TRAVERS SMITH

Issue 66 September 2017

What's Happening in Pensions

IN THIS ISSUE:

- **IBM case on employer duties:** IBM has succeeded in overturning the High Court judgments that it breached duties to scheme members and employees when seeking to make adverse pension changes.
- **Bradbury v BBC – pensionable pay increase cap:** The Court of Appeal has rejected Mr Bradbury's claims against the BBC in relation to the capping of pensionable pay rises at 1%.
- **Pension scams:** The government has confirmed broad details of its proposals to clamp down on pension scams.
- **British Steel Pension Scheme:** The Pensions Regulator has given initial approval to a proposed regulated apportionment arrangement to separate the British Steel Pension Scheme from Tata Steel.
- **No contract for transfer credit terms:** The Pensions Ombudsman has rejected a complaint brought by a member in relation to generous revaluation terms applied to his transferred-in benefits but lost on a subsequent transfer. In doing so, he decided that there was no contract made between the trustees and the member in relation to the transfer credit terms, so they could be changed.
- **Early exit charges and member-borne commission:** Regulations have been laid, effective from 1 October 2017, implementing the government's previously announced decisions on restricting early exit charges and member-borne commission payments.
- **Contracting-out reconciliation:** HMRC will now consider late expressions of interest to register for the contracting-out scheme reconciliation service.
- **State pension age:** The government has provisionally proposed accelerating the state pension age increase from age 67 to 68, by implementing it between 2037 and 2039 rather than from 2044 to 2046.
- **Pensions Regulator – monetary penalties and professional trustees:** The Regulator has provided guidance on the way it will set financial penalties for breaches of legal requirements and has set out a revised description of what it considers to be a "professional trustee".
- **PPF compensation and bridging pensions:** The government has published a consultation on adjusting PPF compensation for members with bridging pensions.

IBM case on employer duties

IBM **has succeeded** in its appeal against the High Court decisions that it breached duties to employees and pension scheme members when seeking to make adverse pension changes. It is understood that there will be no appeal to the Supreme Court. If this is right then the pension changes will all stand.

The Court of Appeal's decision contains useful guidance as to the grounds on which employers can be challenged over their decisions.

Background

In 2004/5, IBM proposed and then implemented "Project Ocean", under which it increased member contribution rates in its contributory DB scheme and reduced accrual rates in its non-contributory DB scheme.

In 2005/6, IBM implemented "Project Soto", under which DB members were given the option (a) to remain in the DB sections but with only 2/3rds of salary increases being pensionable or (b) to transfer to the DC section of the main IBM scheme, keeping full salary linkage for their accrued DB benefits.

As part of both these projects, there were various communications from IBM, some written and some oral. IBM never guaranteed the continuation of the DB sections but did say that the changes were for "long-term sustainability", and mentioned a "continuing commitment" to the DB sections, taking steps to "secure the sustainability" of the DB section, and a "commitment to underpin [their] sustainability".

In October 2009, IBM announced further changes. Under "Project Waltz", the schemes' DB sections would be closed to future accrual; future pay increases would not be pensionable at all; a short early retirement window (on existing favourable terms, subject to IBM's consent) would be offered to eligible members; and following that window, early retirement on an enhanced basis would not normally be granted.

The changes to make future pay increases non-pensionable were made by agreement with members (under non-pensionability agreements or "NPA"s). Members who did not agree would not be given salary increases. This was later modified so that salary increases would not be granted in 2009, 2010 or 2011, after which the matter would be reconsidered. The other changes were made using powers in the scheme rules, including powers in the eligibility rules to give "exclusion notices" terminating membership.

High Court decision

In April 2014, the High Court (Warren J, see **WHiP Issue 46**) held that that IBM was in breach of its *Imperial* duty of good faith towards pension scheme members (from the 1990 *Imperial Tobacco Pension Fund* decision of the High Court), so far as concerned accrual of benefits and changes to its early retirement policy, and in breach of its implied contractual duty of trust and confidence to employees so far as concerned the 2009 NPAs.

Warren J had considered that a member's reasonable expectations may, on the facts, be critical and in this case, there was "no doubt" that Project Waltz conflicted with the members' reasonable expectations. In addition, IBM's conduct of the consultation in connection with Project Waltz was sufficient for the members to question the integrity and good faith of IBM and to give rise to a breach of IBM's contractual duty.

In a later remedies hearing, Warren J had held that the exclusion notices were voidable and liable to be set aside in their entirety and that in most cases IBM could not rely on its non-pensionability and early retirement changes (see **WHiP Issue 51**).

Court of Appeal decision

The Court of Appeal allowed IBM's appeal, holding that IBM did not breach its *Imperial* duty of good faith to pension scheme members or its contractual duty of trust and confidence to employees in relation to the Project

Waltz changes.

