Issue 55

December 2015

What's Happening in Pensions

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VAT and pensions

HMRC has announced an extension of the transitional period that was due to expire on 31 December 2015, during which employers may continue to rely on HMRC's old guidance on recovering the VAT they pay in respect of services to a pension scheme. That guidance was set out in VAT Notice 700/17. The transitional period will now expire on 31 December 2016. Please see **WHiP Issues 49** and **51** for background.

New HMRC Brief 17/15 also outlines HMRC's latest thinking on three potential options for helping employers to recover VAT, none of which is perfect:

- **Tripartite contracts**

  HMRC's thinking on the use of tripartite contracts (ie, contracts between a service provider, the trustees and the employer) has not changed. HMRC confirms that employers are not entitled to a corporation tax deduction in respect of asset management costs they pay directly: they can only claim a deduction for costs recognised in their profit and loss account (which is restricted by accounting rules) and contributions to pension schemes. "Alternative tripartite structures" that would allow a corporation tax deduction are being considered but no further explanation is given. The Brief does not address concerns that have been raised about possible conflicts of interest for the service provider.

- **Supply of scheme administration services by pension trustees to an employer**

  There is a section on the possibility of trustees contracting with the employer to provide the service of running a pension scheme. The trustees would then contract with, and pay, third party service providers. There are, however, also difficulties here with regard to VAT paid in respect of asset management services.

- **VAT grouping**

  There is a section on the implications of the trustee "VAT grouping" with the employer. This would not be an option for some schemes. HMRC says that the joint and several liability provisions that apply to VAT group members would not entitle it to recover VAT from the assets of the pension scheme except to the extent that the VAT debt is attributable to the scheme. Whilst that is reassuring, the law is not as clear as trustees might like.

We are expecting more from HMRC in the New Year.

Pensions Regulator: DB risk management

The Pensions Regulator **has published new guidance** for DB scheme trustees on the development and implementation of an integrated framework for managing risk. This builds on recent Regulator publications calling for an integrated approach to scheme funding, including the current scheme funding code of practice (see **WHiP Issue 47**) and guidance on employer covenant (see **WHiP Issue 53**). Integration refers to combining consideration of funding, investment and employer covenant risks.

The new guidance is not prescriptive. It aims to provide practical help on what a proportionate and integrated approach to risk management might look like and how trustees can use it as part of their plans for meeting their scheme's funding objectives.

Pension protection levy 2016/17

The Pension Protection Fund **has published** its **final materials** for the 2016/17 pension protection levy. There are very few changes from the draft materials published in September (see **WHiP Issue 54**), which themselves included relatively few changes compared to the 2015/16 regime.

The levy estimate is confirmed as £615 million, down from £635 million estimated last year, reflecting improved Experian insolvency scores for employers and guarantors but balanced by a deterioration of smoothed scheme funding levels.

The September consultation document announced that the PPF intended to contact schemes that had previously classified themselves as "last man standing" schemes but that did not do so for 2015/16. The PPF has now confirmed that such schemes can expect additional levy invoices soon for the earlier years, clawing back the flat rate 10% levy discount that previously applied to last man standing schemes. Later in the year, the PPF will be contacting schemes that do not confirm on Exchange by 31 March 2016 that they have received legal advice that supports their claim to be a last man standing scheme.

The parameters, rules and guidance are largely the same but there are some changes:

- **Contingent assets (eg, guarantees)**

  The contingent assets guidance incorporates elements of the PPF's January 2015 note on guarantor strength (see **WHiP Issue 50**), which will be reissued shortly.

  "Type C(i)" contingent assets (letters of credit or bank guarantees with evergreen duration) can now be recognised where the issuer is an insurer (not just a bank). The standard form agreement has been amended accordingly. This was already permitted for "Type C(ii)" contingent assets (letters of credit or demand guarantees with fixed duration to support a schedule of deficit reduction contributions).

