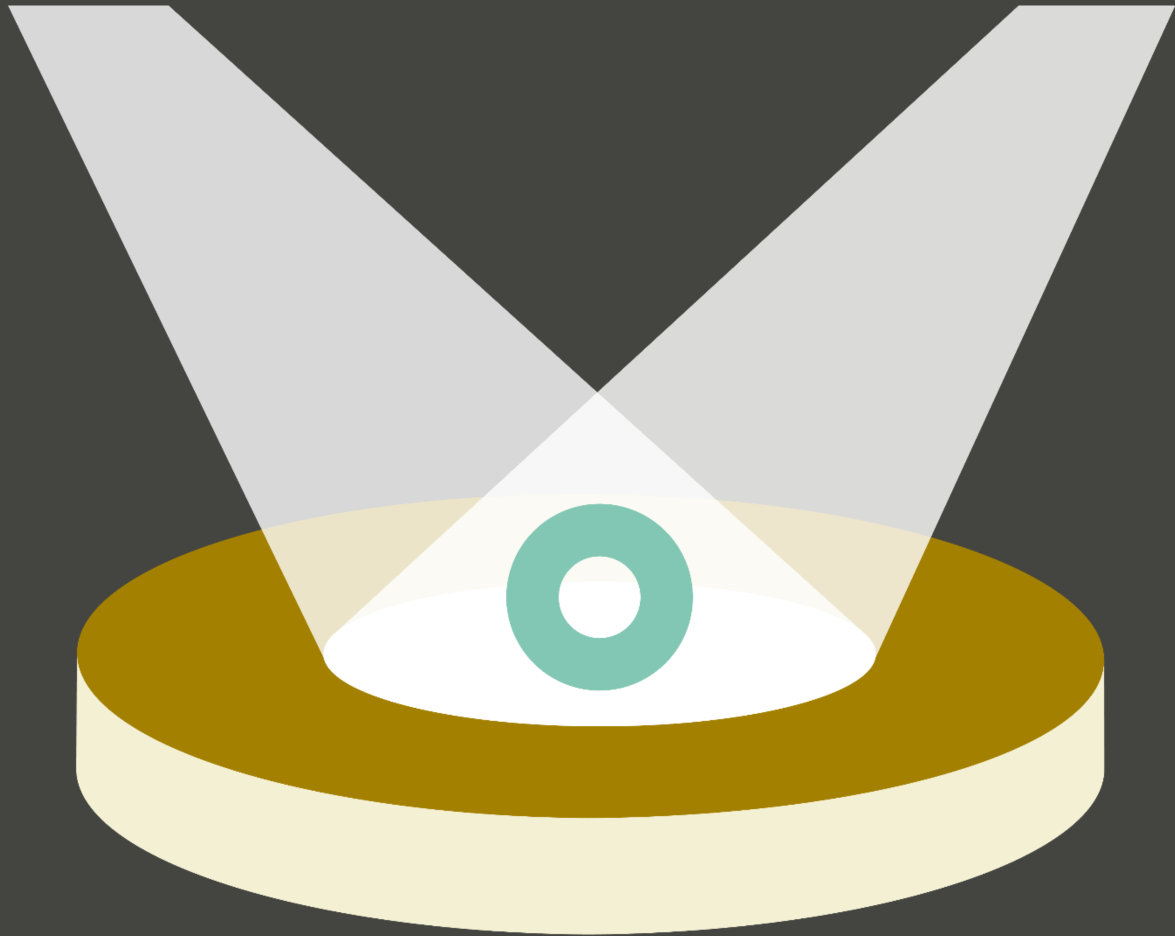
TRAVERS SMITH

Implications of the Virgin Media Case



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What are we going to talk about?

- Recap of the history
- Facts of the case
- Decision:
    - Void?
    - Alterations to future service benefits?
    - Adverse alterations only?
- Appeal
- Regulation making power?

What are we going to talk about?

- Review now?
- Potential triggers for review?
- Factual uncertainties
- Which amendments?
- Insurance transactions
- Potential (partial) fixes?
- Professional negligence?
- Any questions or observations?

Recap of the history

- Contracting out between 1997 and 2016
- Reference scheme test
- Restrictions on amendments:
  - Section 37 of the Pension Schemes Act 1993
  - Regulation 42 of the Contracting Out Regulations 1996

Recap of the history

Contracting-out requirements 1997-2016

- From April 1997 to April 2016, an employer could apply for a salary-related contracting out certificate in respect of schemes providing benefits “broadly equivalent” to or better than the benefits provided by the “Reference Scheme”
- Details of this ‘reference scheme test’ (RST) were set out in legislation. There were two parts to the RST:
  - **Firstly:** an overall test had to be met - that the average amount or value of benefit to be provided by the scheme was no less than the average amount or value of the benefits under the RST for the relevant group of employees
  - **Secondly:** the Scheme Actuary also had to be satisfied that no more than 10% of the individual members or their spouses/civil partners would fail the equivalence test. The test focused on the benefits which were to accrue over the three years following certification and – apart from those reaching normal pension age during those three years – members had to be assumed to leave service at the end of the period
- Where the format of the benefits offered by a Scheme differed from the format of the Reference Scheme Benefits, a value-based comparison could be carried out

Recap of the history

Legislative requirements – making changes to contracting out schemes

Pension Schemes Act 1993 section 37 (extract)

37 (1) Except in prescribed cases, the rules of a scheme that was a salary related contracted-out scheme cannot be altered unless the alteration is of a prescribed description.

