Appointment of Independent Trustee – Application by Pension Regulator to Determinations Panel at own instigation – Independent Trustee to have exclusive powers to act – Extent to which members' views should be taken into account - Whether Determination Notice or consequential order should be revoked or varied – No – References dismissed.

THE PENSIONS REGULATOR TRIBUNAL

(1) JOHN SIMPSON
(2) ROY BENYON
(3) FREDERICK SHAW **Applicants**

- and –

THE PENSIONS REGULATOR **Respondents**

Tribunal: **TERENCE MOWSCHENSON QC (Chairman)**
MAURICE BATES
IAN ABRAMS

Sitting in public in London on 23 November 2006

The Applicant in person

Miss Christine Brightwell for the Respondents

DECISION

1. The Applicants ("the Applicants" or "the trustees") are the trustees of the Derfshaw Ltd Retirement Benefit Scheme ("the Scheme") established by an Interim Trust deed dated 27th April 1983.

2. The Respondent ("the Regulator") is the regulatory body responsible for many aspects of the regulation of occupational pension schemes. The Regulator's statutory objectives in exercising its functions include the protection of the benefits of members of occupational schemes: section 5 (1) (a) of the 2004 Act.

3. The Scheme is a defined benefit scheme which the Applicants contend went into winding up on 30th September 1999. The principal employer to the Scheme is Derfshaw Ltd ("Derfshaw"). The other employers which participated in the Scheme were Kestner Engineering Company Ltd ("Kestner") and Lennox Foundry Company Ltd ("Lennox") both wholly owned subsidiaries of Derfshaw. There are approximately 80 employee members of the Scheme. Mr Simpson the First Applicant is a pensioner member of the Scheme and a former director of both Kestner and Lennox; Mr Benyon, the Second Applicant is a retired employee and a member of the Scheme; and Mr Shaw, the Third Applicant, is the managing director of, and principal shareholder in, Derfshaw. The Applicants have been the trustees of the Scheme for more than 20 years.

4. A valuation as at 1st January 2001 revealed a deficit in the Scheme on the Minimum Funding Requirement basis of £558,000; since that date the deficit has increased substantially. There is a deficit on the Minimum Funding Requirement whether or not the Managed Fund, referred to below, is held as an asset of the Scheme for all the members.

5. On the 19th January 2006 the Applicants referred to the Tribunal a Determination Notice of the Pension Regulator Determinations Panel ("the Determinations Panel") made on 13th December 2005 and notified to the Applicants on about 22nd December 2005.

6. By the Determination Notice the Applicants were informed that the Determinations Panel had approved the Regulator's application for the appointment of an independent trustee of the Scheme pursuant to section 7(3)(a) of the Pension Act 1995 Act ("the 1995 Act") and had appointed Thomas Eggar Trust Corporation Limited ("the Independent Trustee") as trustee of the Scheme. Under section 7(3)(a) of the 1995 Act the Regulator may appoint an independent trustee on the grounds that it was satisfied that it was necessary to do so in order to ensure that the trustees of the Scheme as a whole have, or exercise, the necessary knowledge and skill for the proper administration of the Scheme. That

power is a reserved regulatory function and the decision whether to exercise it, and the exercise of it, are both to be carried out by the Determinations Panel constituted under section 10 of the 2004 Act: section 10(1) to (4) and schedule 2 of the 2004 Act.

7. Pursuant to section 8(4)(b) of the 1995 Act the Determination Notice and the Order providing for the appointment of the Independent Trustee provided that the powers and duties of the Independent Trustee were to be to the exclusion of all other trustees of the Scheme, i.e., the Applicants.

8. The power in section 7(3)(a) of the 1995 Act is in addition to the powers contained in section 7(1) and (5A) of the 1995 Act. The wording of the section is clear and is reinforced by paragraph 9 of schedule 2 of the 2004 Act which refers to the power contained in section 7(3)(a) independently of the other powers in section 7 of the 1995 Act. Accordingly the Regulator, acting by the Determinations Panel, can initiate the steps required to appoint an independent trustee.

