Pension Trustee Liability Insurance

The role of Trustee is complex; Pension Scheme Trustees in particular have onerous duties and are entrusted with making decisions which potentially affect hundreds of members. Trustee Liability Insurance has developed to provide protection to Trustees on the occasions that things may have gone wrong.

This Briefing Note discusses some key concepts relating to insurance protection available for Professional Trustees and offers some practical tips to consider when reviewing or seeking to rely upon such insurance cover.

Am I already protected by law?

The law will protect Trustees from personal liability in certain situations, but these safeguards are limited and not always practical:

Court protection for breach of trust. Section 61 of the Trustee Act 1925 gives the Court a discretion to relieve a Trustee of all or part of his or her liability for a breach of trust after the event. Although this provides a safety net, the process of obtaining such relief costs time and money, with no guaranteed outcome. The courts appear reluctant to use this power, especially where a Professional Trustee is involved or the Trustee acted from a position of conflict.

Winding-up a scheme where there are unknown beneficiaries. Section 27 of the 1925 Act permits Trustees to distribute a scheme's assets without the risk of future liability to then unknown members. Whilst this protects against unknown benefit cost, it provides no cover for the costs of dealing with any such members or claims brought.

Transferring to the PPF. Section 161 of the Pensions Act 2004 discharges a Trustee of his associated rights and liabilities upon transfer to the PPF, but this does not operate to extinguish any personal liability associated with a Trustee's actions dating from before PPF entry.

The benefits of an insurance policy

To achieve wide ranging protection, beyond that offered by statute, a Trustee should consider insurance. Protection can include:

Immediate protection

Whist the court can excuse a breach of trust long after it is committed, insurance offers protection immediately from the time a claim is made. Given the upfront costs of litigation, this is of immediate practical value to a Trustee.

Defence costs

Defending claims against Trustees can be costly; similarly, in the case of spurious claims, these costs are an unfortunate yet necessary expense. Without appropriate insurance cover, Trustees can face having to meet these personally.

Third party dispute costs

The Trustees may need to bring a claim against a third party, for example for negligent errors in scheme documentation or for mistaken overpayments having been made by administrators. Trustee liability insurance can fund such actions.

Civil fines

This is included as standard by most insurers. However, a policy covering this liability can never be purchased out of the scheme assets, as this constitutes an offence under the Pensions Act 1995. If you are permitted and intending to purchase a policy from the assets of the scheme, make sure you ask the insurer to split the premium so that the element covering civil fines will be paid for by the employer instead.

Where to start – what policy at what price?

The number of insurers in the market has grown significantly over the last 20 years, meaning there is increasing choice for prospective policyholders. Policies from different providers are not all the same and Trustees should be aware of the options for cover and where to go to get them.

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When choosing a policy, Trustees should consider the following:

Broker advice

You will need to speak to an insurance broker about the different policies available and what they will cover. Look out for onerous terms so that you can discuss them with your broker and, where appropriate, your legal advisor. The amount of cover offered varies, and you should consider with your broker your level of exposure when determining the required policy limit. Typically, the policy will have an annual policy limit for all claims, and the limit in that period will include any costs incurred in defending litigation. Also consider that there may be an excess to pay when making any claim.

Who and what is covered?

Who?

Consider who needs to be insured and ensure they are covered, including: individual or corporate Trustees, the sponsoring employer and the pension scheme itself.

TIP: Ensure cover for Trustees is composite. This means that the invalidation of a policy in respect of one Trustee or entity will not affect the cover of the remaining. This is a very important consideration, and can be covered by the insertion of non-vitiation/non-invalidation language.

TIP: Do not automatically assume that Directors & Officers Liability ("D&O") insurance will provide cover to Pension Scheme Trustees, the terms must be carefully reviewed. Pension Trustee liability is often excluded.

What?

Loss for claims for a wrongful act

This is the basic cover typically provided for amounts Trustees are legally liable to pay resulting from a wrongful act; an example being incorrectly overpaying benefits. In addition, cover can include:

Litigation costs

Protection against litigation includes cover for costs incurred in defending (and in some cases bringing) any claims.

TIP: Your policy will typically say that you cannot (1) incur costs of litigation without insurer consent or (2) compromise or settle the claim. You should also check obligations to notify of circumstances that may lead to claims, as well the claim itself, as failure to comply can result in the claim being declined by insurers.

