

## 1. The Queen's Speech – Pensions

The Queen's Speech on 4 June 2014 announced proposals for two new Pensions Bills. The new legislation will (i) deliver the increased 'flexibility' changes to defined contribution ("DC") pension schemes revealed in the March 2014 Budget and (ii) inaugurate collective defined contribution ("CDC") schemes.

### *The Pensions Tax Bill*

The purpose of the Bill is to give effect to the changes to the pension tax rules giving individuals at retirement greater freedom and choice over how to access their DC pension savings.

In particular, from April 2015, individuals aged 55 or over will be able to withdraw all of their DC savings, subject to their marginal rate of income tax in that year rather than the current 55% charge for full withdrawals. The facility to take a tax-free lump sum, usually 25% of an individual's pot, will continue to remain available.

It is worth noting that taking benefits as a lump sum may push a member up into a higher tax bracket. A tax liability of 40% will be chargeable in circumstances where the individual's total income (outside of the personal allowance of £10,000 and any tax free lump sum) exceeds (currently) £31,865 a year; care would need to be taken to ensure that any flexibility afforded to withdraw pension savings is not outweighed by the risk of higher rate tax charges being levied.

Although annuity purchase will no longer be compulsory (and indeed has not been since 2011), the option to do so will, in principle, continue to be available for those who wish to have the security of a guaranteed fixed income whilst

### Key issues

1. The Queen's Speech – Pensions
2. High Court finds IBM in breach of its implied duty of good faith
3. Pensions Act 2014
4. New Money Purchase definition – regulations finalised

those individuals who want greater control over their finances will, as stated above, have the option to withdraw their savings at anytime via a variety of other means including unlimited drawdown.

The Bill will also introduce anti-avoidance provisions to prevent individuals taking advantage of the new flexible arrangements for tax avoidance purposes. The aim is for the Bill to be effective by April 2015.

#### **The Private Pensions Bill**

The Government is concerned that the increase in DC flexibility may lead to an increase in transfer requests from members of defined benefit ("DB") schemes. They are consulting on how to deal with this and one option appears to withdraw transfers from DB to DC. It remains to be seen whether the changes will be made. However, employers and trustees with DB schemes may wish to consider notifying members that this option may not be available in the long term (although care should be taken on how any such message is communicated).

Sponsored by the Department for Work and Pensions ("DWP"), the stated purpose of the Bill is to provide wider choice for individuals in the private pensions market.

The Bill will make provision for the Government's "defined ambition" pension schemes which allow for a greater degree of risk sharing between employers and employees.

A new legislative framework in relation to the different categories of pension schemes will establish three "mutually exclusive" definitions for scheme type, namely defined ambition ("DA"), DB and DC. Schemes will be defined according to the type of pensions promise offered,

so that, for example, DB will offer a promise on the full income, DA will offer a promise on part of the income or pension pot and DC, no promise at all.

The Bill will also include provisions relating to the "guidance guarantee" originally proposed in HM Treasury's consultation paper, "*Freedom and Choice in pensions*" which was published in March 2014. From April 2015, pension providers and trust-based schemes will be under a legal duty to offer each of their DC members at the point of drawing benefits, access to "free and impartial face-to-face guidance" on their financial choices in retirement. The aim is to ensure that individuals understand the choices open to them, how to engage with products and providers confidently and knowledgeably, and how to access independent financial advice in order to make the retirement decisions that best suit their needs.

Finally, the Bill will enable the establishment of CDC schemes. These schemes (which are modelled on those used in the Netherlands) essentially aim to mitigate investment risk by pooling the funds of workers from different companies. As with conventional DC schemes, the contribution levels are fixed and the level of pension depends on investment returns. However, instead of buying an annuity, the retiree receives an income from the fund which can be reduced if returns are poor. The scheme's liabilities will be equated to the scheme's assets by changing the level of indexation or revaluing members' benefits, so that no funding deficit can arise.

Whilst CDC schemes can achieve economies of scale by negotiating lower fees for fund management and

administration and can also invest in riskier, less liquid asset classes that might achieve higher returns, trustees of such schemes must balance the interests of retirees with those of current workers to ensure that the retirement income received by the current worker is not prejudiced because the scheme has run out of money.

## **2. IBM - High Court finds IBM in breach of its implied duty of good faith**

The High Court has provided some clarity on the circumstances in which an employer may be regarded as having breached its implied duty of good faith in relation to proposed changes to its pension scheme.

In particular, the case considers how an employer can create reasonable expectations for its pension scheme members regarding their future pension provision and the circumstances whereby a departure from such reasonable expectations can lead to a breach of the employer's implied duty of good faith to its employees. The case goes significantly further than previous cases on the subject and is likely to cause concern for employers which have made changes to their schemes.

However, it is important to remember that any breach of the duty will, in most cases, be specific to the particular facts of each case.

#### **Facts of the case**

The case concerned changes proposed in 2009 and made in 2011 by the claimants, IBM and IBM United Kingdom Limited ("IBM"), to its UK pension arrangements (the "IBM Schemes"), as part of a project known internally as "Project Waltz". The defendants were representative

beneficiaries, together with the trustee, of the IBM Schemes.

The Court had to consider whether IBM had breached (i) the implied duty of good faith (as set out in *Imperial*<sup>1</sup>) not to act, without reasonable and proper cause, in a way that is objectively calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee and (ii) the implied contractual duty under employment law not to seriously undermine the relationship of mutual trust and confidence that exists between an employer and employee.