9. Pursuant to section 96(6)(m) of the 2004 Act the power to appoint an independent trustee can be exercised without waiting for the expiry of the period in which the determination might be referred to the Tribunal, and if referred, until the reference and any appeal there from, has been finally disposed of.

10. The Determinations Panel acted on the basis that the Scheme was in winding up and gave a number of grounds for coming to the conclusion that it was appropriate to appoint an independent trustee to the Scheme: The grounds were:

    10.1. The trustees' lack of understanding of, and in some cases unwillingness to comply with, the relevant statutory, regulatory and fiduciary requirements which they should have complied with in carrying out their duties as trustees;

    10.2. the trustees' failure on a number of occasions to take appropriate independent advice on their duties in winding up the Scheme;

    10.3. the trustees' failure to manage properly the problems caused by the inherent conflict between Mr Shaw's interests as the managing director and shareholder of the principal employer and his responsibilities as a trustee.

11. The Applicants raised two grounds in their original references to the Tribunal and a third ground emerged later. The grounds raised were:

    11.1. that the Determinations Panel ignored the wishes of he majority of the members of the Scheme ("the Consultation Issue");

    11.2. that the decision of the Determinations Panel had the effect of relegating the Applicants to "second class" trustees;

11.3. that the Managed Fund was a separate earmarked fund and did not form part of the common or Main Fund of the Scheme ("the Ear Marked Fund Issue").

12. By an order made on 17th July 2006 the Tribunal ordered that the Applicants were to be at liberty to argue that the fact that each Applicant had been relegated to a "second class" trustee with no powers or duties after 22 years "in post" was a proper matter to be taken into account in determining what was the appropriate action for the Regulator to take.

13. The Applicants did not adduce oral evidence in support of their references but did produce a number of witness statements from members describing their understanding of how the Managed Fund was to be applied. The Regulator called Mr Vernon Holgate a director of the Independent Trustee who was cross examined by Mr Shaw.

14. The Determinations Panel set out a number of facts and matters which led them to consider that it was appropriate to appoint the Independent Trustee. We do not propose to set them out fully in this decision as the Applicants' references only refer to one matter directly. The matters included that:

Understanding and Compliance

14.1. The trustees did not understand, or were unwilling to accept a duty to comply with section 73 of the 1995 Act. Section 73 sets out the order in which the assets of a Scheme must be applied if it is in winding up and an order in which the liabilities must be satisfied in the event that the Scheme has insufficient assets to satisfy the liabilities.

14.2. The trustees did not understand, or were unwilling to accept, that the Managed Fund which comprised an insurance policy ("the APV Policy") was an asset of the Scheme as a whole and accordingly, pursuant to section 73 of the 1995 Act had to be used for the benefit of all the members despite clear advice from the Scheme Actuary to that effect.

14.3. The trustees, despite being aware of the requirement in section 75(5) of the 1995 Act that a determination and calculation of the employer's statutory debt must be obtained from the Scheme Actuary, failed to obtain such a calculation. In May 2003 Mr Shaw on behalf of Derfshaw put forward a proposal for a Supplementary Compromise and Waiver ("the Compromise") of the debt which was subsequently agreed by the trustees at a meeting held on 16th September 2003 and confirmed at a trustees' meeting held on 14th October 2003. Mr Shaw appeared to be unaware that the waiver of a quarter of his and his wife's pension rights was in breach of section 91(1) of the 1995 Act and there was a possibility that this might render the Compromise unenforceable.

14.4. The trustees showed a lack of willingness to comply with the statutory requirements on them to produce audited trust accounts pursuant to section 41 of the 1995 Act and Regulation 2(1)(a) of the Occupational Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (SI 1996/1997) within seven months of the end of the financial year to which they relate. The trustees assumed, without taking any advice, that that they would not have to produce Scheme accounts after the Scheme went into winding up in 1999. The trustees have so far failed to have the Scheme accounts for 2003 and 2004 audited.

Seeking and Taking Advice

14.5. The trustees failure to review the suitability of the Scheme's investments after winding up as required by section 36(4) of the 1995 Act. The trustees did not obtain any advice as to suitability of the Scheme's investments or in relation to the investment of £275,000 invested in December 1999.

