

What's happening in Pensions



Issue 53

August 2015

In this issue:

Assessing the employer covenant: TPR guidance

Summer Budget

Annual allowance taper and pension input period changes
Fundamental reform of pensions taxation?
Pension Wise
Right to sell annuity income
Unfunded EFRBSs

GMP equality

DC decumulation flexibilities

Government consultation on transfers with early exit charges
TPR and FCA surveys
Work and Pensions Select Committee inquiry

Finance Act 2004 tax regime

Overseas transfers: new ROPS list
Finance Bill
Lifetime allowance reduction

Proposed EU IORP II directive

Pensions scams

Pensions Ombudsman determinations
New "scorpion" campaign materials
"Project Bloom"

State pension reform and the abolition of contracting-out

Regulations
Guidance on the new state pension for those who have been contracted-out

Appeals to the Court of Appeal

IBM
Meaning of "benefits accrued due"

Pensions Ombudsman: redress for non-financial injustice

Automatic enrolment: compliance and enforcement

Assessing the employer covenant: TPR guidance

The Pensions Regulator has published new guidance for DB scheme trustees on assessing and monitoring the employer covenant. This is the first in a series of guides for trustees relating to the revised DB scheme funding code of practice that took effect in July 2014 (see **WHiP Issue 47**). That code advocates an integrated approach to managing scheme risks, under which the employer covenant, investment and funding are considered together.

Covenant is described in the code by reference to the employer's legal obligation and financial ability to support the scheme now and in the future (a departure from the previous code which only referred to ability and willingness to fund the scheme). This guidance expands on this new formulation of covenant and is broadly in line with the approach taken in other Regulator guidance, including the clearance guidance. In particular, the statutory employers are central to covenant (together with any other legal obligations to the scheme, such as guarantees or other contingent assets). There is also guidance on covenant assessment for "last man standing" and formally segregated schemes, and schemes with partial winding-up rules.

The guidance describes how to go about assessing covenant proportionately to the circumstances and risks, and it includes illustrative examples. It addresses the responsibilities of trustees in:

- understanding the strength of the employer covenant and the risks to the scheme;
- approaching the assessment process and engaging an external covenant adviser;
- monitoring the covenant and contingency planning; and
- taking action to improve scheme security.

There are appendices applicable to schemes sponsored by not-for-profit organisations and non-associated multi-employer schemes (such as industry-wide schemes).

Press release:
<http://www.thepensionsregulator.gov.uk/press/pn15-39.aspx>

The guidance says that, as a minimum, trustees should undertake a full covenant review at each actuarial valuation but also monitor the covenant regularly between formal reviews and have "well-developed contingency plans so they can take prompt and effective action when required".

Summer Budget

The Summer Budget included the following pensions announcements.

Annual allowance taper and pension input period changes

As had been expected, the Government will introduce a taper to the annual allowance for high earners from 6 April 2016. This will mean a lower annual allowance and (where applicable) money purchase annual allowance for most individuals with adjusted annual incomes over £150,000. ("Adjusted annual income" includes taxable income plus employee pension contributions paid from pre-taxed income and the value of employer DC contributions or the employer-funded element of DB accrual.)

In connection with this, and unexpectedly, pension input periods are being aligned with tax years. There are special transitional provisions for the 2015-16 tax year, involving two "mini-tax years".

Please see our briefing note **Pension input periods and the tapered annual allowance** for details of these changes and the implications for trustees.

A new Finance Bill includes the draft legislation to implement these changes.

Fundamental reform of pensions taxation?

The Government is consulting on whether there is a case for a fundamental reform of pensions tax relief, in order to encourage saving for retirement. It says that it is concerned that the complexity of the current system may be undermining the incentives for pension saving and that individuals may engage more readily with a simpler system.

The Government suggests as one possible outcome that the current "EET" (Exempt-Exempt-Taxed) system could be replaced by a "TEE" system similar to that applicable to ISAs. Contributions would be paid from taxed income, with a Government top-up, and benefits would be paid tax free.

The Government also asks if DB and DC members should be treated differently for tax purposes.

The consultation runs until 30 September 2015.

Pension Wise

Access to Pension Wise, the free pre-retirement guidance service set up by the Government, is to be extended to those aged 50 and above, from a date yet to be announced. There will also be a new marketing campaign to promote the service.

Right to sell annuity income

The Government will set out its plans for a secondary annuity market in the autumn, with its proposed implementation now delayed until 2017. (See **WHIP Issue 51** for background.)

