

Pensions Update – Issue 129 November 2009

High Court decision on trustees selecting against the PPF



Independent Trustees Services Limited v Hope and Others

The judgement in this case was handed down on 10 November 2009. It considers whether the trustees properly can implement a proposal to exercise their power to buy-out benefits applying more than a proportionate share of scheme assets in circumstances where the effect of the proposal would be to improve benefits for members, ultimately at the expense of the PPF.

The High Court ruled that the application of a disproportionately large share of assets would be an improper exercise of the buy out power. Further, it would be contrary to public policy if the existence of the PPF allowed trustees to act in a way which would otherwise be improper.

Facts

Scheme: The sponsoring employer of the Ilford Pension Scheme (**Scheme**), Ilford Ltd, went into administrative receivership on 20 August 2004. The business was sold on 15 February 2005 at which time pensionable service and future service accrual ceased. The Scheme has a material deficit. There is no prospect of recovering further amounts from the employer. It is expected that the Scheme will ultimately fall into the PPF. As yet, no insolvency event has occurred and therefore the Scheme is not in an assessment period. When the trustees call in the debt, that will trigger the insolvency process.

Members: If the Scheme enters the PPF, some members' benefits will be materially reduced. A small group of relatively high earning employees who took enhanced early retirement during 2000/2001 in exchange for waiving other entitlements and who are still below the Scheme's normal pension age will be particularly badly affected. In some cases benefits will reduce by more than 50%. This is because of the combined effect of PPF compensation being 90% for those under a scheme's normal pension age and benefits being subject to a cap at age 65 (£31,936.32 in 2009/10). When members took enhanced early retirement in 2000/2001, the PPF did not exist and the then statutory priority order would have given them preference.

Proposal: The trustees were asked to consider exercising the power to buy-out by securing benefits for these members in full before a PPF assessment period was triggered. The members would receive their benefits in full from an insurance company; the PPF would ultimately bear the extra cost. It was common ground that such a buy-out would not be proper if the PPF did not exist. The trustees had concerns as to whether they could lawfully and properly select against the PPF in this way. However, if it were lawful, they proposed to buy out benefits in full for all members below normal pension age and buy out those benefits for members below normal pension age which would not be replicated by the PPF (to the extent that the Scheme assets were sufficient). This would materially increase the under funding of the benefits which were ultimately to be assumed by the PPF. The Trustee applied to court for directions.

High Court decision on trustees selecting against the PPF

Decision

Henderson J held:

"the proposal falls well outside the purposes for which the buy-out power... was conferred"

"In no sense can the statutory right for members to receive PPF compensation... be described as an asset of the Scheme."

"as a matter of law, ... the prospective availability of compensation under the PPF,... is not a relevant factor for the Trustee to take into account in the exercise of the [buy-out] power"

The proposal would be an improper exercise because:

- it would secure benefits in excess of those to which members would otherwise be entitled
- it would apply a disproportionately large (and unfair) share of assets

- In the circumstances, the PPF is not a relevant factor on public policy grounds
- The existence of the PPF is likely to be an irrelevant factor where it is used as justification for acting in a way that would otherwise be improper

Comment

This is not a surprising decision on its facts. The public policy arguments for not permitting trustees to select against the PPF seem overwhelming. The result is that it is now clear that trustees must not take into account the existence of the PPF where to do so would "game" the PPF.

Beyond that, this case should not significantly alter trustees' behaviour. This case clarifies that PPF compensation must not be regarded as a scheme asset when considering what is a fair proportion of scheme assets and supports the view that trustees need to consider very carefully the assets to apply on a partial buy-out, transfer payment or any other liability management exercises such as pension increase exchanges, particularly where trustees have discretion to apply more than a share of fund.

Where the effect of the exercise of a power would not be to "game" the PPF, the existence of the PPF may still be relevant. For example when trustees are considering a proposal to compromise an employer's debt, considering whether to bring about an employer insolvency event or considering different de-risking options, it is likely that the existence of the PPF will be a relevant factor.

Trustees will need to consider carefully whether the PPF is relevant in relation to any particular decision that they are making.

If you would like to discuss this further please contact:

Rachel Rawnsley ☎ 0113 209 2290 ✉ rachel.rawnsley@addleshawgoddard.com
Catherine McAllister ☎ 020 7880 5791 ✉ catherine.mcallister@addleshawgoddard.com
Jade Murray ☎ 0113 209 2446 ✉ jade.murray@addleshawgoddard.com

© 2009 Addleshaw Goddard LLP. All rights reserved. Addleshaw Goddard LLP is a limited liability partnership registered in England and Wales (with registered number OC318149) and is regulated by the Solicitors Regulation Authority. Ref. 440721. Extracts may be copied with prior permission and provided their source is acknowledged.

All material is by Addleshaw Goddard LLP lawyers, and is made available for information only. Existing law is stated as it applies in England and Wales at the date of publication. While provided in good faith and believed to be accurate, the application of the material to any specific situation depends on the law as it applies or is interpreted at any given date and also depends on the precise facts and circumstances applicable in that situation and any other relevant factors. It may be affected by detail which, for reasons of space, it has not been possible to include. Accordingly, it should not be acted on or relied upon without further specific advice. If we can be of further assistance, please contact the partner with whom you normally deal or any of the persons listed.

Addleshaw Goddard LLP is not authorised under the Financial Services and Markets Act 2000, but we are able in certain circumstances to offer a limited range of investment services to clients because we are members of The Law Society. We can provide these investment services if they are an incidental part of the professional services we have been engaged to provide.