Managing conflicts of Interest

14.6. In agreeing the Compromise in September 2003 the trustees failed to deal adequately with Mr Shaw's conflict of interest. Mr Simpson and Mr Benyon failed to take independent advice either as to the resources available to Derfshaw or on the level of settlement which they should seek to achieve and rejected legal advice to the effect that they should seek independent financial advice. The two trustees therefore accepted Mr Shaw's implicit assertion that "such a contribution [to increase the level of the settlement] was impossible, bearing in mind the employer's financial situation and cash flow".

14.7. As a consequence the trustees did not comply with their fiduciary duty to seek to recover as much as possible from Derfshaw. Mr Shaw failed to deal properly with his own conflict as managing director and shareholder in Derfshaw. After refusing an increase in the trustees meeting held on 14th October 2003 Mr Shaw participated in a decision by the directors of Derfshaw to declare a dividend of £400,000 out of Derfshaw's retained profits at the end of 2003.

14.8. The trustees failed to ensure that the compromise payment of £100,000 was paid immediately. It was made in March 2005.

15. In the course of the hearing before the Determinations Panel the trustees expressed a willingness to take independent advice in the future in relation to allocation of the Scheme assets amongst the members and in relation to the obligation to draw up accounts; that was not sufficient to persuade the Determinations Panel from its conclusion that it was necessary to appoint an independent trustee.

16. As noted above, the matters set out in the references are not directed to all the matters set out above. In particular the references do not refer to the Compromise or the management of Mr Shaw's conflict of interests, or the failure to take advice or prepare accounts.

17. On the hearing of a reference the Tribunal may consider any evidence relating to the subject matter of the reference whether or not it was available to the Regulator (or the Determinations Panel) at the material time and must determine what (if any) is the appropriate action for the Regulator to take in relation to the matter referred to the Tribunal: section 103(3) and (4) of the 2004 Act. Accordingly the Tribunal is not an appeal tribunal in the strict sense of being limited to reviewing the decision referred to it. It can consider new evidence and must determine what (if any) is the appropriate action for the Regulator to take in the light of all the evidence before it.

18. On determining a reference the Tribunal must remit the matter to the Regulator with such directions (if any) as the Tribunal considers appropriate for giving effect to the determination. The directions may include an order confirming the Regulator's determination and any order made as a result of it, or varying or revoking the determination and consequential order: Section 103(5) and (6) of the 2004 Act.

19. We shall deal with the issues in the order in which they were dealt with at the hearing.

The Ear Marked Fund Issue

20. As noted above there is a deficit in the Scheme on the Minimum Funding Requirement basis.

21. The Applicants contend that the Scheme was placed in winding up on 30th September 1999. No written documentation appears to have been produced to evidence that Derfshaw gave 3 months notice to the trustees of its intention to cease making contributions to the Scheme in accordance with Rule 13.1 of the Scheme Rules. Further there are no minutes of a meeting of trustees evidencing the passing of a resolution to wind up the Scheme or contemporaneous documentation evidencing that the Scheme had been wound up. The Applicants are adamant that the Scheme is in winding up and was placed in winding up from 30th September 1999.

22. The Independent Trustee reserves its position as to whether the Scheme is in winding up. Matters affected by the question whether the Scheme is in winding up include the manner in which the assets of the Scheme should be applied and whether the Scheme might have a claim against the Pension Protection Fund which it might do if it were wound up after 6th April 2005.

23. We do not need to decide whether the Scheme was placed in winding up for the purposes of this determination and do not do so. However the fact that the Applicants consider that the Scheme is in winding up is a relevant factor when considering the manner in which the Applicants discharged their duty as trustees. If they considered that the Scheme was in winding up they would be expected to conduct the affairs of the Scheme on that basis and to take all reasonable steps to maximise the assets for the benefit of the members.