Unfunded EFRBSs

The Government will consult on tackling the use of unfunded employer-financed retirement benefit schemes (ie, unregistered pension schemes) to obtain a tax advantage in relation to remuneration. No further detail has yet been given.

GMP equality

The Pensions Ombudsman has determined that the trustees of the Campden R.A. Pension Scheme were entitled to delay equalising benefits under the scheme to remove the effect of GMP inequalities until the Government's current deliberations in this regard are complete. The scheme was not in winding-up.

Whilst the Ombudsman's determination of Dr Kenworthy's complaint will be of some comfort to other contracted-out DB schemes still paying benefits with GMP-related inequalities, there are reasons for caution.

In the 2001 case, *Marsh Mercer Pension Scheme v Pensions Ombudsman*, the High Court held that the then Ombudsman had exceeded his jurisdiction in directing GMP equalisation. The Court held that he should have either (a) declined to determine the complaint or (b) limited his determination to the benefits of the complainant, Mr Williamson.

It is difficult to reconcile the Ombudsman's determination in this latest *Campden* case with the High Court's judgment in *Marsh Mercer*. The Ombudsman did not decline to determine Dr Kenworthy's complaint but nor did he give a determination as to whether or not Dr

Summer Budget documents:
<https://www.gov.uk/government/topical-events/budget-july-2015>

HMRC policy paper:
<https://www.gov.uk/government/publications/pensions-tapered-annual-allowance>

HMRC technical note:
<https://www.gov.uk/government/publications/pensions-technical-note-transitional-provisions-for-aligning-pension-input-periods>

Finance Bill:
<http://services.parliament.uk/bills/2015-16/finance/documents.html>

Consultation on tax reform:
<https://www.gov.uk/government/consultations/strengthening-the-incentive-to-save-a-consultation-on-pensions-tax-relief>

Determination:
<https://www.pensions-ombudsman.org.uk/determinations/2015/po-4579/campden-r-a-pension-scheme/>

Kenworthy is entitled to levelled-up benefits under the law as it presently stands.

Dr Kenworthy, like Mr Williamson, may feel that he has been thwarted in his request for a clear ruling on his entitlements under current law. Determinations of the Pensions Ombudsman can be appealed to the High Court but costs and the amount of additional benefit involved usually mean that cases such as this are not appealed.

Please see our briefing note **Equalisation of benefits that include GMPs and WHiP Issues 32 and 38** for background on the legal developments in this area.

DC decumulation flexibilities

Government consultation on transfers and early exit charges

The Government is consulting on questions around exit charges and transfer processes. Although framed as a consultation, it reads like a call for evidence in that it asks a lot of questions but contains almost no proposals.

The Government is seeking to establish whether:

- individuals face unjustifiable exit charges for accessing their benefits flexibly or transferring them to another arrangement (investment deductions, such as market value adjustments, are not in scope);
- transfer processes can be made quicker and smoother; and
- improvements can be made to the requirements for appropriate independent advice (in relation to the transfer of safeguarded (broadly DB) benefits worth more than £30,000).

The consultation is short on proposals regarding **exit fees and charges** but there are suggestions of imposing a cap for those aged 55 and over, or perhaps a more flexible variation on that theme. A voluntary approach to restricting exit fees and charges will also be considered.

The Government asks for views on adopting a separate process for **transfers** of flexible (broadly DC) benefits. The consultation paper refers to the seven day switching scheme for bank current accounts as an example of an industry being able to make a transfer process smoother and more efficient.

The Government asks for evidence of how the requirement for **appropriate independent advice** is working in practice and how it could be improved. It stresses that DC benefits with guaranteed annuity rates (GARs) are safeguarded benefits and so within this regime if they are worth at least £30,000.

The consultation closes on 21 October 2015 and a response is expected shortly thereafter. There is also an online survey for individuals.

TPR and FCA surveys

The Pensions Regulator has begun its survey of the prevalence of exit fees and charges and transfer processes in occupational pension schemes. The Regulator is surveying a "representative sample of schemes" and its findings will be passed to the Government.

A similar exercise by the Financial Conduct Authority is underway in relation to personal pensions. The FCA's investigation also asks providers to say what flexible options they offer and covers advice requirements and the treatment of insistent clients (ie, individuals who act contrary to the advice they receive).

Work and Pensions Select Committee inquiry

The Work and Pensions Select Committee, chaired by Frank Field MP, has launched an inquiry into "*whether people are adequately supported in making good, informed decisions about their retirement savings in light of the changes on access to pensions and pension drawdown introduced in April 2015*".

