IN FOCUS

SECTION 37 OF THE PENSION SCHEMES ACT 1993: ISSUES DISCUSSED IN *VERITY TRUSTEES* AND THE IMPACT OF THE DWP'S PROPOSED RETROSPECTIVE LEGISLATION

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Introduction

The first half of this year has seen some major developments in the consequential issues flowing from the Court of Appeal's landmark judgment in *Virgin Media Ltd v NTL Pension Trustees II Ltd*[1] on s 37 of the Pension Schemes Act 1993 (the "PSA 1993"). First, there has been a High Court trial looking at a number of those consequential issues – *Verity Trustees v Wood*, heard by Trower J in February-March this year – in which judgment is awaited. Secondly, the Department for Work and Pensions announced on 5 June that new legislation will be introduced to address the consequences of *Virgin Media*.

This article starts by looking at a number of the s 37 issues that were canvassed in *Verity Trustees v Wood*. As the case is still live, this article will only describe the main s 37 issues debated during the trial and briefly outline some of the key arguments, all of which are a matter of public record. We will find out from the *Verity Trustees* judgment in due course which of the arguments is correct and what the proper legal analysis is (subject to any appeal), so this article does not offer any commentary or critique of the issues. I will then look at the proposed new legislation and say a little about how it might potentially interact with the sort of issues considered in *Verity Trustees*.

[1] [2024] EWCA Civ 843.

Issues discussed in *Verity Trustees*

Background

By way of reminder, from 6 April 1997 s 37(1) PSA 1993 provided: "*Except in prescribed circumstances, the rules of a contracted-out scheme cannot be altered unless the alteration is of a prescribed description.*" It was held in the *Virgin Media* litigation that the consequence of breaching s 37(1) was that the purported alteration was void.

In the period 6 April 1997 to 5 April 2016, the prescribed alterations for s 37(1) purposes were set out in reg 42 of the Occupational Pension Schemes (Contracting-out) Regulations 1996.[2] Regulation 42(1) provided: "*For the purposes of section 37(1) of the 1993 Act … the alterations which are prescribed are any alterations which are not prohibited by paragraph (2), (2A) or (2B).*"

Critically, from 6 April 1997, reg 42(2) provided:

> "*The rules of a salary-related contracted-out scheme cannot be altered in relation to any section 9(2B) rights under the scheme unless —*
>
> *(a) the trustees of the scheme have informed the actuary in writing of the proposed alteration,*
>
> *(b) the actuary has considered the proposed alteration and has confirmed to the trustees in writing that he is satisfied that the scheme would continue to satisfy the statutory standard in accordance with section 12A of the 1993 Act if the alteration were made, and*
>
> *(c) the alteration does not otherwise prevent the scheme from satisfying the conditions of section 9(2B) of that Act.*"

"*Section 9(2B) rights*" were defined in reg 1(2) as:

> "*… rights to the payment of pensions and accrued rights to pensions … under a scheme contracted-out by virtue of section 9(2B) of the 1993 Act which are attributable to an earner's service on or after*

[2] SI 1996/1172.

the principal appointed day [6 April 1997] in employment which is contracted-out in accordance with section 9(2B) of the 1993 Act … ."

From 6 April 2013, the start of reg 42(2) was amended so that the prohibition applied to alterations "*in relation to any rights which are to accrue under the scheme in so far as such rights are attributable to an earner's service in contracted-out employment on or after the date on which the alteration to the rules takes effect*".

As is well-known, it was held in the *Virgin Media* litigation that, from 6 April 1997 to 5 April 2013, the reg 42(2) prohibition on alterations in relation to "*section 9(2B) rights*" applied not only in relation to rights that had accrued but also to rights yet to be accrued. Therefore changes to future service benefits were capable of falling with the prohibition. From 6 April 2013 to 5 April 2016 when salary-related contracting-out was abolished, it was clear that the prohibition applied in relation to changes to future service benefits ("*rights which are to accrue*").

The *Virgin Media* judgments did not identify the precise scope of the concept of "*section 9(2B) rights*" or "*rights which are to accrue*" for reg 42 purposes. Exactly what kind of benefit changes to a salary-related contracted-out scheme were caught by s 37 / reg 42? This was one of the main issues considered in the *Verity Trustees* trial, to which I now turn.

