Sackers

Quarterly briefing

December 2014

Highlighting significant developments in pensions law, covering key areas such as pensions reform, regulatory developments, new legislation and cases

Q4
December 2014

On the front cover this quarter:
Chirag Ghelani, Associate

Abbreviations

AA: Annual allowance

ABC: Asset backed contribution

CAB: Citizens Advice Bureau

CDC: Collective defined contribution

CPI: Consumer Prices Index

DA: Defined ambition

DB: Defined benefit

DC: Defined contribution

DWP: Department for Work and Pensions

EIOPA: The European Insurance and Occupational Pensions Authority

FCA: Financial Conduct Authority

FSD: Financial Support Direction

GMP: Guaranteed Minimum Pension

HMRC: HM Revenue & Customs

HMT: HM Treasury

ICAEW: Institute of Chartered Accountants in England and Wales

IFA: Independent Financial Adviser

IGC: Independent Governance Committee

NEST: National Employment Savings Trust

NICs: National Insurance Contributions

PO: Pensions Ombudsman

PPF: Pension Protection Fund

SPA: State pension age

TPAS: The Pensions Advisory Service

TPR: The Pensions Regulator

In this issue

Agenda for pensions reform 3

DC focus

Freedom and choice in pensions 4
Charges 5
Governance 5
Update on auto-enrolment 6

DB focus

Abolition of DB contracting-out 7

International Pensions

EU developments 8
Changes to the pensions tax regime in Jersey 8

Regulatory

Pension Protection Fund 9
HMRC 10
The Pensions Regulator 10

Cases 11

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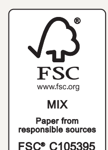

Agenda for pensions reform

The new world

Before George Osborne stood up to deliver the 2014 Budget, few could have foreseen the seismic shift in the pensions landscape that would be on the horizon. Ever since, the Government, pension schemes and their advisers have been focusing on delivering the Chancellor's promise of a world of freedom and choice, before the new measures are implemented on 6 April 2015.

The latest DC developments are set out on pages 4-6

Not only will those with DC benefits be able to take control over how they (and their dependants) access their retirement fund, but other measures, including the guidance guarantee, cap on charges in DC default funds and minimum governance standards, all seek to ensure that those DC funds are more transparent and provide better value for money.[1]

Still to come…

Short service refunds from DC schemes are set to be abolished, so that members with only DC benefits will become entitled to short service benefit after 30 days' qualifying service. The change will only apply to individuals who first become active members of a DC arrangement on or after the provision comes into force, with the Government currently aiming to introduce this in October 2015.

The Pensions Act 2014 provides a framework for a new system of automatic transfers (known as "pot follows member") that will allow the consolidation of small pots. This facility will apply, initially at least, to DC pots of up to £10,000. Regulations that will flesh out this measure are awaited, but the intention is that it will be introduced alongside the abolition of short service refunds in 2015.

On hold?

With all hands on the Government deck getting ready for 2015, other pensions measures have seemingly been put on the back burner.

Some pension scheme mergers have been on hold whilst we await an Order to address the payment of transfer values between registered pension schemes and the possibility that this may result in a pension input amount. Block transfers are to be excluded from the scope of the Order with effect from the 2011/12 tax year.

We await progress on a number of measures

GMP equalisation has been on the backburner for some time and we are unlikely to see any further progress here until after the General Election.

Meanwhile, the Pensions Ombudsman's office has been dealing with an increasing number of complaints relating to pension liberation. We understand that many of these relate to the refusal by providers of personal pension schemes to implement transfer requests, but a number also relate to the disappearance of pension monies in cases where transfers have been processed. The Ombudsman's decisions in these cases are awaited, as is a code of practice on pensions transfers by The Pension Liberation Industry Group.

Autumn Statement 2014

And finally, the Autumn Statement[2] will be delivered by the Chancellor on 3 December 2014. We are not expecting any major announcements relating to pensions, but this year's Budget taught us to expect the unexpected!

