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Is there a shift in the wind over the duties owed by trustees to scheme employers and scheme beneficiaries following the *KeyMed* litigation? *What should trustees be doing to mitigate risk ?*

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How should trustees take the interests of employers into account ?

- Trustees: employers: beneficiaries *"The eternal triangle"*
- Depends on the issue being addressed
- But *Keymed* case suggests that trustees owe no fiduciary duty to the employer in formulating (at least)
  - investment policy or
  - funding strategies
- Different from what many had thought before ?

"… trustees in my opinion continue to be under a duty to have regard to the proper interests of the employers in exercising their powers." Christopher Nugee QC APL lecture September 2015 para 14

Bill of fare

- The position before *Keymed*
- What *Keymed* says
- Practical implications
  - Funding strategy – *tPR June guidance*
  - Investment Policy
  - Benefit Design

How should trustees take the interests of employers into account ? Position before *Keymed: MNRPF (2015)*

- Starting point is the purpose of a pension trust – not like a private trust. Purpose is:
  - To provide benefits under the rules
  - To maintain a balance between assets and liabilities so that benefits can be provided (see *Edge* 623A-D)
  - Nb for a gloss on the purpose, insofar as it relates to benefit design see *BA* (2018) para 102 and 116
- Principal obligation of the trustees is to further the purposes of the trust:
  - may involve acting in the best interests of the beneficiaries
  - But obligation is not simply to act in the best interests of the beneficiaries (*MNRPF* #228)

Trustees may take interests of employer into account

- There is therefore no bar on the trustees taking into account the Employers' financial interests (#231) cf *Edge 626 G*
- However, doing so is ancillary to the primary purpose - Key conclusion in *MNRPF*:

"*Accordingly, in my judgment*, ***as long as the primary purpose of securing the benefits due under the Rules is furthered and the employer covenant is sufficiently strong to fulfil that purpose***, *it is reasonable and proper* ***should the Trustee consider it appropriate to do so***, *to take into account the Employers' interests*" (#233 – my emphasis)

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Are the trustees under a duty to take the interests of the Employer into account ?

Again, may depend on the context, but there are indications that this may be the case:

- Chadwick LJ in *Edge* at 626G:

  The trustees "***must*** *consider the effect that any course which they are minded to take will have on the financial ability of the employers to make the contributions which that course will entail*"

- Hart J in *Alexander Forbes v Halliwell* (2003) at para 22

  The trustees were "*entitled* ***and indeed bound*** *to consider the interests of the employers as well*"

- Warren J in *Urenco* (2012) at 45.

  "The Trustee ***must*** *act taking into account the interests of all the beneficiaries and indeed of Urenco itself"*

- And see, Patten J in *Law Debenture Trust v Lonrho Africa* (2003) at para 3, Patten J in *MNOPF* (2005) at para 50, Park J in *Smithson v Hamilton* (2007) at 101, Christopher Nugee QC APL lecture para 14 (on powers generally) and 15 (on investment powers)

But is this obligation actionable by the employer in damages ?

- Distinction between these two propositions:
  - Trustees ought to take the employer's interest into account in making a decision
  - Trustees owe a fiduciary obligation to the employer which would entitle the employer to bring a claim against the trustees in damages
- Submissions in *Keymed:*

"*……if the proper purpose of the trust involves taking an employer's interests into account … then it ought to follow that a duty is owed to the employer to properly take its interests into account*" (Keymed #117)

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Keymed v Hillman and Woodford [2019] EWHC 485

- Claim brought by company against its former executives for enhancing their DB and DC pensions
- BUT Defendants had whistle blown on the group – whiff of vendetta ? (cf para 469)
- Defendants were principal members and trustees (with others) of executive scheme
- Employer was cash rich

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Keymed v Hillman and Woodford [2019] EWHC 485

- As trustees:
  - Adopted cautious investment strategy (100% cash and gilts from 60% gilts, 40% equities in October 2010 - #419)
  - Received 12 large special contributions from the employer (procured/supported by the Defendants as directors)
  - Removed actuarial reduction for younger spouses because D1 was about to marry a much younger woman
- Claim for damages (a) for breach of fiduciary duty as directors and also (b) for breach of trust as trustees (#75(2))
- What were the duties owed to the employer by the defendants as trustees ?