(2) Regulations made by virtue of subsection (1) may operate so as to validate with retrospective effect any alteration of the rules which would otherwise be void under this section.

Occupational Pension Schemes (Contracting-out) Regulations 1996 reg 42 [now deleted]

42 (1) For the purposes of section 37(1) of the 1993 Act the rules of a salary-related contracted-out scheme cannot be altered —

(a) in relation to any section 9(2B) rights under the scheme unless —

i. the trustees of the scheme have informed the actuary in writing of the proposed alteration to the scheme rules, and
ii. the actuary has considered the proposed alteration and has confirmed to the trustees of the scheme in writing that he is satisfied that the scheme will continue to satisfy the statutory standard in accordance with section 12A of the 1993 Act after the alteration is made, and
iii. the alteration is not one which would otherwise prevent the scheme from satisfying the conditions of section 9(2B) of that Act;

Recap of the history

Rule amendments and the role of the Scheme Actuary in practice

- So when amendments were made to a contracted-out scheme post-April 1997, the scheme actuary was required to confirm to the trustees that the amendments did not affect the scheme's continued ability to meet the RST.

Note: an exception to this was if the trustees' lawyers confirmed that no such confirmation was required in relation to the changes being made by a particular deed.

- In order for the actuary to do this, the trustees needed to inform him/her as to the nature of the amendments that are to be made. This would usually be by provision of a draft deed of amendment.
- The deed itself may have made reference to the provision of the actuarial section 37 / regulation 42 confirmation, with the actuarial certificate then normally(?) attached to the final Deed effecting the amendments.
- The form / wording of the actuarial certificate was not prescribed.

Recap of the history

‘Continuing to satisfy the statutory standard’ – common issues?

- If the Scheme had more than one benefit scale, then the RST check needed to be carried out separately for each benefit scale
- The RST has some features which may have differed from Scheme benefits eg
  - Based on ‘Qualifying earnings’ which were gross earnings between a lower and upper limit
  - The Scheme Actuary was required to consider not only the quantities of benefit but also who was entitled to receive the benefit eg spouses’/civil partners’ pensions had to be payable to legal widow(er)s and surviving civil partners respectively

What about scheme closure?

- If a Scheme closed to future accrual then it was not entirely clear whether it continued to be subject to the requirements of regulation 42(2) and therefore whether the actuary had to provide a Section 37/Regulation 42(2) certificate

Summary: whether a Section 37 / Regulation 42 certificate was required for a Scheme amendment was dependent on the amendment in question. Similarly the ease with which the Scheme Actuary could provide that certification varied, depending on the Scheme benefit design and the amendment in question

Facts of the case

- Scheme contracted out on a reference scheme test basis
- 1999 deed to reduce rate of revaluation for deferred members in respect of future service benefits
- Assumption no actuarial confirmation
- New TDRs with actuarial confirmation in 2010
- If void, higher rate of revaluation in respect of accrual between 1999 and 2010
- Estimated cost of increased liabilities c.£10M

Void?

- Section 37 PSA 93:

  "The rules of a contracted-out scheme ***cannot be altered*** *unless the alteration is of a prescribed description"*

- Reg 42 Contracting Out Regs 96

  "The rules of a salary-related contracted-out scheme ***cannot be altered*** *in relation to any section 9(2B) rights under the scheme unless -*

  (a) the trustees of the scheme have informed the actuary in writing of the proposed alteration,

  (b) the actuary has considered proposed alteration and has ***confirmed to the trustees in writing*** *that he is satisfied that the scheme would continue to satisfy the statutory standard in accordance with section 12A of the 1993 Act if the alteration were made, and*

  (c) the alteration does otherwise not prevent the scheme from satisfying the conditions of section 9(2B) of that Act"

Void?

- Section 37 PSA 93:

  "*Regulations made by virtue of subsection (1) may operate so as to validate with retrospective effect any **alteration of the rules which would otherwise be void** under this section*"

Alterations to benefits in respect of future service?

- Requirement for actuarial confirmation applied to alterations in relation to "**any *section 9(2B) rights*** *under the scheme*"
- *"section 9(2B) rights are –*

  > *(a) rights to the payment of pensions and **accrued rights** to pensions (other than rights attributable to voluntary contributions) under a scheme contracted-out by virtue of section 9(2B) of the 1993 Act, **so far as attributable to an earner's service in contracted-out employment on or after [6 April 1997***]"

- Common ground "*accrued rights*" included benefits in respect of service between 1997 and the date of the alteration.
- Does "accrued rights" include benefits in respect of service after the alteration?

