TRAVERS SMITH

What's happening in Pensions

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Autumn Statement and Finance Bill 2013

The Chancellor of the Exchequer delivered his Autumn Statement on 5 December 2012. Various associated documents were published the same day. Draft clauses for the Finance Bill 2013 were published the following week. The key pensions points are as follows.

Annual and lifetime allowances reduced

The **annual allowance** will be reduced from £50,000 to £40,000 from 6 April 2014. There are no changes proposed to the existing "carry forward" rules. Up to £50,000 unused annual allowance can therefore be carried forward from the tax years before 2014/15.

The **lifetime allowance** will be reduced from £1.5 million to £1.25 million (equivalent to a pension of £62,500 pa before commutation), also from 6 April 2014. There will be a new fixed protection system (to be known as "fixed protection 2014") which will work in the same way as the 2012 regime.

The Government will discuss with interested parties whether to offer a "personalised protection regime" in addition to the fixed protection regime. This would give individuals a lifetime allowance of the greater of the value of:

- their pension rights on 5 April 2014 (up to an overall maximum of £1.5 million); and
- the standard lifetime allowance of £1.25 million.

The key difference from the existing enhanced and fixed protection arrangements is that individuals with personalised protection could carry on saving in their pension scheme without losing their protection. Any pension savings above the individual's lifetime allowance would be subject to the lifetime allowance charge when benefits are taken.

Please see our briefing note **Finance Act 2011 tax changes** for more detail of how the current arrangements work.

HM Treasury website:
http://www.hm-treasury.gov.uk/as2012_index.htm

HMRC website:
http://www.hmrc.gov.uk/budget-updates/march2012/autumn-statement-dec2012.htm

Restriction of pensions tax relief overview note:
http://www.hmrc.gov.uk/budget-updates/march2012/pensions-tax-relief.pdf

Finance Bill draft clauses:
http://www.hm-treasury.gov.uk/finance_bill_2013.htm

Income drawdown

The capped income drawdown limit (for those not eligible for flexible drawdown) of 100% of the value of an equivalent annuity will be increased to 120% for pensioners of any age. The effective date seems likely to be 6 April 2013. Draft legislation is expected shortly.

Scheme deficits

The Government will consult on providing the Pensions Regulator with a new statutory objective to consider the long-term affordability of scheme funding recovery plans to sponsoring employers.

It also recognises that volatility in measures of pension scheme deficits have been causing employers difficulties. It will therefore also consult on whether to allow schemes undergoing valuation in 2013 or later to smooth asset and liability values.

The Pensions Regulator issued a short response. It said that it will maintain its current stance on scheme funding until it becomes clear that the law will be changing. This means that its April 2012 statement (see **WHiP Issue 33**) continues to apply: trustees must calculate technical provisions on a mark-to-market basis using prudent assumptions and any *"strongly held views about future financial market conditions"* should be accommodated in the recovery plan rather than by adjusting the technical provisions.

Pensions Regulator announcement:
http://www.thepensionsregulator.gov.uk/press/the-regulators-response-to-the-governments-defined-benefit-announcement.aspx

Long-term gilts

The Government proposes to remove the current 50 year cap on gilt maturity dates.

Bridging pensions

Amendments to the Finance Act 2004 will allow the ending of bridging pensions at any time between age 60 and the member's state pension age without the making of an unauthorised payment. This reflects the raising of state pension ages above 65. Currently, a bridging pension that continues after age 65 would result in an unauthorised payment.

As previously reported (see **WHiP Issue 36**), the Government has separately consulted on giving trustees and employers of schemes with restrictive amendment powers a power to amend their bridging pension rules to reflect the changes to state pension ages.

Pension Protection Fund

Pension protection levy determination

The PPF has published its 2013/14 Levy Determination and associated documents, including the contingent assets appendix and guidance. It has confirmed the pension protection levy estimate as £630 million, in line with its consultation proposal (see **WHiP Issue 36**). There are the following material changes this year.