Verity Trustees v Wood

In *Verity Trustees*, the pension scheme had been subject to many benefit changes in the relevant period 6 April 1997 to 5 April 2016, often with a view to reducing the level of benefits. The parties who had the task of arguing for the maximum validity of the changes were the scheme's Trustee and one of its Employers. The party given the task of arguing for maximum invalidity was a representative member of the scheme (the "Rep Ben"). The case proceeded on the assumed basis that there was no evidence of reg 42(2) confirmations having been provided by the scheme actuary at the material times (though the facts had not yet been fully investigated).

Issue: the scope of "section 9(2B) rights"

Consistently with their allocated task, the Trustee/Employer argued in *Verity Trustees* that the concept of "*section 9(2B) rights*" (and indeed "*rights which are to accrue*" from 6 April 2013) should be given a narrow scope. This would restrict the ambit of the prohibition in reg 42(2) of the Contracting-out Regulations 1996.

Thus the Trustee/Employer argued that "*section 9(2B) rights*" should be construed purposively, so that the concept went no wider than the purpose of the contracting-out legislation, namely to ensure that a contracted-out scheme delivered a level of benefits meeting the statutory standard in ss 12A/12B PSA 1993. Accordingly, so it was argued, "*section 9(2B) rights*" and "*rights which are to accrue*" should be construed as being confined to the elements of pension that were relevant to the s 12B reference scheme, that is, the retirement age, accrual rate, earnings definition and pensionable service definition so far as relevant to pensions for earners and their spouses/civil partners. The rationale for this argument was that, as the s 12B reference scheme was limited to the provision of pensions (not other types of retirement benefit) for earners and their spouses/civil partners, only the elements relevant to the calculation of those pensions should fall within the scope of reg 42(2).

In contrast, consistently with her allocated role, the Rep Ben argued for a wide interpretation of "*section 9(2B) rights*" and "*rights which are to accrue*". The Rep Ben relied on the express terms of the statutory language, which was not subject to any restrictions of the sort alleged by the Trustee/Employer. For example, the definition of "*section 9(2B) rights*" was "*rights to the payment of pensions and accrued rights to pensions*", which, so the Rep Ben argued, was wide enough to encompass pension rights falling outside the s 12B reference scheme (such as late or early retirement pensions, or pensions for survivors other than spouses/civil partners). The rationale for this argument was that the legislation deliberately threw the net wide, leaving it to the scheme actuary to decide, when considering his/her confirmation under reg 42(2)(b)-(c), whether the alteration would affect compliance with the statutory standard. That meant, so the Rep Ben argued, that it would appropriately fall to the scheme actuary to police the boundaries of the reference scheme test

rather than to the trustees. This was said to be supported by the fact that the relevant actuarial professional guidance note, GN28, referred to "*benefits*" and to certain lump sums which did not appear to form part of the statutory reference scheme in s 12B.

Issue: application of the "section 9(2B) rights" definition

There was then argument about which side of the line various types of benefit change fell. For example, the Trustee/Employer argued that alterations to the rate of pension increases/revaluation were not changes in relation to "*section 9(2B) rights*", because, so they argued, such increases were not part of the statutory reference scheme in s 12B, but instead were a separate requirement under reg 25 of the Contracting-out Regulations 1996. In contrast, the Rep Ben argued that such increases were an inherent part of the "*rights to the payment of pensions and accrued rights to pensions*" and "*rights which are to accrue*" (and, as it happens, were the very type of benefit change in issue in *Virgin Media*), and so fell within the scope of reg 42. Similar arguments were brought to bear in relation to early and late retirement pensions, non-statutory survivors' pensions, lump sums and so on.

However, there was agreement between the parties that the closure of a pension scheme to new joiners (or restricting the eligibility of new entrants to join) did not fall within reg 42(2). Future joiners were not in employment contracted-out by reference to the scheme and did not have "*section 9(2B) rights*" or "*rights which are to accrue*" in relation to it.

Issue: closure of scheme to future accrual

The parties disagreed about whether a rule amendment to close the scheme to future accrual was an alteration in relation to "*section 9(2B) rights*" or "*rights which are to accrue*" requiring compliance with reg 42(2).

The Trustee/Employer argued that an amendment to close the scheme to future accrual was one which of itself terminated contracted-out employment under the scheme, because no earner would then be in service qualifying him/her for a pension. Therefore, said the Trustee/Employer,

such an amendment did not affect any "*section 9(2B) rights*" or "*rights which are to accrue*" attributable to contracted-out employment.

