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What's Happening in Pensions

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Finance Act 2017

The government withdrew swathes of content from the Finance Bill in order to be able to get it enacted before Parliament was dissolved on 3 May for the 8 June general election. The Bill received Royal Assent on 27 April 2017 and became the **Finance Act 2017**.

The Act includes measures announced at the Spring Budget (see **WHiP Issue 63**). It introduces a 25% overseas transfer charge on transfers to overseas schemes in some circumstances (see below) and makes changes to the taxation of foreign pensions.

Omitted provisions

The pensions provisions that were removed were those relating to:

- the reduction of the money purchase annual allowance from £10,000 to £4,000; and
- the improvement of the income tax exemption for employer-arranged pensions advice, including an increase from £150 to £500 and no requirement for the full cost of the advice to be within that limit. (This is not to be confused with the "pension advice allowance", which is already law – see below.)

These changes were meant to have been made from 6 April 2017. The government **said in Parliament** that (if re-elected) it will introduce a new Finance Bill including all the removed provisions at the earliest opportunity after the election.

There is uncertainty about whether the effective date for reducing the money purchase annual allowance will still be 6 April 2017. See our **briefing note** for a discussion of this.

The overseas transfer charge

A 25% tax charge applies to some overseas transfers formally requested on or after 9 March 2017 (the day after Budget day). The "overseas transfer charge" applies to a transfer to any qualifying recognised overseas pension scheme (QROPS) unless (broadly) both the individual and the receiving arrangement are resident in the same country or in different EEA countries, or the QROPS is provided by the individual's employer. The individual's residency requirement applies in the tax year in which the transfer was made and the following five tax years, so the charge can become due later if the individual moves. On the other hand, the tax is refundable if he or she becomes resident in the same country as the QROPS in that period.

The charge is to be deducted from the transfer payment and paid to HMRC by the transferring scheme or provider. If the charge applies later then payment is the responsibility of the QROPS manager. In either case, the individual is jointly and severally liable.

The charge can also apply to an onward transfer made by a QROPS to another QROPS in the tax year in which the original transfer was made or any of the following five tax years.

Trustees and providers making overseas transfers must inform HMRC about them (this is the case whether or not the overseas transfer charge applies). There are also requirements for giving information to members.

Transfers to an overseas scheme that is not a QROPS continue to be unauthorised payments: as such, they are subject to an unauthorised payments charge and a scheme sanction charge.

"Optional remuneration"

The provisions of the Bill relating to optional remuneration (eg, salary sacrifice and flexible benefit programmes) were retained. There is a general clampdown on the tax and National Insurance advantages of such arrangements but with specified exceptions, including in relation to pensions.

The final language of the Act has the effect that salary sacrifice (or flexing) for retirement benefits retains the tax and National Insurance advantages. However, salary sacrifice (or flexing) for the provision of death benefits under an unregistered scheme (eg, an excepted group life scheme) has lost its tax and NIC advantages from 6 April 2017, though there are limited transitional exceptions for existing arrangements. The position as regards death benefits provided under a registered pension scheme is not entirely clear. HMRC guidance may clarify the position.

Pension advice allowance

Final regulations have confirmed the detail of the "pension advice allowance". From 6 April 2017, individuals are permitted to access up to £500 from their DC pension savings to pay for "retirement financial advice", if their scheme rules allow. They may do this at any age, but only once in a tax year, up to a maximum of three times in all. The regulations have introduced a new authorised payment: a "pension advice allowance payment". See our **briefing note** for details.

Conservative Party plans for new Pensions Regulator powers

Theresa May has announced Conservative Party plans to give greater powers to the Pensions Regulator in relation to corporate acquisitions and dividend payments if the Conservatives win the general election. They include powers for the Regulator "to scrutinise takeovers and unsustainable dividend payments that threaten the solvency of a pension scheme". The Regulator could "be given new powers to block a takeover". There could also be punitive fines for leaving a pension scheme under-resourced; directors could be struck off; and there could be a criminal offence of intentionally or recklessly threatening a scheme's solvency.

Our **briefing note** considers the available detail of the proposals and the extent to which they might be implemented.

Pension protection levy

The 2017/18 levy

The PPF finalised its **pension protection levy determination** for 2017/18. There were no changes of substance to the determination and guidance published provisionally in December 2016 (see **WHiP Issue 62**). For all of the PPF's 2017/18 levy documents, see **here**.

