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What's Happening in Pensions

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Select committee inquiry into DB pensions

Parliament's Work and Pensions Select Committee has been receiving written and oral evidence in its inquiry into the regulation and protection of DB pensions. The Pensions Regulator and the Pension Protection Fund have made suggestions for the stricter regulation of DB scheme funding and greater Regulator powers in relation to corporate activity.

The **Pensions Regulator's written evidence** calls on the Government and Parliament to consider:

- giving the Regulator more flexible **information gathering** powers and enhanced powers of investigation (including powers to "seize and sift" relevant documents and compel interviews); and imposing an enhanced duty to cooperate with the Regulator;

- greater flexibility over **valuation** periods, allowing the Regulator to require valuations more frequently than every three years from higher risk schemes, and a staged reduction in the 15 month period for completing valuations;

- specifying in legislation desired outcomes and acceptable parameters for **scheme funding**, avoiding the need for the words "prudence" and "appropriate" to be interpreted, with schemes having to justify their approach; and

- new obligations for employers to approach the Regulator for **clearance**, for example:

  - mandatory clearance in certain circumstances (except perhaps for "sufficiently well-funded" schemes), for example "where action weakens the scheme sponsor, not just the sale/purchase of a business but in circumstances including where support (covenant) for the scheme is weakened through corporate activity such as dividend payments, change of control, share buy-backs and loans"; and

  - enhanced notification and whistle blowing requirements to help stop the Regulator being deliberately excluded from discussions.

Separately, the Government **has agreed** that the Select Committee should take on formal pre-appointment scrutiny of future appointments of the Chair of the Pensions Regulator.

The Pension Protection Fund's **written evidence** calls for:

- a more interventionist **scheme funding** regime, with a requirement for shorter recovery plan periods for schemes with stronger employers and restrictions on the length of recovery plan periods and "back end loading" of contributions;

- a period of **intensive scrutiny** for schemes with poor funding and weak employers, perhaps including the appointment of an independent trustee and consideration of employer restructuring and of winding up the scheme; with perhaps a new power for the Pensions Regulator to require winding-up at the request of either the trustees or the PPF;

- review of the Regulator's **anti-avoidance processes** and consideration of imposing duties on employers and trustees to engage with the Regulator around transactions, with the increase of contribution notice and financial support direction amounts to include a "fine" element where there is no such engagement; and

- consideration of options for **consolidating small schemes**.

DB scheme funding

In a new Pensions Regulator senior staff **blog**, Andrew Warwick-Thompson (Executive Director for Regulatory Policy) has **shared his views** on DB scheme deficits.

He says that funding data does not bear out the argument that in general DB schemes are unaffordable. He points out that company dividend payments are increasing in relation to deficit reduction contributions, saying that this indicates that the latter can at least be maintained and could be increased, albeit by reducing dividends. He also says that deficit figures reported in the media are often calculated using the buyout basis, rather than the scheme specific funding basis, and that buyout costs are currently very high due to "exceptionally low" bond yields.

VAT

HMRC has extended by another year the transitional period during which employers may continue treating VAT on pension fund management costs as input tax in accordance with the old VAT Notice 700/17. It has not yet finalised its views on various suggested methods for employers to maximise their VAT recovery on pension scheme expenses under HMRC's revised approach following the *PPG* case (see **WHiP Issue 41**). The transitional period now expires on 31 December 2017.

New **HMRC Brief 14** (2016) says:

> *"It's taking longer than expected to reconcile the [PPG] court decision with pension and financial service regulations, accounting rules and emerging case law. It's therefore been decided to extend the transitional period for a further 12 months. This means that taxpayers may continue to use the VAT treatment outlined in **VAT Notice 700/17: Funded Pension Schemes** until 31 December 2017. Towards the end of this period we'll review this position and consider the need for a further extension if necessary.*
>
> *Some taxpayers may have already made changes to their structure and/or contractual arrangements to comply with the judgment. Provided the employer and pension scheme trustees agree and both apply the same treatment, these taxpayers may continue with those arrangements. If they wish, they may choose to revert back to the previous treatment during the transitional period.*
>
> *The guidance that HM Revenue and Customs was intending to publish on possible options for recovery has currently been put on hold whilst we fully consider the wider implications of the options being proposed. In the meantime, VAT can be recovered on fund management costs in line with the guidance laid out in the previous Revenue and Customs Briefs. Taxpayers are advised, however, that adopting alternative structures to comply with the VAT requirements could have wider implications, in particular in respect of regulatory requirements and Corporation Tax deductions."*