Press release:
http://www.pensionprotectionfund.org.uk/News/Pages/details.aspx?itemID=302

- The levy scaling factor is reduced from 0.89 to 0.73 and the scheme based levy multiplier is reduced from 0.000085 to 0.000056. This means that fewer schemes will have their levy capped.
- Trustees can no longer expect to be given any benefit of the doubt when certifying the value of a guarantee (which can be less than its face value): they are told to certify what the guarantor could *"definitely afford"* if the scheme's sponsoring employer were to suffer an insolvency event (this being when a guarantee would be called upon). In practice, it will be safest for trustees to apply, as far as possible, the same test as the PPF. This means applying a "stress-test" formula to asset and liability values and smoothing the scheme's funding level to reflect changing market conditions over the previous five years.
- Counterparties (banks and securities custodians) with at least an A- credit rating (or A3 if rated by Moody's) will now be accepted.
- The deadline for certifying deficit reduction contributions made on or before 30 March 2013 has been put back to 5pm on 30 April this year (for 2012 it was 10 April).

Compensation cap

The Pensions Minister has said that the Government will be looking at options for reforming the PPF compensation cap. Concerns have been expressed about the "cliff edge" whereby members above normal retirement age receive significantly greater compensation than members just short of that age. One option is for PPF compensation calculations to vary with length of pensionable service.

RPI to remain unchanged

The Office for National Statistics (ONS) has announced that it will not be proceeding with any of its proposed options for changing the Retail Prices Index (RPI) calculation formula, despite noting that it does not comply with international standards. (See **WHiP Issue 36** for details of the original proposals.) Starting in March 2013, however, it will also publish a

Press release:
http://ons.gov.uk/ons/rel/mro/news-release/rpirecommendations/rpinewsrelease.html

new index “RPIJ” which will be the same as RPI save that it will use a geometric averaging formulation rather than an arithmetic one. RPIJ is expected usually to produce lower measures of inflation than RPI.

There will be no direct impact on pension schemes’ indexation and revaluation obligations, and returns on RPI-linked bonds and gilts will continue to be calculated as they are at present. There is no indication that the Government will use RPIJ for any pensions-related purposes.

Automatic Enrolment

For background on the automatic enrolment requirements, please see our briefing note **New requirement to enrol workers in a pension scheme**.

Earnings trigger and qualifying earnings band
The Government has confirmed the automatic enrolment earnings trigger and qualifying earnings band for 2013/14.

- The earnings trigger for 2013/14 will be £9,440, ie, remaining aligned with the income tax personal allowance despite its higher than previously announced increase from £8,105 on 6 April 2013.
- As proposed (see **WHiP Issue 36**), the qualifying earnings band will be £5,668 (the NICs lower earnings limit) to £41,450 (the NICs upper earnings limit – which is lower than for 2012/13).

Consultation response:
http://www.dwp.gov.uk/consultations/2012/ae-thresholds-2013-2014.shtml

Hybrid schemes: loophole to be closed
The Pensions Minister has announced a change to the automatic enrolment legislation, to take retrospective effective from 19 December 2012, closing a loophole that allows employers to postpone automatic enrolment until 1 October 2017 for members who will be enrolled in a hybrid scheme, even if they are only given DC benefits. It is not clear whether the amended law would limit the postponement right to individuals provided with only DB benefits under the hybrid scheme, or whether part DC/part DB accrual will still permit postponement.

The ministerial statement says that employers already affected by the automatic enrolment requirement will have to backdate contributions to 19 December 2012. Jobholders need not pay backdated contributions but if they wish to do so then employers and schemes will have to allow these to be spread *"over an extended period"*.

Ministerial statement:
http://www.parliament.uk/documents/commons-vote-office/December_2012/19-12-12/15-DWP-AutomaticEnrolment.pdf

Fixed and enhanced protection
HMRC has confirmed a limited change of stance in relation to the potential loss of fixed protection when an individual opts out of membership after "contractual enrolment" (ie, enrolment before his/her automatic enrolment date).