The determination includes the previously proposed (see **WHiP Issue 63**) separate rule (C5) and **Appendix** for schemes that cease to have a substantive sponsor following a restructuring. The PPF also issued a **policy statement** on that separate rule. The PPF will consult again on the rules for such schemes before finalising the 2018/19 levy rules.

The next triennium

The PPF **has consulted** on proposals to change the pension protection levy rules for the three levy years beginning with 2018/19. The PPF seeks only to make significant changes to these rules every three years (triennium) and the time has come for the latest review. The conclusions will be published in the autumn alongside draft levy rules for 2018/19.

Contingent assets: Of particular note, the PPF is proposing:

- that in order to certify or recertify a very high value parent company guarantee (£100 million or higher is proposed), a guarantor strength report must be prepared by a professional adviser. The report must demonstrate that the guarantor would be able to meet the terms of the guarantee in the event of the employer's insolvency. This reflects concerns that the PPF continues to reject a sizeable proportion of the guarantees that it reviews;
- changes to its methodology where the guarantor is also an employer;
- allowing trustees to certify separate realisable recovery amounts for each of multiple guarantors (without there being any change to their joint and several liability under the guarantee);

- a full review of the standard form contingent asset agreements. NB following this review, all existing contingent asset agreements would have to be amended/re-executed before the end of March 2018 in order to be recognised for the 2018/19 levy year; and

- changes in relation to the assessment of asset-backed contribution arrangements that are based on unsecured loan notes.

Insolvency risk scores: The PPF's proposals focus on two ways in which it plans to develop the approach to measuring insolvency risk.

- There are proposals to revise how employers are allocated to scorecards, to introduce two new scorecards (in place of "Large and Complex" and "Independent Full") and to rebuild the "small accounts" scorecards (where insolvency predictions have proved to be the least accurate). These changes aim to improve predictions and tailor scorecards better to company size. This is intended to result in SMEs and 'not-for-profits' paying levies that better reflect their risks.

- The PPF proposes to adopt the use of credit ratings for some of the largest employers and a specific methodology for regulated financial services entities.

The PPF expects almost two thirds of schemes to see a reduction in levies. However, some schemes (one fifth is estimated) – particularly some of those with very large employers – would see an increase.

The PPF seeks views on the benefits of continuing with monthly scores or moving to an assessment at 31 March each year. Scores will only be measured, at the earliest, from October 2017 for the first year of the triennium.

Schemes can view the implications of these proposals for their scheme and its employers on the PPF score portal (**www.ppfscore.co.uk**).

Other: The PPF also seeks views in other areas, including some suggested by the Work and Pensions Select Committee (see **WHiP Issue 62**). These include the possibility of a levy discount for good governance and reducing the administrative burden for smaller schemes.

Pensions Regulator: investment guidance

The Pensions Regulator has published new DB **investment guidance** for trustees. It follows the common principles set out in the Regulator's July 2016 **DC investment guidance** (see **WHiP Issue 59**) with specific considerations for DB schemes. The guidance is linked to the Regulator's code of practice on DB scheme funding.

The guidance includes sections on:

- Governance, including the trustee board's role in investment governance, working with investment advisers and preparing the statement of investment principles.

- Investing to fund defined benefits. This includes guidance on setting an appropriate investment strategy (which the Regulator considers to be a key part of an integrated risk management approach), understanding investment risks and using models to help in setting the investment strategy.

- Using matching assets, understanding the risks of matching assets and the requirement for scheme assets to be properly diversified.

- Understanding growth assets and the risks involved and putting in place appropriate methods to manage those risks.

- Implementing a DB investment strategy and understanding and managing the associated risks.
- Monitoring the scheme's investments and investment strategy.

New option for deferring an employer debt

The government **is consulting** (until 18 May 2017) on a proposal to allow employers who have an employment-cessation event under a multi-employer scheme to defer, subject to several conditions, paying their section 75 debt and instead continue to be treated as if they were still a scheme employer for funding and other purposes. (Having an "employment-cessation event" broadly means ceasing to employ any active members.) This will be called a “deferred debt arrangement” and will apply to multi-employer schemes for associated or non-associated employers. The option would be available from 1 October 2017.

Respondents to the March 2015 government call for evidence in relation to schemes for non-associated employers (see **WHiP Issue 51**) pointed out that single employer schemes can be frozen when the employer no longer has any active members, so avoiding the trigger of a section 75 debt, but there is no similar option for an employer in a multi-employer scheme.

