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making financial sense of the future

Keith Webster  
CMS Cameron McKenna



## Trustee Investment - advice, delegation and liability

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### Investment: a big liability risk for Trustees?

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Section 33(1) Pensions Act 1995

“Liability for breach of an obligation under any rule of law to take care or exercise skill in the performance of any investment functions ... cannot be excluded or restricted by any instrument or agreement.”

## In practice – risk is very small

- Section 33 only applies to breach of the trustee' duties, it does not make trustees liable for all investment loss
- Limited expertise expected of trustees
- Taking advice provides almost total protection
- Delegation reduces liability risk
- Use of funds reduces liability risk
- For trust companies, individual director risk is unheard of

Risk of liability most likely due to procedural failure

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## Investment duties: power of investment

- Trustees can only exercise powers given to them
- Section 34(1) PA95
  - “same power... as if they were absolutely entitled to the assets of the scheme”
- “subject to any restriction imposed by the scheme”
  - Restrictions on asset classes
  - Requirement to follow member direction
- WorldCom ERISA litigation
  - “a person is a fiduciary to a plan only to the extent the person functions as a fiduciary”

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## Investment duties: trust law

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### Re Whiteley (1886)

“take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide”

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## Investment duties: more trust law

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### Cowan v Scargill (1995)

- “the paramount duty of the trustees is to provide the greatest financial benefits for the present and future beneficiaries”
- “trustees must invest to yield the best return for the beneficiaries judged in relation to the risks of the investment in question”
- “trustees must do the best they can for the benefit of their beneficiaries and not merely avoid harming them”
- “honest and sincerity are not the same as prudence and reasonableness”

## Duties under legislation – s36 PA95/Regulations

- Must invest with a view to giving effect to Statement of Investment Principles
- Must invest in the best interests of members
- Ensure security, quality, liquidity and profitability of portfolio as a whole
- Appropriate to the nature and duration of technical provisions
- Predominantly investments on regulated markets
- Properly diversified

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## What level of expertise is required?

- Traditional prudent man test
- Impact of TKU
  - Scope guidance contains a lot on investment
  - Sufficient KU to understand and challenge advice
  - Must cover areas in guidance even if not on committee
  - Members of committee may need more KU than in guidance
  - When considering regulatory compliance, tPR will compare KU to guidance
- Ombudsman used TKU but no excuse for new trustees
- Higher expectations if have expertise
  - Professional trustees/Accountant/Solicitor

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## Need for advice

- Trust law duty to take advice
- S36 PA95: Must obtain and consider proper advice
  - Compliance with Investment Regulations
  - Suitability of investments
  - Compliance with SIP
- Proper advice means
  - Authorised person if regulated activity or qualified by ability and experience
  - Given or confirmed in writing
- Must decide at what intervals advice is revised

## Role of advice

- Obligation to follow advice?
  - Case law v legislation
- Advice must be on prudence not just on whether permitted
  - Lawrence Graham Trust Corp (Q00623)
- Trustees cannot rely on colleague seeing the advice
  - Mr R Adam (M00358)
- Must consider advice (s34)
  - TKU guidance says must be able to challenge advice
- If things go wrong, sue the adviser

## Does following advice always prevent trustee liability?

Generally, YES but

- Adviser must be given right brief
- Must ask for advice at right time
- Advice must be from authorised/qualified person
- Advice must be confirmed in writing

## Protection from delegation

- Delegation of trustee powers to an expert
  - Day to day management must be delegated unless authorised
  - Delegation cannot increase trustees' duty
- Liability for decision to appoint and retain delegate
  - Protection from taking advice
- Liability for acts of delegate (including fraud)
  - Depends on type of delegation
  - Protection from monitoring and advice
- Additional protection provided by claim against delegate

## Four types of delegation of investment decisions

### Section 34 Pensions Act 1995 permits only:

1. Delegation to fund manager who can take decisions without breaching FSMA authorisation requirements
2. Delegation to fund manager where decision is not regulated activity in UK
3. Delegation to a sub-committee
4. Delegation using 12 month power of attorney under Trustee Act 1925

Under 3 and 4, trustees still liable for acts of delegate, but may have claim against delegate and advice will provide protection

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## Delegation to authorised fund manager

- Delegation not investment, so s36 advice not required
- Under s34 trustees not liable for fund manager's acts provided reasonably satisfied fund manager
  - has appropriate knowledge and experience
  - carrying out work competently
  - complying with SIP and Investment Regulations
- How to get this protection:
  - Advice and monitoring
  - Annual compliance certificates
  - Risk due to changes in SIP
- Responsibility under s34 not the same as liability under s33

