Institute and Faculty of Actuaries

BAKER & MCKENZIE

Case Law and Pensions Ombudsman Update

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Case law update

"Sale" of section 75 debts	Trustee of the Singer & Friedlander Pension Scheme v Corbett
Section 75 / Interests of the Employer	Merchant Navy Ratings Pension Fund Trustees v Stena Line and others
Pension scheme changes	IBM v Dalgleish (where are we now?)

“Sale” of Section 75 debts | Singer & Friedlander

Singer & Friedlander

Background

- Arising out the failure of Kaupthing, Singer & Friedlander (Icelandic Bank) (entered administration in October 2008)
- A Section 75 debt of nearly £74m was triggered
- October 2014 – Trustees had received dividends from administration (recovered just over £60m of section 75 debt – 81.5p in the £)
- Administration unlikely to be completed until 2017
- Administrators estimated Trustees would ultimately receive around 85p in the £
- Trustees wanted to wind up the Scheme
- Brokers willing to purchase section 75 debt for 90p in the £

Issues

- Court was asked to consider whether:
  - section 75 debts are capable of assignment; and
  - whether a reasonable and properly advised Trustee could effect such an assignment

Singer & Friedlander

Findings

- Can a section 75 debt be assigned?
  - Debts are generally capable of assignment
  - Nothing in section 75 which says a section 75 debt should be treated differently
  - No public policy grounds to deny assignment
  - Considering moral hazard powers:
    - If a debt were assigned this may result in inconsistencies with the Pensions Regulator's moral hazard powers
    - The moral hazard "overlay" arguably changes the nature of a section 75 debt
  - BUT these were not reason to prevent assignment

Findings

- Could a reasonable and properly advised Trustee assign the debt?
  - The Trustees indicated they would study the market and obtain professional advice
  - If that was done, Court said it is a decision Trustee could reasonably and properly take in the circumstances

- An interesting conclusion:
  - PPF eligibility issues (albeit not relevant in this case)
  - The purchaser has taken the view he could recover more
  - Query whether decision will be of much wider application?
  - Would such an approach be available if scheme not in winding up?

Section 75 / Interests of the employer | The MNRPF Case

The MNRPF Case

Two relevant issues

Should trustees take into account the interests of employers?

1

What is the status for Section 75 debt purposes of a scheme which has closed to future accrual but retains enhanced benefits for current employees?

2

The MNRPF Case

Background

Non-sectionalised industry-wide defined benefit occupational pension scheme

Closed to future accrual in 2001

Power of amendment vested in Trustee (no employer consent required)

Contribution regime introduced in 2001 made 40 Current Employers liable for entire deficit; 200 Historic Employers had no liability to contribute

Trustee applied to Court for approval of revised contribution regime under which all employers would be liable to make deficit contributions

The MNRPF Case

Employers' interests

> as long as the primary purpose of securing the benefits due under the Rules is furthered and the employer covenant is sufficiently strong to fulfil that purpose, it is reasonable and proper should the Trustee consider it appropriate to do so, to take into account the Employers' interests both when determining whether to widen the pool of those liable to contribute and when considering whether to seek to reduce the element of cross-subsidy.

The MNRPF Case

Employers' interests

May be appropriate for trustees to take into account employers' interests, e.g. in the context of funding discussions

But:

- Must ensure member security is not prejudiced
- Does not impose an obligation on trustees to consider employers' interests
- Guidance given in context of deciding how to apportion liabilities amongst employers in an industry-wide multi-employer scheme

The MNRPF Case

Section 75 debts

Certain members remained entitled to revaluation of their benefits at a higher rate so long as they continued to be employed by a Current Employer

Court held that MNRPF was nonetheless a frozen scheme for Section 75 debt purposes:

- no Section 75 debt triggered when a Current Employer ceases to employ members entitled to enhanced revaluation, but
- Current Employers remain potentially liable for a Section 75 debt in the event of insolvency or scheme wind-up whether or not they subsequently cease to employ members entitled to enhanced revaluation

The MNRPF Case

Section 75 debts

Same reasoning could be said to apply to schemes which retain a final salary link (or other form of enhanced benefit for current employees) following a scheme closure

But we do not regard the position as entirely resolved

Scheme changes | IBM (where are we now?)

The IBM Case

Background

- IBM United Kingdom Holdings Limited and another v. Dalgliesh and others
- 30 days in the High Court in 2013
- 435 page judgment from Warren J issued on 4 April 2014
- 228,000 words
- 28,000 pages of trial bundles
- “Liability judgment” does not address consequences of the Court’s findings
- **Remedies** dealt with at a separate hearing
  - judgment handed down on 20 February 2015
- Further hearings have been held on other consequential and procedural issues related to the liability and remedies judgments

The IBM Case

What were the main issues?