Fixed protection is lost if (among other things) a new arrangement is started for the member. HMRC had previously said in its Registered Pension Schemes Manual (RPSM) that those who opt out under scheme rules (rather than under the statutory right – which does not apply to those contractually enrolled) would lose fixed protection because they would have started a new arrangement. It now accepts that this will not be the case "*if the scheme has a legally binding rule that treats an individual who opts out of scheme membership as never having been a member of the scheme*". Most schemes will not currently have such a rule: consideration might therefore be given to adding one.

RPSM page:
http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM11101520.htm

HMRC also now accepts that if the individual takes advantage of the "cooling-off" cancellation period for personal pensions under FSA rules then there is no loss of protection because the arrangement is treated as not having been made and contributions as not having been paid.

A separate RPSM page confirms that contributions deducted by mistake, or before a member has exercised his or her right to cancel during a personal pension cooling-off period, are not to be treated as contributions for tax relief and taxation of refund purposes.

RPSM page:
http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM05302020.htm

HMRC has confirmed to the Association of Consulting Actuaries that it takes the same position as described above on enhanced protection. The RPSM will be corrected to reflect this.

ACA/HMRC Correspondence:
http://www.aca.org.uk/files/HMRC_and_ACA_exchange_re_auto-enrolment_outside_PA_2008_-_Fixed_and_enhanced_protection-2_November_2012-20121102111317.pdf

HMRC has always accepted that an opt-out under the automatic enrolment statutory right (where it applies) does not prejudice fixed or enhanced protection or flexible drawdown.

Five step checklist for trustees
The Pensions Regulator has published an update of its five step action checklist for trustees on automatic enrolment.

Press release:
http://www.thepensionsregulator.gov.uk/press/pn12-33.aspx

NEST constraints consultation

The Government has published a call for evidence on the impact of NEST's annual contribution limit (currently £4,400 pa) and the prohibition of transfers in and out. It wants to know if these restrictions are influencing employers' choice of automatic enrolment schemes in a way that was not intended. The Parliamentary Work and Pensions Committee recently recommended that the restrictions be removed.

Call for evidence:
http://www.dwp.gov.uk/consultations/2012/nest-auto-enrolment.shtml

The Government has outlined possible future proposals for the removal or amendment of the restrictions, as follows:

- Remove the annual contribution limit and the transfer restrictions altogether at the end of staging (February 2018)
- Amend the transfer restrictions for individuals to allow NEST to participate in an automatic transfer approach for small DC pots
- Allow individuals freely to transfer DC pots into and out of NEST
- Allow NEST to accept bulk transfers
- Allow bulk transfers, but only where the average value of DC pots across a specific bulk transfer is no more than a set amount
- Increase the annual contribution limit
- Place an obligation on NEST that a fixed percentage of members must not breach the contribution limit during the course of the year
- Remove the annual contribution limit at a specific point during staging

Evidence is to be submitted by 28 January 2013. The Government intends to publish a summary of responses in Spring 2013.

NEST amendments

The Government has consulted on proposals for amendments to the order governing NEST. The most interesting proposals are as follows.

Consultation:
http://www.dwp.gov.uk/consultations/2012/prop-amendments-nest-order.shtml

- Employers would be able voluntarily to cease to participate in NEST by giving notice. (There is currently no way to leave the scheme.)
- For an individual with multiple employments, NEST would be able to accept minimum contributions from all of the employers even if they together exceed the maximum permitted contribution.

Short service refunds

The Government has announced that it has changed its mind about allowing "micro pots" (DC pots of less than about £200, though the figure was never decided) to be refunded when short service DC refunds become prohibited and the "pot follows member" system is introduced. It now takes the view that micro pots should be transferred, probably to the member's new employer's automatic enrolment scheme.

The announcement is not currently available online. Please ask us if you would like a copy.

