

Ombudsman's Determination

Applicant	Mr S
Scheme	Water Companies Pension Scheme – Bristol Water plc Section (the Scheme and the Section respectively)
Respondent	The Water Companies (Pension Fund) Trustee Company (the Trustee)

Complaint summary

Mr S has complained about the Trustee's decision to return a surplus of approximately £12 million to the employer, Bristol Water plc (**Bristol Water**), on the winding-up of the Section.¹

Although this complaint just relates to Mr S, I understand that Mr S has been liaising with the Bristol Water Pensions Action Group and that some of his submissions comprise of information obtained through that group.

Jurisdiction

1. Legislation excludes from my jurisdiction the issue of whether the Trustee complied with the statutory requirements which govern refunds of surplus to an employer on a winding-up. Therefore, as has been explained to Mr S, I only have jurisdiction to investigate whether the Trustee followed the correct process in reaching its decision.
2. I say this because in determining Mr S' complaint I must have regard to the exclusion from my jurisdiction contained in Regulation 4(2)(b) of The Personal and Occupational Pension Schemes (Pensions Ombudsman) Regulations 1996 (**Regulation 4(2)(b)**), which states:

“For the purposes of the investigation or determination of any complaint or dispute, the Pensions Ombudsman shall not make any findings of fact to the effect that a person responsible for the management of an occupational pension scheme has failed to comply with the requirements under the following provisions of the 1995 Act: (b) section 37 and 76 (payment of surplus or excess assets to the employer)”.

¹ Following the acquisition of Bristol Water plc by Pennon Group last year, and subsequent transfer to South West Water (also part of the Pennon Group) on 1 February 2023, the Company's name was changed from Bristol Water plc to South West Water Limited trading as Bristol Water.

3. Essentially, Regulation 4(2)(b) precludes me from making findings of fact in relation to non-compliance with Section 76 Pensions Act 1995 (**Section 76**). Section 76 deals with the statutory requirements which must be met before any surplus is paid back to the employer. It follows that I cannot consider the extent to which the Trustee complied with Section 76. Compliance with Section 76 is a matter for The Pensions Regulator (**the Regulator**). I understand that the Regulator has written to Mr S and other members in relation to the issue of the Trustee's compliance with Section 76, following complaints raised by members. In that correspondence, the Regulator has made clear that its legal powers relate to compliance with Section 76 only, stating that: "Our legal powers only extend to making sure the trustees comply with this process, and we are liaising closely with the trustees of the Scheme to confirm that they have complied with the requirements. The decision to pay the surplus to Bristol Water plc doesn't fall under our legal remit, so we won't be investigating their decision, based on the current facts."
4. However, as my office has communicated to Mr S, it is possible for me to look at this complaint by focusing on the exercise of discretion under the Scheme rules and whether the decision-making process was correctly followed when deciding to pay the surplus to Bristol Water. This is not something that the Regulator is investigating when considering compliance with Section 76. The parameters of my investigation are therefore limited to whether the Trustee followed the relevant requirements of the Scheme rules; interpreted the Scheme rules correctly; took into account the appropriate factors in reaching its decision; and made a reasonable decision (broadly, a decision which was not so unreasonable that no reasonable person acting reasonably could not have made it).

Summary of the Ombudsman's Determination and reasons

The complaint should not be upheld against the Trustee as, in making the decision to return surplus to Bristol Water, it acted properly and made a reasonable decision.

Detailed Determination

Material facts

5. The Scheme is a segregated pension scheme. Bristol Water is a sponsoring employer in relation to the Section. Mr S is a pensioner member of the Section.
6. On 27 June 2018 the Trustee wrote to all members of the Section informing them that it had entered into an agreement to insure the pension benefits with Aviva, through the purchase of a bulk annuity policy (often referred to as a "buy-in"). The letter stated that this decision would not affect members' benefits or entitlements in the Section. However, the letter also explained that, within the next year, the intention was for Aviva to take over direct responsibility for the administration and payment of the benefits (that is, the benefits would be "bought out" by Aviva). To achieve this, Aviva

would issue individual insurance policies to members of the Section. The Section would then be wound up.

7. In May 2019 the Trustee issued an update to all Section members informing them of the need for the Trustee to carry out a GMP equalisation exercise ahead of the wind-up of the Section. This would increase the expected time to wind-up.
8. On 20 July 2021 the Trustee issued a further letter on the wind-up of the Section. It confirmed that the Trustee had formally triggered the winding up of the Section and that the insurance policy with Aviva would be converted to individual policies. The letter also explained what would happen to the Section surplus:

“Surplus assets will remain in the Section after all members’ benefits have been secured in full. A proportion of these surplus assets will be used to meet any outstanding expenses of the Section, including the expenses that have been incurred in winding up the Section. It is envisaged that some surplus will remain once these expenses have been met.

Under the Scheme Rules, the Trustee may, in consultation with Bristol Water plc use any such surplus to increase members’ benefits if it considers it just and equitable to do so. Any remaining assets will then be paid to the employers.

After considering ways in which the surplus may be distributed, the circumstances of the winding up including that the surplus arose due to Bristol Water plc continuing to make contributions to reduce the Section’s investment risks, the history of the Section and legal advice it has received, the Trustee proposes that once all the Section benefits have been secured in full for all members any surplus assets, less tax, will be returned to Bristol Water plc.

...

The Trustee estimates that the value of assets remaining after all members’ benefits have been secured in full and any expenses have been paid could be approximately £12 million. The final figure will be known only once the winding up has been completed.”

9. The letter also stated that the proposed refund of surplus could not be made until (i) the liabilities of the Section had been fully discharged (through the assignment of individual policies to members); and (ii) the notice requirements under Section 76 had been satisfied. The letter explained that the Trustee was required by the Pensions Act 1995 to give members of the Section a statutory notice period of two months, followed by a second statutory notice of three months before any surplus assets could be returned to Bristol Water. The letter sought to discharge the Trustee’s obligation to issue the first of these two statutory member notices. The letter stated that, if members wished to make a representation about the proposal to repay the

surplus assets to Bristol Water, then this should be addressed to the Scheme's administrators Lane Clark & Peacock LLP (**LCP**).