24. The Managed Fund consists of the APV Policy with AXA Sun Life plus cash in a bank account amounting in aggregate to £517,631 (according to unaudited accounts to 31st December 2004). The APV Policy was acquired from the proceeds of the transfer value (approximately £280,000) relating to the transfer into the Scheme of about 44 employees of APV Kestner Ltd and APV Lennox Foundry Co Ltd, the businesses of which were acquired by Derfshaw in 1983, and who decided to transfer their APV 1974 Scheme benefits into the Scheme in the same year. Certain APV employees did not transfer their benefits. We shall refer to the APV employees who transferred their pension benefits to the Scheme as "the APV employees". The Applicants contend that when the rights of the APV employees were transferred into the Scheme in about October 1983 an amount representing their accrued rights were transferred into the APV Policy and was ear marked to provide enhanced benefits to the APV employees. The accrued basic pension rights of the APV employees together with the other employees who became members of the Scheme were to be met by the Main Fund of the Scheme and financed by contributions from Derfshaw. An asset of the Main Fund includes an insurance policy with AXA ("the Deposit Administration Policy"). The Main Fund was valued at £ 836,000 according to unaudited accounts to 31st December 2004 (excluding the value attributable to the Managed Fund). There are now nine remaining APV employees who remain members of the Scheme who would be eligible to benefit from the Managed Fund to the exclusion of the other members of the Scheme if the Applicants are correct.

25. The Regulator contends that the Managed Fund was not ear marked and forms part of the Main Fund. The point is important because if the Managed Fund is separate from the Main Fund it is only available for the remaining nine APV employees and does not form part of the Main Fund; accordingly the deficit on the Main Fund will increase by an amount corresponding to the value of the Managed Fund.

26. There is no unequivocal documentary evidence to support the assertion that the Managed Fund was ear marked for the APV employees. One would have expected any such appropriation to be evidenced by documentation creating, in effect, a separate trust or sub trust of the Scheme and evidence of a written resolution of the trustees to hold the Managed Fund for the APV employees. We were referred to a number of documents which suggest that consideration was given to applying the Managed Fund for the benefit of the APV employees. The documents included:

26.1. a letter from Sun Life dated 28th January 1983 which appears to be considering an arrangement under which the costs of providing for "past service" benefits of the APV employees was to be included in the cost of future contributions to the Scheme. The second page of the letter is missing.

26.2. a document said to represent a decision of the trustees which reflects consideration of the issue. However the document does not state that it is a minute of a meeting of trustees. Furthermore it does not record a resolution but reflects consideration of one method of dealing with the transfer value of £279,000;

26.3. various schedules which suggested that the Managed Fund had been used to augment the benefits of APV employees; and

26.4. a letter dated 18th July 1984 apparently sent to APV employees which is consistent with an intention to use the Managed Fund to benefit APV employees together with an example of a letter dated 18th September 1984 describing such a purported enhancement in relation to a Mr Clackett.

27. We were also referred to what appears to be an explanation to members prepared on 11th August 1986 of the manner in which the Managed Fund might be applied. That states . . .

> ". . .The trustees investigated the various possibilities and after taking advice chose to invest the transfer value into a managed fund – separate from the main fund – which enabled the trustees to control what happened to the money, and to ensure that it was used for appropriate purposes. Appropriate purposes means, in the trustees' views, enhancing the pension benefits of those people who took a transfer, rather than a refund. This policy has been consistently adopted as members have retired, and the trustees' policy is not expected to change.".

The document then sets out a series of questions and answers which make it plain that no member has a right to the Managed Fund. Question 3 is "Is the money invested solely for members who transferred from APV Scheme? The answer is set out below:

> "The money has been invested by the trustees, and the policy is for it to be used for members who transferred from the APV Scheme. For instance, we have two further retirements this year; one took a refund, the other transferred. Only the person who transferred will have his pension enhanced by the trustees"

28. It will be noted that the answer refers to the policy of the trustees. It does not state that the Managed Fund is held on trust exclusively for the APV employees as a separate trust or sub trust of the Scheme. The Managed Fund could be kept separate from the Main Fund in the sense that the assets of the two funds were not

merged, but were invested through two insurance policies, without being held for different beneficiaries.

29. We were also referred to a number of witness statements from members of the Scheme stating that they were aware that the Managed Fund was to be applied for the benefit of the APV employees to the exclusion of the other members of the Scheme.