1 See our DC briefing (October 2014)

2 The Treasury's papers relating will be available from its Autumn Statement 2014 webpage

DC focus

Freedom and choice in pensions

Taxation of Pensions Bill

This Bill will introduce changes to the pensions tax rules needed to enable individuals to access their DC pension savings flexibly, as announced in the Budget.[3]

Framework for flexible access to DC pots

Once in force, the Bill will introduce a wide range of options as to how individuals can use their DC pension savings from the age of 55. Access to DC savings will be subject to the payment of income tax at the individual's marginal rate (rather than the current 55% charge for full withdrawal).

In addition to the various options proposed in the August draft,[4] the Bill also now includes provision to enable individuals to pass on their unused DC pension to any nominated beneficiary when they die, abolishing the current 55% tax charge which applies to pensions passed on at death.

New reporting requirements

There are a number of new reporting requirements for both trustees / scheme administrators and individuals, where an individual has accessed their pension savings flexibly. These reporting requirements will require that the individual gets the right information to declare on their self-assessment tax return and calculate any AA charge due and HMRC has sufficient information to ensure the right amount of tax is paid.

To enable trustees or managers of registered pension schemes to make any of the new types of payment, should they choose to do so, the Bill will introduce a permissive "scheme rules override".

In force April 2015

The Bill will be debated during Parliament over the coming months with a view to finalising the legislation ahead of the April 2015 implementation date. During this process, amendments of a technical nature can be expected, but substantive policy changes are unlikely to be made.

Pension Schemes Bill

Also before Parliament is the Pension Schemes Bill,[5] which will introduce the non-taxation elements required to implement the DC flexibilities, as well as a legislative framework for defined ambition schemes, in particular CDC.

The Bill will amend existing pensions legislation to ensure that the new flexibilities operate as intended, providing for, among other things:

Non-taxation elements of flexible regime

- the guidance guarantee for DC members
- a prohibition on transfers to DC from unfunded public service DB schemes
- a requirement for DB schemes to check that an individual has taken advice from an IFA before a transfer out to a DC scheme can be made.

DA schemes are designed to slot into the gap between DB and DC, with the intention of providing employers with pension options which allow for greater sharing of risk, whilst providing more certainty than the traditional DC model for individual pension savers. In the Government's opinion, the provision of DA schemes will lead to greater confidence in pension saving and therefore increased engagement.

3 See our Alert: Taxation of Pensions Bill (15 October 2014)
4 See our September Quarterly Briefing for details
5 See our Alert: Pension Schemes Bill introduced framework for defined ambition (30 June 2014)

DC focus cont.

The guidance guarantee

One of the key elements of the new flexible regime will be the introduction of a free and impartial guidance service to help pension savers decide what to do with their pension pot when they retire. The guidance, which will be funded by a levy on regulated financial services firms, will be tailored to individuals' personal circumstances but will not recommend specific products or providers.

TPAS and CAB to provide guidance guarantee

HMT has been consulting on plans to give the FCA responsibility for setting standards for guidance and monitoring compliance. Schemes will be responsible for signposting the guidance, setting out the fact that guidance is available (and that it is free and impartial), showing how the service can be accessed, and providing the information that a member will need to make an informed decision about their pension savings (whether or not they use the guidance).

HMT has confirmed that the service will be available by phone, face-to-face or online. TPAS and the Citizens Advice Bureau have been named as the Government's partners to provide the guidance service, with HMT retaining overall responsibility for implementation.

Charges

Cap on DC default funds

From April 2015, there will be a general cap on DC default fund charges of 0.75% of the funds under management.

Cap on "member borne deductions"

This will apply to all member borne deductions (MBDs) relating to scheme or investment administration, which include anything taken as a flat fee or percentage from members' funds under management, contributions or investment returns, specifically related to the administration of assets. Transaction costs are excluded for the time being but will be reviewed in 2017. MBDs are to replace "annual management charges" as a measure of charging and it is intended that MBDs will enable a consistent frame of reference between different providers.

