



N A B A R R O

CLARITY MATTERS

# Recent case law and future implications

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# IBM plans – the facts

- One corporate trustee responsible for 3 trusts:
  - IBM Pension Plan  
("Main Plan" – Open & Closed, DB and DC sections)
  - IBM IT Solutions Pension Scheme  
("I Plan" – Open DB)
  - Group Life Assurance  
("GLA" – death benefits only)
- 60,000 members
- £7 billion assets



# A history of scheme change.....

## *Project Ocean (effective April 2005)*

- Increase in member contribution rates
- Parent company guarantee of employer funding obligations for ongoing accrual, deficit repair and statutory employer debts to 2014
- Employer contributions of £200m for 3 years

## *Project Soto (effective 6 July 2006)*

- Member choice of:
  - continued DB accrual with 2/3 pay rise pensionable; or
  - enhanced DC accrual with full final salary linkage to DB benefits
- Payment into Plans to eliminate funding deficit
- Extension of Guarantee to 2017



# Introduction to the “good faith issue: IBM’s May 2009 actions

*Project Waltz (Presented to Trustee in May 2009 and to employees in July 2009)*

- 5000 employees affected
- 5 elements:
  - 1) Closure to future DB accrual from 6 April 2011 effected by exercise of unilateral “exclusion power” in the Rules
  - 2) Sever final salary linkage through “Non-Pensionability Agreements” from 2009 so pay rises only pensionable for DC purposes
  - 3) New restrictive early retirement policy (i.e. no consent from active status unless exceptional circumstances) with effect from 6 April 2010



## *Project Waltz (cont.)*

- 4) Early retirement window: from 21 October 2009 to 16 November 2009 members could apply to go early ... subject to:
  - Company's decision by 4 December 2009, then 7 days to accept offer
  
- 5) Hybrid deferred membership of the DC Section of Main Plan with effect from 6 April 2011:
  - Final salary linkage (but remember the Non-Pensionability Agreements)
  - 2 year enhanced Employer contributions
  - Statutory revaluation underpin
  - Ill health early retirement benefits



# Going to Court

- 6 weeks trial in February to April 2013
- 20 factual witnesses  
(including 11 from Representative Beneficiaries)
- 4 expert witnesses on actuarial and accountancy matters
- Judgment on 4 April 2014
- 435 pages
- 1596 paragraphs and 5 annexes
- 9 day “Remedies Hearing” in July 2014 to establish key legal principles relevant to remedies



# Project Waltz – the legal issues

1. Was the Main Plan “unilateral exclusion” power validly introduced?
2. Was the manner in which the power was exercised within the scope of the power itself?
3. Was the power exercised for an improper purpose?
4. Did IBM act contrary to its duty of good faith when:
  - exercising the exclusion powers?
  - requiring members to sign NPAs?
  - implementing the early retirement window?
  - implementing the “new early retirement” policy?
  - inviting the Trustee to exercise its discretion to admit members to the M Plan (DC) section?
  - implementing Project Waltz generally?





# The Court's answers in April 2014

Exclusion powers:

1. *Was the Main Plan power validly introduced?*

Yes, but final salary linkage retained

2. *Was the manner in which the power was exercised within the scope of the power itself?*

Yes

3. *Was the power exercised for an improper purpose?*

No



... but

4. *On the question of acting in “good faith”:*

IBM was found to have acted in breach of its contractual duty of trust and confidence and in breach of its implied duty of good faith when:

- implementing the Project Waltz changes (including the early retirement window and new early retirement policy); and

- presenting DB active members with a choice of signing a Non-Pensionability Agreement or receiving no future pay rises



# The Court's reasoning...

- Project Waltz was inconsistent with members' “reasonable expectations” and disappointment of those reasonable expectations went to the heart of IBM's relationship with its employees
- Communications giving rise to the reasonable expectations were given as the basis on which members would take decisions relating to careers and retirement
- IBM UK and its parent company should have adopted proposals to meet their objectives that were consistent with members' reasonable expectations



# In particular...

- The early retirement window was unreasonably short
- No reasonable employer would have adopted the Project Waltz proposals in the form they took in 2009
- The employer was in breach of its “Imperial” duty of good faith
- The employer was also in breach of its contractual duty of trust and confidence in respect of the Non-Pensionability Agreements entered into in 2009



# Lessons learned

The Court's findings were very fact specific to IBM but nevertheless there are wider implications:

- Trustees:
  - Taking on a new scheme / potential cans of worms
  - Considering employer proposals about future service changes
  - Implementing NPAs / other “extrinsic contracts”
- Employers:
  - Avoiding the creation of “reasonable expectations”
  - Acquiring DB schemes through share purchases
  - Entering into valid NPAs / extrinsic contracts



# Plus...

- Pay attention to the correct procedures
- The detailed Trust Deed & Rules wording really matters
- Record keeping is vital
- Give enough time for member decision-making
- Dealing with “opportunistic” member complaints