Finance Act 2016

The **Finance Act 2016** received Royal Assent on 15 September 2016. The following are the most significant pensions aspects:

Lifetime allowance reduction

The lifetime allowance has been reduced from £1.25 million to £1 million for the 2016-17 and 2017-18 tax years. Thereafter, it will be increased by reference to annual CPI increases. The Act also includes provisions on fixed protection 2016 and individual protection 2016. These are very similar to their 2014 equivalents but with no deadline for registration. Anyone applying for fixed protection 2016 must have stopped contributing and/or opted out of benefit accrual before 6 April 2016.

Scheme administrators are required to tell members, on request, the value of their benefits as at 5 April 2016 for the purposes of calculating their individual protection 2016 lifetime allowance.

There is no automatic enrolment exception for individuals with fixed protection 2016 or individual protection 2016 in the way that there is for individuals with earlier lifetime allowance protections: this requires separate legislation which has not yet been made or even published in draft. This means that new jobholders who have claimed, or intend to claim, fixed protection 2016 must quickly opt out of the scheme in which they enrolled in order to remain entitled to that protection. They will need to do this within the statutory one month opt-out period if they are automatically enrolled or, if they are contractually enrolled, before there is any DC contribution or they are treated as having any DB accrual.

Bridging pensions, etc

The Act enables the tax rules on bridging pensions and state pension offsets to be aligned with other legislation by regulations. Tax legislation limits the reduction of a pension that may be applied when a bridging pension or similar arrangement ends, by reference to the level of the basic state pension.

Subsequently issued **regulations**, which come into force on 8 November 2016 but with effect backdated to 6 April 2016, specify that the following reductions are now permitted:

- Individuals who reached state pension age before 6 April 2016 (ie, receiving the old state pensions)
  The existing rules are restated. These allow a reduction of between 125% and 250% of the basic state pension (depending upon the individual's contracting-out history) at any time between age 60 and age 65.

- Individuals who reach state pension age on or after 6 April 2016 (ie, entitled to the new state pension)
  New rules allow a reduction that does not exceed 200% of the new single tier state pension. The reduction can be made at any time between age 60 and age 65 or (if later than age 65) the individual's actual state pension age.

For more on the issues caused by changing state pensions and state pension ages on bridging pensions and similar arrangements, see our briefing note **Bridging pensions – state pension age issues**.

Serious ill-health lump sums

The Act replaces the 45% tax charge on serious ill-health lump sums paid to individuals who have reached age 75 with tax at the individual's marginal rate. It also removes the rule that a serious ill-health lump sum can be paid only from an arrangement that has not had a benefit crystallisation event, so that one can be paid from unused drawdown funds.

Excessive dependants' pensions

The test for the tax charge that applies when a dependant's pension is large compared with the member's pension at death is simplified. This test applies when the member's pension started after 5 April 2006 and the member dies aged 75 or over.

Drawdown and inheritance tax

Assets left in drawdown funds at death now do not attract inheritance tax. This change is backdated to 6 April 2011.

Limitation period for recovery of overpayments

The High Court has given its **latest ruling** in *Webber v Department for Education*, concerning the extent to which the Teachers' Pension Scheme can recover past overpayments of pension from a member. Its conclusion was different from that of the Pensions Ombudsman and the provisional view of a different High Court judge earlier in the same proceedings (see **WHiP Issue 57**).

Mr Webber started to receive an early retirement pension from the Teachers' Pension Scheme in 1997. In September 2001, he returned to teaching full-time. The Teachers' Pension Scheme rules require pensioners to notify the administrator if they return to teaching work. If the earnings are above a specified level in any tax year then the pension is reduced. Mr Webber notified the administrator of his new earnings in September 2001 but his earnings for the 2001/2 tax year, being for only part of the tax year, did not lead to a reduction.

The administrator did not, however, make any reduction for the following eight tax years in which Mr Webber did have earnings above the reduction threshold.