- **Asset-backed contributions (ABCs)**

  The updated ABC guidance gives details of "lighter touch" rules for recertifying ABCs, including a "prudent estimation" approach to valuation. When recertifying an ABC arrangement, the previous valuation and/or legal opinion can now in some cases be updated, instead of having to produce a new valuation and/or opinion.

- **Experian scores and excluded mortgages**

  Experian insolvency scores will, as expected, be averaged over the 12 month period ending 31 March 2016, rather than the shorter period used last year.

  Employers with no Experian score will be given a scheme average where 50% of the scheme employers, weighted by membership, have Experian scores.

  Experian will automatically exclude material mortgages that were certified for 2015/16 without the need for recertification. Immaterial mortgages will still need to be certified annually for exclusion. The PPF is checking that employers or groups which have all their mortgages disregarded, because they have certified that they have an Investment Grade CRA Rating, are still in that position. If not, scores will shortly be recalculated and the new scores posted on the pension protection score portal.

  It is made clearer that a restatement or confirmation of an existing mortgage will not be treated as a new charge and can be certified for exclusion. This can also be done where a replacement mortgage specifies that the borrowings must be used to repay the original mortgage (but there are strict criteria as regards timing).

  There is a little more flexibility for employers to call for Experian to review a score, for example if information relating to mortgages was not available at the relevant measurement time.

  The PPF has decided not, at this time, to extend the credit rating mortgage exclusion to cover credit ratings from agencies other than Experian.

  The PPF is working with Experian to consider the likely effect of new accounting standard FRS 102 on scores for the 2017/18 levy year.

- **Company accounts**

  Companies that provide Experian with full accounts, whilst filing abbreviated accounts with Companies House, will be able to provide preceding years' full accounts to allow calculation of the "trend variable". (But companies must provide the same type of accounts for all the years; they cannot pick and choose.)

The proposal to convert company accounts that use a currency other than sterling by using the exchange rate applicable at the date of the most recent accounts (rather than as at the start of the levy year) will not be implemented until next year.

Government announcements on tax and legislative changes

The Chancellor of the Exchequer made relatively few pensions announcements at the **Spending Review and Autumn Statement**. He had already announced that the Government will respond to its consultation on possible fundamental pensions tax reform (see **WHiP Issue 53**) at the next Budget. The date for that has been announced as 16 March 2016.

The most significant announcements and proposed changes are as follows. **Draft Finance Bill clauses and accompanying notes** on some of these have now been published.

Lifetime allowance reduction

The Government has published **draft legislation** on reducing the lifetime allowance from £1.25 million to £1 million for 2016-17 and 2017-18 and thereafter increasing it by reference to CPI increases. The legislation also covers the protections against the reduction that will be available to individuals.

Individual Protection 2016 and Fixed Protection 2016 will be very similar to their 2014 equivalents but with changes to the registration process and deadlines. **HMRC Pension Schemes Newsletter 73** included the following:

> "*From April 2016 there will be two protection regimes available, Individual Protection 2016 (IP2016) and Fixed Protection 2016 (FP2016). There will be no application deadline for these protections. However individuals will need to apply for protection before they take their benefits as they will need the HMRC reference number if they want to rely on the protection.*
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> ...
>
> *We are introducing a new online self-service for pension scheme members to apply for protection and this service will be available for members to use from July 2016. Members will no longer receive a lifetime allowance protection certificate, instead once they have successfully applied for protection the online service will provide them with a reference number which they will need to keep.*
>
> *We are also introducing an online service for scheme administrators to check the protection status of their scheme members. We are exploring options for what this will look like and will provide more information on this in due course.*
>
> ...
>
> *There will be a period between the new protection regimes becoming available in April 2016 and the introduction of the new online self-service in July 2016. For this period we will introduce an interim process for pension scheme members who want to take benefits before the introduction of the new online service. Scheme members will be able to write to HMRC between April 2016 and July 2016 and we will check the details of their protection and respond to the member in writing. This can then be presented to the scheme administrator in advance of the full application being made after July 2016.*"

Scheme administrators will be required to tell members, on request, the value of their benefits as at 5 April 2016 for the purposes of calculating their individual protection lifetime allowance. HMRC is planning to introduce an online service for administrators to check the protection status of their scheme members.

