

The acid test

Is acting in the “best interests of the members” the right guiding principle for trustees? – wonders Philip Stear, Travers Smith

I like to imagine an episode of the comedy quiz show *QI*, devoted entirely to pensions.

About halfway through, Stephen Fry drums his fingers on the table, squares up his cards and asks the question the audience has been waiting for: “So, what is the main duty of a pension scheme trustee?”

Alan Davies hits his buzzer with aplomb. “To act in the members’ best interests,” he says. “Of course”.

At which point the comedy siren wails. There was no “of course”. It was the obvious answer, but not the right one.

Alan Davies slumps back in his chair. He is used to this. But Jimmy Carr leans forward quizzically: “Hang on, are you sure that’s wrong? Really?”

We hear it so often – the refrain that the job of trustees is to act “in members’ best interests” – that to hear it doubted or even denied may come as a shock. However, it has recently become clearer that it really is not very helpful, or even correct, to describe pension scheme trustees’ duties in this way (apart from in one context, investment – as to which, see below). This refinement has been in the air for some time, but it is a 2015 decision of the High Court, *Stena Line v Merchant Navy Ratings Pension Fund (MNRPF)*, that really drives it home. Pension scheme trustees who have approached decision making through a “best interests” lens will need to adjust their perspective. On the whole, it will be a liberating experience. Beguiling as the “best interests” principle is, it never really made proper sense.

Breach of duty

Consider a number of matters that have not untypically come before trustee boards in the last few years. An employer proposes to cease further accrual of final salary benefits, by an amendment requiring the trustees’ consent. How and when could it be in the best interests of members to agree? Years ago, there used to be the argument that the employer could terminate the scheme,

In a nutshell

- the “best interests” of the members is not the acid test previously thought and trustees will need to adjust their perspective
- two legal cases – *Cowan v Scargill* and *MNRPF* – have concluded that trustees need to take commercial considerations into account
- in practice, trustees may have a high degree of freedom to act as they think appropriate in many circumstances.

which made it easy to agree to its demands. That has lacked credibility, though, since the full buyout deficit has been payable on a winding up. Maybe the employer cannot afford the scheme in its current form: unless accrual is ended, it will go bust. But that is often not the reality either. What if it is simply the case that to remain competitive and maintaining profitability for shareholders, the employer needs to reduce or end accrual? In this, case it may be hard to see that the proposal is in the best interests of members, even though it is entirely reasonable commercially.



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Another example is where trustees have a power which allows them to change the index for pension increases from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI). There is plenty of evidence that CPI is superior to RPI as a measure of the inflation that is actually experienced by consumers. It also acknowledges that RPI has an inbuilt tendency to exceed CPI. So which is it to be? What is in the members’ “best interests”? It is easy to see the argument that it must be RPI; and not obvious how that would be countered if “best interests” is the defining test.

The truth is that the “best interests” principle, if taken at face value, would often limit the ability of trustees to respond

The “how to” guide for trustees

1. Make sure you know what the purpose is and only make a decision which furthers it

This means two things: the purpose of the pension scheme (which is broadly to provide benefits for employees and ex-employees of scheme employers and their dependants), but also the purpose of the power you are considering exercising.

2. Make sure you take into account relevant considerations and ignore irrelevant ones

This may involve taking legal advice, because what is relevant and irrelevant is a question of law. Very often, whether a consideration is relevant or irrelevant will boil down to an analysis of the purpose. Note, however, that the employers’ interests are relevant considerations.

3. Decide, following a review of the purpose and the relevant considerations, what you think is appropriate

As long as it is permitted by the trust deed, has been reached as described above and is genuinely the trustees’ conclusion as to what is appropriate, a trustee decision will be secure, unless it is so unreasonable that no reasonable body of trustees would have reached it.



the trust needs to be able to adapt to changing commercial needs in relation to compensation and benefits. The scheme has a business context, and the interests of its employers are relevant considerations for the trustees to take into account.

So if the “best interests” of the members are not the acid test previously thought, what does this mean for trustee decision making (see **Box**)?

What this means in practice is that trustees may have a high degree of freedom to act as they think appropriate in many circumstances.

They have to focus on the purpose of the power they are exercising, and they need to be careful about what they do and do not take into account. However, there is no “right answer” and they are not forced in a particular direction as the “best interests” principle might dictate.



The truth is that the “best interests” principle, if taken at face value, would often limit the ability of trustees to respond sensitively to challenges in the commercial marketplace.

Philip Stear



sensitively to challenges in the commercial marketplace. If the trustees’ duty really was to act in the members’ best interests, not only would they have the role of negotiating hard on the members’ behalf, they would potentially be in breach of duty if they did not achieve the best outcome for them.

The purpose of the trust

So from where does the idea that the trustee role is to champion the members’ best interests come?

Mostly, in fact, it comes from one legal case, which occupies an important footnote in the industrial history of the last quarter of the twentieth century: *Cowan v Scargill*. This concerned the Mineworkers’ Pension Scheme, and a disagreement between the trustees appointed by the National Coal Board management and the National Union of Mineworkers. It was heard in April 1984, only weeks before the miners’ strike of that year got fully under way. The NUM wanted the trustees to adopt an investment policy including principles to shore up the UK coal industry, avoiding industries competing with coal and overseas investment. The judge said no. The duty of the trustees was to exercise their powers in the best interests of the present

and future beneficiaries of the trust, which were normally their best financial interests. Indeed, that principle has now been enshrined, for investments, in the statutory framework for pension scheme investment.

Scrolling forward 30 years, the *MNRPF* case concerned a unilateral trustee power to impose a funding regime on non-associated employers. The trustees were proposing to broaden the funding burden for reasons of commercial fairness between employers and former employers. The argument being made for the members was that the trustees should focus the deficit repair burden on the employers with the strongest covenants, and it was contended that this would be “in the members’ best interests”.

The judge held that this was not the test: the duty is for the trustee to promote the purpose for which the trust was created. In many circumstances, what might be said to be in the members’ best financial interests is aligned with the purpose of the trust. But not always, because the purpose goes deeper. A pension scheme sits in a commercial context, and was established, not out of charity, but to deliver a component of the employer’s overall remuneration package for its employees. Consistent with that purpose, therefore,

Commercial circumstances

Consider the two examples given above. In relation to an employer proposal to end accrual, the purpose of the amendment power must be to enable the employer to adapt its retirement offering to reflect changing commercial circumstances. On this basis, it is entirely appropriate for the trustees to note (for example) that because the employer’s main competitors only provide defined contribution benefits, it will hamper its ability to compete if it is required to continue providing defined benefit ones.

In relation to the exercise of a trustee power to switch from RPI to CPI, the main observation would be that the purpose of the escalation provision must be to prevent the erosion of the value of pensions in payment because of inflation, not to improve the value of pensions in real terms. Accordingly, the relevant consideration becomes not “which is better for members?”, but “which index better represents the inflation experienced by our pensioner members?”

Without the “best interests” principle, trustee decision making has been liberated and flexibility restored.

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