The mistake was discovered in 2009 and Mr Webber's pension was reduced to the correct amount. The administrator wrote to Mr Webber in November 2009 requiring repayment of the overpayments. Mr Webber paid £3,775, which he calculated as the overpayment for the 2009/10 tax year, but refused to repay any of the earlier overpayments. He ultimately complained to the Pensions Ombudsman in April 2011. Teachers' Pensions responded to the complaint in accordance with the Ombudsman's procedures in December 2011. Mr Webber relied on the statutory six year limitation period: he argued that, to the extent that he had to repay the overpayments, only those made in the last six years could be recovered. But six years up to when?

One judge expressed the view earlier in the proceedings that the administrator was entitled to claim for overpayments made in the six years before Mr Webber filed his complaint with the Ombudsman (ie, April 2011). However, he did not hear arguments on the point and did not make a formal ruling on the question.

The Ombudsman later determined that it should be the six years up to the date the administrator first claimed recovery from the member (ie, November 2009).

Now the High Court has ruled that the administrator can claim back overpayments made in the six years before the date of receipt by the Ombudsman of the administrator's written response to Mr Webber's notice of complaint (ie, December 2011). This will result in a significantly lower recovery for the scheme.

The deputy judge had to apply limitation legislation that is designed to work where it is the party who claims to be owed money (here, the scheme administrators) who is bringing the claim. In this case, it was the party from whom repayment was sought who brought the claim. The deputy judge had to decide which stage of the dispute with Mr Webber was most closely equivalent to the issuing of a court claim form by the scheme administrator. He decided that this was when the scheme administrator formally responded to the complaint to the Ombudsman in accordance with the Ombudsman's procedures.

The deputy judge recognised that a member from whom recovery was sought could profit by delaying taking his complaint to the Ombudsman but said that the scheme administrators could protect their position by issuing a court claim form. We note, however, that there would then be issues with the Ombudsman's jurisdiction to adjudicate the dispute.

This case has implications for the ability of any pension scheme to recover overpayments. Where trustees discover historic overpayments, they may wish to take legal advice as early as possible about how best to protect their position and maximise the amount that can be reclaimed.

A **statement** from the Ombudsman says that they are now reviewing their processes and procedures for dealing with overpayment cases.

DC: Pensions advice allowance

The Government **is consulting** (until 25 October 2016) on proposals to allow individuals under age 55 to take up to £500 tax free from their DC pension pots to pay for retirement advice: the "*Pensions Advice Allowance*". The scope of this advice is not currently clear.

Schemes and providers would not be required to offer the Pensions Advice Allowance. The Government acknowledges that some scheme rules and policies do not currently allow them to do so.

It is proposed that the option will be available from April 2017. The scheme or pension provider would make the payment directly to the adviser. The Government is considering allowing individuals to take multiple allowances. Automated advice would be included but not guidance.

This proposal was previously announced at the 2016 Budget (see **WHiP Issue 57**).

New Pension Schemes Bill

The Government has introduced a new **Pension Schemes Bill** to Parliament. It includes provisions for regulating master trusts and in relation to DC early exit charges.

Regulation of master trusts

The bulk of the content concerns a proposed new regime for authorising and supervising master trusts. This is designed to address concerns about the sustainability of some of the 84 (and counting) 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 will have six months from commencement of the legislation to apply for authorisation or to decide to wind up the scheme. However, the Bill purports to impose notification and discontinuance funding obligations from 20 October 2016.

DC early exit charges

The Bill also includes very short provisions allowing the Government to make regulations that will override contracts so as to restrict DC early exit charges. The Government recently consulted on proposals to cap such charges at 1% for existing contracts and 0% for new contracts (see **WHiP Issue 58**).

Secondary annuities market

The Government **has announced** that it has decided not to permit a secondary market for annuities. The original proposals would have allowed individuals who have bought annuities to sell them for a lump sum. The Government concluded that *"creating the conditions to allow a competitive market to emerge could not be balanced with sufficient consumer protections"*.

Brexit

The Government **has announced** that the Prime Minister will trigger Article 50 by the end of March 2017. This would start the two year period for the UK to leave the European Union (unless all member states agree to an extension). A High Court case is underway about whether the Prime Minister has the power to trigger Brexit herself or whether Parliament needs to approve the decision.

The Government has also promised a bill in the next Queen's Speech (in Spring 2017) to repeal the European Communities Act 1972 but enshrine existing directly applicable EU law in UK law. The UK jurisdiction of the European Court would end. No further details have yet been published.