#### **Implied duty of good faith**

The test for whether there has been a breach of the implied duty of good faith is a severe one – the employer's conduct must be so irrational or perverse that no reasonable employer would have acted in such a way.

The Court found that IBM's amendment exercises (which occurred prior to the Project Waltz changes) affecting the DB sections of the IBM Schemes had created "reasonable expectations" for members about the future of those schemes which they continued to hold, not unreasonably, at the time the Project Waltz changes took effect. IBM's proposed closure of the DB sections of the IBM Schemes to future benefit accrual as part of Project Waltz was pivotal to the employment relationship between IBM and its employees and inconsistent with the reasonable expectations that had been created.

Furthermore, although an employer is entitled to take into account its own financial interests when deciding how to exercise its powers under the pension scheme, the Court did not consider that the business reasons

advanced by IBM (both on a global level to make costs savings in order to meet its commitment to investors and on a local level where they had to address their lack of competitiveness and profitability, as demonstrated by their failure to meet their targets) were sufficient to justify making the changes.

Consequently, the closure of the DB sections to future benefit accrual, amounted to a breach of IBM's implied duty of good faith.

#### **Contractual duty not to undermine the relationship of mutual trust and confidence**

The Court also found that IBM's actions were in breach of its implied duty not to undermine the relationship of mutual trust and confidence when it indicated that there would be no salary increase **at all** in the future for those members who did not sign non-pensionability agreements.

In 2009, IBM announced that members would have to sign non-pensionability agreements in order to receive future salary increases. Although the Court agreed that in isolation, non-pensionability agreements were acceptable, the way these particular agreements were couched (in terms that were unilateral and high pressured) meant that the approach that had been taken was draconian, and consequently, IBM was held to have acted contrary to its implied contractual duty of trust and confidence.

In addition, the Court found that IBM's consultation with employees about the Project Waltz changes was not open or transparent even though it had been carried out in compliance with the relevant legislation. IBM did not take on board suggestions made by members during the consultation

process, had concealed the real reason for the changes from the members (i.e. to maintain business targets) despite repeated requests made by the pensions consultation committee for details of the business rationale behind Project Waltz, and failed to comply with its own Business Conduct Guidelines and Core Values which spoke of a mutual relationship of "honesty based on clear communication..." between IBM and its employees. Finally, it was apparent that IBM had come to a conclusion on the proposals before the consultation period had even ended.

#### **Comment**

We understand that IBM intends to appeal against the ruling in this case. However, in the meantime, employers who are considering closing their DB schemes to future accrual should note the legal principles arising from the case, as it currently stands.

While the facts of the case are unusual, it seems sensible that employers should resist the temptation to give assurances to the effect that no further changes are expected in relation to their pension scheme in the foreseeable future (as the IBM case clearly cautions against instilling any false hope even where such a statement is caveated by a significant change in financial and economic circumstances). Care should be taken in any communications exercise with members (especially where the communications require members to make decisions about their careers and retirement) not to give the impression of a promise or to create a reasonable expectation for members that the status quo will prevail.

### **3. Pensions Act 2014**

The Pensions Act 2014 received

Royal Assent on 14 May 2014. At the heart of the Act is the introduction of the single-tier state pension from 6 April 2016 which will replace the current basic state pension and state second pension ("**S2P**") with a flat-rate payment.

The abolition of S2P will spell the end of contracting-out on a salary-related basis and provisions have been included in the Act to give employers of contracted-out schemes the power to amend their scheme's rules to alter members' future accrual rates or increase their contributions to offset the cost to the employer of increased National Insurance contributions. Should they elect to do this, employers will need to comply with the minimum 60 days statutory consultation requirements.

Other notable changes include:

- Bringing forward the date at which the State Pension Age ("**SPA**") increases to age 67 to 2028 and providing the framework for SPA to be reviewed regularly.
- Restricting the charges that may be imposed on members of DC schemes and imposing new minimum quality standards in relation to the governance and administration for all DC schemes.
- Introducing a new framework for the automatic transfer of members' small DC pots to their new employer's pension scheme when they change employment.
- Introducing a new statutory objective for the Pensions Regulator effective from 14 July 2014.

## 4. New Money Purchase definition – regulations finalised

In the [December 2013](#) edition of our Pensions Update we reported on the DWP's publication of draft regulations implementing a new statutory definition of "money purchase benefits" under section 29 of the Pensions Act 2011. Section 29 provides that a benefit is only "money purchase" when it is calculated solely by reference to the particular assets i.e. the assets must always be sufficient to meet the scheme's liabilities with no possibility of a funding deficit.

The regulations supporting section 29 will now be split into two sets, the first having been laid in draft for approval before Parliament on 17 June 2014. The intention is for both sets to come into force at the same time as section 29, before the end of July 2014.

The crucial difference to note from the consultation draft relates to the backdated effect of the regulations with the result that in general schemes will not need to revisit past decisions. However, going forward, schemes with benefits that have been re-assigned as "money purchase" (namely those that offer any kind of guarantee, or that internally annuitise or provide underpin benefits) will need to take advice on how the new definition will affect them.

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<sup>1</sup> Imperial Group Pension Trust  
Ltd v Imperial Tobacco Ltd [1991]  
1 WLR 589.

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