Pensions Ombudsman's jurisdiction

Case report:
http://www.bailii.org/ew/cases/EWHC/Ch/2012/3508.html

In *Pensions Ombudsman v EMC Europe*, the Ombudsman referred a point of law to the High Court concerning his jurisdiction. The Court ruled that the Ombudsman could not consider a member's complaint about a funding compromise agreement. This was because the parent company that had ultimately provided the funding would be affected by any determination but could not be joined in the proceedings as a respondent, or bound by the determination, because it had never participated in the scheme.

A member of the Data General Employee Benefits Plan had complained about an agreement under which participating employers' liabilities to the scheme were compromised by payment of a single lump sum contribution. The payments came from the US parent company, EMC, which was a party to the agreement, but they were routed through the UK participating employers. The scheme then went into winding-up.

It was accepted that the Ombudsman had no jurisdiction over EMC because it had never participated in the scheme. It was argued that the Ombudsman should not consider the complaint against the subsidiaries because determination of the claim would prejudice EMC's interests. This was on the basis that any decision to set aside the agreement would adversely affect the value of its shareholdings in the subsidiaries. EMC also argued that, as it would not be bound by any such determination, it would still be able to enforce the agreement and prevent the trustee from seeking further contributions from the employers, and so the determination would be ineffective.

The Ombudsman argued that, if EMC's arguments were accepted, it would prevent him from hearing many other complaints because there would very often be a parent company affected by the outcome of his decision. Such companies could even seek to be added as a contractual party to agreements with their subsidiaries in order to exclude the Ombudsman's jurisdiction.

The judge held that the Ombudsman did not have jurisdiction. He found, relying on the Court of Appeal decision in *Edge v Pensions Ombudsman*, that where, as here, the parent company has a contractual right of its own adversely affected by the pursuit of the complaint to a successful determination, then it is entitled to complain that its right should not be overridden in proceedings to which it either is not (as was the case in *Edge*) or cannot (as in the present case) be made a party and therefore bound.

It was important that EMC had been the source of the funding. The judge thought that the position would be different if the relevant party's contractual involvement was artificial.

Unisex annuities and drawdown

Amending regulations under the Equality Act 2010 took effect from 21 December 2012, prohibiting sex discrimination by insurers when calculating premiums and benefits under new policies, including annuity policies. This follows the CJEU decision in the *Test-Achats* case and a Government consultation (see **WHiP Issues 31** and **35**). Please see our briefing note **Unisex actuarial factors and annuities** for more detail of the implications for occupational pension schemes.

Regulations:
http://www.legislation.gov.uk/uksi/2012/2992/contents/made

The Government has published amendments to regulations governing drawdown pensions which allow women to draw higher amounts than previously. From 21 December 2012, the male rates apply to both men and women. These are more favourable because men are not expected to live as long as women.

Regulations:
http://www.legislation.gov.uk/uksi/2012/2940/contents/made

Government report: "Reinvigorating workplace pensions"

Government report:
http://www.dwp.gov.uk/publications/policy-publications/reinvigorating-wplace-pensions.shtml

The Government has published a report setting out the proposals it will be examining with a view to reinvigorating workplace pensions. The report covers the following areas.

Defined ambition
The Government has set up a working group to consider options for "defined ambition" pensions. These are arrangements that fall within a spectrum between classic DC and classic DB, designed to share risks between employers and members. The report notes that career average and cash balance schemes are already possible but suggests other options that will be considered, as follows, some of which would require legislation.

