CLIFFORD CHANCE

UK: PENSIONS UPDATE - SEPTEMBER 2017

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1. PROPOSED ACCOUNTING CHANGES MAY WARRANT RULE CHANGES

The International Accounting Standards Board has been consulting on proposed changes to IFRIC14 (which prescribes when it is possible for an employer to recognise a balance sheet asset for a pension scheme that is in surplus on the IAS19 basis).

The changes have not been implemented yet, but if they are implemented as currently proposed, an employer may no longer be able to account for a surplus assuming the gradual settlement of liabilities over time if the pension scheme trustees have a unilateral power to buy-out benefits in member names in a single event (regardless of whether or not the scheme's funding position would make this practically impossible).

The impact of this is could be that an employer would only be able to recognise an asset if there is a surplus in the pension scheme calculated on a buy-out basis (rather than an IAS19 surplus). The employer would also have to recognise an additional liability if they are making past service deficit contributions.

This is an issue which is likely to affect many employers (as a unilateral trustee buy-out power is a relatively common occurrence in pension scheme rules) unless action is taken before the proposed changes to IFRIC14 come into force.

At this stage, the changes are still in proposal form, but it is anticipated that the final form amendments will be issued later this year and that the amendments will apply to annual reporting periods beginning on or after 1 January 2019.

Employers should check their scheme rules to see whether or not they contain such a unilateral buy-out power and if so, may wish to consider implementing a rule change to amend the power (e.g. by introducing a requirement for employer consent). Discussions with trustees are likely to be required where their agreement is needed to make rule amendments.

2. CASE LAW UPDATE

IBM[1] – Court of Appeal

The Court of Appeal handed down its long-awaited judgment in the case of IBM last month. The Court upheld IBM's appeal and dismissed the representative beneficiaries' cross-appeal, deciding that IBM had not breached its implied duty of good faith or its implied contractual duty of trust and confidence in connection with the changes it had made to its defined benefit (**DB**) pension schemes and overturning the High Court's judgment (delivered by Mr Justice Warren). It is understood the representative beneficiaries will not be pursuing an appeal to the Supreme Court.

Background

Warren, J had previously ruled that IBM had breached its duties, in particular by: (i) creating "reasonable expectations" as part of previous benefit change projects for members that DB accrual would continue, which were then confounded when IBM later purported to close the

[1] *IBM United Kingdom Holdings Ltd and another v Dalgleish and others [2017] EWCA Civ 1212*

schemes to future accrual; and; (ii) asking employees to sign "non-pensionability agreements" (**NPAs**), under which future salary increases would not be pensionable. The Court of Appeal overturned these decisions.

Key points of interest

- The Court of Appeal said that where a case involves the exercise of an employer's discretion, a much more restricted approach should be applied in considering whether it is in breach or not of its implied duty. (Did the decision-maker take into account only relevant factors (and no irrelevant factors)? Was the decision one that no reasonable decision-maker could have reached?).
- Although expectations of employees (deemed "Reasonable Expectations" by Warren, J) can be a relevant factor to be taken into account by a decision-maker, they should *not* be afforded a special legal status which means they must be complied with unless there is some special change in circumstances. To elevate so-called "Reasonable Expectations" to a status where they have overriding significance over and above other relevant factors is incorrect.
- Even if Warren, J had been correct in giving special status to so-called "Reasonable Expectations" (which he was not), he still failed to apply the correct test because he came to a decision that there had not been a relevant change in financial and economic circumstances that justified departing from these Reasonable Expectations – however, the correct approach should have been whether Warren, J considered *IBM* could rationally have taken the view that there had been such a change.
- The Court of Appeal did not see that the long-term practice of IBM consenting to early retirement on favourable terms should be viewed as a positive reason that the policy would continue to be applied.
- Regarding the NPAs, failure or refusal to offer a pay rise to which an employee is not contractually entitled may in some circumstances be a breach of the implied duty of trust and confidence, but the circumstances have to be extreme (applying the rationality test). Warren, J did not apply this test to the NPAs and the Court of Appeal was of the view that, had he done so, he could not have found sufficient factual material to justify his finding that the imposition of NPAs as a condition of awarding a pay rise was itself a breach. The NPAs in this case were not substantially distinguishable from the NPAs in ***Bradbury v BBC*** (see below).