10. On 21 July 2021 Mr S emailed LCP to object to the proposed return of surplus to Bristol Water. He stated that: "All monies paid into the Scheme were done so to benefit its members". Consequently, he believed it was "morally indefensible to return any monies back to Bristol Water in order to boost its profits and ultimately to pay it out as dividends to its shareholders".
11. The Trustee responded on 24 August 2021. It referred to the position under the Scheme's rules and said:

"The relevant rule is 28.5 (for pre 1994 joiners) or rule 29.5 (for post 1994 joiners), which says the following:

If any Appropriate Assets remain after complying with the relevant requirements of the Pensions Act 1995, the Trustee may in consultation with the relevant Designated Employer increase all or any of the benefits or provide additional benefits to any extent that it considers just and equitable. Any Appropriate Assets then remaining will be paid to the Employer, in such proportions as the Trustee determines acting on actuarial advice and after consulting the Designated Employer. The requirements of Section 76 of the Pensions Act 1995 (excess assets on winding up) must be satisfied before any payment is made to the Employers.

This means that the Trustee has discretion as to how it allocates any surplus assets but subject to a requirement to first consult with the Designated Employer, Bristol Water plc.

In formulating its proposal, the Trustee has carefully considered the Section's history and the sources of the surplus in the Section. The surplus has arisen through a combination of different factors including changes in market conditions, investment performance and the contributions made to the Section. However, it was the Trustee's view that the significant additional contributions paid by the Company in the mid-2000s, which allowed the Section to adopt an investment strategy with materially reduced risk thereby providing additional security to members, were a significant and clearly attributable factor in reaching a surplus position and this should be recognised in its subsequent allocation. Please see the Appendix [included as **Appendix 1** to this Determination] for details of the contributions paid into the Section over the last 20 years.

The Trustee also took into account that all members' benefits have been secured in full with Aviva Life and Pensions UK Limited including any uplifts due following the recent exercise to remove inequalities in Guaranteed Minimum Pensions (GMPs) between men and women. In addition, as part of the data cleanse and GMP reconciliation exercise recently undertaken, where it has been identified that members have historically been paid higher benefits than due to them under the Section's Rules, those higher payments have been allowed to continue and no

reduction to such benefits has been made (and no overpayments sought from members).”

12. On 27 August 2021 Mr S wrote to LCP to say it was his intention to refer the matter to my office. Mr S also said:

“The most recent letter from the Trustee (20th July 2021) states that the “surplus arose due to Bristol Water plc continuing to make contributions to reduce the Sections investment risks”. On the face of it that would seem straight forward. However, that is not the case, in addition to the money paid in by the company there is:

- profit made by the investments
- monies paid in by the membership
- increase in members contribution.
- money remaining when members passed away. With the breakthroughs in modern medicines, it is not unusual for people to live well into their eighties. Sadly, we hear of many that did not. As the members partner only receives 50% of the members pension entitlement; this could represent a significant amount of the so called ‘surplus’.

Additionally, there were times when Bristol Water saw the Scheme as being in surplus, at which time it took a pension holiday. However, members did not. Therefore, during these times it was only the employees that were funding the Scheme. Furthermore, when there was a perceived shortfall, employees were asked to significantly and permanently, increase their contributions from 5.8% to 8%, not an insignificant increase. Had Bristol Water not taken the pension holidays the increase in members contributions may not have been necessary.

We must also not lose sight of the fact that members were always told all the money in the fund was ring fenced. When members joined the scheme, they were given a booklet titled “Your Pension Your Rights”. In the booklet it clearly states, and I quote “the fund is kept entirely separate from the company’s assets and is used only to secure benefits for members and their dependents”. I do not believe there is any ambiguity in that statement, it is quite clear there is no case for returning any monies to Bristol Water.”

13. Mr S also wrote to the Trustee on 12 September 2021 raising concerns over the consultation process and asking that it be extended. In particular, Mr S believed that it was “heavily biased” and was “hardly an equitable ‘two way’ consultation process”.
14. In response to Mr S’ complaint and a high number of member queries, the Trustee wrote to all Section members in November 2021 providing further details of its decision to return the surplus to the employer. This included a question and answer sheet. Among the answers the Trustee explained that over the period 2001 to 2016

the company had contributed some £37 million in contributions, compared to some £7 million paid by the members of the Section.

15. On 28 January 2022 the Trustee issued its second and final notice of the proposed return of the Section surplus to Bristol Water, as required under Section 76. The expiry date of the notice was 30 April 2022 and said:

“Once the notice has expired, all Section benefits have been transferred to individual annuity policies in members’ names and, where relevant, the Pensions Regulator has given us clearance to go ahead, the surplus funds will be returned to Bristol Water plc and the windup of the Section will be completed.”

16. Mr S also progressed his complaint through stage 1 of the Scheme’s IDRPs. Mr S’ complaint was not upheld, and he appealed under stage 2 of the Scheme’s IDRPs. The Trustee did not uphold Mr S’ complaint under stage 2 of the IDRPs. In its stage 2 response letter of 9 May 2022, the Trustee provided some further clarification of its decision to return the surplus to Bristol Water:

“The Trustee believes it has acted properly (and within its powers and the law) at all times in carrying out its duties in respect of the wind-up of the Section, including in its decision not to exercise its discretion to increase members’ benefits thereby resulting in any surplus funds on the completion of wind-up being returned to Bristol Water plc in accordance with the Section’s Rules.

...

Firstly the Trustee would like to be clear that Bristol Water plc has had no influence over the Trustee’s decision to return the expected surplus funds to Bristol Water plc following completion of the Section’s wind-up. It has been consulted with in a similar manner to the consultation with members.

The decision was reached by the Trustee, with input from its actuarial and legal advisors and after full and careful consideration of all relevant factors, including the reasons the surplus has arisen and the risk burden prior to the benefits being fully secured with an insurer.

