ML Covered - July 2024

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Welcome to the first edition of ML Covered, our new monthly round-up of key events that are relevant for those dealing with Management Liability Policies covering D&O, EPL and PTL-type risks.

De facto directors – an insured person by any other name?

On 24 July 2024, the Court handed down judgment in respect of *Lime and Black BPS Ltd (in liquidation) v Gill and others* [2024] EWHC 1898 (Ch) in which the Court was required to consider the roles of de facto directors.

The claim was brought on behalf of Lime and Black BPS Limited (in liquidation) (the **Claimant**) by its joint liquidators, MHA, against five defendants, these being the director (Mr Gill), de facto director (Mr Mistry) and companies of whom Mr Gill was also the sole director and shareholder of.

The central elements of the claim were around de facto directors' duties under sections 171 to 177 of the Companies Act 2006 (**CA 2006**), and concerned allegations of breach of fiduciary duty, dishonest assistance, knowing receipt and unlawful means conspiracy.

It was alleged (and the judge found in favour of) that Mr Mistry, who had been previously sentenced for conspiracy to defraud, was a de facto director and had allowed the company to engage in VAT fraud for sums over £3M. In essence, the fraud involved the company failing to account to HMRC for output tax VAT received from its customers, with the money being diverted for the benefit of Mr Gill and Mr Mistry.

In January 2023, judgment in default was entered against all of the defendants, bar Mr Mistry. The claim then proceeded solely against Mr Mistry.

The Court considered that Mr Mistry was a de facto director given that he carried out acts that were "cumulatively directorial in nature", which included being involved in the setting up of the company, administering the company's workplace pension scheme and processing IFX payments for the company. As such, the Court held that Mr Mistry was subject to the director duties as set out in sections 171 - 175 CA 2006, and that it was necessary to have regard to the statutory codification of directors' duties in case law and equitable principles as well.

The Court subsequently held that Mr Mistry acted in breach of his fiduciary duty and so ordered him to pay over £1.7M plus interest and costs, and refused to grant Mr Mistry permission to appeal.

The "Insured Person" definition in ML policies often includes "de facto directors" and this case serves as an important reminder to Insurers, in the context of de facto directorships, to consider how widely covered an "Insured Person" definition is under their policies. In this case, the Court noted that when determining whether an individual was a de facto director it is necessary to look "at what the director actually did and not any job title actually given to him." Notably, the Court stated that, "it is also important to look at the acts in their context. A single act might lead to liability in an exceptional case."

In this case the judge referred to previous case authority that described a de facto director as "one of the nerve centres from which the activities of the company radiated." Understanding the senior management structure of a Policyholder company may help Insurers to identify whether there are de factor directors working in the background that are the "nerve centre" of the company's operations.

To read the judgment, please click here.

Time to get changed – the key updates (and immediate 5 changes) to the FRC's Stewardship Code

In an attempt to support the UK financial market, reduce the existing reporting burden and promote better stewardship success, the Financial Reporting Council (**FRC**) has announced key revisions to the current UK Stewardship Code (the **Code**)

The Code is a voluntary code governed by the FRC, which is aimed at asset owners, asset managers and service providers who invest money on behalf of UK pensioners and savers. To date, there are 287 signatories, managing c.£50 trillion in assets across the UK.

The goal of the Code is to promote sustainable benefits for the environment, society and governance whilst securing long-term financial benefits for customers. For D&Os, there remains a fine balance between maintaining a robust internal management process whilst also delivering profits for shareholders. The revisions to the Code by no means exclude one of these objectives to the detriment of the other. However, what may be seen as regulatory "red tape" by some D&Os has been reduced in these revisions in recognition of the existing reporting burdens on senior management.

What's the change?

On 22 July 2024, the FRC announced five immediate changes, coming into effect in the next application window (being 31 October 2024) to reduce the reporting burden on the existing signatories:

- Remove the requirement to annually disclose all ‘Context’ reporting expectations, except for new reports or material changes.
- Remove the requirement to annually disclose against 'Activity' and 'Outcome' reporting expectations for some Principles.
- Explicitly allow use of content from previous reporting and cross-referencing of such reports.
- Set clear expectations of what is considered an ‘outcome’ for stewardship purposes.