The Rep Ben was given the task of opposing these arguments. She contended that, just as (according to *Virgin Media*) a reduction in accrual rates was a change to "*section 9(2B) rights*", a reduction in accrual to zero was also such a change. Immediately prior to the alteration, future service benefits and employment were contracted-out, and if the purported effect of the change was to put an end to that, then there had been an alteration in relation to "*section 9(2B) rights*" and "*rights which are to accrue*". The Rep Ben argued that a closure to future accrual accordingly fell within reg 42(2) but that no actuarial confirmation could be given for the change, since the scheme would obviously not comply with the statutory standard post-alteration. The answer to this apparent conundrum, said the Rep Ben, was that the contracting-out certificate ought to be surrendered with effect from just before the closure amendment, so that at the point of closure future rights under the scheme would no longer be "*section 9(2B) rights*" or "*rights which are to accrue*". The Rep Ben added that this meant that the procedural requirements for ceasing to be contracted-out under reg 9 of the Contracting-out Regulations 1996 (and elsewhere) could not be side-stepped.

The Trustee/Employer argued in response that reg 9 did not allow for a prospective surrender in the way suggested by the Rep Ben, or at any rate that reg 9 did allow for a retrospective surrender such that the certificate could simply be surrendered after the closure amendment had been made.

<u>Issue: implied limitation in s 37</u>

In the alternative, the Trustee/Employer argued that s 37 was subject to an implied limitation that it only applied to alterations using a power which as a matter of law was capable of effecting amendments that could cause the scheme no longer to satisfy the conditions of s 9 PSA 1993. They argued that if (as one sees from time to time) the scheme rules contained a guarantee that post-6 April 1997 benefits would be at least the level of the s 12B reference scheme, then the scheme's amendment power could not be used to cause non-compliance with s 9 PSA 1993. If that were so,

then, it was argued, such amendments fell outside the mischief at which s 37 was directed, as the purpose of the legislation went no further than ensuring that pension schemes delivered benefits at least meeting the statutory standard. Accordingly, the Trustee/Employer argued that their proposed limitation should be read into s 37, or alternatively into reg 42.

In response, the Rep Ben argued that the test for implying language into legislation was not met. She said that the proposed implication was neither necessary nor compellingly clear,[3] not least because the legislation already made express provision for exceptions. Nor, she said, was it consistent with the scheme of the post-1997 legislation to think that the legislator intended to rely on guarantees in the scheme rules rather than actuarial confirmation.

Issue: triennial reassurance

One of the issues alluded to but left open in *Virgin Media* was whether a subsequent triennial reassurance certificate could validate an alteration that was otherwise void under s 37 / reg 42(2).

By way of background to this issue, from 6 April 1997 reg 16 of the Contracting-out Regulations 1996 provided that a contracted-out scheme's employer could be required to provide the Secretary of State (later HMRC) with confirmation of the scheme's continued compliance with the contracting-out requirements, including a reference scheme test certificate from the scheme actuary. The Contributions Agency's manual CA14C provided for such confirmation to be given at least triennially, accompanied by a reference scheme test certificate.

In *Verity Trustees*, the Trustee/Employer argued that such a triennial reference scheme test certificate was capable of satisfying the requirements of reg 42(2) in relation to an earlier rule alteration. If a requisite actuarial confirmation had not been provided at the time of the rule alteration, the purported alteration was void. In that scenario, argued the Trustee/Employer, the intended alteration remained a "*proposed alteration*" for the purposes of reg 42(2)(a) and, being part

[3] Compare *Pwr v DPP* [2022] UKSC 2.

of the purported scheme rules considered by the actuary when giving his/her subsequent triennial certificate, the intended alteration was the subject of the actuary's confirmation in that certificate. Thus, said the Trustee/Employer, all the requirements of reg 42(2) were met as from the date of the subsequent triennial certificate, so the purported alteration became prospectively valid at that stage.

The Rep Ben's counter-argument was that once there was non-compliance with reg 42, the intended alteration was simply void and no longer "*proposed*" for reg 42(2) purposes. Nor would the actuary have considered the change as a "*proposed alteration*" at the time of his/her subsequent triennial certificate, nor was it possible to say that the *trustees* had informed the actuary in writing of the alteration at the time of the subsequent certificate (as required by reg 42(2)(a)) because triennial reassurance was an employer-led process. Further, said the Rep Ben, from 6 April 2002 the legislation and guidance were changed so that formal triennial reassurance certificates were no longer required; the actuary did not have to say anything if he/she was satisfied of the scheme's continued compliance.

