

Report under s89 of the Pensions Act 2004

Governance issues arising from the
Hugh Mackay Retirement Benefits Scheme
(‘HMRBS’ and the ‘Scheme’)

Background

The Scheme is a defined benefit (DB) pension scheme. It has approximately 450 members.

The Scheme’s original sponsoring employer operated in the carpet manufacturing sector and experienced financial difficulties in the early part of this century. In May 2003 the role of sponsoring employer passed to **Chartpoint Limited** (‘**Chartpoint**’), a company formed in February 2003.

The Scheme accounts for the year to April 2003, show it was predominantly invested in managed funds with no specified property investments. Those for the year to April 2009 show it was almost 87% invested in direct property investments with the balance being substantially property-related. The latter Scheme accounts also show total bank borrowings of £21.9m, of which £18.9m was to be repaid after more than five years.

The Scheme accounts covering the four years 2006 to 2009 show that the Scheme paid £1,155,341 to **Chartpoint**, in respect of the provision of services to the Scheme and commission on the sale or refinancing of investments.

Regulatory action

Acting on information received, in October 2009 The Pensions Regulator (the ‘regulator’) investigated publicly available information relating to the operation of the Scheme.

The regulator’s investigation identified a number of unusual features regarding the operation of the Scheme. These included a concentration of investments in property and property-related investments and charges in excess of £1.1 million paid by the Scheme to the sponsoring employer. In order to protect members’ benefits, the regulator made an application to the Determinations Panel (the ‘Panel’) under the Special Procedure seeking the appointment of an independent trustee with exclusive powers. The Panel met in December 2009 and determined to appoint **Pi Consulting (Trustee Services) Limited** to act as trustee of HMRBS with exclusive powers. The relevant determination notice is at: www.tpr.gov.uk/docs/DN1904655.pdf

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The Pensions
Regulator

In February 2010, as required by Section 99 of the Act, the Determinations Panel reviewed its previous decision to appoint a trustee. At that review the Original Trustees conceded that they had breached:

1. Regulation 4(5) of The Occupational Pensions Schemes (Investment Regulations) 2005 (the 'Investment Regulations') which provides that scheme assets must consist predominantly of investments admitted to trading on regulated markets.
2. Regulation 5 of the Investment Regulations which provides that the trustees should not borrow save for reasons of temporary liquidity.
3. Section 247 of the Act which provides that the trustees should have sufficient knowledge and understanding of the law relating to pension schemes, including investment principles, so as to enable them to adequately discharge their obligations as trustees of the scheme.

The Panel confirmed their earlier appointment of **Pi Consulting (Trustee Services) Limited**.

In the regulator's view, the scale and severity of the breaches was such that the three original trustees (the 'Original Trustees') were not fit and proper persons to be trustees of any pension scheme. The regulator made an application to the Panel for the prohibition of the Original Trustees. This was heard in October 2011. The relevant determination notice is at: www.tpr.gov.uk/docs/DN2100925.pdf

Outcome

The Panel concluded that the Original Trustees were not fit and proper persons to be trustees of trust schemes, because they were not competent and capable. The Panel determined that they should be prohibited from acting as trustees of trust schemes in general. Accordingly, the Original Trustees are now prohibited from acting as trustees of schemes in accordance with section 3 of the Pensions Act 1995.

The regulator maintains a register of prohibited trustees: www.thepensionsregulator.gov.uk/regulate-and-enforce/prohibition-of-trustees.aspx

General

This case illustrates the importance of adhering to guidance issued by the regulator and to the requirements of pensions legislation (the Investment Regulations particularly in this case). It provides a stark illustration of the risks to schemes where guidance and relevant legislation is not followed. It also highlights that trustees should have sufficient knowledge and understanding to evaluate properly professional advice obtained, before it is implemented.

The regulator believes that it would be helpful to draw trustees' attention to the following areas in terms of the awareness of legislation and guidance required to discharge their fiduciary duties properly:

- The Investment Regulations require that scheme assets are invested in a manner appropriate to the nature and duration of the expected future retirement benefits payable under the scheme. Part of this consideration is that assets must consist predominantly of investments admitted to trading on regulated markets. In this case, the Original Trustees had invested all, or substantially all, of the assets of the Scheme in property or property-related investments, including two speculative property developments.
- The Investment Regulations also provide that schemes may not borrow, save where such borrowing is short-term and for liquidity purposes. The Original Trustees committed the Scheme to bank borrowings of over £21 million secured on the property assets such borrowings financed, of which the majority had a maturity exceeding five years. This had multiple negative effects for the Scheme.

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General continued...

- By their nature, speculative property investments are not cash generative until completed and let. In the course of construction, they generate no return to the scheme. Secured bank borrowings need to be serviced, representing a further drain on scheme funds. In the event the property developments are not completed, as was the case here, the full value of the asset cannot be realised. Where property values fall, the scheme has an asset which is worth less than the scheme has invested, whilst the debt remains outstanding accruing interest.
 - Section 247 of the Pensions Act 2004 requires that trustees of occupational pension schemes have adequate trustee knowledge and understanding. To support this requirement, the regulator has developed the **Trustee toolkit** which currently has over 42,000 registered users. Where appropriate, the regulator would expect trustees to seek professional advice to support and develop their knowledge and understanding: www.tpr.gov.uk/guidance/guidance-trustee-knowledge-and-understanding.aspx as well as utilising the dedicated trustee section on The Pensions Regulator's website.
 - Conflicts of interest are not uncommon. It is important that these are properly recognised and appropriately managed. The regulator has issued guidance on this important element of good scheme governance: www.tpr.gov.uk/guidance/guidance-conflicts-of-interest.aspx#s1894
 - In this case there were, demonstrably, instances of conflicts which were not managed. For example, here one of the Original Trustees had a financial interest in two properties which were subsequently acquired by the Scheme.
- Whilst it was claimed that the conflict was declared and the conflicted trustee 'stepped out of the room' at the time the other trustees took the decision to purchase, it is clear that prior to that stage and right up to the point of purchase the conflicted trustee was actively involved in all decisions involving the property. The Panel's description is that the trustee's conflict was acute'.
- The lack of proper record-keeping was also stark. Whilst the Original Trustees met regularly, (frequently with professional advisers present), few of those meetings were minuted. Consequently it is difficult to determine the process which the Original Trustees and, in some instances, their advisers had followed in reaching investment and other important decisions.

Issued by The Pensions Regulator in relation to the Hugh Mackay Retirement Benefits Scheme
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