



Court clarifies Railways Pension Scheme funding

High Court clarifies obligations in relation to Railways Pension Scheme funding

In December 2022, the High Court handed down in its judgment in Railways Pension Trustee Company Limited and ATOS. This case concerned the operation of the shortfall provisions of the Atos Section of the RPS and their interaction with the Railway Pensions (Protection and Designation of Schemes) Order (the "Protection Order").

The judgment broadly clarifies that, insofar as a Section of the RPS contains benefits referable to "protected persons" (as defined for the purposes of the Protection Order), the effect of the Protection Order is to create a "balance of cost" funding obligation on the Section employers, and that the Protection Order prevents the Trustee and Section employers from taking action which would be likely to cause members to opt out of their protected benefits. The findings of the court will be of interest to all employers participating in the RPS, and may well affect funding discussions at future actuarial valuations.

Background

The Railways Pension Scheme is the scheme established to provide pensions in the railways industry following privatisation. It was designed to broadly replicate the benefits provided by the British Rail Pension Scheme. Like the British Rail Pension Scheme, it operates on a "shared cost" basis, with employers and employees paying contributions based on a 60:40 split. It comprises a number of independent sections, including the Atos Section. On privatisation the Protection Order was put in place to provide certain protections for pre-privatisation employees. The Protection Order includes provisions relating to the right to participate in the scheme and to build up benefits for protected members (Article 5), and to the funding of schemes in which there are protected benefits (Article 7).

Although the judgment contains limited information on the background facts, it seems that no valuation of the Atos Section has been completed since December 2013 and that the Atos Section has a deficit of c. £18m based on the draft December 2019 valuation results. It appears that there are a limited number of active members in the Atos Section and that the Section employers and Trustee have been unable to reach agreement as to how the valuations could be settled.

The Trustee applied to the court for directions on the operation of the shortfall funding provisions of the Atos Section ("Rule 21"), which are consistent across all shared cost sections of the RPS, and on how the provisions of the Protection Order apply for the purposes of funding. Broadly, Rule 21 provides that where there is a shortfall, unless the Section employers and Trustee agree a basis for making good the shortfall, a process for the actuary to determine how the shortfall will be dealt with applies. This process potentially involves increasing employer and member contributions up to 130% of the normal long term funding rate and, if there is still a shortfall, reducing future service benefits so as to make good the shortfall.

What were the main arguments?

In summary, Atos argued that:

- Rule 21 provides a mechanistic and comprehensive basis for eliminating any shortfall.
- If the Trustee and Section employers cannot reach agreement, the actuary must increase contributions up to 130% of the normal rate (on a 60:40 shared cost basis).
- If a shortfall remains even after the increase, the actuary must reduce future service benefits so as to eliminate the shortfall.
- The Section would only become "balance of cost" (with the Section employers meeting all contribution costs) if there are no active members remaining.

Against this, the Trustee argued:

- Rule 21 is not a mechanistic provision and includes discretion for the actuary to determine the basis on which the shortfall can be eliminated as far as practicable by taking the steps provided for in the Rule.
- In making an assessment, the actuary is entitled to look at the practical effect of increasing member contributions and/or reducing benefits for active members. In the case of the Atos Section, increasing contributions up to the level permitted by Rule 21 would only have contributed c. £900,000 to the £18m deficit and would be likely to cause active members to opt out, thereby putting the full deficit on the shoulders of the Section employers.
- Article 7 of the Protection Order provides for a balance of cost obligation on the Section employers to the extent the Section contains benefits referable to protected persons; and
- Article 5 of the Protection Order, which relates to the participation in and accrual of rights in the Scheme, would prevent the Trustee, Section employers and actuary from taking steps which would be likely to have the effect of causing protected members to opt out of the Section (i.e. setting unaffordable contributions or reducing future service benefits).

What did the court find?