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## Delegation to fund manager where not regulated activity

- Trustees are liable for fund manager's acts but...
- Trustees can exclude liability because Section 33 does not apply provided reasonably satisfied fund manager
  - has appropriate knowledge and experience
  - carrying out work competently
  - complying with SIP and Investment Regulations

## Liability of fund manager delegate

- Manager cannot exclude most liabilities under FSMA and s33
  - Manager must comply with SIP and Investment Regulations
- But
- Manager only liable for delegated acts
  - Fraud or negligence by an underlying manager not necessarily a breach by delegate



## Delegated consultancy

- Consider which of 4 delegations is being used
- Delegation of higher level decision means
  - Investment decision by trustees at higher level
  - s33 liability applies to that higher level
  - Trustee s34 monitoring and protection applies at higher level
  - s34 protection requires delegate to monitor underlying managers
- Issues to consider
  - Adviser cannot exclude liability for own acts
  - Liability chain for underlying managers
  - Ability of trustees to monitor adviser performance

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## Use of investment funds

- Usually is investment decision rather than appointment of fund manager
- Need s36 advice on investment
- Decisions by manager within fund are not delegated from trustee and so s33 and s34 does not apply
  - Manager not obliged to comply with SIP/Regulations
  - Trustees not required to confirm compliance with SIP/Regs
- Trustees potentially liable for decision to invest and retain but
  - Advice should provide protection
  - Important to review advice
  - Delegation of decision increases protection

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## Derivative contracts

- Generally thought to be an investment decision
- Need s36 advice
- Not appointment of fund manager and so no s34 protection from liability
- If breach of duty, risk that trustees cannot obtain collateral from scheme assets
- Advice is crucial for protection

## Trustee companies – yet more protection

- Company not directors are liable as trustee
- s33 and s34 do not apply to directors
- Directors liable to trustee company
- General director duties apply
  - no duty to avoid loss to trust fund (*Gregson* 2008)
- Directors less liable for sub-committees and delegates
- Dog-leg claim unlikely
- Directors subject to Regulator penalty if company liable

## What if protection fails

- Claimant needs to show a different decision would have been taken, with a different outcome, if trustees had acted properly
- Claims against third parties may avoid loss
- Section 33 prevents excluding or restriction liability, but arguably does not prevent employer indemnity or insurance protection

## Liability – example 1

### Facts

- Scheme in wind up
- Trustees advised to hold assets on deposit
- Instead, trustees purchased shares in companies in which they had a personal interest
- Shares became worthless

Mr Robson (F00826)

Breach of duty?

Trustees liable?

## Liability – example 2

### Facts

- Trustees held scheme assets in cash for 2 years despite advice that needed to invest it
- Same trustees had previously converted employer loan into shareholding in employer

Mr Adam (M00358)

Breach of duty?

Trustees liable?

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## Liability – example 3

### Facts

- Demutualisation bonus paid by insurer in relation to scheme investment
- Trustees paid bonus into company's bank account because company had paid the contributions which were invested in the insurer

Kemp v Sims (2008)

Breach of duty?

Trustees liable?

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## Liability – example 4

### Facts

- Trustees purchased bonds issued by employer
- Purchased at par (ie no discount) even though Trustees knew employer was on verge of insolvency

Withers v Teachers Retirement System of New York

Breach of duty?

Trustees liable?

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## Liability when it goes wrong – example 5

### Facts

- Trustees converted employer loan with guarantees and security into ordinary shareholding in employer
- Objecting trustee was removed from office by employer
- No advice taken
- Employer went bust and shareholding worthless

Mr J Dodwell (L00497)

Breach of duty?

Trustees liable?

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## Liability – a summary

- Liability only imposed for the worst cases
- Trustees are not experts, but need to be diligent
- Must take advice and unlikely to be liable if consider and follow that advice
- Delegation is likely to protect trustees

## Procedural liability – the biggest risk

- Statement of Investment Principles
  - Breach of duty if not invested in line
  - Time delay risk - tail wagging the dog
  - Risk to fund manager
- Advice
  - Not in writing
  - Not considered by all trustees
  - Delay in implementation
- Irregular monitoring of delegates
- Misunderstanding investment power

But claimant still needs to show different outcome

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## Questions or comments?

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The views expressed in this presentation  
are those of the presenter.