Keymed

- Company relied on the dicta above (it seems) to argue that the trustees owed the company a fiduciary duty:

"*if the proper purpose of the trust involves taking an employer's interests into account … then it ought to follow that a duty is owed to the employer to properly take its interests into account*" (#117)

- Defendants' case was that the trustees can take the interests of the employer into account but:

"*the key point is that the trustees are not <u>required</u> to take those interests into account, and there is no claim against the trustees if they do not, and instead prefer the interests of the members over those of the employer.*" (#118)

Keymed

- The judge sided with the Defendants:

  "119(7) The employer's interest does not, therefore, derogate from my conclusion that the trustee does not (by virtue of his position as trustee of a pension scheme) owe a fiduciary duty to both the beneficiaries of the scheme and the employer sponsoring the scheme. I certainly do not regard the decision of Asplin J in Merchant Navy Ratings as in any way suggesting that such a duty follows from the fact that a trustee may consider the interests of the employer. Rather, Asplin J was saying that provided the primary duty that trustee owes to his or beneficiaries is respected, then it is not improper to consider other interests……

  120. Accordingly, I hold that, as a matter of law, the Defendants qua trustees owed no duties to KeyMed"

- Nb ref to "*should they consider it appropriate to do so*" at para 233 of MNRPF.

Implications of *Keymed*

- Is *Keymed* confined to its facts ? (nb there may be "special circumstances" which are different – (#120 fn103) – *White v Jones* ?)
- Complex point as to standing of company to sue in cases where the decision challenged is merely voidable (cf *AMP v Barker* para 90).
- If the trustee owes no fiduciary duty to the employer, can the trustee ignore the interests of the employer in making decisions ?
  - Funding
  - Investment
  - Benefit design

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Funding – "overfunding"

- Allegation in *Keymed* was that the trustees adopted a policy which gave unreasonably high security for member's benefits:
  - Not made out (#447) but no duty owed to employer to adopt a reasonable policy (#119)
- In case law, limit on trustees' ability to call for very high levels of funding is the statement of Chadwick LJ in *Edge* at 623E
  - Prudent trustees "*will aim to ensure that the likelihood of surplus outweighs the risk of deficit*"
  - But "*it is no part of the trustees function to set levels of contribution which will generate surpluses beyond those properly required as a reserve against contingencies*"
- Practical bar to trustees' claiming very high levels of contribution is the requirement that the schedule of contributions be agreed with employer or, if not agreed, referred to tPR:
  - In practice must be justified but wide degree of discretion in setting assumptions and length of recovery plan, which are interlinked (cf tPR "Funding defined benefits" guidance para 142)

Funding – "underfunding"

- However, case law is clear that the trustees should only be taking into account the interests of the employer if:
  - The employer covenant is sufficiently strong to fulfil the purpose of securing scheme benefits (*MNRPF* #233) or
  - The trustees consider that the best way to secure scheme benefits is to ensure that funding requirements are set at a level at which they are affordable/will not jeopardise the business (*MNRPF* #233 and *Edge* per Scott V-C 537B-C and CA at 633D
- This creates a "tipping point":
  - Where the financial position of an employer is steadily worsening, at some stage it will reach the point where neither of these two requirements are fulfilled.
- Impact of *Keymed* ?
  - Trustees' only fiduciary duty is to the beneficiaries

tPR on funding in unusual times (13.6.20 guidance)

- Only 10% of schemes have so far agreed an extension
- tPR expects trustees to undertake due diligence before agreeing another extension (/any extension ?)
- If there is good evidence that the covenant has materially worsened and is not expected to recover in a reasonably short timeframe, trustees should consider whether it would be in the best interests of members to update the scheme's funding arrangements (eg calling a new actuarial valuation and/or revising the recovery plan) to more accurately reflect the sponsoring employer's position.

tPR guidance 13.6.20 – Company demonstrates a requirement for suspension or reduction

- Where due diligence shows that a suspension or reduction in contributions is necessary and appropriate (for example, the employer has an immediate or demonstrable cashflow need for the foregone contributions), trustees should seek protections and other mitigations eg:
  - Block on payment of dividends
  - If possible agree a trigger for recommencement of payment of contributions
  - Company to pay trustees equally to other creditors
  - Security for the scheme in any refinancing
  - Improved financial information
  - Shortfall in contributions to be made good within the existing recovery plan unless *"there is sufficiently reliable covenant visibility available to suggest otherwise"*.

tPR guidance 13.6.20 – Company has not demonstrated a requirement for suspension or reduction

- Further suspension may be appropriate: "*provided that trustees are confident and can explain how the suspension would not be a breach of their fiduciary duties. In particular, trustees need to consider whether the contribution suspension may result in a write-down of scheme assets if the employer is unable to repay them or it would reduce recovery if the employer becomes insolvent*."
- tPR expects trustees to:
  - Agree only short term concessions, especially if they are not confident that they will receive timely and reliable financial information
  - Consider particularly carefully whether a postponement of a large contribution is justified (and cf requests to release security)

Investment

- Trustee investment power will normally be unilateral
  - Statutory obligation for trustees to consult employer on statement of investment principles (s.35(5)(b) PA 1995 and *Pitmans Trustees v Telecommunications Group* (2004))
- Clear from *Keymed*:
  - No independent fiduciary duty owed to company in relation to investment policy (on facts)
- And from MNRPF:
  - Trustees could take into account financial interests of company if the company's covenant was strong enough to allow it to do so (#233)
  - But this was not dependent on whether the financial interests of the company in fact benefited the members (#234) – particularly relevant to historic schemes.