Based on a classic DB starting point:

- Indexation of pensions conditional on there being sufficient funding
- Removal of the requirement to increase pensions in payment
- Removing spouses' pensions (currently required only in contracted-out schemes and contracting-out is already expected to be abolished)
- On early leaving, conversion of DB benefits to a DC transfer value or a sum for annuity purchase
- DB pensions that fluctuate with funding levels
- Linking normal pension age to state pension age (for service from the date new legislation is introduced)

Based on a classic DC starting point:

- A guarantee against investment loss (at least for member contributions) for some investment options, funded by a levy
- A guarantee of retirement income in later years (decreasing insurers' longevity risks), funded by a levy paid to a new guarantee fund: insurers would only pay annuities to a specified age and the guarantee fund would then take over
- Guaranteed rates of return for a fixed term
- Standardised income guarantee insurance – policies insuring against investment losses
- A centralised, employer-funded "smoothing fund" – to help targeted benefits to be met

The Government has ruled out allowing "collective DC" schemes. These are centralised DC arrangements with targeted (but not promised) DB benefits that are paid as scheme annuities from the pension fund and scaled back if funding deteriorates. The large scales allow assets to be invested collectively in equities for longer than would normally be recommended for an individual. Whilst collective DC works well in Denmark and the Netherlands, the Government says that it is those countries' systems of compulsion that make it work.

Improving DC pension outcomes
The Government will be monitoring member charges very closely and will take steps *"within months"* to disqualify a scheme as an automatic enrolment scheme if its charges are too high. It will also be encouraging transparency in this area.

Other options for improving DC pension outcomes include:

- automatic escalation of contributions, under which members' contribution rates increase when their salaries rise;
- reducing the number of DC schemes by encouraging centralised multi-employer schemes that benefit from economies of scale.

Red tape challenge
The Government has concluded, following its "red tape challenge", that pensions legislation is largely fit for purpose. It does intend, however, to simplify disclosure of information requirements by merging the regulations for occupational and personal pension schemes and simplifying terminology. There will be a consultation on this shortly.

Pensions Regulator consultation on DC regulation

Press release:
http://www.thepensionsregulator.gov.uk/press/pn13-03.aspx

The Pensions Regulator is consulting on the future regulation of work-based DC pension arrangements, in the light of increased membership due to automatic enrolment. The consultation includes a paper on the Regulator’s approach to DC regulation and a draft Code of Practice and guidance for trustees on the governance and administration of DC occupational pension schemes. The Regulator is working closely with the FSA with a view to a consistent approach being applied to group personal pensions.

The regulatory approach paper includes a checklist of 31 expected DC quality features: this has been expanded from the Regulator’s June 2012 draft (see **WHiP Issue 34**). Trustees will be expected to disclose to members, perhaps via the scheme’s annual report, how they comply with the Regulator’s expectations or be able to explain how what they are doing is compliant with the law. Master trust providers will be expected to obtain independent confirmation that they comply. The Regulator will publish a specific enforcement report annually and its annual report will cover the use of its powers in this regard.

The new Code of Practice will sit alongside existing codes on trustee knowledge and understanding and internal controls: there is a good deal of overlap.

The consultation closes on 28 March 2013.

DC pension illustrations

FRC Press release:
http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2012/December/FRC-updates-Standard-on-Assumptions-for-Pension-Sc.aspx

The FRC has published a revised version of actuarial standard TM1 which sets out the assumptions to be used in annual statutory money purchase illustrations (SMPIs). It removes the cap on illustrative rates of return (which is 7%) because, it says, this has at times been used by some providers as a default assumption. The change will take effect for SMPIs with illustration dates on or after 6 April 2013.

The FRC will review what happens with illustrations in practice, to ensure that assumptions used are justifiable, and will encourage providers to give members comprehensible information about the assumptions used on request.

FSA Announcement:
http://www.fsa.gov.uk/static/pubs/policy/ps12-17.pdf

The FSA has also announced that personal pension providers must use lower illustrative rates of return when marketing and selling pension products. From 6 April 2014, providers must use rates of 2%, 5% and 8% (rather than 5%, 7% and 9% as at present). They may comply from 6 April 2013 if they wish.

These announcements follow a joint FRC/FSA consultation in June 2012 (see **WHiP Issue 34**).