30. In the course of the hearing Mr Shaw confirmed that the Scheme Actuary was not informed that the Managed Fund had been appropriated as contended by the Applicants. That was apparent from correspondence between the Scheme Actuary and the trustees to which we were referred. If there had been an appropriation of the Managed Fund (i.e., an actual transfer of the beneficial interest in the Managed Fund for the benefit of the APV employees) one would expect the Scheme Actuary to be aware of it because that would be a factor he would need to know in calculating the level of contributions to the Scheme from time to time.

31. Furthermore, until the issue arose, the Scheme accounts were not drawn up so as to differentiate the manner in which the Managed Fund could be applied. It was shown as an asset of the Scheme as a whole. We refer by way of example to draft accounts for the year ended 31st December 1997 in which the Managed Fund appears as an asset of the Scheme but the Deposit Administration Policy did not. The draft accounts were sent to the Scheme Actuary and elicited a response dated 26th February 1999 from the Scheme Actuary, then at Sun Life Corporate Pensions Department, to the trustees stating that the accounts were incorrect as both policies should have been included as assets of the Scheme. The trustees replied on 2nd March 1999 agreeing to include the Deposit Administration Policy as an asset but not suggesting that the trusts upon which the proceeds of the Managed Fund or the Deposit Administration Policy were held were different. On 18th March 1999 the trustees assured the Scheme Actuary that the accounts had been amended as suggested by him to show both the Managed Fund and Deposit Administration Policy as assets. These accounts were then apparently sent to the Scheme auditors who certified them as noted in the trustees' letter dated 7th May 1999.

32. In July 2003 the trustees were advised by the Scheme Actuary (then at Axa Sun Life Services PLC) both on the telephone and by letter dated 2nd July 2003 that the Managed Fund had not been segregated from the Main Fund and could not then be segregated. The letter emphasised that when the Scheme was fully funded the trustees might have had a policy of applying the Managed Fund for the benefit of the APV employees but once the Scheme was in winding up, and in deficit, the Managed Fund had to be applied in accordance with section 73 of the 1995 Act and the Managed Fund could not be applied for the benefit of the APV employees to the exclusion of the other members of the Scheme.

33. Notwithstanding the Scheme Actuary's opinion the trustees, apparently acting on legal advice, decided to pursue their intention of applying the Managed Fund for

the APV employees and informed the Scheme Actuary to that effect by letter dated 9th September 2003. On 13th November 2003 the trustees resolved to augment the pensions of two APV employees (one of them the Second Applicant and one of the trustees in the sum of £50,000) and the other an employee, in the sum of £40,000. However the Scheme Actuary intervened to prevent the payments being made. The Scheme Actuary was concerned about the trustees proposed course of action in relation to the Managed Fund and wrote on 5th February 2004 to the Occupational Pensions Regulatory Authority ("OPRA") (at the time responsible for the regulation of occupational pensions) pursuant to section 48 (1) of the 1995 Act to inform OPRA that he considered that he was being asked to apply the Managed Fund in a manner inconsistent with section 73 of the 1995 Act. We understand that in fact no allocations were made from the Managed Fund in breach of section 73 of the 1995 Act due to the intervention of the Scheme Actuary.

34. We were not shown any audited accounts for the years prior to 2003 but it was common ground that none of those accounts differentiated in the manner in which the Managed or Main Funds were held. We were shown unaudited accounts for the years ended 31st December 2003 and 2004 in which for the first time the trustees attempted to insert a note to the effect that the Managed Fund was ring fenced for the APV employees. By the time these accounts were being prepared the issue as to the manner in which the Managed Fund was being held was the subject of debate. The auditors declined to certify the 2003 and 2004 accounts if they contained the note.

35. When the Scheme was solvent it might have been a proper application of the Managed Fund to apply it in giving the APV employees an enhanced pension whether or not it had been "ring fenced" for them, but once the Scheme was in winding up the status of the Managed Fund has to be determined. There is a difference between the trustees applying a policy as to the application of the Managed Fund and the trustees appropriating the Managed Fund so that it was held exclusively for the APV members. In the former case the Managed Fund would remain an asset of the Scheme available for all the members in the event of a winding up; in the latter it would not.