As previously communicated, now that the Section is winding-up and all the promised benefits have been fully secured with an insurer, the Section’s Rules set out the Trustee’s powers in respect of any surplus funds. Specifically rules 28.5 (for pre 1994 joiners) and rule 29.5 (for post 1994 joiners) give the Trustee the discretion to “increase all or any of the benefits or provide additional benefits to any extent that it considers just and equitable”. However, this is subject to a requirement to first consult with the Designated Employer i.e. Bristol Water plc in this case.

If the Trustee decides not to increase benefits (as is the case here, and we set out in section 2.2 below further details of the reasons the Trustee decided not to

exercise its discretion in this area) under the Rules, the remaining surplus once the Section's wind-up is complete must be paid back to the Designated Employer.

...

The Trustee's primary role is to ensure that members' promised benefits are paid as they fall due, and it has historically set assets aside to enable it to do that, such assets coming from a combination of member and employer contributions, in varying proportions, plus investment returns. With this primary role in mind the Trustee has worked for many years to achieve its long-term objective of securing all members' benefits in full with a reputable insurance company. The Trustee believes that this is in members' best interests because, in contrast to the investments previously held by the Section, an insurance policy provides a precise match to the benefits payable now and in the future and so reduces the long-term risks for members.

Until members' benefits were secured in full with Aviva (thereby ensuring members benefits will be paid on time and in full), the exact cost of providing all of these benefits was uncertain. The cost depended on things like how financial markets perform and how long people live. Importantly, whilst the Section was ongoing all of the "downside" risk lay with Bristol Water plc. Should the money set aside have turned out to not be enough, it was their responsibility to make good the shortfall. Historically, Bristol Water plc has also, at the Trustee's request, paid significant additional contributions to try and mitigate some of those downside risks.

The Trustee's fundamental view is that because Bristol Water plc has borne all of the downside risk for the duration of the operation of the Section, and the fact it has paid in a significantly greater proportion of the overall contributions since the inception of the Section, it is fair and reasonable to return the surplus to it. In particular, in the Trustee's opinion, Bristol Water plc's significant additional contributions of over £16m between 2005 and 2016 that (a) allowed the Section to materially reduce and mitigate the Section's investment risks and (b) allowed for funding "prudence" to guard against possible future unknown adverse events, is the fundamental reason the Section has reached its current surplus position. With all such risks having (fortunately) not materialised, the Trustee considers it appropriate to return the full surplus after costs to Bristol Water plc and not to penalise it for having been willing to facilitate and fund the Trustee's low risk investment strategy and prudent approach to reserving for adverse, albeit unrealised, contingencies.

On the other hand, Members have not had to bear any downside risk and have had their full entitlement secured, the value of which is considerably more than what they paid in as contributions. For example, the Scheme Actuary has confirmed that a typical member of the Section who accrued benefits on the 80ths scale (i.e. joined the Section before 1 July 1994) will have received more as their "as of right" lump sum at retirement, i.e. before considering any of their annual pension benefit, than they paid in as member contributions.

You mention that contribution holidays were taken by Bristol Water plc. It is correct that Bristol Water plc paid contributions at reduced levels for certain periods in the 1990's and early 2000's (including contribution holidays in respect of the benefits accruing to members on the '100ths benefit scale') but the laws at the time required overfunded schemes to reduce that overfunding and one way of doing that was to take a short contribution holiday. There were severe tax consequences (tax approval would be withdrawn) if the surplus was not removed, which would have been very detrimental to the Section.

You also refer to increases in contribution levels by members of the Section. The Trustee acknowledges that for those who joined the Section before 1 July 1994 member contributions were increased from 5% pa to 8% pa over a two-year period in 2005/2006. This was a decision Bristol Water plc was entitled to make as part of its remuneration package with its employees. It is not the case that the increase in member contributions funded any part of the Section's deficit, the Trustee set the deficit funding contribution requirements for the Section and these were wholly met by Bristol Water plc. Whilst we acknowledge that members did contribute (and those contributions were increased for benefits built up after March 2005 for members who were accruing on the '80ths benefit scale') we remain of the view that it is the Bristol Water plc's contributions, particularly the additional contributions paid in addition to regular contributions during the period 2005 to 2016, that are overwhelmingly the reason for the surplus arising."

Summary of Mr S' position

17. There is a rule within the pension scheme that allows the Trustees to return any surplus to members and beneficiaries by agreement with the employer. Mr S believes that the Trustee's decision to refund the entire surplus to Bristol Water was not in the best interest of the Section's members. Therefore, the Trustee is "failing in [its] duties to members and beneficiaries".
18. Mr S notes that the Trustee says that Bristol Water has had no influence over the Trustee's decision to return the surplus to it. Yet it says before any money can be returned, the Trustee must first consult with Bristol Water. This being the case, Mr S comments: "if Bristol Water had no influence, one must ask what the consultation was about? There were only two options to consider, enhance members benefits or return money to Bristol Water. Clearly, Bristol Water would know that if it opposed an enhancement to members the only option left was to return the money to the sponsor, Bristol Water".
19. Mr S further notes that the Trustee "makes much of the money Bristol Water paid in between 2005 and 2016. It goes on to justify pension holidays taken by Bristol Water for periods in the 1990's and the early 2000's, yet in 2005/2006 members contributions were increased from 5% to 8%. Essentially, shortly after Bristol Water had taken a pension holiday, member contributions went up by 60%. When challenged on this increase the Trustee gives no explanation other than 'this was a

decision Bristol Water plc was entitled to make as part of its remuneration package with its employees'. In essence, the Trustee did it because it could".