Cover for benefits

Some policies also provide valuable cover for pension benefits owed to the members which are payable only as a result of a wrongful act. This cover does not extend to benefits which would have been paid in any event. The vast majority of policies make it clear that the payment of benefits is excluded from the definition of 'Loss' under the policy, meaning only a few policies will actually have benefits cover included.

Missing beneficiary cover

Missing beneficiaries do not always have to prevent a scheme winding-up. Tailored insurance policies can be obtained to meet payments due to those beneficiaries in the event they contact the scheme years after wind-up is complete.

Unusual circumstances – consider tailored cover whenever a scheme is undertaking an unusual transaction, although the costs of the insurance will have to be justified by the risk being avoided and no class of member must be discriminated by the use of funds to purchase the policy. This balancing act was considered by the courts in *Leadenhall Independent Trustees Ltd v Welham (2004)* when Trustees were considering insurance specifically to cover GMP equalisation and associated claims. Ultimately it was decided insurance could be purchased provided it was out of the scheme's surplus.

The exoneration clause – what is it and how will it affect your insurance policy?

Most trust deeds and rules contain an exoneration clause typically protecting Trustees from liability resulting from a breach of trust, provided the breach was not committed knowingly and intentionally or as the result of dishonesty or fraudulent behaviour.

However, if the exoneration clause can be relied upon then it may relieve your insurer from having to pay for the loss arising from the excused act.

Why would this happen? Subject to the limitations of the exoneration clause an exonerated Trustee has no personal accountability for his or her breach and therefore no personal obligation to compensate the scheme for loss. In this situation the loss would most likely be borne by the sponsoring employer with the policy paying only for the defence costs of any claim and not for the actual loss.

TIP: Check exactly what your insurance covers in order to avoid the employer or scheme paying for any loss. Ideally, your policy should explicitly state that it will pay for losses arising even following the operation of an exoneration clause, and not solely losses arising from *"the personal obligation of a Trustee".*

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Who pays?

Typically, a PTL policy will be paid for by the sponsoring employer either directly or by indemnifying Trustees for a policy they have bought themselves. Whilst this may seem a practical and sensible arrangement, employers cannot always be relied upon to meet the costs of insurance.

TIP: Trustees should ensure the scheme deed and rules contain an express power permitting the Trustees to purchase insurance. Without it Trustees face having to either buy insurance themselves, or make an application to the court to use scheme assets as payment for a policy.

Notifications – how do I make a claim?

Read the policy document and any guidance notes on notification of a claim when the policy is issued or renewed. Generally:

- Cover is typically on a 'claims made' basis. No matter when the events giving rise to the claim took place, you must claim on your current policy in the policy period.

Notification requirements depend on the wording of the policy, but may include any of the following obligations:

- To obtain cover Trustees may have to notify your insurer of any circumstances that "may give rise to a claim" or that could be "reasonably expected to give rise to a claim" during the course of the policy period.
- Notification may have to be made 'as soon as practicable'. If you delay unduly in notifying circumstances, insurers may use the delay to avoid providing cover. If in doubt, it is simplest to make a notification.
- Remember to update notifications if events develop and the potential claim changes. If you do not, insurers may only recognise the limited circumstances of your initial notification and not the claim it ultimately became.

What does my policy mean?

Some key features of policies include:

The operating / insuring clause

Do not be taken in by its brevity, the operating clause sets out the cover provided. The detail is found in the Definitions which should be read carefully.

Conditions precedent ("CPs")

This is a requirement that must be fulfilled before the insurance comes into existence or, more usually, before the insurers are liable to deal with a particular claim under the policy. If the CPs are not complied with, the insurer can decline the claim.

TIP: Familiarise yourself with CPs, insurers will not accept an excuse that you did not know what they were.

Basis of Contract Clauses

The statements you make in the proposal form as part of your policy application can be converted into warranties under the consequent contract of insurance. Any clauses to this effect are particularly onerous and should be resisted, so do not feel that there is no room for negotiation.

Exclusions

All policies will include exclusions which should be read carefully. Apart from the obvious and expected exclusions of dishonest and fraudulent conduct, these can include a 'failure to fund', examples of which can include a Trustee's failure to monitor sufficiently the employer covenant or contributions to the scheme.

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