The proposed conditions for a deferred debt arrangement are that:

- The “funding test” already used for some apportionment arrangements is satisfied. This involves the trustees being reasonably satisfied that ongoing funding will continue to cover technical provisions (ie, that all contributions due under the schedule of contributions will continue to be paid) and that the arrangement will not adversely affect benefit security.
- The trustees consent in writing.
- The scheme is not in a PPF assessment period or likely to start one in the next 12 months (or in winding-up).

A deferred debt arrangement would come to an end, potentially triggering a section 75 debt, if:

- The employer once again employs an active member (in which case an employment-cessation event is treated as not having occurred and so no section 75 debt is triggered).
- The employer decides and the trustees agree. (It is not clear why trustee agreement should be needed.)
- A relevant event (other than an employment cessation event), eg, insolvency or winding-up, occurs in relation to the employer.
- The employer "restructures" (this is not defined).
- A freezing event occurs in relation to the scheme. (It is not clear why this should trigger the debt.)
- The trustees are reasonably satisfied that the employer has failed to comply with its scheme funding obligations and serve a notice on the employer.
- The trustees have reasonable concerns about the weakening of the employer covenant in the next 12 months and serve a notice on the employer.

RPI and CPI: *Thales* case

In a case involving the Thales UK Pension Scheme, the **High Court** has interpreted scheme rule provisions on the circumstances in which RPI can (or must) be replaced with an alternative index for the purposes of uprating pensions. The provisions have some idiosyncrasies, and the judge interpreted terms by reference to their particular context, but the judgment will be of some assistance when considering the meaning of other schemes' rules which include similar expressions.

The judge held that scheme rule provisions had been triggered that allow RPI to be replaced when RPI is "altered" or "its compilation is materially changed". In the circumstances, however, there was no scope within those rules to move to an index other than the altered RPI.

The judge added generally that it would require "exceptional circumstances" for trustees to adopt an alternative index, such as CPI, in order to reduce company costs if in doing so they would be acting to the detriment of scheme beneficiaries.

Transfers of contracted-out rights

The government has briefly **consulted on** and **responded** to limited proposals for facilitating the transfer of contracted-out rights in payment to a scheme that has never been contracted-out. Further proposals may follow.

Amending regulations have been introduced to correct a disparity between the legislation relating to the transfer with consent of contracted-out rights in payment, as compared with those not yet in payment. Transfers of contracted-out rights in payment cannot be made with the member's consent under legislation as it currently stands.

The regulations are intended to help achieve scheme restructuring plans, perhaps with the BHS scheme in mind, and so only apply in very limited circumstances. The government laid the regulations very quickly but, due to the dissolution of Parliament for the general election, they will not come into force until 3 July 2017.

The changes will allow the transfer of GMPs and/or section 9(2B) rights in payment with the pensioner's consent where there is a regulated apportionment arrangement or the scheme is in a PPF assessment period. Further conditions for making such transfers are that the individual:

- consents to the transfer in writing;
- acknowledges in writing to the transferring scheme the receipt of a statement showing the benefits to be credited in respect of the transfer; and
- acknowledges in writing to the transferring scheme that the credited benefits may be in a different form and amount and that there is no statutory requirement on the receiving scheme to provide survivor's benefits.

The government confirms that it intends "to consider extending the transfer of pensioner members to new schemes more generally in the near future together with bulk transfers that are made without member consent".

Pension Schemes Act 2017

The **Pension Schemes Bill** received Royal Assent on 27 April 2017 and became the **Pension Schemes Act 2017**. The Act includes provisions for regulating master trusts and in relation to DC early exit charges.

Regulation of master trusts

The bulk of the Act's content concerns a new regime for authorising and supervising master trusts. This is designed to address concerns about the sustainability of some of the dozens of master trusts that have been set up following the introduction of automatic enrolment. Key elements are as follows.