20. Mr S asserts that the Trustee also fails to address the change from RPI to CPI. He argues that, from 2011 to 2021, had pensions increased by reference to RPI as was originally the case, they would have increased by 32.7%; because the increase rate changed to reference CPI, pensions increased by only 19.4% for that period. Whilst this represents a significant loss to pensioners, it also substantially reduces future liabilities, making the Aviva buy-out much more viable and arguably, contributed to the surplus. However, Mr S states that none of these factors seem to have been given due consideration.
21. Mr S notes that the booklet, "Your Pension and your Rights", given to all employees when they joined the Scheme, clearly states that the money in the Scheme can only be used for the benefit of its members. Specifically, it says that if the Scheme is wound up the residue of the funds should go back to members. This point he argues, is simply dismissed by the Trustee, saying "it does not form part of the schemes governing documentation and neither is it contractual; as such it is non-binding". Mr S then queries why that information was given if it was non-binding.
22. Mr S rejects the Trustee's contention that the surplus is derived exclusively from monies paid in by Bristol Water over a relatively short period. He believes that the surplus is made up from various elements over a much longer period. He notes that, in March 2017, a year after the Scheme had closed, the Scheme funds were £16.4 million short of the cost of the proposed buy-out. Later in 2017 the Trustee stated that, because of better-than-expected returns on the Section's assets and improvements in the price of insuring the Section's benefits, the Section was very close to being able to fully underwrite all benefits without requiring additional funding from Bristol Water.
23. Mr S argues that by late 2017 sufficient funding was available to facilitate the buy-out with Aviva. As the Scheme closed in 2016, the shortfall of £16.4 million cannot have been cleared because of any additional funding by Bristol Water. Mr S believes that it is more likely that it was cleared due to, in the Trustee's own words, "better-than-expected returns on the Section's assets" i.e., the performance of the stock market. Mr S suggests that it is at least arguable that the surplus is not money paid in by Bristol Water, but money built up by the return on stock market investments. Mr S believes even if it is not illegal it is certainly morally indefensible that Bristol Water should benefit from the stock market investments made with the Scheme's money. Bristol Water is effectively using the Scheme's money as if it were part of its own stock market portfolio fund.
24. Mr S's view is that the member consultation was inadequate and was a "tick box exercise" which "has been tainted by the Trustee's failure to openly engage in an honest discussion".

25. Mr S states that the members simply ask that they have a fair and equitable share of the surplus. Mr S does not question that the legislation allows the Trustee to return the surplus to Bristol Water, but he does question whether that is what was intended when Parliament introduced the legislation.
26. The Trustee had the ability to supplement members' pensions using the surplus, which would be acting in the best interests of the members. Not to do so is a flagrant dereliction of the Trustee's duty and main focus to act in the interests of the members of the Scheme. This is supported, Mr S says, by previous history in other United Kingdom pension schemes where a surplus existed, such as the British Coal Scheme and generally the legislation other countries have in place always returns some, or all of any pension surplus to the members. The Pension Regulator says "It is important that trustees act in the interests of scheme members and can make independent decisions". Mr S argues that returning the surplus to Bristol Water is not in the interests of the members of the Scheme.
27. Mr S has provided a document titled "Memorandum of Association" dated 12 March 1974 which was made when the Trustee Company was established. Reference has been made to section 4 and section 9 which Mr S argues restrict the return of any surplus to Bristol Water.

Section 4 states as follows:

"The income and property of the Company shall be applied solely towards the promotion of its objects as set forth in this Memorandum of Association and no portion thereof shall be paid or transferred directly or indirectly by way of dividend, bonus or otherwise howsoever by way of profit, to members of the Company and no Member of its Council shall be appointed to any office of the Company paid by salary or fees, or receive any remuneration or other benefit in money or money's worth from the Company."²

Section 9 states as follows:

"If on the winding up or dissolution of the Company there remains, after the satisfaction of all its debts and liabilities, any property whatsoever, the same shall not be paid to or distributed among the members of the Company, but shall be given or transferred to some other institution or institutions which shall have objects similar to the objects of the Company, and which shall prohibit the distribution of its or their income and property among its or their members to an extent at least as great as is imposed on the Company under or by virtue of Clause 4 hereof, such institution or institutions to be determined by the members of the Company at or before the time of dissolution, and if and so, far as effect cannot be given to such provision then to some charitable object, to be determined by the members of the Company."

² Reference to the Company is to The Water Companies (Pension Fund) Trustee Company, as defined in the Memorandum of Association.

28. Mr S says that he is concerned about the relationship between the Trustee and Bristol Water. He points out that it is claimed on the one hand that Bristol Water had no input to the decision to return the surplus to it, yet on the other hand there is clear reference to a "consultation" between Bristol Water and the Trustee regarding the surplus. On this matter he believes Bristol Water had the opportunity to influence the Trustee by virtue of the fact they were 'consulted'.
29. Mr S also says that it is a concern that members of the Trustee board are senior managers of other water companies and that if their own pension schemes have a similar surplus, they could be deemed to have a pecuniary interest on behalf of their own company. He adds that many of the Trustee board members have been on the board for a long period and had extensions to their initial term of office. Mr S states that the legislation is open to misinterpretation and needs to change to align with other countries so that trustees do not have any leeway in how pension surpluses are distributed. He cites South Africa and Switzerland as examples.

Summary of Trustee's position

30. The Trustee disagrees with the allegations made in the complaint and summarises its key reasons for doing so as follows:
- The Trustee believes it has fully and at all times complied with its obligations and duties under the Rules and the law in the process of securing member benefits in full and winding up the Section.
 - In exercising its power to distribute surplus (and, in particular, in determining not to exercise its discretion to augment members' benefits) the Trustee has followed the correct process, taken account of all relevant factors and has considered the matter very carefully. It remains of the view that it is appropriate for the surplus to be returned to Bristol Water.
 - The Trustee believes it has provided adequate notification and extensive explanations to members as part of the consultation exercise and otherwise. In particular, the Trustee has carefully considered and responded to the points raised by Mr S and other Section members throughout the process. This included responding to complaints raised by Mr S and other members of the "Bristol Water Pensioner Action Group" through the Scheme's IDRPs which are raised again in Mr S' complaint letter to the Pensions Ombudsman of 21 July 2022.
31. Turning to the Memorandum of Association, this is in relation to the Trustee Company and is therefore irrelevant to the complaint. The provisions within it around non-distribution of assets to members of the Company relate to the assets of the Trustee Company itself (not the pension scheme assets held under trust). The rules relating to the return of surplus/trust assets on a wind up of the Bristol Water Section of the Scheme are clearly contained in the Bristol Water Section's pension scheme rules. There are no proposals to distribute any assets from the Trustee Company to Bristol Water.