Warren, J's finding that IBM was in breach of its contractual duty in relation to the consultation process was not challenged and so was not considered by the Court of Appeal, but the Court did conclude it would not be appropriate to order IBM to carry out a further consultation before it can implement the scheme closures as this would change the position of IBM and the scheme members too radically. Members will, however, be able to claim damages for breach of the contractual duty in relation to the conduct of the consultation. (The Court of Appeal said that although the consultation regulations are clear that only the remedies set out therein are available for breach of those regulations, this does not affect remedies for breach of the contractual duty).

Employers may be relieved by the Court of Appeal's decision; in particular its departure from the High Court's approach to so-called "Reasonable Expectations", such that these do not need be given special status over other relevant factors in decision-making. However, it continues to remain important for employers to conduct consultation in an open and transparent manner when proposing benefit changes.

Bradbury v BBC[2] *- Court of Appeal*

In July, the Court of Appeal unanimously dismissed an appeal by Mr Bradbury against the imposition of a pensionable salary cap by his employer (the BBC) by way of NPAs.

The Court held that on a proper construction of the scheme rules, the BBC was permitted to determine whether a pay rise should be pensionable and the BBC had not breached its implied duty of trust and confidence in imposing the pensionable salary cap.

3. NEW MONEY LAUNDERING REGULATIONS COME INTO FORCE

New money laundering regulations[3] came into force on 26 June, replacing the old (2007) regulations. Updated HMRC guidance has also been published[4].

The old regulations required certain categories of person to register with HMRC and to put in place policies and procedures to monitor and manage money laundering and terrorist financing risks. The new regulations revise the

2 *Bradbury v BBC [2017] EWCA Civ 1144*

3 *The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.*

4 https://www.gov.uk/guidance/money-laundering-regulations-trust-or-company-service-provider-registration

regime, although the core principles underpinning it remain the same.

The drafting of the new regulations is open to interpretation and there are differing views across the pensions industry as to the extent to which the new requirements will apply to pension scheme trustees.

Broadly, the new regulations impose three key requirements:

1. **A requirement to register with HMRC and put in place policies and procedures to monitor and manage money laundering risks** (which, in principle, could apply to professional pension scheme trustees).

2. **A requirement to keep detailed records of information on all the trust beneficiaries** (which, in principle, could apply to all pension scheme trustees).

3. **A requirement to report information about the trust to HMRC via the Trust Registration Service, including information on all the trust beneficiaries** (which, in principle, could apply to all pension scheme trustees).

In relation to (1), HMRC's updated guidance specifically exempts professional trustees of occupational pension schemes from having to register with HMRC. It also provides that a dormant company that does not charge for its services will not fall within the scope of the regulations – often, pension schemes with a professional trustees are set up so the scheme trustee itself is a dormant company (and the professional trustee is one of the trustee directors), in which case, they would seemingly not be caught by the requirements referred to in (1) above.

In relation to the requirements in (2) and (3), there is some debate as to whether these only apply to professional trustees (who may then be exempt). However, even if this is not the case and trustees are considered to fall within scope, HMRC has helpfully confirmed in correspondence with the pensions industry that:

- HMRC acknowledges that some of the detailed information which trustees would be required to hold to comply with the requirement in (2) may be difficult for schemes to comply with and a proportionate approach should be taken, such that the requirement to maintain accurate and up-to-date records of all the beneficiaries and potential beneficiaries of the trust can be satisfied by keeping a record of the description of the class of beneficiaries and potential beneficiaries.

- In relation to (3), information only needs to be reported if in a given tax year the trustees of the scheme are liable to pay any of the following UK taxes: income tax, capital gains tax, inheritance tax or stamp duty (in relation to the assets or income of the trust). As for (2), a proportionate approach should be taken such that providing a more generic filing (a description of the class of the scheme's beneficiaries and potential beneficiaries) should be sufficient. Where reportable, the information should be reported by 31 January after the tax year in which the trustees incurred the relevant tax.

HMRC has indicated that further guidance will be provided this autumn and it is hoped this will provide further clarity for pension scheme trustees.

4. REDUCTION TO MONEY PURCHASE ANNUAL ALLOWANCE (POST FLEXIBLE ACCESS) TO GO AHEAD

The Government has confirmed that the Finance Bill 2017 policies announced prior to the snap general election to start from April 2017 will be effective from that date when they come into force.

This means that provisions which were left out of the Finance Bill 2017 (due to it being fast-tracked ahead of the election) will be reintroduced, including a reduction to the money purchase annual allowance from £10,000 to £4,000, which is to be contained in new legislation to be published later this year. The reduction will apply retrospectively to 6 April 2017 and therefore apply for the 2017/18 tax year onwards.