Whilst the cap only applies to default funds in DC schemes used for auto-enrolment, since most people who are currently in a workplace pension scheme will either have been auto-enrolled into it, or be in a scheme that qualifies for auto-enrolment purposes, in practice the cap will be an issue for most schemes.

A list of the charges included in the cap can be found on our website.[6]

Governance

New legal requirements on the horizon

As part of the Government's drive to create a more level playing field between trust- and contract-based schemes, we can expect to see a considerable addition to DC specific legislation in the shape of new requirements for trustees, assessing value for money, compliance with the charge cap and producing an annual governance statement, among other things.

6 DC default fund charge cap – what's in and what's out?

DC focus cont.

Master trusts: independent assurance

In May 2014, the ICAEW (in association with TPR) published a voluntary assurance framework for master trusts, which aims to enable trustees of such arrangements to demonstrate to employers that their scheme is managed to a high standard.[7]

The People's Pension obtained independent assurance under the framework in September 2014, the first master trust to do so.

Independent governance committees

IGCs to be in place by April 2015?

The FCA has been consulting on proposed rules to require the providers of contract-based pensions to set up and maintain IGCs. The proposals expand on the Government's plans for personal pension schemes to be governed in a more "trust-like" way,[8] with a view to introducing IGCs from April 2015.

Update on auto-enrolment

Opt-out rates

1 October 2014 marked the second anniversary of the start of automatic enrolment. According to TPR figures, in that period, around four and a half million workers have been enrolled into workplace pensions, with some 28,000 employers now subject to the duty to enrol their eligible jobholders into pension saving.

New data released by NEST reveals that those under the age of 30 who have been automatically enrolled are remaining in pension saving. A 5% opt-out rate in this category contrasts with more than 28% among those aged 60 and over.

Thresholds for 2015/16

Whether an individual is eligible for auto-enrolment depends on whether they earn in excess of the "earnings trigger". Contributions payable in respect of an eligible jobholder also depend on their earnings within the "qualifying earnings band".

The DWP is consulting on the proposed thresholds for 2015/16.[9] While it is likely to continue basing the qualifying earnings band on the NI lower and upper earnings limits, the DWP is considering four different options for the earnings trigger:

Consultation closes 25 November 2014

- freezing the trigger at its current level of £10,000
- raising the trigger by indexation (CPI or Earnings)
- increasing the trigger to £10,500 in line with the threshold for paying income tax
- using the benchmark replacement rate determined by the Pension Commission.

Removal of NEST restrictions in the pipeline

NEST members are currently restricted in terms of the amount they can save (a cap on contributions of £4,600 applies) and prohibited from transferring their NEST savings to another arrangement. With a view to giving NEST members access to the same flexibilities enjoyed other DC scheme members, as well as the ability to save more for their retirement, the DWP has been consulting on provisions to remove these restrictions with effect from 1 April 2017.[10]

7 See our Alert: TPR publishes master trust assurance framework (6 May 2014)
8 See our Alert: Next step towards a level playing field for workplace pensions (11 August 2014)
9 Workplace pensions automatic enrolment: review of earnings threshold (DWP, 15 October 2014)
10 NEST: removal of the annual contribution limit and transfer restrictions (DWP, 9 October 2014)

DB focus

Abolition of DB contracting-out

Single tier State pension from 6 April 2016

In April 2016, the current state pension will be replaced by a flat rate, single tier pension.[11] A key consequence of this is that employers will no longer be able to contract their employees out of the additional State pension on a salary-related basis. DB contracting-out will therefore cease to exist from the same date.

Implementing the changes

One of the most significant implications of the abolition of DB contracting-out is that both employers and employees will need to start paying the standard rate of NICs. Currently, in return for the employer providing a pension meeting the statutory minimum, employer contributions are reduced by 3.4% and employee contributions by 1.4%.

Power to amend scheme rules

Employers will have a unilateral power to amend their scheme rules to offset the increase in employer NICs. Regulations (currently in draft) set out how the statutory modification power may be used and the rules which contracted-out schemes will need to comply with when contracting-out comes to an end.