- IBM closed its Plans to further Defined Benefit (DB) accrual in 2011 and made other related changes (Project Waltz)
- Did IBM breach its duty of trust and confidence towards Plan members in doing so?
  - Did it act “irrationally or perversely”?
  - What was the significance of the members’ “Reasonable Expectations” that DB accrual would continue?
- Did IBM breach its duty to consult in good faith with the membership?
  - Was it transparent in giving its reasons?
  - Did it consult with an open mind?
- Focus here on the so-called *Imperial* duty of trust and confidence (but the case also decided / confirmed some important points on construction of scheme rules and effect of restrictions on power of amendment)

The outcome and lessons to be learned

IBM breached its duty of trust and confidence to the members:

- The changes were contrary to the members' "Reasonable Expectations" that DB accrual would continue (Projects Ocean and Soto in 2004 and 2006)
- IBM acted "irrationally or perversely" when acting contrary to those "Reasonable Expectations"
- IBM did not consult meaningfully with members

Implications

- Mere existence of "Reasonable Expectations" not fatal to future changes
- Consider carefully prior communications and documentation to establish what "Reasonable Expectations" the members may have
- The employer's business case may be key – be open and transparent about it
- Consult with members frankly and with an open mind
- Communicate with members and trustees carefully
- If you are a trustee – check the employer is observing these requirements

Where are we now? (Remedies and Appeal)

- **Liability judgment:**
  - changes not necessarily swept away entirely / deferral to accommodate "Reasonable Expectations" / may not necessarily prevent future changes
- **Remedies judgment:**
  - "Reasonable Expectations" longstop – 31 March 2014
  - Exclusion notices (closure to accrual): voidable
  - Non-pensionability agreements (cap pensionable salary): unenforceable
  - New early retirement terms: old policy continued to 31 March 2014
  - Damages (in principle) available for breaches of contractual duty
- **Appeal:**
  - IBM has been given permission to appeal liability and remedies judgments
  - May go to Supreme Court
  - Ancillary litigation from members

Application of IBM since the judgment (1)

- *UC Rusal Alumina Jamaica and others v Miller and others*
  - Privy Council in November 2014 (Jamaican pension scheme, return of surplus)
  - refusal of consent by employer to allow increase to pensions on winding up – in order to maximise surplus
  - ultimately remitted to court of first instance in Jamaica for reconsideration
  - potential importance of "Reasonable Expectations" to *Imperial* duty recognised
  - *IBM* a high-water mark?

Application of IBM since the judgment (2)

- *Bradbury v British Broadcasting Corporation*
  - Pensionable salary cap (1% p.a.)
  - Breach of implied duty of trust and confidence?
  - Mr Bradbury argued various grounds for breach including that changes breached his "Reasonable Expectations" that:
    - scheme rules would be complied with and followed in making any changes
    - the definitions of "pensionable salary" and "basic salary" would be honoured
  - **Warren J dismissed the appeal**
    - **"Reasonable Expectations" vs "mere expectations"**

Application of IBM since the judgment (3)

- Ombudsman decision (*Thomson – PO 1203)*
  - Decision not to grant further discretionary increases
  - Complainant argued “Reasonable Expectations” as to future increases
    - past custom and practice
    - assurances given in 2002
  - Ombudsman: *Imperial* duty test a “severe” one
    - past practice not sufficient to give rise to “Reasonable Expectations”
    - more than a statement of intention would be required
  - Distinguished *IBM*

Pensions Ombudsman determinations

Today's selection……

- **Section 75 - a disclosure duty for trustees?**
- **Pensions liberation - the Ombudsman's approach**
- **Commutation factors - review by GAD**

Section 75 employer debt

A duty on trustees to warn employers?

Section 75 employer debt | Albermarle Baptist Church (774) (December 2014)

Issue

Trustee not obliged to warn employer of potential section 75 liability arising

Facts

- Baptist Ministers' Pension Fund - c1000 participating employers (individual churches)
- Each Church typically employs one active member from time to time (i.e. the local minister)
- Employer debt legislation: debt may arise when participating employer ceases to employ an active member where at least one employer continues to do so – employment cessation event (ECE)
- Minister leaving = potential debt trigger
- Since 2005, 400 ECEs had occurred (!)
- **One Church complained to the PO:**
  - trustees should have warned it of implications of section 75 before Church rejoined the Fund in 2007
  - had it been aware, would not have let minister join Fund

