

# Pensions Regulator Update

Edition #4

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Welcome to this edition of our update on the Pensions Regulator.

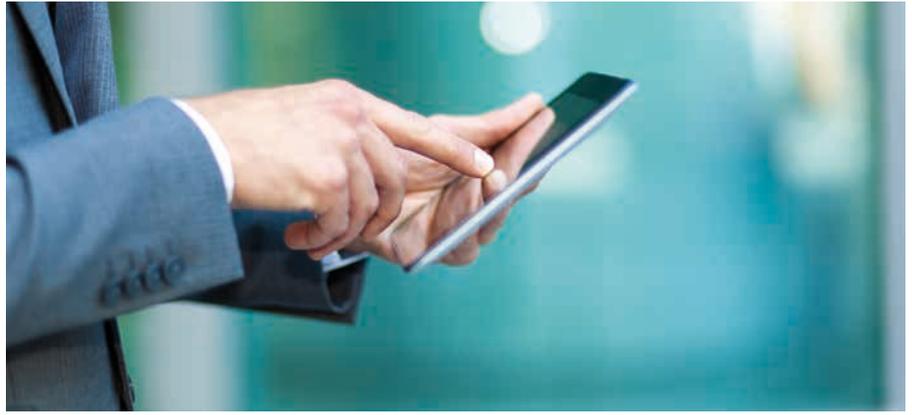


This publication looks at recent and ongoing action by the Pensions Regulator. We also look at the Pensions Regulator's powers and how it uses them.

Please let us know if you have any comments or queries on this publication or, indeed, if you have any suggestions for topics you would like covered in a future edition.

### The Pensions Dispute Resolution Group

## In the news



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...it is notable that the trustees who were fined included professional trustees.

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### New Chief Executive

In December 2018, TPR announced the appointment of Charles Counsell as its new Chief Executive. He will take up his post in April of this year following the departure of Lesley Titcomb at the end of her term as Chief Executive at the end of February.

### TPR's first fraud prosecution

In December 2018, TPR announced that it is prosecuting a director of a professional trustee for fraud by abuse of position (contrary to Section 1(2)(c) of the Fraud Act 2006) and making a prohibited employer-related investment (contrary to Section 40(5) of the Pensions Act 1995). The individual is accused of transferring more than £200,000 of pension scheme funds into his bank account and those of companies controlled by him. This is the first time these powers have been used by TPR.

### Salvus Master Trust

In October 2018, TPR published a report regarding the trustees of the Salvus Master Trust, who have been fined a total of £5,000 for failing to process core financial transactions promptly and accurately. The trustees had failed to invest £1.4m in employer contributions for three years. This is the first time the Regulator has issued a penalty for a breach of this requirement and it is notable that the trustees who were fined included professional trustees.

### Martin Currie regulatory intervention report

In September 2018, TPR published its report in relation to its grant of clearance for an agreement reached between Martin Currie Investment Management Limited (“**MCIM**”) in respect of the Martin Currie Retirement and Death Benefits Plan. TPR had begun an investigation after being notified of a flexible apportionment arrangement under which MCIM would be replaced as employer by the ultimate holding company of the group, which was based in Bermuda.

TPR challenged the arrangement and commenced an investigation which concluded that there had been material detriment to the scheme as a result of it. At this point it was open to TPR to exercise its moral hazard powers. However, following negotiations, the parties instead agreed to a new flexible apportionment arrangement, which addressed TPR's concerns. This case shows TPR's willingness to reopen matters even after a transaction has concluded and procedural requirements were met. However, this will not necessarily lead to enforcement proceedings where the parties are able to re-open negotiations and allay TPR's concerns.

### Rentokil determination notice

In July 2018, TPR announced that it had fined Rentokil Initial Pension Trustee Limited £25,000 for failing to complete the 2012 and 2015 valuations of the Initial Hospital Service Limited No.1 Pension Scheme by their respective deadlines. The fine was

imposed under Section 10 of the Pensions Act 1995 for a failure to obtain an actuarial valuation under Section 224 of the Pensions Act 2004. The reason given for the delay was a planned merger with a separate scheme run by sponsoring employer, Rentokil Initial Plc. The Determinations Panel's view was that this was not a good reason for failing to comply with the statutory requirements.

## Chappell loses appeal against conviction

In our previous edition we reported that Dominic Chappell had been convicted for failing to comply with an information notice issued by TPR in exercise of its information gathering powers under section 72 of the Pensions Act 2004. Mr Chappell subsequently appealed his conviction and in September 2018, TPR reported that he had lost his appeal in Hove Crown Court. Mr Chappell is likely to be in the news again later this year in relation to the main moral hazard proceedings relating to his involvement with the BHS pension schemes which have been referred to the Upper Tribunal.