Very cautious investment policies

- Gilts only approach approved in *Keymed* (eg # *Keymed* 429)
- But trustee is not obliged to adopt the most extreme risk free approach without reference to other factors (*MNRPF* #234)

Benefit design

- Normally requires consent of company so question of fiduciary duty owed by trustees to company *prima facie* would not arise
- Unilateral power a special case ? Issue now seems to be settled by *BA* (2018)
  - Where trustees have unilateral power to amend benefits, the exercise of that rule is subject to a proper purpose limitation (ie so that the power may not be exercisable)
  - Exercise of power *prima facie* void if in breach of the proper purpose
- Surpluses ?

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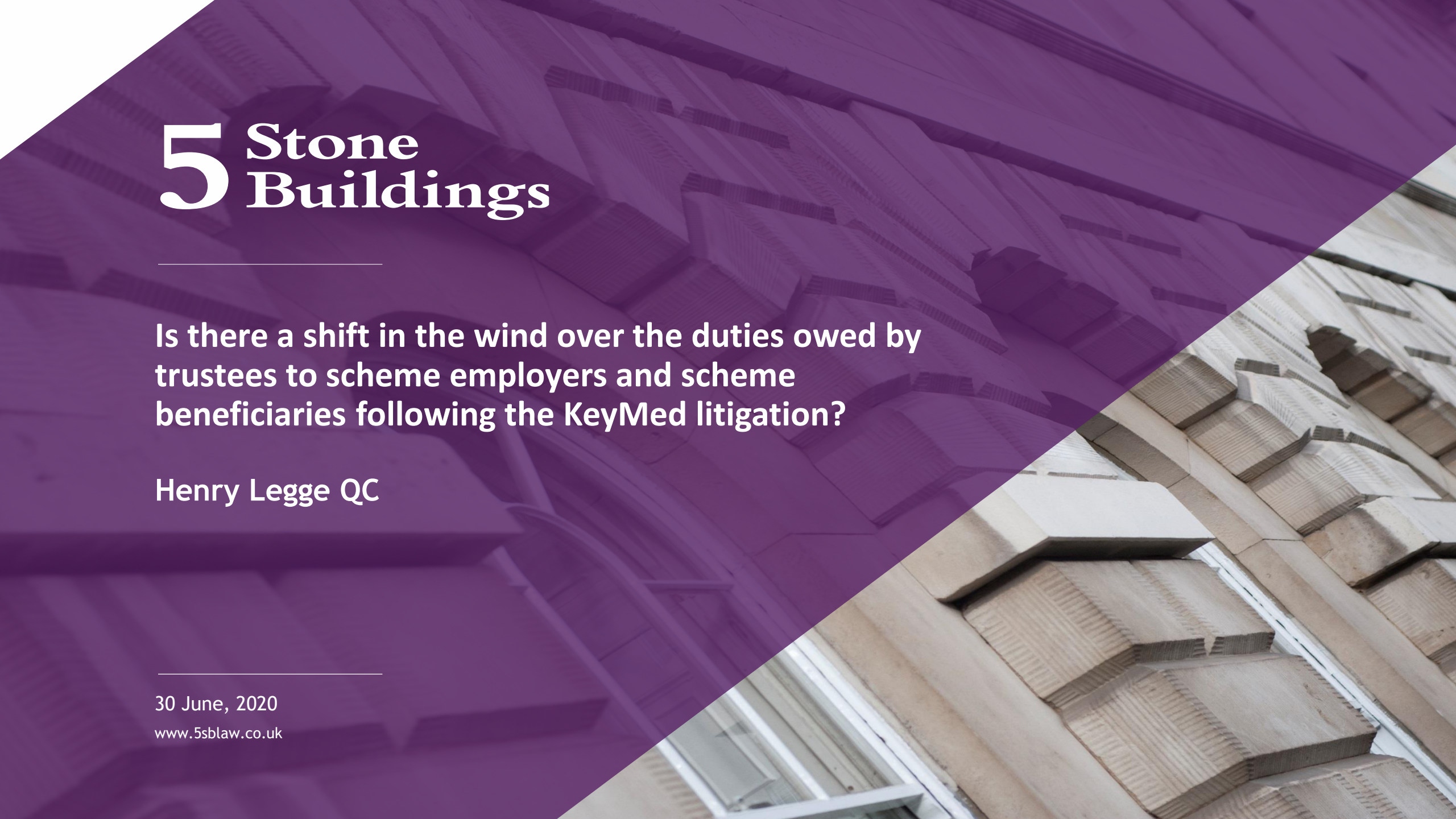
Henry Legge QC



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