of the schemes agreed that the actuary (alone) set the collective contribution rates in Rule 12.1. However, they disagreed on the construction of Rule 18.7.5 and whether the actuarial underpin applied. The issue was whether the words after the semi-colon (our emphasis added above) made it necessary for the actuary to obtain the sponsoring employer's agreement in setting the contribution rate. A was concerned that if the actuarial underpin applied, employer contributions would be "front-loaded" (this meant that even though the total amount of contributions required to meet the schemes' deficit would not be affected, payment of contributions would be not be spread evenly and A could have cash flow problems).

A argued that Rule 18.7.5 required employer agreement to determine the contribution rates and therefore the actuarial underpin did not apply. The trustees argued that the actuary had power to set the contribution rates (without employer agreement) and so the actuarial underpin did apply. A asked the court about the construction of Rule 18.7.5 and whether the actuarial underpin applied.

**Decision.** The court found in favour of the trustees and held that the actuarial underpin did apply to Rule 18.7.5. The court took a practical constructive approach (as set out in *British Airways Pensions Trustees Ltd & ors v British Airways plc & ors [2002] PLR 247*). Rule 18.7.5 should mirror Rule 12.1; the court did not expect a rule governing future contributions to be drafted differently from one governing past service deficit.

**Comment.** This decision is a useful example of the application of the new scheme funding regime.

*Case: Allied Domecq (Holdings) Limited v (1) Allied Domecq First Pension Trust Limited and (2) Allied Domecq Second Pension Trust Limited [2007] EWHC 2911 (Ch).*

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