Pensions: The Law

Pension law is complex. But understanding the basics of the law is extremely important if pension scheme members are to ensure that their rights are protected.

Pension fund trustees in particular have a duty to ensure that they understand their duties and how a pension scheme is operated.

This leaflet sets out the basics of pensions law, the duties of employers and of trustees and the rights members have under the law. Note that this leaflet is no substitute for obtaining legal advice directly relating to your pensions issue, and we are not responsible for any reliance upon its contents.

Introduction

All private sector pension schemes are founded upon the law of trusts. Parliament has added to, or modified the common law (that is the judge made law) by Statute. The main Acts of Parliament affecting pension schemes are the Pension Schemes Act 1993, the Pensions Act 1995 and the Pensions Act 2004, which were passed to reform pensions law following the Maxwell scandal. There are an enormous number of statutory instruments but the common law is still the current which flows under this raft of legislation.

Case law specific to pension schemes is complex. The Courts rely on 18th and 19th century cases concerning traditional trusts (which predominantly concerned family wealth). But the Courts recognise that pension schemes are different because:

Benefits under pension schemes are earned by the service of members under their contracts of employment and, where the scheme is contributory, by their contributions.

There are tax benefits available.

Occupational pension schemes may also interrelate with the State pension scheme. If a scheme is "contracted out" of the State Second Pension then there is another detailed body of social security law which governs the relationship between the occupational scheme and the State social security system.

There is a common professional practice relating to occupational pension schemes, arising from the work of actuaries, fund administrators and investment managers as well as lawyers. This is used as a guide to the legal regulation of pension schemes but it is not binding law.

Nine times out of ten, the answer to any question will be found in the deeds and rules.
There is a three-way relationship which lies at the heart of a pension scheme. It is a triangle, with the trustees, the employer, and the beneficiaries at each corner. The trustees have rights and obligations in their relationship with the employer, and in their relationship with the beneficiaries, which must be considered separately.

Does my employer have to provide me with a pension?

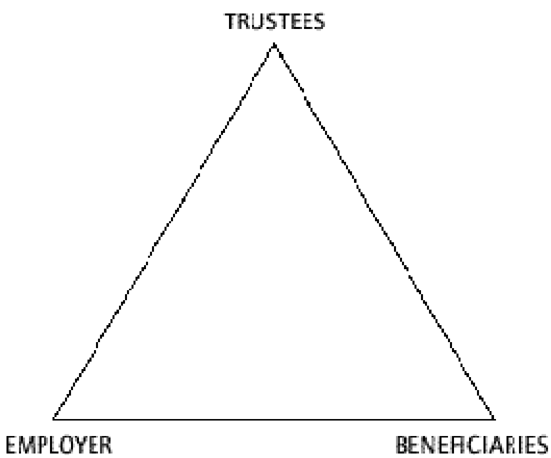
From 1 October 2012 all employers will be obliged to enrol their workers into a qualifying workplace scheme if they are not already in one. At present, many workers fail to take up valuable pension benefits because they do not make an application to join their employer's scheme. Automatic enrolment is meant to overcome this. Jobholders will still be able to opt-out of the regime but employers must not offer any inducement to do so.

How is a pension scheme set up?

Public sector pension schemes are made by Parliament and are governed by statutes and statutory instruments. That is the exception rather than the rule. However, private sector pension schemes are usually set up as trusts, creating a trust fund to which the employer is obliged to contribute. The scheme may require employees to contribute as well, but many schemes do not.

Trusts are a very old legal concept, developed as a means of passing on inherited wealth. One party gives the trust property to another (the trustee or trustees) but on condition that the property is used only in the best interests of a third party: the beneficiary or beneficiaries. In a pension trust, the first party is the employer and the beneficiaries are the employees, former employees, and the family members who might obtain some form of benefit under the Rules of the scheme.

The basic relationships form a triangle:



What is the role of the trustees?

The trustees own all of the assets of the scheme (including any surplus assets). They must invest them, and spend them looking to the best interests of the scheme's members, taking care to balance the interests of all of the classes of beneficiary. They have to look after the interests of pensioners and deferred pensioners (that is, early leavers) as well as current employees.

Best interests, for these purposes, mean the financial best interests of the beneficiaries. The Courts perceive the interests of scheme members to be limited to obtaining the maximum pension. The trustees therefore have to invest the assets with a view to obtaining the maximum return without taking excessive risks. That is usually interpreted as balancing the investments between shares and Government bonds but recent stock market experience is causing many fund managers to re-examine the wisdom of holding shares, which are expected to earn greater returns but are more risky.

The Pensions Act 1995 has reinforced the obligations placed upon the trustees, so far as investment decisions are concerned. Whilst, as a general rule, the deed and rules can limit the liability of trustees (by exonerating them for any losses caused by negligence) it is not possible to exclude the trustee's liability for negligence in investment decisions. But if they appoint a qualified fund manager they will not be liable for the act or default of the fund manager provided that they have taken all reasonable steps to satisfy themselves that the fund manager has the appropriate knowledge and experience and is carrying out his or her work competently. In other words, they must take care in ensuring that a proper person is appointed and in supervising the manner in which that person carries out the task of investment.

The trustees must draw up a statement of investment principles setting out their policy regarding the kind of investments that they will make, and the balance between different kinds of investments. They must also specify how they will approach socially responsible investment, and how they will exercise their voting rights as shareholders (never forgetting, however, that they must maximise the return).

