

# Trustee toolkit downloadable



## The trustee's role

### Tutorial 5 of 5: Trustee liabilities and protections

Here you will find out about breaches of the law and the types of protections that may be available to you as a trustee.

This tutorial is related to the following units in the defined benefit (DB) and defined contribution (DC) scope guidance:

- Protections and immunities offered by trustees (1n).



This tutorial is linked to **Scenario 2** and the case example **Brian's big mistake**.

The Pensions  
Regulator

# An administrative error

As a trustee it's your responsibility to make sure that the scheme is run properly. However, if an error occurs then it is important to sort it out quickly. If problems can be resolved promptly then this reduces the chance of loss to the members.

## Complaints

Kelly is a trustee for her company's pension scheme. Earlier this year it was reported to the trustee board that benefits were being underpaid. Unsurprisingly, the affected members complained to the administrator and the scheme trustees.

## Investigation

On investigation, Kelly established that the problem was due to a breakdown in a specific internal control at the scheme's administrator's office.

## Resolution

Having established the cause of the problem, the trustee board worked with the administrator to ensure that the problem was quickly resolved (from both the member's and scheme administration point of view).

The trustee board also received written assurance from the administrator that it had taken the necessary steps to ensure that steps had been taken to ensure that this specific internal control problem will not occur again.

## Protection

Kelly and her fellow trustees are responsible for resolving the scheme administration problem and, generally speaking, are accountable for breaches of the law even if they are delegated to a third party. Trustees (and certain other parties) have a legal duty to report breaches of material significance to The Pensions Regulator.

However, in this instance, Kelly feels that there was no deliberate mistake by the scheme administrator, and the errors were resolved quickly and satisfactorily. She is therefore wondering whether the administration breach is a breach of material significance which must be reported.

# Follow the traffic lights

The Pensions Regulator has a traffic light framework to help trustees decide whether a breach of the law is serious enough to report ('of material significance'). Trustees have a legal duty to report these serious breaches to the regulator.

## Red

These will always be of material significance and should be reported.

## What is a red breach?

A breach is in the red category when one or more of the following applies:

- It is caused by dishonesty, poor scheme governance, poor advice, a deliberate contravention of the law,
- Its effect is significant
- Inadequate steps are being taken to put matters right, or
- It has wider implications, for example, where the identified issues may apply to a number of different schemes.

## Examples of red breaches

- Widespread administrative delays and errors in an occupational scheme, including frequent cases of incorrect benefits being quoted or paid, a lack or non-receipt of information, such as transfer value quotations and benefit statements, and where the problem has been known for some years yet still persists
- A persistent or significant departure from the scheme's statement of investment principles (eg to allow a significant departure from agreed asset classes) as it may have a significant effect on a DC member's fund expectations
- A widespread and persistent misallocation of member contributions to DC member accounts, including AVC arrangements, where the trustees and/or administrator are aware of the misallocation and have taken no steps to resolve the matter or have failed to resolve it promptly
- An authorisation of a loan from the scheme to an associate of the trustee's.

## What about the breach in Kelly's scheme?

This is not a red breach for Kelly's scheme. The breach was not widespread or persistent, or dishonest or deliberate. It was also resolved quickly with procedures put in place to prevent this from happening again. However it is dependent on the circumstances and in your scheme the outcome may be different.

## Amber

The position here is less clear cut but trustees should take account of the context of the breach and consider the tests in the reporting breaches code and accompanying guidance when deciding whether or not to report.

## What is an amber breach?

An amber breach does not fall obviously into the red or green classification. The decision whether or not to report will require a balanced judgement. In this context other previously reported or unreported breaches will be relevant.

Amber breaches might, for example, consist of several failures of administration that, although not significant in themselves, have a cumulative significance because steps are not taken to put things right.

## Examples of amber breaches

- Several members of a DC scheme have complained via the scheme's internal dispute resolution procedure about the late notification of their normal retirement options (including the availability of an Open Market Option) but have not had an appropriate response from the trustees, and the administrative cause of the problem is taking a long time to rectify
- Trustees of a DB scheme have failed to obtain an actuarial report as at an intermediate anniversary between the regular triennial actuarial valuations within the period allowed (twelve months from the effective date). The actuary has concerns about the delay or the lack of action on the trustees' part.
- The scheme auditor discovers the benefits for some scheme members have been incorrectly calculated
- A failure to observe the requirements of the scheme's provisions.

## What about the breach in Kelly's scheme?

This is not an amber breach for Kelly's scheme. This was a single issue which was put right quickly. Procedures were also put in place to prevent this from happening again. However it is dependent on the circumstances and in your scheme the outcome may be different.

## Green

These are not of material significance and do not need to be reported (although they should be recorded).

### What is a green breach?

'Green' breaches are those that are not caused deliberately or dishonestly, or by poor governance or poor advice; they are not significant, steps are being taken to put them right, and they don't have wider implications.