The FRC also announced revisions to its application process, along with five new areas of focus for revision of the Code as:

- **Purpose** - clarifying what is meant by effective stewardship and how reporting against the Code can help to deliver this.
- **Principles** - considering what reporting will be necessary to deliver on a renewed purpose of the Code.
- **Proxy Advisors** - supporting greater transparency of their activities.
- **Process** – reducing the reporting burden and ensuring accessibility and usefulness of that information to all underlying investors and other stakeholders.
- **Positioning** – co-ordinating with other regulators (such as the Financial Conduct Authority, the Department for Work and Pensions and the Pensions Regulator) to ensure improved clarity and implementation whilst reducing confusion and duplication.

What's the impact?

The changes to the annual disclosure requirement may cause some internal debates within companies as to what amounts to a "material change". The FRC's accompanying notes read that: "signatories to the Code are best placed to identify which changes from their previous years' reporting are substantively different compared to previous disclosures." There are some examples provided of "material changes" which include changes to new policies such as conflicts of interest. D&Os of signatory companies should ensure they keep records of any changes that were deemed material as the FRC expects this to be explained in the company's annual report. We expect that Insurers will take interest in a company's recent "material changes" at the time of writing a new risk or renewal.

With FRC's effort to provide more clarity and to streamline the reporting process, we envisage that this is a welcoming update for the existing signatories, and that this might encourage more market participants to sign up to the Code.

To read more, please click here.

A "new" problem for pension professionals?

The Court of Appeal's decision in *Virgin Media v NTL Pensions Trustees II Ltd* has confirmed that the lack of s.37 actuarial confirmation (required for amendments impacting member benefits in contracted-out schemes) will render the amendment invalid/void, regardless of whether s.37 actuarial confirmation would have been granted had it been sought at the time. As a result, there are likely to be Defined Benefit (**DB**) schemes where amendments are now invalid/void due to a lack of s.37 confirmation, and additional benefits may fall to be paid if now invalid/void amendments sought to reduce benefits.

What does this mean for pension professionals and their insurers?

We consider that actuaries and lawyers are most at risk of claims where there are s.37 issues and scheme employers (now responsible for additional benefits caused by invalid/void amendments) who look to pursue the professionals that were responsible for implementing the amendments to a scheme. For PTL policies, there is a risk that the following provisions in PTL policies could be triggered:

1. **Mitigation expenses -** costs incurred by schemes to see if they have a problem and measures to resolve the problem, including contacting impacted members and recalculating benefits;

2. **Third party pursuit** - schemes (via employer/trustee) may pursue advisers involved at the time of the amendments lacking s.37 actuarial confirmation or those in place later on, if a claim against advisers at the time of a now invalid/void amendment is out of time for limitation purposes;
3. **Court application costs** - schemes may incur these costs if they want to test the unresolved issues in terms of what counts as actuarial confirmation and to test the impact (if any) of an actuarial confirmation identified but prepared after the effective date of an amendment.

Is this final?

Pension professionals will be hoping that the decision is appealed and overturned by the Supreme Court, but it is widely thought that the Supreme Court is unlikely to give permission for the appeal given the thoroughness of the judgment. However, it remains possible that the new government could pass legislation (potentially via the Pension Schemes Bill) that overrides the adverse consequences of the decision, particularly for amendments to scheme rules that are only invalidated by the lack of written actuarial confirmation – the government may not want uncertainty in the pensions market given calls for UK investment via pension funds as part of its plans to generate a "*big bang on growth*".

If the decision stands, we expect there to be debate (and potentially litigation) as to what amounts to "actuarial confirmation" – the Court of Appeal noted that a formal certificate appended to the document making the amendments was not required (just "written confirmation") which raises a question as to whether correspondence with the actuary will suffice and whether the actuary has to clearly state that the reference scheme test had been satisfied. We also expect pension professionals to explore whether they can rely on later actuarial confirmation that post-dates the effective date of the amendment (if so, there will be a question as to whether the confirmation can apply retrospectively, or only from the date it was given).