Bankruptcy

The Court of Appeal **has upheld** the High Court's decision in *Horton v Henry* (see **WHiP Issue 50)**. It ruled that Mr Henry's trustee in bankruptcy was not entitled to an income payments order over undrawn personal pension funds, nor to require Mr Henry to draw benefits from them so that he could claim payments of income. This decision protects undrawn pensions from a bankrupt's creditors.

Mr Henry had a SIPP and three personal pensions. He was aged 58 and so entitled to draw benefits under all of them but had not yet done so. His trustee in bankruptcy, Mr Horton, applied to court in December 2013 for an income payments order seeking payment of a 25% lump sum and three years' pension instalments from the SIPP, and three years' capitalised income from the personal pensions. Mr Horton also intended to make a further application after April 2015, when the "freedom and choice" decumulation changes to tax legislation entitled Mr Henry to take all his benefits.

The Court of Appeal upheld the High Court decision that benefits not yet in payment could not be said to be payments to which Mr Henry was "entitled" for the purposes of the Insolvency Act 1986. That referred only to benefits already in payment. The trustee in bankruptcy had no right to make decisions and elections on Mr Henry's behalf because the rights to do so are not part of the bankrupt's estate. Another provision of the Act which requires a bankrupt to *"do all such other things … as the trustee may for the purposes of carrying out his functions … reasonably require"* did not extend to requiring Mr Henry to draw his benefits because the trustee in bankruptcy had no "function" in relation to protected pension benefits.

The Court of Appeal agreed with the High Court judge that the earlier High Court decision in *Raithatha v Williamson*, in which the Court did allow a trustee in bankruptcy to access undrawn pension funds (see **WHiP Issue 33**), was wrong.

The High Court's decision in *Blight v Brewster* (see **WHiP Issue 33**) was distinguished. In *Blight*, an individual who was not bankrupt was ordered to elect to take his pension commencement lump sum so that a third party debt order could be satisfied. The distinction was drawn on the basis that pensions are expressly protected by legislation on bankruptcy (in that they are excluded from a bankrupt's estate) but they are not protected in the same way in the absence of bankruptcy.

State pension age

The independent state pension age reviewer, John Cridland CBE, **has launched** a consultation with an interim report. The consultation runs until 31 December 2016.

As required by its terms of reference, the report looks at:

- affordability: the ratio of pensioners to working age people and spending on pensions as a proportion of GDP, as well as the role the triple lock has as an uprating policy commitment;

- fairness: whether outcomes are fair between and within different generations of pensioners, for instance men in routine jobs have six years' difference in life expectancy at birth compared with men in professional jobs; and

- fuller working lives: understanding why people drop out of the labour market early and how government and industry might mitigate this.

In looking at life expectancy, the report considers regional variations. It also asks about the challenges faced by those who rely most on the state pension and so are most likely to be affected by future changes. These include carers, people with poor health or disability in later life, the self-employed, women and ethnic minorities.

The report opens a discussion on alternatives to a universal state pension age, recognising that the nature of work and retirement is changing as people move from a fixed retirement age to an approach where they may work part-time or change career in later life. It also considers options such as supporting individuals to work longer and early access after a long working life to either a full or a reduced pension.

Single financial guidance body

The Government **has announced** plans to develop *"a single public financial guidance body which is responsible for delivering debt advice, money and pensions guidance to the public"* (sic).

This follows a Government consultation (see **WHiP Issue 57**) on setting up a two body delivery model for government-sponsored guidance. The proposal had been to replace the Money Advice Service with a new money guidance body and to combine the Pensions Advisory Service and Pension Wise in a new pensions guidance body. Now the Government has decided that a single combined body would be better able to respond to consumers' financial guidance needs. The Government will next consult on the design of the single body.

Disclosure of investment transaction costs

The FCA **has published** a **consultation paper** setting out proposed rules and guidance aimed at standardising the disclosure of DC pension investment transaction costs.

Under changes introduced from 6 April 2015 (see our briefing note **DC charges and governance**), trustees of schemes with DC benefits and personal pension independent governance committees must report to members on DC investment transaction costs insofar as they can obtain information about them. They must also assess value for money for members. There is not yet, however, a duty on asset managers to provide information on transaction costs for this purpose.

The FCA's proposed rules set out a standard method of disclosing transaction costs, based on a comparison of actual prices with the value of the asset immediately before the order to transact entered the market (the so-called "slippage cost").