- Master trust operators will need to be authorised by the Pensions Regulator, which will maintain a list of authorised schemes.
- The Regulator must be satisfied that the scheme meets five criteria:
  - Key individuals must be "fit and proper" persons.
  - The scheme must be financially sustainable. It must have a sound business strategy (including a written business plan) and sufficient financial resources to meet the costs of setting up and running the scheme and to comply with the requirements that apply on discontinuance (see below).
  - The scheme's financial backer (the "scheme funder") must be a separate legal entity which carries out no other functions.
  - The scheme's "systems and processes" must be adequate. (Regulations will set out what this means.)
  - There must be a "continuity strategy", setting out how the interests of members will be protected in the event of certain specified "triggering events" (see below), and administration charge levels.
- Annual accounts for the scheme and scheme funder must be submitted to the Regulator. The Regulator may also, no more than once a year, request a "supervisory return" from the trustees. There will also be a duty for specified persons to notify the Regulator of "significant events" (which will be described in regulations).
- In the event of a "triggering event", the Regulator and employers must be notified and an implementation strategy must be submitted to the Regulator for approval. Triggering events include the proposed withdrawal or refusal of authorisation, the scheme funder's insolvency, a decision to terminate the scheme, and the trustees deciding that the scheme is at risk of failure. Unless the situation is rectified, members' accrued rights must be transferred out and the scheme must then be wound-up.

Trustees of existing master trusts have six months from when the authorisation provisions are commenced to apply for authorisation or to decide to wind up the scheme. The commencement date is expected to be 1 October 2018. However, the Act purports to impose notification and discontinuance funding obligations for existing schemes from 20 October 2016 (the date the Bill was first published). Those provisions are commenced from the date of enactment (27 April 2017) and apply to master trust schemes then in existence and any new master trusts set up after that date.

DC early exit charges

The Bill also includes very short provisions allowing the government to make regulations that will override contracts to restrict DC early exit charges. The government is consulting on regulations to cap such charges at 1% for existing contracts and 0% for new contracts (see below).

Early exit charges and member-borne commission

The government **is consulting** (until 31 May 2017) on draft regulations to introduce restrictions on DC early exit charges and extend the prohibition on member-borne commission payments.

From 1 October 2017, the regulations would:

- introduce restrictions on early exit charges payable by members of occupational pension schemes providing money purchase benefits. These reflect equivalent provisions already applied by the FCA in relation to personal pensions since 31 March 2017. Broadly, early exit charges cannot be higher than 1%; existing early exit charges below 1% cannot be increased; and new early exit charges cannot be made.

- extend the existing prohibition on member-borne commission payments by occupational pension schemes used for automatic enrolment, to cover contracts entered into before 6 April 2016. The existing prohibition of member-borne commission payments only applies to new contracts entered into since that date: see **WHiP Issue 56**.

Pensions Ombudsman: compensation for non-financial loss

The High Court has urged the Pensions Ombudsman to increase his upper limit for compensation not infringing legal rights from £1,000 to £1,600. (This is often referred to as compensation for non-financial loss or for distress and inconvenience.)

In ***Baugniet v Capita Employee Benefits and the Department for Education***, the Teachers' Pension Scheme issued an incorrect transfer-in service credit quotation to Dr Baugniet. By the time the matter was resolved, there was an embargo on transfers-in, following which the factors used to calculate service credits were changed. This resulted in a shorter service credit for Dr Baugniet.

The Pensions Ombudsman declined to award Dr Baugniet compensation for financial loss, finding that he was partly responsible for the delay. However, the High Court held that the member's delay did not entirely negate Teachers' Pensions' delay. He instructed the Ombudsman to reconsider the member's complaint as a claim of negligence causing financial loss.

The Ombudsman had awarded Dr Baugniet £750 in compensation for distress and inconvenience. The judge referred this back to the Ombudsman for reconsideration. In doing so, he urged the Ombudsman to increase his upper limit for compensation not infringing legal rights (ie, for non-financial loss) from £1,000 to £1,600. The £1,000 figure (which is to apply other than in exceptional circumstances) was set by the High Court in 1999 in *Swansea City Council v Johnson*. The judge said that maintaining a limit of £1,000 is "out of touch with the value of money".

The Ombudsman has a **factsheet** (published in June 2015) on redress for non-financial injustice.

Effect of invalid amendment of pension increase rule

The Court of Appeal has given its judgment in ***FDR Limited v Dutton***, overturning a much criticised High Court decision. The case concerns the interpretation of scheme rules following an invalid amendment of the pension increase rule.

The FDR pension scheme rules originally provided that pensions in payment are increased each year by a fixed rate of 3%. The scheme was amended in 1991 to provide that pensions should in future be increased each year by the lower of the annual RPI increase and 5%, ("5% LPI"). The scheme was thereafter administered on the basis that all pensions were increased by 5% LPI, including for service before 1991.