The Pension Schemes Bill

Labour appears to be prioritising pensions with the announcement of a Pension Schemes Bill at the opening of parliament on 17 July. The government has confirmed it intends to boost investment and tackle waste in the pensions system. The bill aims to create a private pensions market that encourages consolidation of small pension pots and generates 'value-for-money' for pension savers (the government has said that it could increase pension pots by over £11,000, or 9% at retirement for an average earner).

The key measures for defined contribution (**DC**) schemes include:

- Encouraging the consolidation of small DC pension pots - it is possible pots could be consolidated automatically (which will require significant work by pension providers) or that pots will follow members (preventing the creation of multiple pots);
- The 'value for money framework' - the government wants to ensure that all DC schemes are working on a level playing field and providing value for money. The bill proposed a standardised test that trust-based DC schemes will need to meet to demonstrate they deliver value, which should lead to a consolidation in the pensions market. The FCA is expected to ensure the framework is applied to contract schemes and consistently across the whole pension market; and
- Retirement products - the bill could require pension schemes to offer retirement products and solutions so people have a pension and not just a savings pot when they retire. The intention is to

put the onus on trustees of occupational pension schemes to provide products within schemes for members at retirement.

Other measures include:

- Consolidating the DB market through superfunds to offer greater protection to members in closed schemes;
- Reaffirming the Pensions Ombudsman (**TPO**) as a competent court - this would remove the need for trustees to apply to the County Courts to enforce TPO decisions in relation to overpayments; and
- Amending the special rules for end of life and extending the definition of 'terminal illness', so that eligible members within the Pension Protection Fund and the Financial Assistance Scheme can receive a lump sum payment at an earlier stage.

The reaffirmation of the TPO as a competent court is likely to be welcome news to pension trustees given this removes a difficulty when it comes to recoupment of overpayments. However, the potential for different products in retirement to be offered by pension schemes arguably introduces a new risk for trustees.

TPR publishes new superfunds guidance

The Pensions Regulator (**TPR**) has set out its expectations for capital release in defined benefit (**DB**) superfunds, which is intended to boost market innovation whilst retaining protection for scheme members. Superfunds are a type of pension fund that transfers the assets of DB schemes from the original sponsor to a "superfund" that is intended to run the schemes until the members have been paid or the schemes are able to enter into a buyout arrangement with a buy-out provider.

The updated superfunds guidance states that capital can be released up to twice a year, provided that the total assets (in the pension scheme and capital buffer) exceed minimum capital adequacy requirements. Previously the guidance only allowed capital to be released when benefits were bought out. TPR has said that "*the capital release level is set to encourage a thriving and competitive superfund market while still maintaining a 99% probability of meeting members' benefits, which is in line with DWP's tolerance limits*". TPR has also set additional safeguards to ensure that superfunds do not pick favourable dates when markets are high to release capital and that there is a formal governance process around capital release.

TPR has noted that the updated guidance may encourage more superfunds (as it stands, there is only one - Clara-Pensions - that has passed TPR's assessment process), on the basis it will make it more attractive for providers to enter the market if a surplus above a healthy funding level can be taken ahead of buyout.

The updated guidance can be found here.

Statutory Code of Practice on Dismissal and Re-engagement

What is the purpose and scope of the Statutory Code of Practice on Dismissal and Re-engagement?

The process known as “fire and rehire” is where employees are let go and then offered to return under new contract terms. For most employers, it is only initiated as a last resort, when changes to contractual terms are essential and employees’ agreement cannot be obtained.

Fire and rehire practices received attention during the Covid-19 pandemic, when it was felt that some employers were forcing detrimental changes on staff by dismissing and rehiring, leaving employees with a stark choice between accepting less favourable terms or losing their income entirely at a time of great economic uncertainty. Although not strictly speaking a fire and rehire exercise (as staff were not rehired, but replaced by agency workers), P&O Ferries’ dismissal of 800 workers without consultation in March 2022 added further weight to calls to ban the practice entirely.