(The money purchase annual allowance applies where an individual has flexibly accessed their savings under a defined contribution arrangement in a particular tax year; in which case they become subject to a modified annual allowance of (currently) £10,000 in respect of future defined contribution savings made in the same tax year).

5. PENSIONS GREEN AND WHITE PAPERS

The Pensions Regulator and the Pension Protection Fund (**PPF**) have recently published responses to the green paper published by the Government earlier this year. The green paper was designed to start an informed discussion on perceived issues with the current regime of DB pension regulation. (Please see the *May edition of* *UK: Pensions Update* for more details).

The Pensions Regulator's response

The Regulator says it considers the DB funding regime to be working largely as Parliament intended, but agrees with the Government that it is right to "examine the evidence in detail" and flags a number of possible changes which it feels would support its vision for the future.

In particular, the Regulator proposes changes to its scheme funding powers, information gathering powers and the introduction of a DB chair's statement. Specifically:

- **Clearance**: the Regulator maintains its view that a blanket requirement on parties to obtain clearance ahead of any planned corporate activity would be disproportionate, although it remains open to proposals that would strengthen its clearance powers (e.g. by requiring clearance in some defined circumstances).
- **Funding**: the Regulator puts forward a case for creating greater flexibility in the scheme-specific funding regime, by giving the Regulator power to set standards (e.g. through detailed codes or guidance, supported by a legally enforceable "comply or explain" regime) rather than by passing legislation.
- **Trustee investment choices**: the Regulator notes its support for changes enabling trustees to take advantage of a wide range of investment opportunities and indicates that scheme consolidation may assist with this.
- **Affordability**: the Regulator acknowledges there may be a case for treating schemes with sponsors who can readily afford contributions differently from those where there is significant underfunding alongside sponsor financial constraint. The Regulator notes the Government's suggestion to cut indexation to reduce the burden on employers given that some schemes have been prevented from adopting CPI as their inflation measure by a "scheme rules lottery", but says it does not believe a move on this for schemes across the board could be justified.
- **Wind-up power**: the Regulator makes a case for strengthening its wind-p power to allow it to take into account of all its objectives when considering whether to exercise the power (rather than focusing solely on members' interests).
- **Information gathering powers**: the Regulator says it would benefit from stronger information gathering powers (namely, the ability to compel parties to submit to an interview where the Regulator believes they have information that could assist its casework, and a civil/administrative power to impose fixed and escalating civil penalties which require a lower burden of proof than the current criminal penalties).

The PPF's response

The PPF says that 'considerable risks' remain in the system and there is no doubt that *some* employers and *some* schemes are struggling, but it does not consider there is a case for radically overhauling the current framework. Specific aspects of the system could be developed to better manage risk, e.g. defining boundaries within the scheme funding regime, perhaps policed through a "comply or explain" mechanism. However, it does not believe there is a systemic affordability problem across DB schemes.

White Paper on the horizon

Following the above, the DWP has announced its intention to publish a white paper later this year setting out the Government's proposed next steps on what reform is needed to support the DB pension sector.

6. DWP RESPONDS TO CONSULTATION ON CHARGES AND GOVERNANCE

The DWP has published a response to its consultation on the draft *Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2017*, which closed earlier this year.

The regulations will impose a cap on 'early exit charges' in occupational schemes with effect from 1 October 2017.

'**Early exit charges**' are charges imposed on a member who has reached normal minimum pension age and is looking to take, convert or transfer their benefits, where the charges are only imposed/imposed to that extent because the member is doing this early (i.e. before normal pension age).

The cap will apply only to 'relevant schemes' – broadly, an occupational scheme which provides money purchase benefits (even if only Additional Voluntary Contributions).

The regulations will:

- Cap early exit charges at 1% for members who joined the scheme before 1 October 2017 (or such lower amount as was provided for under the scheme rules – if there is no provision under the rules, then no charges can be applied); and
- Apply a complete ban on early exit charges for members who join a scheme on or after 1 October 2017.

The regulations will also extend the current ban on member-borne commission arrangements to cover all such arrangements entered into before 6 April 2016 (where the commission payment is made on or after 1 October 2017). However, service providers will be allowed six months to make changes to their systems in order to comply, meaning the deadline in practice for compliance will be 1 April 2018.