Conclusions

32. As I have explained in paragraphs 1-4, I cannot make any determination in relation to the Trustee's compliance with section 76 of the Pensions Act 1995. I can only investigate whether the Trustee followed the correct process in reaching its decision, specifically whether it:
- followed the requirements of the Scheme rules;
 - interpreted the Scheme rules correctly;
 - took into account the appropriate factors in reaching its decision; and
 - made a reasonable decision (broadly, a decision which was not so unreasonable that no reasonable person acting reasonably could not have made it).
33. I will therefore look at each of these points separately.
34. It is worth addressing at the outset the submissions which Mr S has made in respect of the Memorandum of Association, which he argues prevents the return of any surplus to Bristol Water. I find that this has no bearing on the issues before me since it relates to the assets of the Trustee Company itself and not, in fact, the pension scheme assets held under trust. It follows that it is the Scheme's rules which are relevant to the distribution of any surplus to Bristol Water, which I deal with below.
35. Similarly, Mr S has made submissions relating to Parliament's intent when it introduced legislation concerning the return of surplus, as well as possible changes to legislation to align UK law with other countries. Mr S has also cited what may have happened with other pension schemes, for example, the British Coal Pension Scheme. However, given my investigation is concerned with the Trustee's decision making process in relation to the Scheme rules, I have not considered these points.

Did the Trustee follow the requirements of the Scheme rules and interpret them correctly?

36. The Section is governed by Rules dated 16 June 2010. Rule 28 (in the Rules which apply to pre-1994 joiners) and Rule 29 (in the Rules which apply to post-1994 joiners) deal with position on a winding-up of the Section. Broadly, these Rules require the Trustee to secure member benefits through the purchase of individual insurance policies or annuity contracts; and to comply with the winding-up provisions of the Pensions Act 1995. In relation to surplus assets, the relevant rule is 28.5 (for pre 1994 joiners) or rule 29.5 (for post 1994 joiners), the first part of which provides the following:

“If any Appropriate Assets [defined as assets of the Section] remain after complying with the relevant requirements of the Pensions Act 1995, the Trustee may in consultation with the relevant Designated Employer [namely, Bristol Water] increase all or any of the benefits or provide additional benefits to any extent that it considers just and equitable.”

37. It is clear from this rule that the Trustee has a discretion, after consultation with the Designated Employer (Bristol Water), to increase all or any of the member benefits or provide additional benefits that “it considers just and equitable.” This power to augment benefits is discretionary: the Trustee “may” augment “all or any” of the benefits “to any extent that it considers just and equitable”. It is therefore open to the Trustee to decide not to augment member benefits where surplus assets remain on a Section wind-up.
38. The Trustee’s discretion to augment member benefits is exercised “in consultation with” Bristol Water. Mr S appears to imply that this consultation obligation, in effect, means that Bristol Water must agree to the augmentation (and he submits that Bristol Water would know that, if it opposed an enhancement to members, the “only option left” would be to return the money to the sponsor). In my view this is an incorrect interpretation of the wording in Rules 28.5 and 29.5. The Rule does not require the Trustee to obtain the agreement of Bristol Water to any proposed benefit augmentation. It does not refer to any agreement or consent requirement; rather it refers only to “consultation”.
39. Mr S has submitted that the ‘consultation’ requirement implies that a discussion took place between Bristol Water and the Trustee. There is no evidence of any such discussion and indeed the minutes of the Trustee meeting of 8 December 2020 state that a letter had been received from Bristol Water requesting that consideration be given to returning any surplus to the Employer.
40. On a plain reading of the wording in Rules 28.5 and 29.5, I find that the requirement to exercise the discretion to augment benefits “in consultation with” Bristol Water requires the Trustee to inform Bristol Water of the Trustee’s proposal and its considerations; and then, with an open mind, to consider Bristol Water’s views on the matter. I do not therefore find that Bristol Water either has the power to prevent the Trustee from increasing member benefits (had the Trustee decided to do so) or, conversely, to insist that it does so. To allow Bristol Water an effective right to veto the Trustee’s decision (either way) on this matter would be to fetter the Trustee’s discretion. I find that Mr S’ concern that Bristol Water could withhold consent to the augmentation of member benefits and effectively force the Trustee to refund the surplus to Bristol Water to be unfounded – as there was no requirement for Bristol Water to consent to any potential benefit augmentation under the Rules.
41. I consider the Trustee’s decision-making process in relation to the potential augmentation of member benefits below. However, I do not see any evidence that the Trustee fettered its discretion in contravention of the Scheme Rules. Extracts from the minutes of a meeting of the Trustee Council held on 8 December 2020 refer to on-going communication with Bristol Water in relation to the allocation of surplus on the Section wind-up, which I find to be consistent with a consultation process. These minutes (and the minutes of subsequent Council meetings) also indicate that the decision not to augment benefits was taken by the Trustee, after considering, amongst other things, representations from Bristol Water.

42. The second part of rule 28.5/29.5 provides:

“Any Appropriate Assets then remaining will be paid to the Employer, in such proportions as the Trustee determines acting on actuarial advice and after consulting the Designated Employer. The requirements of Section 76 of the Pensions Act 1995 (excess assets on winding up) must be satisfied before any payment is made to the Employers.”

43. I understand that Bristol Water is the only employer, so the Trustee was not required to make a determination about the allocation of proportions between employers.

44. Although these rules provide that the requirements of Section 76 must be satisfied before any return of surplus is paid to Bristol Water, as noted at paragraphs 1-4 above, compliance with Section 76 is excluded from my jurisdiction and I am prevented from making a finding of fact on whether the Trustee has complied with those requirements. Therefore, I cannot consider the extent to which the Trustee complied with section 76 of the Pensions Act 1995, even where the question of compliance with that provision is an aspect of compliance with the Section Rules. Compliance with section 76 is a matter for the Regulator.