HMRC Pension Schemes Newsletter 74 gives more information (but with still more to follow) on the interim process for applying for individual protection 2016 and fixed protection 2016. This process is to be used until the online application service is up and running in July 2016. Since the only deadline for applying is the date of drawing benefits, only a small number of people will need to use the interim process. They will, however, need to register again using the online service when it becomes available.

In keeping with the previous fixed protection regimes, anyone applying for fixed protection 2016 must have stopped pension accrual and contributions before 6 April 2016.

Bridging pensions and other tax changes

Legislation will enable the tax rules on bridging pensions and state pension offsets to be aligned with other legislation. Details are left to future regulations but the change is expected to reflect the new single tier state pension and the rise of state pension age above 65. **An order** has already been made and **another order** has been laid before Parliament, amending sex and age equality legislation so that bridging pensions and state pension offsets can reflect either the old or new state pension without amounting to unlawful discrimination. The Government will be consulting with the industry over whether further legislative changes are required.

The test for the tax charge that applies when a dependant's pension is large compared with the member's pension at death **will be simplified**. This is of limited application as it is only required when the member's pension started after 5 April 2006 and the member dies aged 75 or above.

The Government **will legislate** to ensure that assets left in drawdown funds at death do not attract inheritance tax. This will be backdated to 6 April 2011.

Automatic enrolment

The two dates for increasing the minimum automatic enrolment contribution rates will be aligned with the tax year. The dates are currently 1 October 2017 and 1 October 2018 but these will be pushed back six months to April 2018 and April 2019.

Separately, the Government **has confirmed** the 2016-17 figures for the automatic enrolment earnings trigger and qualifying earnings band as follows:

	Earnings trigger	Qualifying earnings lower limit	Qualifying earnings upper limit
Currently (2015-16)	£10,000	£5,824	£42,385
Proposed for 2016-17	£10,000	£5,824	£43,000
Context	Not linked to any other threshold.	Continues to be the same as the NICs lower earnings limit (which is also unchanged).	Continues to be the same as the NICs upper earnings limit (which is also rising to £43,000).

State pensions

The full rate for the single tier state pension has been announced as £155.65 per week (£8,093.80 per annum) for its first year, 2016-17. The basic state pension will be raised, under the "triple lock", by £3.35 per week to £119.30 (£6,203.60 per annum) for 2016-17.

Salary sacrifice

The Government is concerned about the growth of salary sacrifice arrangements (in general, not just for pension contributions) and will be gathering evidence on their use from employers and others.

Selling annuity income rights

The Government confirmed that it will allow a secondary market for annuities from April 2017. A **Government response** to the March 2015 call for evidence (see **WHiP Issue 51**) was later published.

Single and joint life annuities are in scope, including those bought since the decumulation flexibilities became available in April 2015. Most of the difficult questions have been deferred, or passed to the FCA, but it is clear that there will be different rules applicable to higher and lower value annuities.

Sale proceeds will be taxed at the individual's marginal income tax rate. Alternatively, the proceeds can be paid into a pension scheme and accessed flexibly, subject to income tax as and when they are drawn.

Annuity providers will be able to buy back lower value annuities directly from their holders but only third parties will be able to buy the rights to income from higher value annuities. The Government is considering ways for the annuity provider to be notified of the annuitant's death.

The Government is yet to make decisions about consumer protections. The Government will ask the FCA to consider what risk warnings might be appropriate as a "second line of defence" for those who wish to sell their annuity income rights and whether a requirement could be imposed to ensure that any contingent beneficiary has consented.