## TPR letter on Kodak

In January 2019, the Work and Pensions Select Committee published a letter from TPR in relation to the Kodak case. This was a restructuring case which involved the transfer of consenting members of the Kodak Pension Plan to the Kodak Pension Plan No. 2 (KPP2). KPP2 provided lower benefits (but above PPF levels) and was funded by the income stream from Kodak's former businesses. The subsequent performance of these businesses means that KPP2 is likely to enter a PPF assessment period.

The letter notes that the Regulator has learnt a number of key things from the Kodak case (and other restructuring cases), including:

- > Following a regulated apportionment arrangement, TPR will only agree to a scheme continuing without a substantive sponsoring employer with a governance framework being put in place, including a memorandum of understanding with the trustees, which enables the Regulator to monitor the situation and, if necessary, trigger the scheme's wind-up.
- > Schemes that continue without a substantive sponsor need to have strong, sustainable funding arrangements and other measures in place that limit the exposure of the PPF.
- > There needs to be a very compelling case for trustees to take ownership of a business and rely on a small number of investments for future scheme funding, and they need to have the ability to hedge their risks.
- > In addition to challenging the advice and due diligence received by trustees, where appropriate the Regulator should commission its own due diligence from a third party adviser.

Linklaters acted for Eastman Kodak (in Chapter 11) in this case.

## Southern Water regulatory intervention report

In December 2018, TPR announced that it had agreed to a settlement in relation to its enforcement action against Southern Water. Under the terms of the settlement a shorter recovery plan and higher contributions were agreed with TPR than had previously been agreed with the trustees of the pension scheme.

Of particular interest in this case are (i) the threatened use of TPR's scheme funding powers under section 231 of the Pensions Act; and (ii) the agreement of a dividend sharing mechanism.

The power under section 231 allows TPR to impose funding obligations on the employer in certain circumstances. If the case had not settled, this would have been the first time that the power had been used by TPR.

A dividend sharing mechanism was agreed between the trustees and the employer to ensure equitable treatment of the scheme. This reflects TPR's increased focus on the levels of dividend payment being made by employers and is likely to represent a trend in TPR's expectations in respect of corporates who wish to pay substantial dividends in circumstances where the pension scheme is underfunded.

Linklaters acted for Southern Water in this case.

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## Spotlight on TPR's powers: Trustee appointment and removal



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TPR has broad powers to appoint and remove trustees from their roles on the trustee boards of occupational pension schemes and, in extreme cases, to suspend or prohibit individuals from acting as trustees. TPR has tended to use these powers in relation to cases of manifest wrongdoing such as pension liberation vehicles or breaches of trust through the misappropriation of trust funds. They have also been used in cases where for administrative / operational reasons it is appropriate for TPR to intervene.

However, in the current climate where TPR wishes to be seen to use all existing powers at its disposal to take visible, meaningful action at an earlier stage in any investigation, these powers may take on greater significance and be used in a broader range of scenarios. In this article, we set out what TPR's powers are and consider how they may be used in future, particularly in the context of contentious valuation discussions or corporate transactions. This article does not consider court sanctioned prohibition or appointment of trustees or the regime for appointing an independent trustee in an insolvency scenario or during a PPF assessment period.

### TPR's powers

Under the Pensions Act 1995, TPR has the power to appoint additional or replacement trustees and to remove or suspend members of a trustee board or prohibit individuals from acting as trustees.

#### Prohibition

TPR has the power to prohibit individuals from acting as trustees of a particular scheme, a particular type of schemes or of occupational pension schemes in general. In order to make a prohibition order, TPR's Determinations Panel must be satisfied that the individuals are not fit and proper persons to be trustees of the schemes to which the order relates. Once prohibited, the individuals concerned are placed on a list of prohibited trustees. There are currently 25 entries on the version published on TPR's website. If any prohibited individual carries out the functions of a trustee in contravention of the order, they would commit a criminal offence which could lead to a fine or imprisonment. Although the sanctions for non-compliance with a prohibition order are criminal, the standard of proof applied to the assessment of whether an individual is "fit and proper" is a civil one: whether it is more likely than not that the alleged conduct / behaviour concerned had occurred. This was confirmed by the Upper Tribunal in the recent *McLary* case<sup>1</sup>.

The individuals prohibited do not need to have actually been trustees themselves in order to be prohibited from becoming one in the future, as was recently seen in the *Payae* case<sup>2</sup>.

<sup>1</sup> *McLary v Pensions Regulator* [2018] UKUT 234 (TCC)

<sup>2</sup> *Pensions Regulator v Payae Ltd and others* [2018] EWHC 36 (Ch)

TPR's guidance on prohibition orders states that the assessment of whether an individual is a "fit and proper" person considers information which concerns the individual's honesty, integrity, competence and capability and financial soundness as well as the appropriateness of fees charged by the relevant trustees. What is clear from the current guidance is that the concerns have to be significant that a trustee has acted in an improper way. The examples given in the guidance are not exhaustive and so there may be cases where a broader range of activities could prompt a prohibition order. However, in the case of less serious concerns, it is likely that the concerns of TPR can be addressed by using other powers.