Determination

- **Complaint dismissed:** no duty on trustees to warn employers of a potential section 75 debt arising
- Trustees correct to interpret Church as an employer for these purposes
- PO agreed with trustees that no responsibility on trustees to inform participating employers of:
  - the implications of the employer debt regime; nor
  - the ability of a particular employer to avoid triggering a debt using the period of grace mechanism

Commentary:

- practice v legal obligation
- "non-genuine" ECE v "genuine" ECE

Pensions liberation

The Ombudsman's first determinations: transfers made, not made and contractual rights

Liberation: no transfer made | Stobie (3105) (January 2015)

Issue

No statutory right to transfer but provider to consider exercising discretion to pay non-statutory transfer

FACTS

- Mr S: Self Invested Personal Pension with Standard Life (SL) – requested a transfer
- SL suspected pensions liberation: newly registered scheme, newly registered non-trading company
- Discretion under SIPP rules to pay non-statutory transfer – not considered
- SL declined to transfer
- **Mr S complained to the Ombudsman**

***NB: Kenyon (1837), Jerrard (3809)** – technicality: not ops because did not identify a clear class or description of people for whom to provide benefits

****NB: Hughes (7126)** - discretionary power not exercised and not criticised by PO

DETERMINATION

Claim partially upheld:

- no statutory right to transfer because not an "earner" so not possible to secure "transfer credits"*
- but provider should have considered exercising non-statutory transfer power

PO observations:

- trustees/providers "find themselves in a highly unenviable position"
- suspicions about liberation may justify delay to ask relevant questions
- but a transfer could only be withheld beyond the statutory payment period if there were no right to it
- if trustees/providers conclude there is no right to payment, they should be able to justify that

Direction: SL to consider exercise of its discretion if new request made but "serious note of caution" to Mr Stobie**

Liberation: transfer made | Johnston (75869) (June 2015)

Issue The primary question was whether there is a legal right to transfer

FACTS

- Mr J was a member of the Prudential Pension Plan
- October 2012, Prudential received completed documentation, including discharge form signed by Mr J, scheme HMRC registration number scheme and transfer request from Barncroft Associates
- Prudential verified scheme's HMRC registration, and made the transfer (c£18,000)
- Mr J was unable to obtain any further information about his pension fund from the scheme, its trustees or Barncroft Associates
- **Mr J complained to the Ombudsmen that Prudential transferred his pension without making sufficient checks on the receiving scheme**

DETERMINATION

Complaint dismissed:

- Any maladministration making the transfer: had Pru considered their legal obligations to Mr J and acted in line with good industry practice?
- Transfer application seemed to comply with the requirements for acquiring and exercising statutory CETV right; confirmation funds to provide benefits consistent with the Scheme's HMRC registration
- Mr J's statutory right to take a CETV overrode any degree to which Prudential had a duty of care to him
- Regulator's guidance to providers about pension liberation not issued until February 2013, after this transfer took place
- Guidance could be "regarded as a point change in what might be regarded as good industry practice"; Ombudsman could not "apply current levels of knowledge and understanding of pension liberation/scams or present standards of practice to a past situation."

There had been no administrative failure by Prudential

Liberation: contractual right to transfer | Harrison

(3184) (April, 2015)

Issue | **Provider directed to make transfer where member had contractual right**

FACTS

- Mr H was a deferred member of the Prudential Pension Scheme aged 45 in 2013
- Rules provided for member to direct the administrator to transfer funds to another registered pension scheme on request, provided not an unauthorised payment
- Mr H requested transfer to the Cheshire Food Services Pension Scheme (CFSP), purported occupational scheme, administered by Active SSAS Admin Limited
- Active SSAS sent transfer request to Prudential
- Prudential requested and received CFSP's tax registration and trust deed and rules
- Prudential advised would not make the transfer because suspected liberation: (1) Mr H under age 55 (2) Active SSAS only recently registered as a company (3) CFSP only recently registered with HMRC
- **Mr H complained to the Ombudsman that he had a right to transfer**

DETERMINATION

Complaint upheld:

- Contractual rights under rules must be allowed to be exercised, even where they are at odds with statutory rights (here ss94 -95 PSA did not apply as transfer would not have secured "transfer credits")
- Statutory right takes precedence over any regulatory guidance or rule
- Prudential failed to make a detailed analysis to establish if member had a statutory or a contractual right to transfer
- While regulatory guidance from the Pensions Regulator and FCA can be used by a provider to justify detailed enquiries, it cannot be used to frustrate legally established rights
- Mr H had a contractual right to transfer, even though statutory CETV conditions not made out: **Ombudsman had no choice but to direct the provider to make the transfer**

Pensions Ombudsman

Commutation factors and the Government Actuary's Department: the *Milne/Firefighters'* case

Commutation factors and the GAD | Milne (1327) (May 2015)

Issue — **Is the failure to update commutation tables a form of maladministration?**

FACTS

- Mr M complained that GAD should have reviewed and revised commutation tables between a 1998 review and his retirement in late 2005
- Mr M retired at age 50, taking maximum cash £111,038 using 1998 tables
- Rule B7 of Schedule 2 of the Firefighters' Pension Scheme Order 1992 provided for a lump sum of :

  "the actuarial equivalent of the commuted portion at the date of retirement, calculated from tables prepared by the Government Actuary..."