#### Examples of green breaches

- A member's benefits are calculated incorrectly, but the mistake is promptly recognised and corrected, with the trustees being satisfied that the member has not suffered any financial detriment
- Breaches, not involving dishonesty, in schemes where all the members are trustees or directors of the sponsoring employer and their relatives and therefore largely control actions (or lack of action) in relation to the scheme
- Failure to adhere precisely to the detail of the legislation where the breach is unlikely to result in an error or misunderstanding, eg inconsequential and corrected omissions from the records of trustees' meetings.

#### What about the breach in Kelly's scheme?

This is a green breach in Kelly's scheme. The problem was resolved quickly, procedures were put in place to prevent this happening again and it did not have any wider implications. The breach does not need to be reported, but it should be recorded. However it is dependent on the circumstances and in your scheme the outcome may be different.

## What are your liabilities as a trustee?

As a trustee, it's very important to understand what you're liable for. Here you will learn about breach of trust, penalties and criminal prosecution. Before this sounds too alarming, the next section will cover how you can protect yourself from liability.

## Breach of trust

As a trustee you could be personally liable to your scheme's beneficiaries for any loss you cause to the scheme as a result of a breach of trust. This means that as a result of the scheme losing money, you may need to meet the cost out of your own assets unless you have suitable protections in place.

You should be aware that you:

- have 'joint and several liability' with your fellow trustees. This means that if one of them commits a breach of trust, you could also be held responsible
- continue to be responsible for all your decisions during your time as a trustee even after you have stopped being a trustee.

It is relatively unlikely that you will be directly liable for breach of trust unless you have been dishonest.

## Penalties imposed by The Pensions Regulator

In appropriate cases, The Pensions Regulator can impose financial penalties on trustees (of up to £5,000 in the case of individual trustees and £50,000 in the case of corporate trustees or sponsoring employers. If you are fined:

- any exclusion from personal liability in your scheme rules provides no protection against penalties imposed by The Pensions Regulator
- you must pay any penalties personally out of your own money rather than from the assets of the scheme and
- you cannot use scheme assets to pay for insurance against liability to pay penalties which The Pensions Regulator has imposed.

## Prosecutions brought by The Pensions Regulator

The Pensions Act 1995 contains certain statutory criminal offences. For example The Pensions Regulator has power to bring prosecutions in the courts against a trustee acting as a trustee whilst being disqualified from doing so. These offences are potentially very serious as they carry with them custodial sentences and/or fines.

# Trustee protection

Having learned about the problems that could arise on your scheme, you may be concerned about your own position. The different types of protection that exist for trustees can be divided into: discretion of the courts, indemnities and insurance, and exoneration and exemption clauses.

## Discretion of the courts

Section 61 of the Trustee Act 1925 gives powers to the courts to relieve trustees from liability where they have acted honestly and reasonably and ought fairly to be excused.

## Indemnities

A pension scheme's trust deed and rules often contain an indemnity under which a third party (for example, the scheme's principal employer) will ensure that a trustee is not out of pocket if he or she is found liable in the circumstances described.

Sometimes, where the scheme rules do not contain an express indemnity, employers agree to indemnify the trustees for expenses and liabilities incurred through acting as a trustee in a side letter.

Indemnities do not normally apply to expenses and liabilities which have occurred through wilful wrongdoing (ie dishonesty) or which are covered by trustee insurance.

## Insurance

Trustee insurance is insurance in relation to the acts and omissions of the trustees. The trustees should carefully read the scope and terms of any insurance policy. An indemnity (or insurance) is only as good as the person who undertakes to pay out.

Where the indemnifier or insurer is unwilling or unable to pay out, the trustees would have to take legal action to recover the money. An indemnity may be given by the scheme employer or the scheme itself. The trustees should consider whether the indemnity clauses and insurance overlap, or whether a combination of the two provide them with full cover.

## Exonerations and exemptions

Trust deeds and rules often include clauses that limit the liability of trustees for acts and omissions in carrying out their duties. These are known as exoneration or exemption clauses.

Exoneration provisions in the pension scheme's trust deed and rules protect the trustee against claims by members or the employer. Even if your trust deed includes such a clause, you should be aware that the courts will not interpret these clauses as allowing trustees to act in bad faith or recklessly.

## Check your scheme

As you have just seen, trustees can be protected in a number of different ways. How are you protected under your scheme provisions? Take the time now to check your scheme's trust deed and rules.

### How are you protected under your scheme provisions?

- An indemnity clause?
- Insurance?
- An exoneration or exemption clause?
- Other means?

It's important that you know how you're protected. Do you have more than one type of protection? If so, how do they interact? You should always take professional advice if you are not sure.

You should remember that you're only likely to be protected by an exoneration or exemption clause if you've acted honestly and reasonably. They do not cover dishonesty.

### Not protected?

It's very unlikely that you're not protected, as most schemes contain some sort of protection clause. Check your trust document, or consult your fellow trustees to be certain whether or not you are protected. You should always take professional advice if you are not sure.

If you would like to learn more about trustee protections, view the case example **Brian's big mistake**.

You have now reached the end of this tutorial which is the last one in the series.

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