In the first Court of Appeal decision to consider the scope of the *Imperial* duty, the Court decided as follows:

- Warren J had been wrong to give "paramount significance" to members' **reasonable expectations**. The existence of reasonable expectations was a relevant factor to be taken into account but the judge wrongly elevated the members' reasonable expectations "to a status in which they had overriding significance over and above other relevant factors". The High Court was therefore wrong to hold that IBM breached its Imperial duty in implementing Project Waltz by failing to give effect to members' reasonable expectations.

- The **correct approach** is to apply a test equivalent to the *Wednesbury* principles for decision making under public law. This test has two limbs:

  - Has the decision maker taken into account all relevant matters and disregarded all irrelevant matters?

  - Was the decision one that no rational decision maker could have reached?

  It was not argued that any irrelevant matter had been taken into account, or that any relevant matter had been left out of account. Therefore the question was whether the decision taken was one which no rational decision-maker could have reached.

  Although the judge had directed himself that the test to be applied was one of capriciousness, perversity or arbitrariness, which is close to the rationality test, he accorded an overriding significance to reasonable expectations such that they could only lawfully be disappointed in a case of necessity, which is not compatible with the correct approach.

- IBM's decision to make future pay rises conditional on the member signing a **non-pensionability agreement** did not fail the rationality test. (See also the almost contemporaneous decision of the Court of Appeal in *Bradbury v BBC*, below, which also considered such agreements.)

- There was no basis for Warren J to have decided that members had reasonable expectations about the continuation of the favourable **early retirement policy**. The judge was also wrong to hold that IBM had to give notice to all employees announcing a change of its early retirement policy. He had decided this on the basis that a member might decide to leave service in order to take early retirement, only to discover too late that the policy had changed. The Court of Appeal said that there were no evidential grounds for the judge to base his decision on there being such a member. The judgment notes that the 2011 annual benefit statement informed members that a new early retirement policy had been adopted and set out the applicable early payment discount rates.

- IBM had given **exclusion notices** under a scheme rule that allowed it to "... direct that any specified person or class of persons shall not be eligible for membership, or shall cease to be a Member or Members". IBM made such a direction. The representative beneficiaries argued that the power had been exercised in the main scheme for a collateral and improper purpose, in that (a) the members did not in fact cease to be members of the scheme because they immediately joined the DC section of the same scheme and (b) IBM intended to break the final salary link but Warren J had decided (a point that was not appealed) that the exercise of the power was implicitly subject to a proviso such that it could not do so.

  - On (a), the Court of Appeal held that if IBM could have terminated memberships and offered membership of a separate DC scheme then it is not improper to use the power in conjunction with an offer to provide members with the DC benefits in the same scheme.

  - On (b), there was no reason not to hold the direction valid to the extent permitted by the implicit limitation on the power. IBM would have issued the direction notice even if it had been aware that the final salary link would not be broken (not least because the NPAs would also be making future salary increases non-pensionable).

- IBM did not appeal against the High Court's decision that it breached its contractual duty of trust and confidence by the manner in which it conducted its **consultation** on the Project Waltz changes. The beneficiaries are therefore entitled to claim damages against IBM for that breach.

  The representative beneficiaries asked the Court of Appeal for an injunction preventing the implementation of Project Waltz until a fresh consultation had been conducted. The Court declined, saying that a fresh consultation years after the original one could not be made to work.

Bradbury v BBC: Pensionable pay increase cap

The Court of Appeal has rejected Mr Bradbury's appeal in **Bradbury v British Broadcasting Corporation** (see **WHiP Issues 34** and **52**), concerning the BBC's capping of pensionable pay rises at 1%.

Facts

The BBC decided in 2011, by agreement with trade unions in the face of a significant scheme deficit, to restrict benefit accrual under its DB pension scheme by imposing a 1% cap on increases in pensionable pay in each year and giving members the option to avoid the cap by joining a new career average section or a separate DC scheme.

No rule amendment was made to implement the cap. Pay rises were offered on the basis that, if accepted, only a 1% increase would be pensionable.

The definition of "Pensionable Salary" in the scheme rules referred to "Basic Salary". This was defined as "the amount determined by the BBC as being an Employee's basic salary or wages payable under the terms of his or her Continuing or Fixed Term Contract ...". The question arose whether the BBC could rely on this definition to determine that only part of a pay rise is basic salary and so pensionable.