The trustees and employer later agreed that the amendment breached the scheme's amendment power, which included the following proviso:

"*PROVIDED ALWAYS that no such alteration or addition shall (1) operate so as to affect in any way prejudicially (a) any pension already being paid in accordance with the Rules of this Deed at the date such alteration or addition takes effect or (b) any rights or interests which shall have accrued to each prospective beneficiary in respect of pension benefits secured under the Scheme up to the date on which such alteration or addition takes effect* ..."

The Court was asked to settle a disagreement about how the rules should be interpreted so as to determine the pre-1991 accrued pension to be paid each year.

- The trustees argued for the *"Annual Approach"*: compound annual increases of the better, each year, of (a) 3% fixed and (b) 5% LPI.
- The employer argued for the *"Modified Cumulative Approach"*: the pre-1991 accrued pension is the greater of:

  (a) its value as at retirement increased each year (including for the present year) by 3% compound; and

  (b) its value as at retirement increased each year (including for the present year) by 5% LPI compound, modified by applying a floor of 0% in order to avoid the effects of any RPI deflation.

Clearly, the Modified Cumulative Approach would cost the scheme the least and the Annual Approach the most.

The High Court had held that the trustees' Annual Approach was the correct one. The Court of Appeal in a short judgment unanimously ruled in favour of the employer and the Modified Cumulative Approach.

Lewison LJ, giving the Court of Appeal's judgment, held that the High Court judge had been wrong to construe a notional blend of the old and new rules. In his judgment, the correct approach is to consider what the amendment power proviso would have been understood to protect. The Modified Cumulative Approach protects the existing right and enables a pensioner to take the benefits of the new rule if, in any given year, it produces a better outcome. It also does least interference to the integrity of the modified scheme.

State pension age review

Two reports have been published, informing the government's review of the state pension age. The Pensions Act 2014 requires the government to review and publish a report on the state pension age before 7 May 2017 but the government has delayed its report until an unspecified date after the general election.

The **John Cridland report** looked at the key issues that drive state pension age changes, including life expectancy, the challenges faced by those who rely most on the state pension, and the long-term financial sustainability of the system. His recommendations included the following:

- state pension age should rise to 68 between 2037 and 2039 (it is currently due to reach 67 by April 2028 and then increase from 67 to 68 between April 2044 and April 2046);
- state pension age should not increase by more than one year in any ten year period, assuming that there are no exceptional changes to the data used;
- the "triple lock" should be withdrawn and state pensions should increase only in line with earnings (which is all the law requires: higher increases are discretionary);
- deferring state pension should entitle an individual to a lump sum rather than a higher state pension and partial deferral should be allowed; and

- there should be no changes to allow early or flexible access to the state pension, even in cases of severe ill health.

There are also recommendations on using savings to help support carers and facilitating a "mid-life MOT" on work, health and retirement.

The Government Actuary's Department (GAD) was asked to consider two alternative scenarios for the state pension age, reflecting the payment of state pension for either 32% or 33.3% of projected adult life. The **GAD report** concluded that:

- under a 32% scenario the state pension age could rise to 69 between 2040 and 2042; and

- under a 33.3% scenario the state pension age could reach 69 between 2053 and 2055.

The government press release restates its commitment to giving at least ten years' notice of state pension age increases, so any changes will take effect from April 2028 or later.

Convictions for failure to provide documents to the Pensions Regulator

The Pensions Regulator has secured its first convictions in two cases of failure to provide it with information.

- A managing partner solicitor (Anthony Wilson) and his firm (Ashley Wilson) **were ordered** to pay more than £16,000 in fines and costs for failure to provide documents to the Regulator. The Regulator was investigating a suspected pension scam (not involving the solicitor or his firm) and sought documents relating to a property transaction for almost nine months before seizing them by use of a search warrant. Both Mr Wilson and his firm pleaded guilty to refusing to provide documents required under section 72 of the Pensions Act 2004 without a reasonable excuse, which is an offence under section 77.

- The head of a charity **was ordered** to pay £6,500 for refusing to give information linked to a Regulator investigation into unusual scheme investments. Patrick McLarry, the Chief Executive of Yateley Industries for the Disabled, failed to provide requested documents despite being pursued by the Regulator for over 18 months. Mr McLarry claimed that supplying the documents would be a breach of French privacy law. He also said that bank statements were protected by legal privilege and later claimed that he was refusing to provide them on the basis that they might incriminate him. He pleaded not guilty to an offence under section 77 of the Pensions Act 2004 (see above) but was found guilty.

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

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7297 3000
F: +44 (0)20 7295 3500

www.traverssmith.com