The consultation runs until 4 January 2017 and the final rules are expected to be published in the second quarter of 2017.

Pension protection Fund

Pension protection levy 2017/18

The Pension Protection Fund **has published** a **consultation and draft documents** on the 2017/18 pension protection levy. No significant changes are proposed but there are tweaks and possible future changes in the following areas. The consultation closes at 5pm on 31 October 2016. The overall levy estimate is £615 million, the same as for 2016/17.

- **FRS 102 accounting standard:** This new standard can have an unwarranted effect on insolvency risk scores for some employers who use the large and complex or not-for-profit scorecards. It can lead to the inclusion or exclusion of new items in the relevant accounting line for the first time (so-called "change variables") and result in a changed score without there being any different understanding of employer strength. There will be a mechanism for affected employers to certify an adjustment to Experian.

- **Schemes with no genuine sponsor:** The PPF is thinking about how levies should be calculated for schemes with a sponsor that is a shell company or special purpose vehicle. The PPF says that a new approach may be required for such schemes, where the risk to the PPF relates entirely to scheme funding levels and investment risk and not to employer insolvency. The PPF might consult separately about this.

- **Asset-backed contributions:** The 2016/17 simplified requirements for schemes recertifying an ABC arrangement will be kept in place for 2017/18.

- **Parent companies filing small companies accounts:** The PPF has become aware that there are around 20 companies which, although they file small companies accounts on a consolidated basis, are the parents of employers. The large and complex scorecard is not well suited to measuring such companies as it uses data items not included in small companies accounts, typically resulting in a poor score. The PPF considers that it would be more appropriate for these entities to be scored on the "independent small" scorecard (as they already are, for the purposes of their own score, if they are employers).

Compensation cap

A Government **consultation** on modifications to the operation of the increased Pension Protection Fund compensation cap for long-serving members indicates that it intends to implement the increase on 6 April 2017. It will apply to future payments of compensation already in payment but will not be backdated. The consultation closes on 9 November 2016.

Advice requirement for transfer or conversion of safeguarded benefits

Benefits with guaranteed annuity rates

The Government **is consulting** on **draft regulations** specifying how to value DC benefits with guaranteed annuity rates (GARs) for the purpose of ascertaining whether the appropriate independent advice requirement applies. The requirement applies if an individual with safeguarded benefits (most commonly DB benefits but it also includes DC benefits with a GAR) valued at more than £30,000 wishes to transfer them to another scheme or convert them in the same scheme in order to access DC flexible options. The Government's proposal is to value benefits with a GAR for this purpose on the same basis as for a statutory cash equivalent transfer value.

It also proposes a new requirement for trustees and providers to give risk warnings to all individuals with safeguarded benefits when they enquire about a transfer to a DC scheme, whether or not the £30,000 threshold is exceeded.

The consultation ends on 7 November 2016 and the regulations are expected to take effect from 6 April 2017.

Overseas transfers

The Government has issued a **call for evidence** on how the appropriate independent advice requirement (see above) applies to members resident overseas and whether the current process should be changed. The closing date for comments is 23 December 2016.

The Government is seeking to establish whether the advice requirement is workable for individuals living abroad and whether it should be withdrawn or perhaps replaced by a requirement for "equivalent advice" in the individual's country of residence.

Lifetime allowance and annual allowance

Lifetime allowance

HMRC's online "look up service" for scheme administrators to check their members' tax protections **has been delayed** until later this year, having originally been planned for this month. HMRC reminds administrators that they should still check members' protection statuses as outlined in **Pension Schemes Newsletter 80**.

Annual allowance

A new **HMRC web page** gives guidance to affected individuals on working out their tapered annual allowance. A beta (trial) version of a new **annual allowance calculator** for individuals has also been launched.

Autumn Statement

The Government **has announced** that the Chancellor of the Exchequer's Autumn Statement will be delivered on 23 November 2016. Separately, it was **announced** that draft Finance Bill clauses will be published on 5 December 2016.

Lifetime ISA

The Government has introduced **The Savings (Government Contributions) Bill**, containing framework provisions for the Lifetime ISA savings option that providers can offer from April 2017. The Bill does not add to previously announced details (see **WHiP Issue 50**) but new **fact sheets** and **technical notes** give some more detail.

This and previous issues of WHiP can be found on our website **here**.

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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.

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