45. Noting that I only need to look at the first part of rule 28.5/29.5, and need not or cannot look at the second part, I find that the Trustee followed the requirements of the Scheme rules and interpreted these correctly.

Did the Trustee take into account appropriate factors?

46. This aspect of my analysis considers whether the Trustee failed to take something relevant into account or took something irrelevant into account.

47. Mr S is concerned that the Trustee did not act “in the best interest of the members of the Bristol Water section of the Water industry pension scheme” when it decided to refund the entire surplus to Bristol Water. In response, the Trustee has pointed out that members’ benefits have been secured in full and that, as a minimum, members are receiving their full and correct benefit entitlement as set out under the Section Rules.

48. At this stage, it is worth addressing Mr S’ argument that the Trustee has a duty to act in the best interest of the members (although elsewhere in his correspondence he also refers to acting in the best interest of the ‘beneficiaries’, rather than the ‘members’), and that the logical extension of this is that any surplus monies should be paid to members rather than the employer.

49. Firstly, it is clear to me that Bristol Water is a potential beneficiary of the Scheme. This is because the Section Rules, as discussed above, provide that it can receive a distribution of the surplus assets – and so, even on the simplistic formulation (which I shall turn to shortly) of ‘acting in the best interests of the beneficiaries’, it should be considered along with the other beneficiaries when exercising this power. This should not be a controversial proposition – indeed, The Pensions Regulator in its

Trustee Guidance sets out that “Scheme beneficiaries can include ... in some circumstances the employer who, for example, may be able to receive a payment from the scheme if there is a funding surplus or when the scheme is wound up”³.

50. Secondly, the courts have in any event moved away from this simplistic formulation and instead “found that the “best interests of the beneficiaries” should not be viewed as a paramount stand-alone duty”.⁴ Rather, Asplin J’s judgment in that case was that “...it should not be treated as if it were separate from the proper purposes principle. In fact, it seems to me that the way in which the matter was put by Lord Nicholls extra judicially sums up the status of the best interests principle and the way it fits in to the duties of a trustee. It is necessary first to decide what is the purpose of the trust and what benefits were intended to be received by the beneficiaries before being in a position to decide whether a proposed course is for the benefit of the beneficiaries or in their best interests. As a result, I agree with his conclusion that “. . . to define the trustee’s obligation in terms of acting in the best interests of the beneficiaries is to do nothing more than formulate in different words a trustee’s obligation to promote the purpose for which the trust was created”.”
51. As a result, in principle and subject to the other aspects of decision making that are considered in this Determination, I find that a trustee would be acting in accordance with the purposes of the trust where there are surplus assets available on wind-up and, having already secured the members’ benefits in full, the trustee decides to pay those surplus assets to an employer in accordance with the requirements of the rules of its scheme.
52. Furthermore, it was in any event also appropriate for the Trustee to take account of Bristol Water’s interests when considering the distribution of surplus. It is generally accepted in law that trustees are able (and may in fact be under a duty) to take account of a sponsoring employer’s interests when exercising its powers under a pension scheme, provided that those interests are relevant.
53. The Trustee was not bound to increase benefits to every one of the potential beneficiaries or to pay each potential beneficiary equally. In accordance with the Rules, it had to consider whether it was just and equitable to use some or all of the Section surplus to augment member benefits or for this to be returned to Bristol Water. Provided that other requirements such as considering all the relevant information have been complied with, the Trustee was permitted to prefer the interest of some beneficiaries (including all categories of member, and Bristol Water) over that of others.
54. The Trustee has said that it has followed the correct process and took account of all relevant factors when taking its decision on the distribution of surplus. The Trustee has provided copies of extracts of the Trustee Council minutes where the proposed

³ See TPR’s Trustee Guidance: www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/governing-body-detailed-guidance/trustee-guidance

⁴ Re Merchant Navy Ratings Pension Fund; Merchant Navy Ratings Pension Trustees Ltd v Stena Line Ltd [2015] EWHC 448 (Ch)

return of surplus was discussed. The minutes of meetings of the Trustee Council held on 8 December 2020, 14 September 2021 and 7 December 2021 provide a broad indication of the factors which the Trustee considered when taking its decision on the distribution of surplus. The minutes of the meeting of 8 December 2020 record that the Trustee Council considered (i) the views of Bristol Water; (ii) the source of the surplus; (iii) member expectations; (iv) the fact that members' benefits had been secured in full; (v) that there had been certain past augmentations to members' service; and (vi) that Bristol Water had made significant additional contributions to the Scheme to accelerate the de-risking strategy.

55. The Trustee expanded on its decision-making process in its submissions to the House of Commons Work and Pensions Committee which cite the key factors that influenced the Trustee's decision as being:

- For the duration of the operation of the Section, all of the "downside" risk lay with Bristol Water plc.
- Bristol Water plc was supportive of the Trustee's funding and de-risking strategy and paid significant additional contributions to fund for prudence, including over £16m of additional contributions paid between 2005 and 2016.
- The level of Bristol Water's contributions (both regular and additional) were set by the Trustee in order to fund "prudence" (i.e. to protect members' benefits against future risks that may arise). The Trustee did not believe that it seemed fair or appropriate for Bristol Water to be, in effect, penalised for having been willing to facilitate and fund the Trustee's prudent approach to reserving for these adverse, unrealised contingencies.
- The Scheme Actuary provided the Trustee with details of the movement in funding position since 1999, which supported the contention the Trustee's prudent funding strategy (supported by Bristol Water) was a key reason that the Trustee was able to secure all members' benefits in full as early as 2018.

The submissions also set out some of the other factors considered by the Trustee:

- Members would receive their promised benefits in full; and most members' benefits are fully inflation-linked (and those that are not are inflation linked up to 5%). Those members still in-service when Bristol Water closed the Section in 2016 received an augmentation of an additional one year's benefits.
- Since 2000, Bristol Water paid in more than five times the amount paid in by members over the same period. The Trustee acknowledged that there were some periods in the 1990's and early 2000's when Bristol Water paid reduced levels of contributions but stated that this was to ensure that a statutory surplus did not arise (i.e., potentially incurring tax penalties for "overfunding", under legislation in force at that time). The Trustee believes that the amounts involved were materially smaller than subsequent contributions paid.

