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Avoiding the pitfalls of updating Pension Scheme documents

A recent decision[1] from the Retirement Benefits Appeals Tribunal highlights the pitfalls of updating scheme documents. Updates while necessary to reflect current law, policy, and best practices can lead to undesirable consequences. Former employees of Standard Chartered Bank Kenya successfully challenged reduced pension benefits and had the bank ordered to repay a KES 1 billion surplus received from the scheme.

What happened?

After retiring and seeking to access their pension, 600+ scheme members challenged the benefits offered. These members contested the application of undisclosed actuarial factors. Furthermore, the pensioners felt the surplus paid to the bank reduced their pension benefits.

In 1975 the bank established a staff pension fund structured as a defined benefit scheme. In such schemes, retirement income is fixed in relation to years of service and pay at end of employment.

In 1996 the bank ran a voluntary early retirement program, which among other incentives offered early pension access. In the same year, the scheme advised its members of the actuarial factors it would use to calculate benefits. Members unfortunately were not advised of subsequent updates to these factors.

In 1999, the scheme's original trust deed and rules were entirely replaced. The new scheme documents would apply from when the scheme started in 1975. Around the same time, the bank received a refund of surplus funds identified after a valuation of the pension fund.

The Tribunal agreed with the pensioners. It ordered the scheme to recalculate and pay out lumpsum benefits using the latest scheme rules. It also ordered the bank to refund surplus funds received from the scheme as the payment was not permitted unless the scheme was being wound up.

What should I look out for?

Retrospective changes: changes to the structure of and rules governing a pension scheme can be made effective from a past date. This subject to various limitations including that retrospective changes cannot take away accrued rights. However, retrospective changes must be assessed for second-order effects – the unforeseen effects of the immediate consequences. In this case, backdating the updates to the scheme's commencement, affected benefits due to members who retired before the changes were adopted.

Updating members: schemes must keep their members updated of changes to the governing documents and structure. For defined benefits schemes, updates should include the actuarial factors for computing pension benefits. Failing to keep members updated may lead to the scheme being impacted by legitimate expectation. In this case, the scheme had to rely on older actuarial factors as it had not updated members on the current factors.

Stacked amendments: often, due to minor changes in pension law, schemes will update their governing documents piecemeal. This leads to 'stacked amendments', where understanding the current structure and rules of a scheme requires having the original trust deed and rules and all deeds of amendment. This is confusing for scheme members, and should be avoided. Where amendments begin to stack, the trust deed and rules should be completely updated and members sensitized.

Sponsor promises: pension-related promises by sponsors to employees are binding on defined benefits schemes because the sponsor underwrites the scheme. A sponsor of a defined benefit scheme must always synchronize pension promises with the trustee(s). Ensuring synchronization enables the scheme to compute its true pension liability, and avoids surprise deficits.

What next?

Long running schemes need periodical independent legal audits of their scheme structures. These audits will identify any potential exposures which may not have been assessed. Audits are essential where retrospective changes are being introduced or benefits being enhanced. The audit must be independent to ensure it gives the scheme (and sponsor) a truly objective view of the scheme's position.

[1] *RBAT Civil Appeal 8 of 2021 – Abdalla Osman & 628 others v Standard Chartered Bank Limited & 11 others [unreported]*

info@kn.co.ke
@KNLawLLP
KN Law LLP

The Pavilion, 5th Floor
Lower Kabete Road, Nairobi
+254 20 386 1306 | +254 729 891 421

Berkeley Suite, 35 Berkeley Square
Mayfair, London, W1J 5BF
+44 20 7692 1873