An **amendment** to the Bank of England and Financial Services Bill will require those with higher value annuities to take advice before being able to sell their right to the annuity income. HM Treasury will have powers to spell out how this will work and the FCA will be required to make rules governing the advice. Existing clause 27 of the Bill amends section 333A of the Financial Services and Markets Act 2000 to expand the scope of Pension Wise so that it can offer guidance to those considering selling their annuity rights.

Finance (No. 2) Act 2015

The Finance (No.2) Act 2015 has received Royal Assent. It amends the Finance Act 2004 and other tax legislation in two respects:

- It introduces the legislation on the tapered annual allowance (applicable from 6 April 2016) and changes to pension input periods (with effect from 8 July 2015), including transitional provisions for the 2015-16 tax year. See our briefing note **Pension input periods and the tapered annual allowance** for details. We still await details of information requirements that are expected to be imposed on trustees.

- It provides for lump sum death benefits paid from a registered pension scheme on the death of a member over age 75 to be taxed at the marginal rate of income tax that applies to the recipient, where the benefits are paid to an individual. 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 applies to payments made on or after 6 April 2016.

Pensions Regulator: DC

Code of practice

The Pensions Regulator is consulting until 29 January 2016 on a **replacement code of practice** on the governance and administration of occupational pension schemes providing DC benefits.

The new draft code is much shorter than the current code and does not include the Regulator's 31 DC quality features because the Regulator considers that they should now be "business as usual for trustees". The draft code is split into six sections: the trustee board, scheme management skills, administration, investment governance, value for members, and communicating and reporting.

The format of the draft code is more user-friendly than the existing code. It distinguishes clearly between the statutory requirements and the actions that the Regulator expects trustees to take in order to comply, and demonstrate compliance, with those requirements. There is helpful guidance as to what steps it expects trustees to take in relation to communicating with members about their retirement choices and what factors it expects trustees to consider when assessing whether a fund is a default arrangement to which the charges cap applies.

There will be a further consultation in spring 2016 on good practice guidance. The code and the guidance are expected to come into force in summer 2016.

Guidance on charges and governance

The Regulator has updated its website guidance on DC **charges** and **governance**.

FAQs
The Regulator has also updated its **list of FAQs** on the new DC governance and charges requirements, including guidance on what the chair's governance statement should cover, based on the content of the regulations.

Pensions Tax Manual

HMRC has formally launched the **Pensions Tax Manual** to replace the Registered Pension Schemes Manual.

FCA activity

Financial Services Compensation Scheme

The Financial Conduct Authority (FCA) **is proposing** to make changes to the eligibility of occupational pension scheme trustees to claim on the Financial Services Compensation Scheme (FSCS). The following are the relevant proposals.

In the summary below, a small company is one that satisfies two or more of the following requirements: (1) a turnover of not more than £6.5 million, (2) a balance sheet total of not more than £3.26 million and (3) no more than 50 employees.

Eligibility: Trustees of a large employer's occupational pension scheme which provides DC benefits will be eligible to claim. They are currently not eligible, subject to an exception in respect of long term insurance contracts. Insurance companies commonly structure their DC investment products as long term insurance contracts.
The eligibility criteria for trustees of DB occupational pension schemes will not change, so:

- trustees of small employers' DB schemes will still be able to claim; but
- trustees of large employers' DB schemes will still not be able to claim except in respect of long term insurance contracts.

A trustee of a large employer's small self-administered scheme (SSAS) providing DB benefits (which is uncommon) will no longer be eligible to claim, except in relation to long term insurance contracts. (Currently a trustee of a SSAS is eligible, even where the employer is large and regardless of the nature of the benefits provided.)

Compensation limits: The insurance mediation compensation limit for claims relating to pure protection contacts, professional indemnity insurance and general insurance claims arising from the death or incapacity of the policyholder due to injury, sickness or infirmity will rise from 90% to 100% of the claim.