The High Court agreed with the Trustee's arguments on all counts. In particular, it clarified that:

- Rule 21 is not a mechanistic provision and involves discretion on the part of the Actuary, both in relation to the level of member contributions (which can be less than the 40% share) and as regards the level of future service benefit reduction (if any). The judge (Sir Julian Flaux) said:
...the words "so far as practicable" are to be read into that provision. In my judgment, once they are read in, that necessarily involves the conclusion that Rule 21(1) cannot be an exhaustive regime for eliminating the shortfall, since one of the ways in which it will not be "practicable" to do so is if issues arise as to affordability, value for money and collectability which, if ignored, will simply lead to Active Members opting out, so that the shortfall is not addressed at all or only to a limited extent. In other words, the words: "so far as practicable" connote that the Actuary has a discretion as to what practicable steps can be taken to reduce the shortfall as much as possible which necessarily involves consideration of the issues of affordability, value for money and collectability.
- Article 7 of the Protection Order creates a "balance of cost" funding obligation on the Section employers to the extent that there are protected persons in the Section. The judge said:

...the correct construction of Article 7(1) and (2) is to impose on Atos a sufficiency of funding or balance of cost obligation to protect the accrued and accruing pension rights of the Members (whether deferred Members, pensioners or Active Members and both protected and unprotected) by eliminating the shortfall if that is what in the Actuary's opinion is required...

- As was agreed between the Trustee and Atos, if a Section contains protected persons (including former members with protection), the funding obligations under the Protection Order apply to the Section as a whole due to the unsegregated nature of protected and non-protected benefits in the Section.
- Article 5 of the Protection Order does not just apply to protected employees' initial admission to participation, but also prevents the Section employer, Trustee and actuary from taking steps that would have the likely effect of causing active (protected) members to opt out. The judge said:

... it prevents the employer from sidestepping [the right to participate in a Scheme] by making amendments to the Atos Section which obstruct the continuing enjoyment or accrual of no less favourable pension rights than the protected employees had under the BRPS.

and

Article 5 of the Protection Order precludes Atos from agreeing to lift the 130% Cap (in relation to both Protected and Unprotected Active Members) and precludes Atos and the Trustee from agreeing to reduce future service benefits under Rule 21(1)(iv) in so far as, in either case, this would be likely to cause Active Members to opt out.

Comment

It has not been uncommon for employers participating in the RPS to argue that the 60:40 shared cost nature of the RPS is sacrosanct, and that it should be respected – regardless of the impact it may have on member contributions and levels of affordability – on the basis that this was how the British Rail Pension Scheme operated. In practical terms, that may mean that in situations where there are rising deficits, members have to make a difficult decision whether to pay higher contributions or to opt out of future service accrual. The judgment of the High Court has, by and large, put this argument to rest, making it clear that where Rule 21 applies and there is no agreement between the Section employers and the Trustee, Rule 21 provides actuarial discretion and does not operate in a mechanical way to require the shared cost ratio to be maintained to pay off a deficit, or the scaling-back of future benefits

The findings of the High Court are consistent with the positions that have long been argued by the Trustee of the RPS and in some sense should come as no surprise. However, in light of the judgment, it may now be difficult for RPS employers to argue that member contributions should be set solely by reference to the 60:40 shared cost ratio or that there is no freestanding balance of cost obligation on the employers. This is likely to have a material impact on funding discussions that employers have with the RPS Trustee in the future and may well influence discussions employers have with trade unions about contributions and benefit changes.

It is worth noting that, to the extent that the court's findings rely on the Protection Order, they will only apply to Sections of the RPS in which there are protected persons (including pensioners and deferred members who had protected benefits). However, in practice it is unlikely that there will currently be any shared cost sections of the RPS which do not contain at least some protected persons. The court notes that employers could have established separate sections for protected persons and non-protected persons. The implications of the court's judgment may therefore raise the possibility of employers requesting a segregation between the two classes of members – but whether this is practically achievable would need to be considered.

For further information, please contact:



Mark Latimour

Partner

T: +44 746 835 1619

M: +44 20 7919 0779

marklatimour@eversheds-sutherland.com



Gary Delderfield

Partner

T: +44 121 232 1786

M: +44 782 691 8202

garydelderfield@eversheds-sutherland.com



Anne Harris

Consultant

T: +44 121 232 1204

M: +44 786 015 1225

anneharris@eversheds-sutherland.com



Andrew Bell

Principal Associate

T: +44 121 232 1056

M: +44 782 725 3832

andrewbell@eversheds-sutherland.com

eversheds-sutherland.com

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