Reconciliation of GMPs

HMRC is offering a GMP reconciliation service[12] to help pension scheme administrators and trustees reconcile their GMP records for all non-active members against HMRC records ahead of the end of contracting-out. Trustees wishing to use this service should submit their request as soon as possible and in any event before April 2016. We understand HMRC will not provide reconciliation data for any requests made after this date.

Integration with state benefits

Benefits in certain DB schemes have been designed to integrate with State benefits, for example by means of a deduction in pensionable salary, a deduction to a pension in payment or a bridging pension.

Any rules dealing with such benefits should be reviewed before April 2016.

DWP to issue state pension estimates

The DWP has launched a campaign[13] to raise awareness of the change in the State pension. As part of a new service, individuals will receive a personalised written estimate of what they can expect to receive under the new system, based on their work history and NI contributions to date. At the outset, this will be made available to the 2.5 million people who reach SPA in the first five years of the new scheme (between April 2016 and August 2021), before gradually being expanded to all those of working age.

11 See our Alert: Pensions Act 2014 (19 May 2014)
12 HMRC scheme reconciliation service for contracted-out pensions
13 "Your future, your pension" (4 October 2014)

International Pensions

EU pensions developments

Draft Pensions Directive revised

Since the publication of the initial draft of the new EU Pensions Directive in March 2014,[14] two compromise proposals have been published, the most recent on 24 October 2014.[15]

Key changes to the initial draft include:

Further drafts published

- a relaxation in the approach to the changes to the disclosure requirements, moving away from the overly prescriptive earlier wording (which would have allowed no more than two sides of A4 for scheme information)
- a slight softening of the requirement for those "persons who effectively run the institution" (ie trustees) to have professional qualifications. In the current draft, this provision is now limited to "the activities performed for the institution"
- detailed provisions on the requirement for schemes to compile a "risk evaluation for pensions" which could be interpreted as a means to ramp up a scheme's funding requirements.

Whilst account is being taken of representations on the draft, the Directive is still subject to scrutiny by the EU's Council of Ministers and the Parliament, as well as approval by the EU Commission, so further changes can be expected.

Further work on solvency rules

The "holistic balance sheet" – a measure for valuing pension schemes which would require liabilities to be balanced by a mixture of assets, contingent assets, sponsor support and possible access to compensation schemes – no longer forms part of the draft Directive. However, EIOPA is undertaking further related work on the solvency of pension schemes.

New consultation on pension scheme solvency

EIOPA's current consultation[16] looks at how the value of sponsor support might be measured, and the way in which national regulators could employ the holistic balance sheet as a supervisory tool, using a principles-based approach.

EIOPA intends to produce draft technical specifications for a quantitative impact assessment or study by early 2015, after which it plans to develop, at its "own initiative", technical advice to the European Commission.

Changes to the pensions tax regime in Jersey

New measures in 2015

Changes to modernise and simplify the pensions tax regime in Jersey, with a view to bringing it into line with those which apply in the UK, Guernsey and the Isle of Man have been approved.

Among other things, from 1 January 2015, schemes will be permitted to operate flexible retirement and allow members to access their 30% tax-free lump sum in any number of tranches (as opposed to the current maximum of three).

UK schemes with Jersey members may wish to consider whether to take advantage of some or all of the new measures.

14 See our Alert: Pensions back on the EU agenda (1 April 2014)

15 Proposal for a Directive on the activities and supervision of institutions for occupational retirement provision (recast) (EU Council second Presidency compromise)

16 CP-14/040 Consultation paper on further work on solvency of IORPS (EIOPA, 13 October 2014)

Regulatory

Pension Protection Fund

PPF levy

The PPF levy estimate for 2015/16 will be £635 million – nearly 10% lower than the estimate for 2014/15.[17]

The PPF considers that it remains on track to meet its long-term funding target of self-sufficiency by 2030. It also anticipates that, as a result of improved funding, levy estimates for the following two years are also likely to fall further rather than rise, based on the expected path of asset values and yields.