Finance Act 2004 tax regime

Overseas transfers: new ROPS list

HMRC has published a new, significantly reduced, list of "recognised overseas pension schemes" (ROPSs). A qualifying ROPS (or "QROPS") is an overseas scheme to which a transfer can be made from a registered pension scheme without it being an unauthorised payment.

HMRC's ROPS list had been withdrawn, mainly so that schemes could be removed if they failed to confirm that benefits could not be paid before age 55 (other than in circumstances of serious ill health) (see **WHiP Issue 52**). This has been a requirement for a ROPS since 6 April 2015.

The list of nearly 4,000 schemes has been reduced to fewer than 700. For example:

Consultation:

<https://www.gov.uk/government/consultations/pension-transfers-and-early-exit-charges-consultation>

Press release:

<http://www.thepensionsregulator.gov.uk/press/pn15-28.aspx>

Press release:

<http://www.fca.org.uk/news/the-new-pension-flexibilities>

Inquiry:

<http://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/inquiries/parliament-2015/pension-advice-15-16/>

HMRC ROPS list:

<https://www.gov.uk/government/publications/list-of-qualifying-recognised-overseas-pension-schemes-qrops>

- There were previously around 1,600 Australian schemes on the list; there is now only one (a local government scheme). (In Australia, pension benefits can normally be accessed early in cases of financial hardship.)
- The list of over 700 Irish schemes has been reduced to 56.

HMRC does not warrant that any scheme on the ROPS list is in fact a QROPS, or even a ROPS. However, a "good faith release" from a scheme sanction charge (but not an unauthorised payment charge) can apply to trustees who make a transfer to a scheme that is on the list.

Trustees should not, therefore, assume that every scheme on the list is a QROPS but they should not make a transfer to an overseas scheme that is not on the list and should re-check the list immediately before making the transfer. The list is updated twice a month.

Finance Bill

The new Finance Bill includes draft legislation providing that lump sum death benefits paid from a registered pension scheme or non-UK scheme on the death of a member over age 75 will be taxed at the marginal rate of income tax that applies to the recipient. This applies where the benefits are paid to an individual who is the "ultimate beneficiary". Where the recipient is a trust or a company without a marginal tax rate then the special lump sum death benefits charge will still apply. This change applies to payments made on or after 6 April 2016 (even if the death occurred before then).

Lifetime allowance reduction

HMRC's "Pension schemes newsletter 70" confirms that fixed protection and individual protection will be available in relation to the reduction of the lifetime allowance from £1.25 million to £1 million from 6 April 2016 (see **WHIP Issue 51**). It also says that HMRC is considering removing the usual deadlines for applying for these protections. Discussions with stakeholders are taking place and more details are expected in September and in a Finance Bill to be published later in the year.

Proposed EU IORP II directive

The European Parliament's Economic and Monetary Affairs Committee has published a draft report on the revised IORP Directive proposed by the European Commission (see **WHIP Issue 45**). Significant amendments are recommended. The key ones affecting UK pension schemes are as follows:

- The development of EU solvency models such as the holistic balance sheet should be ruled out, on the basis that they are *"not realistic in practical terms and not effective in terms of costs and benefits"*.
- The requirement for a cross-border scheme to be fully funded "at all times" should be replaced by a requirement that all schemes (whether cross-border or not) are fully funded when they are established. (As drafted, this could apparently be satisfied simply by starting with small, fully funded benefits for a single member.)
- The "fit and proper" requirements for individual trustees should be replaced by a requirement that trustees' knowledge and experience are "collectively adequate".
- Detailed rules for the two-page pension annual benefit statement that a scheme would be required to give to members should be replaced by more general principles, with flexibility over implementation given to EU member states.

Pension scams

Pensions Ombudsman determinations

There is now a steady stream of Pensions Ombudsman determinations appearing in relation to suspected pension liberation scams. The determinations issued so far by the new Pensions Ombudsman, Anthony Arter, are entirely consistent with those of his predecessor (see our briefing note **Pension liberation: Issues for trustees (an update)** and **WHIP Issue 52**).

The following determinations by Mr Arter are indicative examples.

Refusal to transfer to a suspected liberation scheme

In his first pension liberation determination as the new Ombudsman, Mr Arter rejected a complaint by Miss D-M Hughes against Royal London over its refusal to transfer the cash equivalent of her personal pension benefits to a suspected pension liberation scheme.