Decision

The Court of Appeal decided as follows:

- **Using the definition of "Basic Salary" to cap pensionable pay:** The scheme definition gave the BBC scope to award a pay increase and determine that that part of it did not constitute Basic Salary, thereby making it non-pensionable. Gloster LJ added:

  "I do not regard the conclusion that the BBC is able to determine whether (and how much of) a pay rise is pensionable as particularly startling. Given, as was accepted by the appellant, he had no contractual right to any pay rise, I see no reason why it should not be open to the respondent to determine how much of that pay rise would count as Basic Salary and therefore how much was "pensionable". In my view that is precisely what the language of the relevant definition clauses allows the respondent to do."

- **Did the cap breach section 91 of the Pensions Act 1995 (which prohibits the surrender of pension)?:** No (though the reasoning raises some questions): *"Section 91 protects the actual, accrued rights of employees. It applies where a person "has a right to a future pension"; it does not apply where a person may acquire a future right to a pension, as a result of a future increase in Basic Salary; i.e. to have a future pay increase. ... The appellant's right under the Scheme rules was to a pension calculated by reference to the level of pay stipulated in the appellant's employment contract. A change to the employment contract, such as the Cap, did not involve any surrender of pension rights because those pension rights merely reflected the terms of the employment contract."*

- **Did the BBC breach its implied duty of trust and confidence to Mr Bradbury?:** No: *"In my judgment, the judge's analysis of the relevant facts, and his conclusion that there was no breach of the*

respondent's duty of trust and confidence, cannot be faulted. The respondent's conduct had to be assessed against the reality of the background that the respondent was faced with a multi-billion pound deficit in the Scheme and where the trustees, the unions and the respondent all agreed that something had to be done."

Pension scams

The government **has published** its **response** to the consultation on pension scams (see **WHiP Issue 61**). Measures in line with the government's original proposals will be introduced, including:

- **Cold-calling:** There will be a ban on pensions cold calling, to include emails and text messages. The ban will be enforced by the Information Commissioner's Office, which has no jurisdiction over overseas firms. Penalties will be for civil offences: there will not be any new criminal offences. The ban will be introduced when Parliamentary time allows.

- **Transfers:** Amendments to legislation will limit the schemes to which a statutory cash equivalent transfer value can be taken. There will only be a statutory right to a transfer to a personal pension operated by an FCA authorised firm; to an occupational pension scheme where there is evidence of genuine earnings from an employment to which the scheme relates; or to an authorised master trust. There will be no cooling-off period or requirement for a discharge letter from the member. These changes are intended to be introduced from late 2018/early 2019, when the master trust authorisation regime is operational.

- **Scheme establishment:** Finance Act rules will be tightened to stop the registration of fraudulent pension schemes. This will include a requirement for a company registering a pension scheme to be active, ie, not a dormant company. HMRC will have a discretion to disapply the requirement. This will be done via a Finance Bill later this year).

British Steel Pension Scheme

The Pensions Regulator **has issued** a determination notice and clearance statement, giving its initial approval to a regulated apportionment arrangement (RAA) to separate the British Steel Pension Scheme (BSPS) from Tata Steel.

The separation is intended to secure the future of the remaining Tata Steel UK Limited (TSUK) business. Without separation, it is expected that TSUK would become insolvent. The Pension Protection Fund **has confirmed** that the arrangement meets its published principles and that it has informed the Pensions Regulator and other parties that it does not object. The RAA is expected to take effect on or about 11 September 2017.

The arrangement will involve the BSPS releasing security over Tata Steel assets and receiving £550 million and a 33% equity stake in TSUK. Members will then be offered the options of (a) a transfer to a new scheme with the same benefits but lower future pension increases; or (b) remaining in the BSPS when it transfers to the PPF. Transfers to the new scheme will only be made if that scheme meets certain qualifying conditions, including as to its initial size and funding level. If the transfer does not go ahead then all members would go into the PPF. The transfer will include a proportionate share of the 33% TSUK equity stake, any proceeds of which would be used to fund additional pension increases.

The new scheme will have TSUK as its sponsoring employer and is designed to be eligible for the PPF. The trustees will pursue a low-risk investment strategy designed to cover the payment of benefits as and when they fall due. The new scheme will not be used for ongoing pension provision.

The Government has updated the web page for its British Steel Pension Scheme consultation (see **WHiP Issue 58**) to say that "The government continues to work closely with the interested parties to ensure the best outcome for pension scheme members. We want to keep all options open while the detail of that is worked through".

Travers Smith advised the trustee of the British Steel Pension Scheme throughout.

No contract for transfer credit terms

The Pensions Ombudsman **has rejected** a complaint brought by a Halcrow pension scheme member in relation to lost generous revaluation terms previously applied to his transferred-in benefits.

The revaluation terms were lost when the scheme was separated from its sponsoring employer by a regulated apportionment arrangement (RAA) and the member decided to transfer to a new scheme with only statutory minimum revaluation rather than fall into the Pension Protection Fund.