The Government announced that it would put in place a statutory code of practice (the **Code**) on using fire and rehire to make changes to employees’ contracts. The revised Code came into force on 18 July 2024. The purpose of the Code is to ensure that an employer takes all reasonable steps to explore alternatives to dismissal and engages in meaningful consultation with a view to reaching an agreed outcome with employees or their representatives. The Code also seeks to ensure that the employer does not raise the prospect of dismissal unreasonably early, or put undue pressure on employees by threatening dismissal where this is not envisaged.

What changes have taken place?

- The revised Code is more concise and reordered to make if more accessible. Of particular note:
- The Code applies regardless of the number affected employees affected, or potentially affected, by the employer's proposals.
- The Code sets out details of the information which must be provided as part of the information and consultation process.
- ACAS should be contacted for advice before the prospect of dismissal and re-engagement is raised with employees.

What is the current position?

The Labour party previously stated an intention to ban the practice of dismissal and re-engagement outright, however, it amended its manifesto to state that it would permit the practice in circumstances where there is genuinely no alternative for the business.

How does this impact employers and what do employers need to consider?

Failure by employers to follow the Code will not enable employees to bring standalone claims, but relevant parts of the Code must be taken into account by Tribunals in reaching decisions. In addition, Tribunals can increase certain awards by up to 25% if an employer has failed unreasonably to comply with the requirements of the Code.

Employers should keep a close eye on these developments, as Labour have stated that the Employment Rights Bill will be introduced within the first 100 days of parliament. A further overhaul of the Code is expected in the near future.

The Statutory Code currently in force can be found here.

The Labour Government's pledge to end the practice of dismissal and re-engagement can be found within the background briefing notes to the King's Speech, available here.

Equality (Race and Disability) Bill

On 17 July 2024, the newly formed Labour Government delivered its first King's Speech, which promised a draft Equality (Race and Disability) Bill. The Government's background briefing notes, published at the same time, state that the draft Bill will operate to "enshrine the full right to equal pay in law."

Background to the draft Bill: why is it required?

The briefing notes set out a number of statistics demonstrating the current inequalities experienced by ethnic minority groups and people with disabilities:

- Most ethnic minority groups earn less than the White British group. Between 2012 and 2022, for example, Black, African, Caribbean or Black British employees consistently earned less than White counterparts.
- The Office for National Statistics identified a pay gap of 13.8% in 2021 and 14.1% in 2019 between the median pay for people with disabilities and people without.

How will the draft Bill look to tackle these issues?

The briefing notes make it clear that the Government intends to "tackle inequality for ethnic minority and disabled people" by:

- Introducing a statutory right to equal pay for ethnic minorities and disabled people; and
- Introducing a mandatory ethnicity and disability pay reporting for large employers (with more than 250 employees).

The briefing notes comment that claimants currently face significant barriers when bringing pay discrimination claims on the grounds of ethnicity or disability.

It is hoped that enshrining in the law the full right to equal pay for ethnic minorities, as well as people with disabilities, will make it easier for them to bring equal pay claims where they have been underpaid. It is also hoped that surfacing pay disparities will enable employers to constructively consider why they exist in their business, and how to tackle them.

Where will the draft Bill apply?

The Bill is likely to extend and apply across Great Britain, mirroring measures in the Equality Act 2010 relating to equal pay and gender pay reporting.

How have the proposals been received?

The Equality and Human Rights Commission (**EHRC**) has commented on the proposals revealed in the King's Speech, with an EHRC spokesperson stating:

"*The EHRC welcomes some of the positive developments for equality and human rights included in the King's Speech yesterday. We look forward to receiving more detail on the Draft Equality (Race and*

Disability) Bill and will consider it carefully. […] As Britain's equalities regulator and a National Human Rights Institution, we stand ready to provide government and Parliament with advice as the detail of all the proposed legislation is developed."

The Race Equality Foundation responded to Labour's proposals when they were first revealed in February 2024, commenting:

"*The Race Equality Foundation believes that the spotlight on closing gaps and addressing different types of discrimination is a step in the right direction, although legislation alone cannot eliminate inequality. More work is still needed across society to fully understand and remedy systemic racism and race discrimination.*"

The full text of the King's Speech can be found here.

The background briefing notes to the speech are available here.