Calculation of compensation – "look through": The FSCS will treat the claim of a trustee of a large employer's occupational pension scheme with DC benefits as a claim of the member or members (or beneficiary), ie, applying the compensation cap in respect of each member individually rather than in aggregate. (Currently this only applies to small employers' schemes.)

The consultation closes on 29 February 2016. Final rules are expected to be published in the second quarter of 2016.

Asset management market study

The FCA **has launched a market study** into asset management, to consider whether competition is working effectively. Part of its scope is to consider how investment consultants affect competition for institutional asset management. An interim report is expected in summer 2016 and the final report in early 2017.

Pensions and retirement income activities

The FCA **has requested information** on charges from firms offering access to flexible access pension products. Responses have been requested by 15 February 2016 and the FCA intends to publish a summary of its findings in summer 2016.

These findings will feed into the FCA's wider "retirement outcomes review", which has been delayed until the second quarter of 2016.

Consultation: Flexible decumulation options and PPF eligibility

The Government **is consulting** until 15 January 2016 on various amendments to regulations, mainly in connection with the new flexible decumulation options. The amendments would take effect from 6 April 2016. In the following summary, we use the terminology in the legislation: broadly, "flexible benefits" means DC or cash balance benefits and "safeguarded benefits" means DB benefits.

Decumulation flexibilities: disclosure

A new disclosure regulation would require trustees to give generic risk warnings to members who are considering drawing their flexible benefits (in any form, including as an annuity) or transferring them out (for any reason), or if they have already decided to do so. These would have to be given as soon as practicable and in any event within seven days of the trustees becoming aware (*"by whatever means"*) of the member's thinking. This practice is currently only encouraged by Pensions Regulator guidance (see **WHiP Issue 51**).

The warnings would have to be accompanied by a statement setting out the members' options and asking members to consider whether or not (a) they have read the risk warnings and (b) they have accessed guidance or advice, in both cases noting the importance of doing so.

Pension Protection Fund eligibility

The PPF entry rules would be amended to expand the circumstances in which an employer can use the application route for PPF entry assessment (eg, in situations where the employer is not capable of suffering an insolvency event). Instead of listing the criteria that an employer must meet in order to be able to apply, the amended regulations will specify the types of sponsoring employers which cannot apply.

This proposal follows on from the experience of Olympic Airlines, which was ineligible for PPF entry when its Greek parent company became insolvent because its UK business had already been wound down.

Pension sharing/earmarking on divorce/dissolution

Trustees would be required to notify a member's spouse where there is an earmarking order and the member applies to take advantage of a flexible access option (eg, an UFPLS or drawdown). The consultation paper assumes that pension earmarking orders would already catch all forms of benefit payment or that taking benefits in a new flexible form might breach such an order. It also notes, however, that the spouse may need to go back to court to apply to vary the order.

The requirement for appropriate independent advice would apply not only to ordinary members wanting to transfer safeguarded benefits to a scheme that offers flexible benefits, or to convert them, but also to pension credit members (ie, former spouses of members who have been given scheme benefits).

Consultation: Governance and investment

The Government **has consulted** on various amendments to existing regulations, including in relation to scheme governance. The consultation also responded to the February 2015 consultation on changes to the law on occupational pension scheme investment (see **WHiP Issue 51**).

Governance: Draft amending regulations propose changes to the 2015 charges and governance regulations (see our briefing note **DC charges and governance**) to do the following:

- *"put beyond doubt that multi-employer group schemes are excluded from the additional governance requirements,"* ie, the requirements that should only apply to master trusts – we met with the DWP to discuss this concern and that has produced this helpful response;
- "*allow a deputy or acting chair to sign the chair's statement where there is no chair in place*".

Investment: The Government has decided not to amend the 2005 investment regulations as previously mooted following recommendations made by the Law Commission (see **WHiP Issue 47**):

- to require statements of investment principles to cover policies on financial and non-financial factors;
- to require trustees to comply with the Stewardship Code or to explain why they have not done so.