New "FAQs" on the levy have been published by the PPF.[18]

New PPF model

For the levy years 2015/16 onwards, the PPF is moving to a new, PPF specific model for measuring employer insolvency risk.[19] The new model, on which the PPF has been consulting, is based solely on information about sponsors of DB pension schemes, focusing on the most predictive variables for such arrangements.

Key features of the new model include:

PPF specific model of employer insolvency risk

- priority for complete data over sources such as Companies House, to allow businesses that file abbreviated accounts to share full accounts with Experian
- recognition of all certified ABCs in the levy calculation
- the exclusion of mortgages that are not relevant to insolvency risk
- further strengthening of the processes for certifying Type A contingent assets (parent company guarantees). New standard form contingent asset documentation is due to be published in December 2014, alongside the 2015/16 levy determination.

The PPF will use insolvency scores from 31 October 2014 in the levy calculations for 2015/16. Although some employers will see a big change in their levy under the new model, there will be no transitional protection for those affected.

Updated valuation guidance

The new definition of "money purchase benefits" came into effect on 24 July 2014, meaning that certain benefits that were previously treated as money purchase and therefore not eligible for PPF protection are now within the PPF's scope and must be included in PPF valuations.[20] As a result, the PPF updated its "section 179" guidance (dealing with a scheme's funding position on the PPF basis).

Guidance updated for new definition of "money purchase benefits"

Following this, the PPF has now updated its guidance on other types of valuation, including valuations under section 143 (used to determine whether a scheme should enter the PPF following an insolvency event), section 152 (for schemes re-applying for entry to the PPF, having carried out a section 143 valuation with a surplus and been unable to secure PPF compensation levels on the annuity market), and section 156 (periodically carried out by closed schemes operating outside the PPF).[21]

17 PPF levy estimate for 2015/16
18 Available on the PPF website
19 See our Alert: PPF announces levy estimate for 2015/16 and conclusions on the levy's future (15 October 2014)
20 See our Alert: Final regulations on reclassifying DC benefits (8 May 2014). Please also note TPR issued guidance on 5 November 2014 on the change to this definition
21 PPF: Further valuation guidance to reflect amended definition of money purchase benefits (16 October 2004)

Regulatory cont.

HM Revenue & Customs

New powers to combat pension liberation

HMRC has new powers (in force from 1 September 2014) to help it combat pension liberation activity. Where it believes that a scheme administrator (generally, the trustees) is not a fit a proper person for the role, HMRC can refuse to register a new pension scheme or de-register an existing scheme.

Assumption that trustees are "fit and proper"

All persons appointed as scheme administrators will be assumed to be fit and proper persons, unless HMRC holds or obtains information which calls that information into question. Now, when a pension scheme is registered, the administrator is required to make a declaration as to their fitness for the role and proper status.

The Pensions Regulator

Scheme return checklists

TPR has published checklists identifying new information that trustees will need before completing their 2014 scheme returns, together with sample returns for DB and DC schemes.[22]

New information required

- DB schemes will need to provide financial assumption information (if the scheme is in surplus), value at risk information (used for assessing the size and likelihood of potential risks) and information relating to the structure, valuation and term of any ABC arrangement.
- DC schemes will need to provide additional or different information in several areas, including in relation to contributions, net assets and membership.

Staff Determinations procedure

TPR has published a new Staff Determinations procedure, setting out how decisions (on issues such as certain trustee appointments and issuing clearance and improvement notices) are made by the executive arm of TPR rather than the Determinations Panel. The purpose of the procedure is to provide more detail about determinations made by members of staff, with a view to promoting greater transparency and enhancing TPR's relationship with the pensions industry.

TPR's regulatory action

In the last quarter TPR has issued reports on its regulatory action in four high profile cases:

- Lehman Brothers
- MG Rover
- Kodak and
- UK Coal.[23]

22 Scheme return 2014: what's new?
23 Full details can be found in the section 89 reports section of the TPR website

Cases

Duty to inform member of personal tax consequences?