Miss Hughes requested a transfer to a single-member, registered small self-administered scheme (SSAS) named after her home address and set up by a new company with which she had just entered into an employment agreement. The company was dormant and no salary was paid to her. Miss Hughes' evidence indicated that she had been cold-called by

Finance Bill:

<http://services.parliament.uk/bills/2015-16/finance/documents.html>

HMRC Newsletter 70:

<https://www.gov.uk/government/publications/pension-schemes-newsletter-70-july-2015/pension-schemes-newsletter-70-july-2015>

Draft report:

<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fNONSGML%2bCOMPARL%2bPE-565.015%2b02%2bDOC%2bPDF%2bV0%2f%2fEN>

Determination:

<http://www.pensions-ombudsman.org.uk/determinations/2015/po-7126/royal-london-personal-pension/>

First Review Pension Services, which had introduced her to the company that set up the scheme, Bespoke Pension Services Limited. A Gibraltar-based investment company was to have been used to invest in property in Cape Verde.

Royal London refused to make the transfer. It did not spell out its reasons but Bespoke, acting as Miss Hughes' representative, challenged what it thought would be the reasons. The Ombudsman rejected the complaint.

The Ombudsman took the usual starting position of assuming that the SSAS was not a mere sham. Consistent with decisions of his predecessor, he found that the proposed receiving scheme was an occupational pension scheme but that Miss Hughes was not an earner in relation to it. The transfer would not, therefore, be to secure transfer credits under the scheme, as required by the transfer legislation, so there was no statutory transfer right.

The Royal London scheme rules gave Royal London a discretion to transfer anyway but the Ombudsman determined that it had not acted improperly in deciding not to make the transfer.

The Ombudsman criticised Royal London for not having properly communicated its concerns, which Royal London accepted, but he made no award for that.

Transfer made unwittingly to a suspected liberation scheme

Mr Johnston applied for a transfer from his Prudential personal pension to the Capita Oak Pension Scheme, via a firm called Barncroft Associates, in autumn 2012. Prudential checked that the scheme was indeed a registered pension scheme and transferred £18,643.

When Mr Johnston stopped hearing from the Capita Oak scheme trustee and could not contact it, he complained that Prudential should have made better checks before making the transfer. Prudential argued that they had followed the correct process at that time (which was before the Pensions Regulator issued guidance in February 2013).

The Ombudsman decided that there was no administrative failure in complying with the transfer request. He held that Mr Johnston was not right to say that Prudential should have carried out greater due diligence. To the extent that Prudential had a duty of care to Mr Johnston, *"it would have been overridden by a statutory duty to make the transfer and simply met by doing as he apparently wished"*.

New "scorpion" campaign materials

The Pensions Regulator is focusing its pension scam warnings on the public. It has added more materials to its website, alerting individuals to pension scams. These include a video message and a new infographic poster.

"Project Bloom"

The Government has issued a press release to raise awareness of pension scams. It mentions that "Project Bloom" has been set up to tackle pension liberation fraud. This multi-agency group is led by the National Crime Agency. Its members also include the DWP, the Pensions Regulator, the FCA, HMRC, the Serious Fraud Office and the National Fraud Intelligence Bureau.

The press release also includes tips for individuals for staying safe and two case studies.

State pension reform and the abolition of contracting-out

Regulations

The Government has published a short consultation response and laid final regulations (though with more to come) on the requirements with regard to the treatment and protection of contracted-out rights after contracting-out is abolished in April 2016.

These regulations will replace provisions of the 1996 contracting-out regulations and supplement amendments to the Pension Schemes Act 1993 made by the Pensions Act 2014 (see **WHiP Issue 46**) and earlier regulations giving employers a statutory power to reduce future service benefits and/or increase member contribution rates in order to neutralise the cost of increased employer National Insurance Contributions (see **WHiP Issue 51**).

Points of interest include the following:

- The Government considers that no action is necessary to help schemes that take account of the basic state pension in their benefit design after state pensions are reformed in April 2016. That is, the Government says, because the basic state pension will still be paid to individuals who reached state pension age before 6 April 2016 and so the figure will still be published officially in an annual uprating order.
- It is confirmed that no "protection rule" is required in scheme rules in respect of members whose contracted-out service ends on 5 April 2016 when contracting-out is

Determination:

<http://www.pensions-ombudsman.org.uk/determinations/2015/po-5869/prudential-personal-pension-plan/>

Press release:

<http://www.thepensionsregulator.gov.uk/press/pn15-33.aspx>

Press release:

<https://www.gov.uk/government/news/government-warning-arm-yourself-with-the-facts-dont-lose-your-pension-to-scammers>

Consultation documents:

<https://www.gov.uk/government/consultations/occupational-pension-schemes-abolition-of-defined-benefit-contracting-out>

Regulations:

<http://www.legislation.gov.uk/uksi/2015/1452/contents/made>

abolished. (This is a rule that is currently required to be included when a scheme ceases to be contracted-out, or in anticipation of that happening, to ensure that benefits are underpinned by properly revalued contracted-out rights.)