# The Gleeds story...

- Gleeds Retirement Benefits Scheme established in 1974 by interim trust deed; definitive trust deed and rules in 1979
- Employers were all partnerships
- Law of Property (Miscellaneous Provisions) Act 1989
  - “An instrument is validly executed as a deed by an individual if, and only if –*
    - a. It is signed –*
      - i. By him in the presence of a witness who attests the signature; or*
      - ii. At his direction and in his presence and the presence of two witnesses who each attest the signature ...”*
- No partner signatures were witnessed



# Over time...

Changes made by deed included:

- Barber equalisation in 1991
- Second Definitive Deed in 1993
- Various deeds of appointment and removal of trustees
- New money purchase section for all new members in 1997
- Introducing member contributions for DB members, reducing DB accrual and removing a minimum 4% pension increase guarantee in 2003
- Change of Principal Employer in 2004
- New money purchase section in 2005
- Closure to future DB accrual in 2006
- New Rules in 2008

£45m increase to liabilities if the deeds were ineffective





# Issues raised with the Court

- Can the Scheme members be prevented from saying that the deeds are ineffective (an “Estoppel Argument”)
- Who are the Trustees?
- Has the amendment power been validly exercised?
- Have pension increases validly been granted?
- Is there still final salary linkage?
- Has a promise to members (an “extrinsic contract”) been made outside the Scheme?

End results: some employees were never members; some members received a windfall



# Pop quiz about executing deeds: valid or invalid?

1. A party signs in the wrong place
2. An individual's signature is witnessed, but the witness does not provide their address
3. The execution clause refers to a company seal, but two directors have signed without using a seal
4. A party pre-signs a blank document onto which the deed is printed and signed by everyone else
5. The parties sign different copies (counterparts) of the deed, but the deed does not expressly say that this is allowed



# MP or not MP, that is the question

- Pre 24 July 2014:
  - *“benefits the rate or amount of which is calculated by reference to payments made....and which are not average salary benefits”*
- On and from 24 July 2014 (but retrospective to 1 Jan 1997):
  - *“benefits the rate or amount of which is calculated by reference to payments made....and which fall within section 181B”*
  - *section 181B: rate or amount calculated solely by reference to assets which (because of the calculation) must necessarily suffice*



# Transitional regulations to “rewrite the past”

- The Regulations apply to:
  - Cash balance benefits
  - Money purchase underpin benefits; top-up benefits
  - Pensions derived from money purchase benefits, cash balance benefits, underpin or top-up benefits
- “Cash balance” benefits means:
  - A sum of money is available under the scheme to provide the benefit; and
  - There is a promise under the scheme about the amount of that sum, but no promise about the rate of amount of pension it will provide

Cash balance benefits are now not money purchase benefits, but may have been treated as MP benefits in the past



# Example...

- **Rule X:** The Trustee will maintain a Retirement Credit Account for the Member
- **Rule Y:** The Trustee will credit to a Member's Retirement Credit Account:
  - A sum equal to any Retirement Credit Contributions paid by or on behalf of the Member; plus
  - Credited Interest
- **Credited Interest** means: “interest on any contribution, as determined by the Trustee with actuarial advice, but no less than 2.5% pa.”
- **Rule Z:** On retirement, the Member gets the sum (including Credited Interest) in the Retirement Credit Account



# So...?

- “Cash balance” benefits means:
  - A sum of money is available under the scheme to provide the benefit [YES – the Retirement Credit Account under Rule X]; and
  - There is a promise under the scheme about the amount of that sum [YES – the Retirement Credit Account with Credited Interest at no less than 2.5% pa under Rule Y], but no promise about the rate of amount of pension it will provide [TRUE – operation of Rule Z]
- But the Trustee (and employer) historically had run the Scheme as if this was a money purchase benefit structure, as the benefits were calculated by reference to the payments made into the Retirement Credit Account



# The answer is: MP is not MP

- And the future consequences for this scheme include:
  - These benefits are now subject to the statutory funding regime and PPF valuation requirements as DB benefits
  - No requirement to send “Statutory Money Purchase Illustrations” to members
  - CETV “realisable value” requirements will apply
  - Different indexation and revaluation requirements may apply
  - Member communications will need to be updated
  - Winding up priority will change
  - Employer debts may trigger
  - Need to appoint an Actuary



# ... or is it?

- Note that cash balance schemes are “**shared risk schemes**” – not DB schemes – under the Pension Schemes Bill 2014
- And in “Freedom and Choice in Pensions” the Government stated that from April 2015, individuals with **Defined Contribution** pension savings will, for example, be able to take their funds from age 55 (ie “Lamborghini pension provision”) and ...

<sup>1</sup> When this document is describing the tax rules and proposed changes to those rules, the term “defined contribution” should be taken to mean both money purchase and cash balance savings as those terms are defined for tax purposes in section 152 Finance Act 2004 (meaning of “arrangement”)

So cash balance benefits are DC, not DB .....  
... for these purposes only?  
... perhaps?  
... (did I mention that none of this is advice?)