Issue: presumptions

The Trustee/Employer initially asked the Court to give guidance about whether, on the assumption that there was no evidence either way as to whether reg 42 confirmations had in fact been given, the existence of such confirmations could be presumed, pursuant to the presumption of regularity or some other presumption.

Given the difficulties of providing such guidance on an assumed basis divorced from the facts of an actual case, this point was not strongly pressed.

Issue: partial validity of partially non-compliant alterations

The final *Verity Trustees* issue that I wish to mention in this article is the question whether partial effect can be given to an alteration which only partially infringed s 37. Take, for example, an alteration to change a contracted-out salary-related scheme's normal retirement date in relation to all periods of service, both pre- and post-6 April 1997. The change in relation to pre-6 April 1997

benefits was not caught by reg 42(2) because it was not concerned with "*section 9(2B) rights*", whereas the change in relation to post-6 April 1997 benefits was caught. Assuming that the latter change lacked a requisite actuarial confirmation and was therefore void, is the former change nevertheless valid?

No-one in *Verity Trustees* argued that the whole amendment would be automatically void in this scenario. The Trustee/Employer argued that, although the infringing aspect of the amendment was invalid, the non-infringing part was automatically valid: they said the legislation only prohibited amendments "*in relation to any section 9(2B) rights*", and outside the ambit of that prohibition there was nothing in the legislation to invalidate the non-infringing part of the amendment. The Rep Ben argued that the question whether the non-infringing part took effect should be answered in accordance with the usual trust law principles of severance (the precise scope of which was in issue in other parts of the *Verity Trustees* trial) and therefore did not automatically take effect; it only took effect if it could be severed from the invalid part in accordance with normal trust law principles.

Impact of the proposed retrospective legislation

On 5 June 2025, the DWP announced that the Government will "*introduce legislation to give affected pension schemes the ability to retrospectively obtain written actuarial confirmation that historic benefit changes met the necessary standards. Scheme obligations will otherwise be unaffected … .*"

It is unclear whether the legislation will take the form of primary legislation[4] or secondary legislation under s 37(2) PSA 1993. Section 37(2) provides that regulations made under s 37(1) "*may operate so as to validate with retrospective effect any alteration of the rules which would otherwise be void under this section.*" It is also unclear when the proposed legislation will be introduced; it may be that

[4] There was nothing about this topic in the recently-published Pension Schemes Bill.

the DWP is waiting to see the outcome of *Verity Trustees* before deciding precisely what legislation is needed.

The language of the DWP's announcement seems to envisage that the current scheme actuary would need to perform a historical assessment to work out if the amended scheme would actually have met the statutory standard at the time of the alteration. If so, that might necessitate a historical reconstruction of the scheme's data and assumptions as far back as 1997, which would presumably be very complicated and in some cases impossible. It will be interesting to see if the legislation caters for this and allows for simplifying assumptions or estimates to be made.

If schemes are able to take advantage of a retrospective certification process, then it may be that many of the issues debated in *Verity Trustees* will cease to be of major financial significance. However, those issues could still be of relevance in deciding whether an actuarial confirmation was required in the first place and whether a retrospective certificate is now needed. And if the administrative costs of obtaining retrospective confirmation at the present time turn out to be much greater than the cost of duly obtaining confirmation at the historical amendment date, there could still be negligence claims arising from the failure to obtain requisite confirmation in the first place, though one might expect the quantum of such claims to be pretty limited and possibly not worth pursuing.

On the other hand, it may be that the new legislation will be sufficiently widely-worded to allow the current scheme actuary easily to provide a "catch-all" confirmation to the effect that the scheme as purportedly amended satisfied the statutory standard at all material times in 1997-2016, potentially lessening the need to identify whether and when actuarial confirmations were historically required but not provided.

It would seem from the DWP's announcement that, in order to save the validity of the alteration, it is necessary that a confirmation could have been given at the historical amendment date. This brings us back to the issue of closure to accrual debated in *Verity Trustees*. As noted

above, one of the arguments was that a closure amendment fell within reg 42(2) but a confirmation could not have been given, such that it was necessary to surrender the contracting-out certificate prospectively prior to the closure. If that argument were to prevail, then it seems doubtful that legislation of the sort described in the DWP's announcement would salvage the validity of the closure, because a confirmation could not have been given at the time. It may be that the DWP will wish to ensure that the new legislation covers off this problem, should it arise.

Conclusion

Any practitioner now advising in relation to a scheme that was contracted-out on a salary-related basis between 6 April 1997 and 5 April 2016 will need to look closely at the *Verity Trustees* judgment and the new legislation when available.

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