There was no duty in this case to inform a member that opting to take his benefits at a particular time would have detrimental personal tax consequences.[24]

A member of a DC scheme, Mr Ramsey, had a promise from his employer that the value of the benefits he would have received in a DB scheme that he was a member of prior to an acquisition would be topped up (the "special arrangement"). When Mr Ramsey elected to take his benefits under the special arrangement, an AA charge was triggered. He complained that he had not been informed of the possible detrimental tax implications of taking his benefits under the special arrangement and claimed that, had he been aware of the tax liability, he would have made the election to take his benefits earlier in order to avoid it.

General duty to act in members' best interests

The Deputy PO found that the company's duty extended only to providing information to the administrator to enable it to provide a pension saving statement, whilst the administrator's only obligation was to provide the statement. In both cases, the information was provided in advance of the statutory deadlines. A failure to warn a member about a potential tax charge could constitute a breach of trustees' general duty to act in the best interests of members and beneficiaries, as "'best interests' essentially means their best financial interests". However, in this case, there was no breach, because before Mr Ramsey elected to take his benefits he was not a member of the scheme in question. As such, the trustee did not owe him a duty to act in his best interests.

Trustees must ensure they keep members informed of new developments. But this case confirms that trustees are not required to advise members of the potential tax consequences of their decisions. Trustees should be careful to make it clear that, for advice on these matters, members should speak to an IFA.

Was there a reasonable expectation of discretionary increases

The Deputy PO dismissed a complaint by Mr Thomson in connection with a decision to stop awarding discretionary inflationary increases in relation to pension accrued before April 1997.[25]

Past practice did not create a reasonable expectation

The Plan's rules gave the trustee discretion, subject to the agreement of the principal employer, to pay increases, and for discretionary increases to be reviewed by the principal employer at least annually. The company's past practice was insufficient to create a reasonable expectation and its decision to stop paying such increases was neither irrational nor perverse.

The "reasonable expectations" argument is an attractive one for members, especially since the decision in IBM (which concluded that IBM acted in breach of its duty of good faith in disturbing members' reasonable expectations). But to make such an argument stick, they will need to ensure that they have convincing evidence to back up their claims.

Forthcoming cases

Decisions are awaited in a number of key pensions cases, including:

- *The Merchant Navy Ratings Pension Fund Trustee Ltd v Stena Line Ltd and others* – a dispute over the apportionment of scheme's pension deficit liabilities and is likely to look afresh at the definition of "active member" in this context.
- *IBM UK Holdings Ltd and another v Dalgleish and others* – following a High Court decision in April this year, the outcome of the remedies hearing in July is awaited.[26]

24 See our summary: Ramsey (PO-3290)

25 See our summary: Thomson (PO-1203)

26 See our Alert: *IBM United Kingdom Holdings Limited v Dalgleish and others* (8 April 2014)

Sackers

Upcoming seminars

We offer an extensive programme of client workshops and seminars. In addition to the quarterly legal updates, our seminars, which are led by our experts, offer clients the opportunity to ask questions and to share experiences on particular topics.

DC trustee training	05/02/15	Afternoon workshop (1:00pm-4:30pm) Aimed at new trustees or those wanting an introduction to DC benefits, this seminar will look at key legal issues for trustees.
Quarterly Legal Update – Seminar	12/02/15	Breakfast seminar (09:00am-10:30am) The latest legal and regulatory developments in the pensions world.

If you would like to attend any of our seminars, please contact our marketing team at marketing@sackers.com.

Our Quarterly video distils content from the Quarterly Legal Update Seminar into bite sized chunks, highlighting some of the current key issues. A selection of short videos on topical pensions-related issues and aspects of our firm is available on our website:

www.sackers.com/news-and-media/videos

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DC Briefing

The first edition of our new publication DC Briefing was published in October. DC Briefing highlights topical news on DC pensions from a legal viewpoint. A copy is available on our website or from your usual Sackers contact.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 (0)20 7329 6699
F +44 (0)20 7248 0552
E enquiries@sackers.com
www.sackers.com

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