- The Trustee acknowledged that members have contributed to the Section historically. However, the Trustee notes that the Scheme Actuary confirmed that a typical member of the Section who is entitled to a guaranteed cash lump-sum will have received more as their “as of right” lump sum at retirement than they ever paid in as member contributions. In other words, they will have received back more as a tax free lump-sum than they paid in, even before considering the annual guaranteed pension. The Trustee asserts that members have therefore received “good value” for their contributions.

56. In its stage 2 IDRPs response, the Trustee placed particular emphasis on its view that Bristol Water had borne all of the downside risk for the duration of the operation of the Section, and the fact it had paid in a significantly greater proportion of the overall contributions since the inception of the Section; therefore, it was fair and reasonable to return the surplus to it. In particular, I note that the Trustee was influenced by Bristol Water’s significant additional contributions of over £16m between 2005 and 2016, which enabled it to pursue a de-risking strategy to what it perceived to be the ultimate benefit of members.
57. I find that all of the above considerations are potentially relevant to the Trustee’s decision in relation to the distribution of the Section’s surplus; and specifically in relation to the extent to which surplus monies should be allocated to augment member benefits and/or refunded to Bristol Water.
58. Mr S has challenged this position and the factual basis of some of the Trustee’s assertions. The source of the surplus is a relevant factor for the Trustee to consider when deciding on the allocation of that surplus. Mr S believes that the Section surplus has arisen due to the performance of the stock market. It may be that some of the Section surplus is due to the return on the Scheme’s investments, but it was the Trustee’s view that it was Bristol Water’s contributions, particularly the additional contributions paid in addition to regular contributions during the period 2005 to 2016, that were overwhelmingly the reason for the surplus arising. This view was based on actuarial advice.
59. I have also noted that as part of the data cleanse and GMP reconciliation exercise it was identified that members have historically been paid higher benefits than those due to them under the Section’s Rules. These higher payments have been allowed to continue and no reduction to such benefits has been made (and no overpayments sought from members). Therefore, it can be said that the members have benefited to some extent from the Section surplus, which would have been greater had members’ benefits been reduced to the correct level (more so if overpayments were recovered).
60. Mr S refers to the increase in the rate of member contributions paid by pre-1 July 1994 joiners from 2005/6. However, this was included in the actuarial analysis of the Section’s contribution history and does not therefore affect the Trustee’s conclusion that the surplus was attributable to a large extent to the contributions paid by Bristol Water. In other words, the Trustee did not overlook a relevant consideration.

61. Mr S also refers to extracts from an undated Scheme booklet received when he joined in 1979 titled “Your Pension Your Rights”. One extract addressed the issue of winding-up on page 4 (under the heading of Tax and Legal Notices, “Changes”), as follows: “if the scheme is discontinued the trustee will use the assets of the scheme for the benefit of members and their dependants as set out in the legal documents”. The booklet also includes the wording at page 6 (under the heading of “Contributions”): “the fund is kept entirely separate from the company’s assets and is used only to secure benefits for members and their dependents”. Mr S argues that these extracts bind the Trustee to use surplus assets to augment member benefits.
62. My view is that the wording in these extracts would be open to a wider and different interpretation to that put forward by Mr S. In any event, as a matter of law, it is well established that explanatory material provided to members of an occupational pension scheme will not generally override the formal provisions of the scheme’s trust deed and rules. This general principle is potentially subject to exceptions, none of which apply in this case. I say this because the booklet does not contain anything that contradicts what is provided for in the scheme rules and in any event contains a clear statement that the scheme rules would override it. On page 4 clearly stating:
- “This booklet is a simple guide and although the contents are accurate it will always be overruled by the legal documents governing the scheme if there is any difference between the two.”
- Therefore, I find that the wording in the Scheme booklet does not have the effect of compelling the Trustee to use surplus assets to augment member benefits.
63. I also note that the minutes of the meeting of the Trustee Council held on 8 December 2020 contain an explicit reference to the Trustee having considered “member expectations” in its discussions on the distribution of surplus.
64. In addition to member expectations, the views of the Section membership would be a relevant factor for the Trustee to consider as part of its decision-making process. I therefore turn to the consultation undertaken by the Trustee with the Section members. As noted in paragraph 8 above, some aspects of member consultation are attributable to section 76 and the regulations made under that provision. My jurisdiction does not extend to investigating compliance with section 76. However, I am able to consider the consultation process in more general terms and reach a conclusion as to whether the Trustee’s actions were consistent with the principles of good scheme administration.
65. The Trustee’s key communications to members are set out in the material facts section of this opinion. The letter of 20 July 2021 invited members to make representations about the proposal to refund surplus to Bristol Water, if they wished to do so. I note also that the plan to refund surplus to Bristol Water was explained in detail to members in the Trustee’s consultation document dated November 2021, which included an extensive question and answer section. It is apparent therefore that the Trustee explained the proposal and invited members to comment on it. The

Trustee was clearly aware of the views of the membership and of the arguments put forward by members who opposed the surplus refund. These were considered primarily at a meeting of the Council held on 14 September 2021, but also at the meeting held on 7 December 2021. The IDRPs complaints in relation to the surplus refund were discussed at meetings of the Council held on 8 March 2022 and 28 April 2022. Given this evidence, I find that the Trustee considered member representations in relation to the surplus refund.