7. DWP RESPONDS TO PENSIONS SCAM CONSULTATION

The DWP has published a response to the consultation it launched last December on measures to tackle pension scams. (For more details, please see the *February 2017 edition of UK: Pensions Update*).

The consultation proposed measures to tackle pension scams, which included: (i) imposing a ban on pensions cold calling; (ii) limiting members' statutory transfer rights; and (iii) making it harder for fraudsters to open new schemes.

1. *Imposing a ban on pensions cold calling*

The DWP confirms that the Government intends to proceed with legislating to implement a ban on pensions cold calling, although the final details still need to be worked out. Legislation will be brought forward when Parliamentary time allows.

2. *Limiting members' statutory transfer rights*

The consultation proposed to limit members' statutory transfer rights so they would only apply where:

- The receiving scheme is a personal pension scheme operated by a provider authorised by the Financial Conduct Authority;
- The receiving scheme is an occupational pension scheme and there is a genuine employment link to that scheme; or
- The receiving scheme is an occupational pension scheme which is an authorised master trust.

In its response, the DWP says it intends to implement these limitations, although further thought will need to be given as to how best to implement the employment link and to ensure members may still transfer to Qualifying Recognised Overseas Pension Schemes. The DWP will consider how the legislation to implement this can align with the roll out of the master trust authorisation regime (which will not be fully rolled out until 2019).

(The alternative options put forward in the consultation paper (including a new retirement for 'insistent' members looking to transfer to sign a discharge declaration), will not be pursued).

3. *Making it harder for fraudsters to open new schemes*

The Government intends to introduce legislation in the Finance Bill 2017 later this year aimed at ensuring that only active companies can register a pension scheme with HMRC (though HMRC will have discretion to register schemes with a dormant sponsor in legitimate circumstances).

8. OTHER PENSIONS NEWS IN BRIEF

- **New financial guidance body to be established**

Following consultation, the DWP has confirmed its intention to create a single body to provide debt advice, money guidance and pensions guidance, and over the summer, the Government introduced the Financial Guidance and Claims Bill. This will provide for a new body to replace the Money Advice Service, The Pensions Advisory Service and Pension Wise.

The new financial guidance body will be set up as an arm's-length body, accountable to Parliament and sponsored by the DWP. The new body will provide guidance and information on all matters relating to occupational and personal pensions.

- **DWP publishes report on State Pension age**

The DWP has published its final report on its first review of state pension age, as required by the Pensions Act 2014.

The report states that it is vitally important for the future of the state pension system to take account of increasing life expectancy.

The outcome of the report is that the Government intends to increase the state pension age from 67 to 68 in 2037-2039; seven years earlier than its currently legislated date. This is on grounds of affordability and evidence on the proportion of adult life spent in retirement. The Government does not intend to formalise policy beyond 2037-2039 at this stage given the uncertainty of life expectancy projections, although says it is minded to commit to "up to 32%" as the right proportion of adult life to spend in receipt of state pension.

The DWP acknowledges this is a significant change and it will carry out a further review before bringing forward the rise in state pension age to 68.

- **Judicial review of LGPS investment guidance**[5]

The High Court has permitted an application for the judicial review of the investment guidance governing the investment strategy for the Local Government Pension Scheme (**LGPS**) issued by the Secretary of State for Communities and Local Government in September 2016.

The investment guidance included requirements that administering authorities must not: (i) use pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries except where

5 *R (Palestine Solidarity Campaign Ltd and another) v Secretary of State for Communities and Local Government [2017] EWHC 1502 (Admin)*

the Government has put in place formal legal sanctions, embargoes and restrictions; or (ii) pursue policies that are contrary to UK foreign policy or UK defence policy.

The application for judicial review was granted on the grounds that the Secretary of State did not have authority

to make such requirements and it fell outside the proper scope of the Secretary of State's powers.

Since the application was permitted, the LGPS investment guidance has been reissued (July 2017) with the offending provision removed.

- **British Steel pension restructuring approved**

The Pensions Regulator has given initial approval to a proposal from Tata Steel UK to restructure the British Steel Pension Scheme and prevent the company becoming insolvent.

The restructuring will be effected by way of a regulated apportionment arrangement (**RAA**). The scheme will receive £550 million from the Tata Steel Group and a 33% equity stake in Tata Steel UK.

Following completion of the RAA, scheme members will be able to choose either to transfer to a new scheme sponsored by Tata Steel UK or to remain in the existing scheme, which will transfer to the PPF.

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