- **Mr M complained to the Ombudsman that using outdated commutation tables gave him a lower lump sum than he should have**

BACKGROUND AND CONTEXT

- March 2009: Court held GAD was under an implied duty, acting for the Government Actuary:

  "to prepare tables and, if necessary, to review and revise them, because they are needed to enable the police authorities to comply with their express obligation to use them"

  (Police Federation case/Police Pension Scheme)

- Nature of the duty on GAD under the Firefighters' Pension Scheme Rule B7 was materially in the same terms as Police Pension Scheme
- Implication: GAD had an implied statutory obligation to review the commutation factors

Commutation factors and the GAD | Milne (1327) (May 2015)

Issue | **Is the failure to update commutation tables a form of maladministration?**

PO JURISDICTION?

GAD said:

- as the Ombudsman's jurisdiction did not cover disputes of fact or law with an administrator, such as GAD, complaint must be limited to one of maladministration
- an error of law, such as a failure to recognise an implied statutory duty, did not equate to maladministration
- so no jurisdiction

The Ombudsman said:

- it had jurisdiction to handle complaints made against a "person responsible for the management of the Scheme" (s146 PSA and regulations)
- GAD was such a person but only in relation to a complaint for maladministration, not a dispute of fact or law
- but it did not follow that a potential breach of law would automatically exclude implied statutory duty issue from the Ombudsman's jurisdiction because of:

  "a considerable degree of overlap between the breach of law and maladministration"

- maladministration was capable of including matters for which there is a legal remedy

Commutation factors and the GAD | Milne (1327) (May 2015)

Issue | **Is the failure to update commutation tables a form of maladministration?**

A LITTLE MORE BACKGROUND

- Originally, GAD instigated review of tables and provided new tables to relevant authority
- Early 1990s, change - GAD worked on basis that Department for Communities and Local Government, as scheme manager, commissioned reviews
- Reviews in 1982, 1986, 1994, 1998 then 2006
- In Police Federation, the aim of rule B7 was to:

"*provide a certain, statutory procedure for achieving actuarial equivalence, consistent with the aim of the Regulations generally to provide clearly identifiable pension benefits in return for officers' service and payment of contributions*."

- Achieved by the rules expressly providing for tables to be prepared by the Government Actuary (and therefore GAD as its agent)
- This gave GAD an implied obligation "to prepare tables and, if necessary, to review and revise them" from time to time
- Courts have held that it is not necessarily maladministration for a decision-maker to take a wrong view of the law

Commutation factors and the GAD | Milne (1327) (May 2015)

Issue Is the failure to update commutation tables a form of maladministration?

DETERMINATION

- GAD should not have switched to an arrangement by which it waited for instructions from the Department to review factors
- GAD made its switch to waiting to be commissioned to review the tables without considering whether it should do so or not
- Passive acquiescence to the change in its responsibility led to it acting inconsistently with the rules by neglecting its implied duty to review

= maladministration

- Even if GAD had been correct in thinking it did not need to initiate reviews, within its limited capacity as body responsible for producing the tables, it should have advised the Department of the need to undertake reviews either at regular intervals or in light of specific developments

PO DIRECTION

- Mr M should be put back in the position he would have been in if the reviews that GAD failed to bring about had taken place before he retired in November 2005
- GAD to pay Mr M simple interest on any resulting back-dated lump sum payment and any tax liability if HMRC did not treat any back-dated payment as part of his tax-free lump sum

Wider implications for Scheme Actuaries?

Where will this end:

- Ombudsman acknowledged complexities of duty of care, allocation of liability and practical arrangements to remedy GAD's maladministration
- "rough and ready" justice?
- further litigation/appeal?

Statutory schemes v non-statutory schemes:

- Wording of scheme rules may be key
  - "actuarial equivalence"
  - "calculated from table prepared by…"
  - "trustees determine, on the advice of the Actuary"?

How frequently to review: valuation/inter-valuation?

Any Questions?

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