66. Mr S has raised with my office (consequent to the making of his complaint) the issue that the Trustee did not take into account the change from RPI to CPI that has meant pensioner members have received a lower level of pension increase. Although this does not form part of his complaint, I note that the Trustee has explained that pensions within the Section both in deferment and in payment are increased in line with the Pensions Increase (Review) Orders, subject to any statutory underpins and caps on increases in payment. These Orders are set by the Government, and in 2010 the Government changed the Orders to be linked to CPI instead of RPI. The Trustee has therefore implicitly been increasing pensions broadly in line with CPI inflation since 2010, but there has been no change to the underlying Rules nor was this an active choice for the Trustee to make at the time.
67. Mr S also raised an issue in paragraph 29 above regarding the constitution of the Trustee board. Mr S states that as it is made up of senior managers of other water companies their decision could be influenced by the possibility of other surpluses being returned to their own companies. However, I have not been provided with and find no evidence that the Trustee has been swayed by any such possibilities. Any such decision made in the future would have to be made on the relevant factors applicable at that time.
68. Overall, I find that the Trustee took into account all relevant matters and no irrelevant ones in reaching its decision.

Was the decision one which no reasonable decision maker would make?

69. The final question I have to consider is whether the decision the Trustee made was unreasonable or perverse; that is, a decision that no other reasonable decision-maker would make.
70. The Trustee has provided copies of its correspondence with Mr S, extracts of the Trustee Council minutes where the proposed return of the Section surplus was discussed, as well as the Notices issued to members. I have reviewed these at length and note from the minutes of the Council meeting held on 8 December 2020 that:
- Bristol Water had augmented the service of all members who were in service immediately prior to the closure of the Scheme; and
 - the factors used by Aviva were generally more generous than the Scheme factors.

71. These comments as well as the facts outlined in paragraph 59 above (that members have historically been paid higher benefits than those due to them under the Section's Rules, that these payments have been allowed to continue and that no reduction to such benefits has been made), demonstrate to me that the Trustee considered the members' position. After considering relevant factors, the Trustee decided against any further augmentation of the members' benefits and instead chose to return the Section surplus to Bristol Water.
72. I do not find that to be an unreasonable decision or one that is perverse to the extent that no other reasonable decision-maker could have made it. That is not to say that another Trustee could not have reached a different decision which was also not unreasonable or perverse.
73. Given my findings above, I do not uphold Mr S's complaint.

Dominic Harris

Pensions Ombudsman

29 August 2023

Appendix

Contribution history of the Bristol Water Section

Every 3 years the Trustee carries out a formal valuation of the Section. Effectively a budgeting exercise so the Trustee expects to have enough assets to pay all benefits as they fall due.

If the valuation reveals a shortfall, the Trustee puts in place a plan to recover this through a combination of investment returns on the Section's existing assets and additional contributions from the Company.

The Trustee's principal role is to make sure the Section has enough assets to pay benefits as per the Rules when they are due and that these assets are appropriately invested. With this duty foremost in its mind, it has long been the Trustee's ultimate goal to reach a level of funding in the Section that would enable it to secure all members' benefits with an insurance company and this is reflected in the funding targets and contribution requirements set by the Trustee at valuations over the last 18 years.

The table below sets out the contributions that have been paid to the Section by active members and the Company since 2001/02. The Company's contributions are set by the Trustee following formal valuations as outlined above and illustrate how the cost of providing Section benefits has increased significantly over this time (principally as a result of increasing life expectancies and falling interest rates). Market and investment risks are borne by Company and with the exception of the increases to member contributions in 2005 and 2006 for 80ths scale members, the Company has borne the entirety of the additional cost throughout this period.

At the 2005 valuation, the Trustee introduced a funding target, agreed by the Company, to be in a position to be able to fully insure the Section by 2035. As a result, the Company agreed to make significant additional contributions between 2005/06 and 2010/11, shown below. Further, at the 2011 valuation, the Company requested that this target be brought forward to 2027, in order to reduce risk within the Section. This acted to increase the regular contributions required from the Company (the main reason behind the increase in company contribution rates in 2012/13) as well as resulting in additional Company contributions being required to achieve this revised target from 2011/12 until the Section was fully funded on this basis.

Contribution history

Scheme	Member contributions		Company contributions			
	Y	80ths scale ⁽¹⁾ members ⁽³⁾	100ths scale ⁽²⁾ members ⁽³⁾	80ths scale ⁽¹⁾ members ⁽³⁾	100ths scale ⁽²⁾ members ⁽³⁾	Additional contributions ⁽⁴⁾
	2001/02	5%	3%	9.8%	0%	£0
	2002/03	5%	3%	9.8%	0%	£0
	2003/04	5%	3%	18.1%	8.1%	£0
	2004/05	5%	3%	19.5%	8.1%	£0
	2005/06	6.5%	3%	19.5%	8.1%	£7,000,000
	2006/07	8%	3%	21%	10%	£1,000,000
	2007/08	8%	3%	21%	10%	£1,000,000

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2008/09	8%	3%	21%	10%	£1,000,000
2009/10	8%	3%	21%	10%	£1,000,000
2010/11	8%	3%	21%	10%	£900,000
2011/12	8%	3%	21%	10%	£490,000
2012/13	8%	3%	28.9%	17.6%	£410,000
2013/14 ⁽⁵⁾	8%	3%	28.9%/36.7%	17.6%/24.9%	£750,000
2014/15	8%	3%	36.7%	24.9%	£440,000
2015/16	8%	3%	33.9%	27.0%	£450,000
2016/17 ⁽⁶⁾	N/A	N/A	N/A	N/A	£110,000
2017/18	N/A	N/A	N/A	N/A	£0
2018/19	N/A	N/A	N/A	N/A	£0

- (1) Members who joined the Section before 1 July 1994
- (2) Members who joined the Section on or after 1 July 1994
- (3) Contributions shown as a % of members' pensionable salaries
- (4) Additional company contributions as requested by the Trustee following valuations to address funding shortfalls (ie paid in addition to those in respect of accruing service).
- (5) In the 2013/14 Scheme Year the required Company contributions in respect of accruing service were increased part way through the year. The first rate shown was paid for the 8 months from 1 April 2013 to 30 November 2013 and the second rate for the 8 months from 1 December 2013 to 31 March 2014.
- (6) The Section was closed to further benefit accrual as at 31 March 2016. At this time the Company granted benefits equivalent to one year's additional service to the current active members of the Section (ie those still in employment). No member contributions were paid to fund this benefit augmentation.