Alterations to benefits in respect of future service?

Mrs Justice Bacon: "*nothing in the language of the Regulations either specified or implied any particular* ***temporal limitation*** *on the rights that were covered by that definition*"

Counsel for the employer referred to caselaw which has interpreted fetters on **amendment powers** in scheme rules which restrict amendments of "accrued rights" as only protecting benefits attributable to service before the date of the alteration.

Mrs Justice Bacon: "*Still less, in my judgement, can the judicial consideration of a rule of a pension scheme, based on the context of that particular scheme, meaningfully inform the interpretation of a clause in regulations which formed part of an overarching statutory scheme, and which must therefore be considered in that* ***(quite different) context***"

Alterations to benefits in respect of future service?

Mrs Justice Bacon:

*"the purpose of the actuarial confirmation mechanism under Regulation 42 was to ensure that the scheme continued to satisfy the statutory standard after the alteration was made … **Continued compliance of a scheme with the statutory standard** was, moreover the **quid pro quo for the reduction in national insurance contributions** in relation to contracted out schemes. In that context it would be **very odd** if the interpretation of s.37 and Regulation 42 permitted a situation where the scheme did not continue to satisfy the statutory standard for benefits accruing after the alteration was made. I do not think that the legislation can sensibly be given that interpretation."*

Alterations to benefits in respect of future service?

Legislation from 6 April 2013:

- Future service benefits - Actuarial written confirmation for alterations "*in relation to any* ***rights which are to accrue*** *under the scheme* ***in so far as such rights are attributable to an earner's service*** *in contracted-out employment* ***on or after the date on which the alteration to the rules takes effect***"

- Past service benefits - "**Section 9(2B) rights**" (same definition as previously) – interpreted as meaning benefits attributable to past service and **no written actuarial confirmation required**. Protected by requirement for benefits to be "*at least equal*" to those provided by reference scheme and by section 67 of the Pensions Act 1995.

Adverse only?

- Actuarial confirmation only required where alterations would or might adversely affect section 9(2B) rights.
- Mrs Justice Bacon “no merit in this point”
- Actuarial confirmation required in respect of all alterations
- Could potentially retrospectively augment

Appeal

- Appeal to the Court of Appeal
- Hearing expected in first half 2024

Regulations?

S.37 "Regulations … may operate so as to validate with retrospective effect any alteration of the rules which would otherwise be void under this section"

Political support?

- Uncertainty
- Windfall benefits
- Scheme deficits
- Employer support
- Journey plans
- Insurance transactions
- Pension Protection Fund
- Member protection

What would the regulations look like?

Review now?

- Fact specific
- Instructions
- Trustee duty to pay the correct benefits
- Limbo period

Potential triggers for review?

- Corporate transactions
- Accounts and auditors
- Member complaints
- Deaths, transfers out, commutations, divorces
- Insurance transactions
- Mergers
- Discharge of employers
- Insolvency events
- PPF entry

Factual uncertainties

- Alterations between April 1997 and April 2016
- Record retention
  - Trustee, administrator, actuary, lawyer
- On balance of probabilities was the written actuarial confirmation given
- Presumption of regularity?
- Recitals?
- Written confirmation does not have to be in the form of a certificate

Which amendments?

- Alterations to schemes contracted out on the reference scheme test between April 1997 and April 2016
- Legislation changes during this period
- Case only deals with a reduction to revaluation in deferment for benefits attributable to future service
- Potentially broad – alterations "*in relation to any section 9(2B) rights under the scheme*". Section 9(2B) rights are "*rights to the payment of pensions and accrued rights to pensions (other than rights attributable to voluntary contributions) under a scheme*"
- Benefit reductions for future service
- Closure to accrual?
- A-day deeds?

Insurance transactions

- Buy-in
- Buy-out
- Residual risks cover
- Run off insurance
- Scheme wind-up
- Employer indemnity

Other potential (partial) fixes?

Retrospective confirmation now?

Could you get the written actuarial confirmation now?

Reg 42 referred to the "***proposed*** *alteration*"

Mrs Justice Bacon: *"the legislation does in my judgement clearly preclude amendments that have not obtained* ***prior*** *actuarial confirmation"*

Other potential (partial) fixes?

- Could it be argued that the amendment took affect when the next periodic confirmation that the scheme met the reference scheme test was given?
- Retrospective amendment now?
  - Section 67 of the Pensions Act 1995
  - Voidable rather than void
  - TPR's role?
  - Restrictions in rules
- Amend now for future benefits?

Professional negligence?

- Claim against advisers?
- Professional negligence?
- Limitation period?

Any questions or observations?

Disclaimer

The content of these slides and this presentation are a summary only of some of the key issues in relation to the implications of the Virgin Media case. No reliance should be placed on the information in these slides or given in the presentation.

The views expressed in these slides and this presentation do not necessarily reflect the views of Travers Smith or WTW.