- An order saves some provisions of the 1993 Act that were due to have been repealed, for the purposes of allowing trustees and HMRC "to carry out any necessary activity" after 5 April 2016 in relation to contracted-out rights accrued before then. These savings operate until 5 April 2019 (with some continuing thereafter). The saved provisions include (among others) those that set out the contracting-out reference scheme test (RST): these are saved so that schemes with an RST underpin can continue to operate on that basis while the Government thinks about what to do about this in the longer term.

The Government still needs to decide what to do in several other areas. There will be further consultations on the following:

- What restrictions will apply to the amendment of formerly contracted-out rights: in the meantime, regulation 42 of the 1996 contracting-out regulations is retained in its current form.
- Amendments to the 2013 disclosure regulations: this may lead to disclosure requirements for trustees relating to the abolition of contracting-out.
- Amendments to the 1996 contracting-out transfer regulations: these will amend provisions relating to transfers from contracted-out schemes.

The DWP and HMRC are working on guidance for scheme administrators which is due to be published in early 2016.

See our briefing note **State pension reform and the end of contracting-out** for background.

Guidance on the new state pension for those who have been contracted-out

The Government has published guidance for individuals on the effect of having been contracted-out on their new state pension calculation. It is intended to explain why their state pension may be lower than they might expect.

Savings order:

<http://www.legislation.gov.uk/uksi/2015/1502/contents/made>

Guidance:

<https://www.gov.uk/government/publications/new-state-pension-if-youve-been-contracted-out-of-additional-state-pension>

Appeals to the Court of Appeal

IBM

The High Court has granted permission to appeal to the Court of Appeal in the case concerning IBM's duties to its employees when taking decisions in relation to its pension scheme, including terminating DB accrual. See **WHIP Issues 46** and **51** for summaries of the High Court judgments.

Meaning of "benefits accrued due"

In *Sterling Insurance Trustees Ltd v Sterling Insurance Group Ltd*, the Court of Appeal is expected to consider the meaning of the phrase "benefits accrued due in respect of any member" in an amendment power restriction.

In this case, an amendment had terminated the accrual of final salary benefits and severed the final salary link for past service benefits. The Court will consider whether this was in breach of the amendment power, which restricted the amendment of "benefits accrued due ...".

This question was not argued in the High Court. The judge granted permission to appeal, noting that it will be desirable for the Court of Appeal to consider this question and, in doing so, the High Court decisions in *Re Courage Group Pension Schemes* (1986) on the meaning of "benefits already secured by past contributions" and in *Briggs v Gleeds* (2014) (see **WHIP Issue 46**) on the meaning of "accrued benefits".

Pensions Ombudsman: redress for non-financial injustice

The Pensions Ombudsman has published a factsheet about the awards he might (and might not) make for non-financial injustice such as distress and inconvenience.

The only change in policy is that awards for "significant" non-financial injustice will now usually be not less than £500, to reflect inflation and "to bring us in line with industry practice" (ie, what other Ombudsman services award). Previously, awards of £50 to £250 were common.

In a statement to Professional Pensions, Mr Arter added:

"When considering whether to uphold a complaint concerning maladministration, we will take into account an offer made which was in line with our previously

Pensions Ombudsman web page:

<https://www.pensions-ombudsman.org.uk/wp-content/uploads/NFI-factsheet.pdf>

published guidance where it was made before the publication of our revised approach to non-financial redress."

Automatic enrolment: compliance and enforcement

The Pensions Regulator has published updated versions of its "*Compliance and enforcement strategy for employers subject to automatic enrolment duties*" and "*Compliance and enforcement policy for employers subject to automatic enrolment duties*". These documents set out the Regulator's approach to enforcing compliance with the automatic enrolment duties.

TPR policy documents:
<http://www.thepensionsregulator.gov.uk/doc-library/strategy-and-policy.aspx#s10490>

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, Peter Esam, Daniel Gerring, David James, Dan Naylor, Paul Stannard and Philip Stear.

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

www.traverssmith.com