The Ombudsman determined that there was no contract made between the trustees and the member in relation to the transfer credit terms, so the generous revaluation terms were of no greater standing than the standard scheme benefit rules.

Early exit charges and member-borne commission

Regulations have been laid implementing the government's previously announced decisions on restricting early exit charges and member-borne commission payments (see **WHiP Issue 65**).

From 1 October 2017, the **Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2017**:

- introduce restrictions on early exit charges payable by members of occupational pension schemes providing money purchase benefits. These reflect equivalent provisions already applied by the FCA in relation to personal pensions since 31 March 2017. Broadly, early exit charges cannot be higher than 1%; existing early exit charges below 1% cannot be increased; and new early exit charges cannot be made.

- extend the existing prohibition on member-borne commission payments by occupational pension schemes used for automatic enrolment, to cover contracts entered into before 6 April 2016. The existing prohibition of member-borne commission payments only applies to new contracts entered into since that date: see **WHiP Issue 56**.

The government has published **guidance** for schemes on the early exit charge restrictions. This includes (among other things) its views on market value adjustments, terminal bonuses and with-profit funds.

Contracting-out reconciliation

HMRC's **Countdown bulletin 25** says that it will now consider late expressions of interest to register for the contracting-out scheme reconciliation service.

State pension age

The government has **issued** its overdue **report on the state pension age** under the Pensions Act 2014.

The government proposes to accelerate the state pension age increase from age 67 to 68, by implementing it between 2037 and 2039 rather than from 2044 to 2046. This was one of the recommendations of the John Cridland report (see **WHiP Issue 64**). This change will affect people born after 5 April 1970 and before 6 April 1978 (ie, currently aged between 39 and 47).

However, the announcement is only provisional. The government said that no steps to implement the proposal will be taken until after the next review, in July 2023. This means that there will not be legislation put to Parliament until after the next general election (in 2022, barring an early election).

Pensions Regulator: Monetary penalties and professional trustees

Policy documents published by the Pensions Regulator provide guidance on the way it will set financial penalties for breaches of legal requirements and set out a revised description of what it considers to be a "professional trustee". The Regulator also issued a **press release** and **consultation response**.

Monetary penalties policy

The **Monetary penalties policy** sets out how the Regulator will use its powers to impose monetary penalties for breaches of pensions legislation (not including breaches of the automatic enrolment requirements, which are covered by a separate policy).

The policy also sets out in particular how the Regulator will calculate penalties for failure to issue a chair's governance statement (see Appendix 1) and failure to complete a scheme return (see Appendix 2), for both of which offences there is zero tolerance.

Professional trustee description policy

The **Professional trustee description policy** sets out how the Regulator will decide whether a trustee is a professional trustee, with some illustrative examples. The Regulator expects higher standards from professional trustees and will normally impose higher penalties on them.

The test is whether a person is acting "as a trustee of the scheme in the course of the business of being a trustee". The Regulator will normally consider someone who promotes themselves as having expertise in trustee matters as being in business as a trustee. A trustee may receive remuneration without being considered as acting in the course of business: for example, a former executive and scheme trustee who stays on as a trustee and is paid for the role, but does not hold any other trustee appointments, would not be considered a professional trustee.

Trustees will be required to indicate in the scheme return whether they consider themselves to be a professional trustee.

PPF compensation and bridging pensions

The government **has published** a consultation and draft regulations on adjusting PPF compensation for members with bridging pensions. The consultation closes on 1 October 2017.

The regulations are designed to resolve an anomaly whereby pensioner members who are in receipt of a bridging pension or other temporary enhancement when their scheme enters the PPF receive PPF compensation for life based on that higher rate. The same anomaly applies to members not yet in receipt of pension for whom a bridging pension will be automatic or the default option (but not if it is an option that they can choose).

The government's proposed approach would involve calculating PPF compensation by actuarially converting bridging pensions into a flat-rate lifetime equivalent amount. The changes will only affect members of schemes that enter a PPF assessment period after the regulations come into force.

The consultation also notes that a pension can increase when a member reaches GMP pensionable age and the guaranteed minimum has to be paid. PPF compensation can therefore be lower than it would be if there was a similar smoothing or step-up applied. The government does not intend to address this issue at this stage but is interested in hearing about the number of members potentially affected and any views on whether it should take action in the future.

This and previous issues of WHiP can be found on our website **here**.

If you do not already subscribe to our pensions mailings and would like to do so, please email **pensions@traverssmith.com**.

Hyperlinks in this document can be clicked via an up to date version of Adobe Acrobat Reader. We are not responsible for the contents of external websites to which we provide links.

If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Susie Daykin, Daniel Gerring, David James, Dan Naylor, Paul Stannard and Philip Stear.

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7297 3000
F: +44 (0)20 7295 3500

www.traverssmith.com