36. The Tribunal do not consider it necessary or advisable to determine the status of the Managed Fund in order to determine the issue before it which relates to the appointment of the Independent Trustee. If the trustees of the Scheme (whoever the trustees might be) consider it appropriate to do so they can seek the directions of the Court as to how the Managed Fund is held; alternatively an APV employee or other member can raise the matter in proceedings. In such proceedings provision could be made for the issues as to whether the Managed Fund is held for the APV employees to the exclusion of the other members of the scheme, or as part of the Main Fund for all the members, to be properly and fully argued.

37. The Applicants did not have the benefit of legal representation before the Tribunal and are convinced that an appropriation occurred. If the issue relating to the

Managed Fund has to be determined, as it appears may well be the case, then the conduct of the matter would be assisted by having an independent trustee as one of the trustees who can consider the matter without any conflict of interest or involvement in the history of the matter.

The Consultation Issue

38. As we understand it this issue relates to the extent to which the Determinations Panel took into account the views of the members of the Scheme as to whether an independent trustee should be appointed. The trustees wrote to members of the Scheme on 18th October 2005 asking them to indicate their opinion as to whether an independent trustee should be appointed. We were referred to a schedule which summarised the opinions of the members and which showed that, with one exception, those members who replied did not wish the independent trustee to be appointed.

39. Counsel for the Regulator represented, and we are satisfied, that the Determinations Panel took into account the results of the survey. We have also taken them into account. We observe, however, that the extent to which the members would have been familiar with the issues which concerned the Determinations Panel is wholly unclear. Furthermore, albeit that counsel for the Regulator accepted that the Determinations Panel could have regard to the views of the members, as the objective which the Regulator (and the Determinations Panel) is concerned with is the protection of the interests of the members as provided for in section 5(1)(a) of the 2004 Act the weight to be attached to the views of members is limited and, in a matter raising issues of the nature raised in these circumstances, cannot be decisive.

Second Class Trustees

40. This issue relates to the fact that the Order under which Independent Trustee was appointed to act included a provision pursuant to section 8(4)(b) of the 1995 Act that its powers were to be exercisable to the exclusion of the other trustees of the Scheme.

41. We consider that, if the Determinations Panel was correct to come to the conclusion that it was appropriate to appoint an independent trustee on the grounds set out in the Determination Notice, then it was correct to provide for the Independent Trustee to have exclusive powers, notwithstanding that the trustees had been in office for a substantial period. The reason for that is that certain of the issues which the Independent Trustee may have to consider might well conflict with the personal interest of certain of the trustees.

Grounds relied upon by the Determinations Panel and not specifically the subject of a reference

42. As noted above not all the grounds relied upon by the Determinations Panel were raised in the Applicants' references. We have taken into account those grounds in coming to our conclusion and the matters set out in the Determination Notice in support of them. The Applicants did not contend, and nothing in the material before the Tribunal suggests, that the matters set out in support of the grounds were incorrect.

Conclusion

43. The Ear Marked Fund Issue raises matters which should be dealt with by a trustee who can approach the matter with an independent mind and without a conflict of interest. The other matters relied upon by the Determinations Panel, including the circumstances in which the Compromise was entered into, the possibility of action against a trustee or Derfshaw for a contribution to the Scheme, the failure by the trustees to keep adequate records of their deliberations relating to the alleged decisions to wind up the Scheme or appropriate the Managed Fund for the APV employees, and to seek appropriate legal and investment advice also lead to the conclusion that the appointment of the an independent trustee was necessary to safeguard the interests of members.

44. Accordingly we consider that the Determinations Panel, and accordingly, the Regulator, was justified in coming to the conclusion that it was necessary to appoint, and in appointing, the Independent Trustee to safeguard the interests of members in the Scheme.

45. The members of the Tribunal are unanimous in reaching this conclusion.

46. For the reasons set out above the references are dismissed, and the Tribunal confirms the Determinations Panel's determination and the Order made as a result of it.

TERENCE MOWSCHENSON Q.C.
CHAIRMAN

RELEASED:

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