Flexible parental leave

Press release:
http://news.bis.gov.uk/Press-Releases/Mums-and-dads-will-share-parental-leave-68330.aspx

The Government has announced its intentions for introducing flexible parental leave. It will consult on implementation shortly. The changes are expected to take effect in 2015, except as noted below.

The 52 week maternity leave entitlement will remain in place as the default position. Statutory maternity pay will continue to be payable to qualifying mothers for 39 weeks.

Women will be able to end their maternity leave and statutory maternity pay early and share the untaken balance of both with their child's other parent. Both parents will need to meet earnings and length of service qualifying criteria to use the new flexible system. Where possible, these will mirror the criteria for existing entitlements.

This flexible parental leave can be taken by the biological father or the mother's partner (husband, civil partner or partner, including same sex) at the same time as the mother's maternity leave or at different times, so long as the total amount of leave does not exceed what is jointly available to the couple.

Flexible parental leave must be taken in a minimum of one-week blocks. The amount available to each parent will be agreed by the parents and each will subsequently need to agree their individual pattern of leave with their employer. In the event that the pattern cannot be agreed, the leave defaults to a single block to commence on a date specified by the employee.

Ordinary paternity leave and statutory paternity pay will remain at the current level of two weeks for the time being.

From March 2013, the right to unpaid parental leave will be increased from 13 to 18 weeks, in order to comply with the revised EU Parental Leave Directive. In 2015, the child age limit will be increased from the current five years to 18 years, providing each parent the right to up to 18 weeks' unpaid parental leave for each child under 18.

There is no mention of pensions in the Government's response but it is expected that any form of paid parental leave will continue to be pensionable as at present. Schemes' procedures may need to be adjusted and, although the law will be overriding, scheme rules should in due course be amended to cover paid periods of flexible parental leave under the new regime.

Industry code on pension charges for employers

Press release:
http://www.napf.co.uk/PressCentre/Press_releases/0265_Industry_publishes_joint_code_on_pension_charges.aspx

A joint industry code of conduct on pension charges has been published. It concerns the disclosure of information by pension providers to employers (not employees) about charges on workplace pensions, by way of a standard template. It is endorsed by the NAPF and ABI, in association with the IMA and SPC. The code is a guide to best practice from 1 January 2013. Once a dedicated web tool has been launched, the code will apply fully (but it will not be mandatory).

Public sector staff transfers: "Fair deal"

Consultation response:
http://www.hm-treasury.gov.uk/consult_fair_deal_policy_pensions_publicsector.htm

Following a July 2012 ministerial statement (see **WHiP Issue 35**), the Government has published a little more detail on its future plans for Fair Deal, including draft guidance. Fair Deal is the policy that governs the treatment of pension rights on an outsourcing from central (but not local) government to a private sector contractor.

This confirms that public service pension scheme members will retain their scheme membership following the outsourcing. There will no longer be an option for new contractors to provide a broadly comparable scheme. They will pay contributions to the public service scheme set by the scheme with the consent of HM Treasury. The rates will *"generally"* be the same as those charged to the public sector body. (Note that the new public sector scheme designs feature an employer cost cap.) Further details are being considered. There is no mention of payments in respect of any underfunding when the private sector employer ceases to participate. (Note that section 75 of the Pensions Act 1995 does not apply to these schemes.)

When an existing contract is retendered and awarded to a new contractor, it will have the option of participating in the public service pension scheme or providing its own broadly equivalent CARE scheme. It must make the same choice for all affected staff. In either case, members will be offered a transfer from the previous contractor's scheme, which if taken will protect their final salary link (for pre-CARE service). The existing contract should already set out bulk transfer terms that apply on a retender. If these do not result in an adequate bulk transfer value to a public service scheme, it is the public sector authority's responsibility to make up the deficit. There will be transitional provisions affecting members with less than ten years to their normal pension age on 1 April 2012.

Comments are to be submitted by 11 February 2013. The timescale for the changes to take effect is not specified.

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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: Paul Stannard, Peter Esam, Philip Stear, Susie Daykin and Daniel Gerring.

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