### Disqualification

A separate ground for removal of a trustee is disqualification upon the occurrence of one of a prescribed list of events<sup>3</sup>. These events generally relate to bankruptcy or disqualification from acting as a director.

### Suspension

Suspension of trustees is an intermediate measure which could be employed pending the outcome of investigations, court proceedings or as a precursor to a prohibition order. In practice this power has been seldom used (a total of five times up to September 2018).

### Appointment

By contrast, the most frequently used powers are those to appoint additional or replacement trustees of a scheme. These powers have been used over 2,000 times to date. Under the Pensions Act 1995, TPR can appoint a replacement trustee if a trustee has been the subject of a prohibition order or disqualification. TPR can also appoint an additional trustee<sup>4</sup> if TPR considers that it would be reasonable to do so:

- (a) To secure that the trustees as a whole have the necessary knowledge and skill for the proper administration of the scheme;
- (b) To secure that the number of trustees is sufficient for the proper administration of the scheme;
- (c) To secure the proper use or application of the assets of the scheme; or
- (d) Otherwise to protect the interests of the generality of the scheme members.

Any member, trustee or the employer may apply to TPR for the appointment of a trustee under the first three grounds.

One of the main reasons that this power has been so widely used is the flexibility over the terms on which the trustee can be appointed. Any trustee can be appointed by TPR on terms which either restrict the powers and duties of the newly appointed trustee or provides that the newly appointed trustee exercises its powers or duties to the exclusion of other trustees<sup>5</sup>. In other words TPR can make the new trustee the sole and controlling trustee of the scheme to the exclusion of the incumbent board.

In certain circumstances, such an appointment can be made without notice to the incumbent trustees or the employer under TPR's special procedure where TPR is of the view that there would otherwise be, an immediate risk to the interests of members of the scheme or to the assets of the scheme<sup>6</sup>.

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3 Section 29 Pensions Act 1995

4 Section 7(3) Pensions Act 1995

5 Section 8(4) Pensions Act 1995

6 Section 97 Pensions Act 2004

TPR has threatened to use this power frequently in contexts where trustee boards are not meeting its standards of good governance, where there is deadlock on trustee boards or significant concerns over conflicts of interest. Examples of the circumstances when this power was used include the following:

### *Telent (2007)*

TPR appointed three independent trustees to act to the exclusion of the other trustees. This appointment was prompted by a request from the incumbent trustee board due to concerns that a takeover of the scheme's sponsoring employer by the Pension Corporation had, as one of its aims, the Pension Corporation desire to control the investment strategy of the scheme. This was in part because of pre-existing funding arrangements which provided that, if certain asset levels were hit, a fund of £514m which had been held in escrow would be released and controlled by the Pension Corporation.

### *Protector Lamp (2009)*

TPR appointed an independent trustee to act to the exclusion of the other trustees where the incumbent trustees had failed to reach agreement on various issues involving the scheme's administration.

### *Hugh Mackay (2009)*

TPR had identified serious concerns of fraud and other criminal activity by the scheme's trustees which made it appropriate to appoint an independent trustee under the special procedure.

### *London Quantum (2015)*

TPR had concerns that the scheme had been involved in pension liberation. In 2018, TPR banned two individuals who were directors of the scheme's trustee Dorriox Alliance Limited from acting as trustees after they allowed millions of pounds of scheme funds to be invested in exotic, high risk investments.

## Comment

In most cases, TPR will exercise these powers where it is clear it is necessary. However, considering TPR's increasingly interventionist stance, we may start seeing these powers threatened in a broader range of situations.

If we consider a scenario where a trustee board is prepared to agree a recovery plan with its sponsoring employer at a length and contribution levels which fall far short of what TPR considers appropriate. The trustees may be under pressure from TPR not to sign up to the proposed valuation. However, the trustees may be considering agreeing the recovery plan because they feel that TPR is demanding too much, the trustees feel they have a more realistic idea of what is affordable to the employer and agreement will, in effect, "bank" a recovery plan for the scheme after which TPR would still be free to take enforcement action against the employer.

In such a case, it is not clear that what the trustees are doing is necessarily inappropriate but it is certainly not in line with what TPR wishes. Is this the sort of case where TPR could start testing its appointment powers to achieve what it considers to be the "proper" administration of the scheme? This may seem unlikely but on the face of the legislation, TPR may consider that it has the power to do this. The mere threat of exercise of this power will be a significant tool in its renewed enforcement campaign.

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## The Pensions Regulator by numbers



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The number of information requests issued in July – September 2018 under s. 72 of the Pensions Act 2004



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The number of clearance applications received by TPR in July – September 2018



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The number of warning notices issued by TPR since April 2017 for late valuations

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