The Government considers that these points are better addressed by Pensions Regulator guidance. The Regulator has already updated its trustee training materials in light of the Law Commission report and is in the process of updating its DC code of practice and guidance (see above).

Consultation: Abolition of contracting-out

The Government **has consulted** on further amendments to legislation consequential on the abolition of contracting-out in April 2016. The amendments of interest concern transfers.

Transfers of contracted-out rights to schemes that were formerly contracted-out will continue to be permitted in broadly the same way as at present. Transfers of contracted-out rights to schemes that were not previously contracted-out will continue to be permitted and the existing requirements for member consent and acknowledgements (eg, as to the possible loss of a contingent spouse's pension) will remain. It will not be possible to make bulk transfers without members' consent, including scheme mergers, where the receiving scheme is a new scheme or any other scheme that has never been contracted-out.

Until 6 April 2017, trustees will be able to apply to the Pensions Regulator for a transfer value payment time extension on the grounds that the scheme has ceased to contract out in the previous 12 months. Thereafter, an application can be made by trustees of a scheme that ceased to be contracted-out on 6 April 2016 only if they have yet to agree the scheme's contracted-out liabilities with HMRC.

The Government will cover issues around reference scheme test underpins when it responds to this consultation. We still await further consultations regarding restrictions on amending contracted-out rights and the interaction of contracting-out restrictions with HMRC trivial commutation rules. The Government had previously said that it would be considering changes to the transfer rules in the light of the new DC freedoms but there is no mention of this in the consultation.

DC member-borne commission ban

The Government **has consulted** on how to implement the ban on member-borne commission payments in most occupational pension schemes that provide any DC benefits and are used for automatic enrolment.

It is proposed that regulations will ban new member-borne commission arrangements from 6 April 2016 and the Government will consult later in 2016 on regulations to ban arrangements entered into before 6 April 2016.

One key issue being considered is whether the duty to ensure compliance with the ban should be imposed on trustees or service providers. In either case, the Pensions Regulator would be responsible for enforcing the ban.

Action has already been taken by the FCA to ban commission arrangements in new group personal pension schemes and it is requiring firms to remove existing commission charges from affected schemes by 6 April 2016.

State pensions

New state pension statements

The Government is launching a new form of state pension statement, estimating entitlements under the new system that starts on 6 April 2016. Individuals will be able to request such a statement. As well as giving a weekly state pension figure, it will give a weekly figure for the "Contracted Out Pension Equivalent" or "COPE". This is the amount that is expected to be paid by the contracted-out scheme.

The Government has published **new leaflets** to accompany the statement. It has also updated **existing leaflets** on the new single tier state pension to reflect the newly announced figure (see above).

Select Committee inquiry

The Work and Pensions Select Committee **has launched an inquiry** into understanding of the new state pension system. There have been concerns that people do not appreciate that they will very often be entitled to less than the full flat rate single tier state pension, for example due to periods of contracted-out employment.

Data protection – US "safe harbor"

The Court of Justice of the European Union (CJEU) **has declared invalid** a European Commission decision approving data transfer "safe harbor" arrangements with the United States. EU data protection regulators have provided guidance on what this means for EU businesses.

The EU Data Protection Directive prohibits the transfer of personal data to countries outside the EEA without consent of the data subject unless certain conditions are met. One permitted option is an approved "safe harbor" arrangement. Many European businesses need to be able to transfer data to the US (for example, because they use cloud storage services which are based on servers located in the US).

Other methods of legally transferring personal data outside the EEA include signing up to "binding corporate rules" for intra-group transfers or entering into an agreement with the transferee based on model clauses approved by the European Commission.

Unless it is practical to stop transferring personal data to the US altogether, it seems that most businesses affected by the decision are likely to put in place agreements with transferees using the Commission's model clauses.

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