Trustee discretions

The trustees have other decisions to make. Typical instances are:

- whether to pay a member an ill-health pension
- who to pay a death-in-service lump sum to
- whether to initiate or agree a rule change
- what transfer values to pay if a member leaves and wants to move their benefits to another scheme
- what employer contributions should be paid.

The way most of these decisions must be taken will be specified in the Rules of the scheme, and they must be observed scrupulously. Setting the employer's contribution rate is more heavily regulated: when the scheme is valued by the actuary every three years, the trustees must agree a schedule of contributions with the employer, within time frames specified by the law. If they can't agree the schedule with the employer then they must impose it.

A decision once made is not easily set aside. The Courts take the view that if the trust deed and rules give the decision making power to the trustees, then the Court should not exercise it for them. There are some important exceptions:

- The right person must make the decision. If the rules say that a decision is for the employer to make then the views of the trustees are irrelevant and a decision made by them is irrelevant.
- The trustees must observe the limits on any discretion given to them. If, for example, the trustees have a power to pay benefits to a "dependant" they may not give benefits to someone who is not dependent upon the deceased member in question.
- If trustees take some action without realising that there is a decision to be made then the action may be set aside. If trustees sign documents without reading or understanding them they risk this happening.
- Trustees may only use a power for the purpose for which it was given. For example a power of amendment is given to the trustees for the purposes of the scheme and that means the provision of pensions and other benefits to scheme members. It is not given to the trustees with a view to protecting the employer and they cannot act to protect the employer from a hostile takeover bid.
- More obviously, decisions can be set aside if, for example, they are taken in bad faith.

What are the employer's obligations under the scheme?

The relationship which exists between the trustees and the employer is defined first and foremost by the trust deed and rules. When lawyers talk about the balance of power they are talking about the powers of the trustees and of the employer, and the manner in which each keeps the other in check.

The most important powers, for these purposes, are:
- the power to wind up the scheme
- the power to amend the scheme
- the power to set the employer's contribution and the power to dispose of any surplus
- the power to make discretionary payments (such as ill health benefits)
- the power to fix the amount of any transfer values which are paid over and above the statutory minimum

The employer usually reserves the power to decide whether or not to allow an employee to join the scheme in the first place.

It used to be the case that the employer could also reserve the right to appoint the professional advisers to the scheme. This is no longer possible. The trustees must appoint the scheme auditor and actuary. The same firm or individual can be appointed to advise the employer as well, and the trustees have to rely on these professionals to withdraw if they think there is a conflict of interest. The trustees should also appoint their own solicitors, either by using the same firm as the employer and relying upon the solicitors to inform them if there is a conflict of interest, or by appointing another firm altogether.

The law has shifted this balance of power in favour of the trustees. The trustees can always amend the scheme to ensure that it does not discriminate against women or men. The priority order, if the scheme is wound up, is now fixed by law. Limited benefit improvements must be made before an employer can receive a repayment out of any surplus.
More importantly, the power to amend the scheme is now limited. If any modification is proposed which will affect accrued rights or entitlements then the trustees' consent must be obtained. If they will be adversely affected then the consent of each member concerned will have to be obtained as well.

Generally, documents from schemes contain specific provisions that set-out the power to appoint trustees, but this power is most frequently vested in the employer. This power must be exercised however in the interests of the pension scheme beneficiaries.

Also, under the Pensions Act 2004 and the Occupational Pension Schemes (Member-Nominated Trustees and Directors) Regulations 2006, unless a scheme is exempt, the trustees of occupational pension schemes are under a duty to secure that arrangements for at least one-third of the total number of trustees to be member-nominated trustees are put in place and implemented.

Members' rights under the contract of employment?

These are usually quite limited. The contract usually refers to the members' explanatory booklet, and the employer reserves the right, in the booklet, to amend or terminate the scheme.

The employer is obliged, however, to treat its employees and former employees in good faith. That means that it must look at each individual's circumstances when, for instance, deciding whether to agree an ill health pension application. And it means that the employer may not exercise its powers under the rules of the scheme in a way which undermines its very purpose.

Remember too that promises made outside the formal contract of employment can have contractual effect. If for instance an employer promises to provide a pension scheme of a particular nature as a condition of a business transfer then employees who rely on that promise may be able to enforce it.

What if I need to complain?

If the complaint is about something the employer has done, then use the ordinary employment grievance procedures. If the complaint is about something the trustees or administrators have done, there is a special internal dispute resolution procedure in every scheme which should be used.

This must specify a two-stage process as a minimum. If the first stage complaint does not provide a solution, then there will be a right of appeal, usually to the trustees. The law requires decisions to be made, at each stage, within two months (unless there is a convincing explanation why more time is needed).

If you are still dissatisfied, you may be able to reach a solution by calling on the services of TPAS, the Pensions Advisory Service. If it can't help, then you could make an application to the Pensions Ombudsman. He can deal with complaints against the employer, the trustees or the administrators.

Note the time limits however. A complaint to the Pensions Ombudsman must be filed within three years of the action or omission which is at the heart of the complaint. An extension can be granted if the member concerned didn't know that there was a problem until some later stage, or if the Ombudsman is satisfied that justice requires an extension.

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