



# PENSIONS NEWS

DECEMBER 2014

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## INTRODUCTION

Welcome to DLA Piper's Pensions News publication in which we report on recent developments in pensions legislation, guidance and case law, as well as keeping you up to speed on what to look out for in the coming months.

This edition brings you the developments from December 2014 including the following.

- **Budget reforms:** a further announcement in the Autumn Statement about the taxation of death benefits; the Taxation of Pensions Act 2014 receiving Royal Assent; and the publication of draft regulations about the transfer of annuities, the provision of information and overseas schemes.
- **Pension Protection Fund:** the publication of the final Levy Determination for 2015/16.
- **Department for Work and Pensions:** a consultation about technical amendments to the automatic enrolment legislation; the response to consultation about the automatic enrolment earnings thresholds for 2015/16; and the response to consultation about the removal of the NEST restrictions.
- **Legislation:** an updated draft of the new IORP Directive; and regulations to limit claims for back payment of holiday pay.
- **Case law:** a judgment about whether a section 75 debt is assignable; and a determination from the Pensions Ombudsman relating to pension liberation.
- **HMRC:** the latest Countdown Bulletin in relation to the end of contracting-out; and the draft Order making amendments to the annual allowance legislation being laid before Parliament.
- **Public service pension schemes:** regulations about record-keeping; a consultation about further amendments to the LGPS regulations; and draft regulations making consequential amendments in relation to various schemes being laid before Parliament.
- **Other News:** amendments to the guidance about Statutory Money Purchase Illustrations; reports from the FCA about its review of the retirement income market and its thematic review of annuities sales practices; and the report of the Independent Project Board on its audit of legacy schemes.

If you would like to know more about any of the items featured in this edition of Pensions News or how they might affect you, please get in touch with your usual DLA Piper pensions contact or contact Cathryn Everest. Contact details can be found at the end of this newsletter.





## BUDGET REFORMS

### AUTUMN STATEMENT

On 3 December the Chancellor delivered his Autumn Statement, with announcements in relation to pensions including the following.

#### Taxation of death benefits

On 29 September the Chancellor announced that from April 2015 there will be changes to the taxation of death benefits in cases where the member had DC savings and the funds were uncrystallised or in a drawdown account when the member died. In summary, the position will be that the remaining DC savings can be passed on tax free if the member was under 75 at the date of death, and will be taxed at marginal rate (for drawdown) or at 45% (for lump sums) if the member was aged 75 or over at the date of death. (The Government's intention is to reduce this 45% charge to marginal rate from 2016/17.) The amendments to the legislation to give effect to these changes were subsequently published as part of the Taxation of Pensions Bill.

In the Autumn Statement the Chancellor announced that the Government has now decided to go further so that from April 2015:

- if an individual dies under the age of 75 with a joint life or guaranteed term annuity, beneficiaries will be able to receive any future payments from such policies tax free if no payments have been made to the beneficiary before 6 April 2015;

- where the individual was over 75, the beneficiary will pay tax at marginal rate or at 45% if the funds are taken as a lump sum (although it is intended to tax lump sums at marginal rate from 2016/17).

The Autumn Statement notes that this will mean that people will no longer have to worry about their pension savings being taxed at 55% on death. The tax rules will also be changed to allow joint life annuities to be paid to any beneficiary.

*The amendments to the legislation to give effect to these latest changes on taxation of death benefits had not been published as at the end of December. As reported below, the Taxation of Pensions Act 2014 (which contains the changes to taxation of death benefits announced in September) has now received Royal Assent and therefore it seems that these latest changes will be reflected in the Finance Bill 2015. We will report again when the draft legislation is published.*

### Pensions tax relief

In the March 2014 Budget the Government stated that it would explore with interested parties whether the tax rules that prevent those aged 75 and over from claiming tax relief on their pension contributions should be amended or abolished.

The Autumn Statement confirms that, following informal consultation since the Budget, the Government has decided not to make changes to the age limit at which tax relief can be claimed on pension contributions.

### TAXATION OF PENSIONS ACT 2014

The Taxation of Pensions Act completed its remaining stages in the House of Commons and all stages in the House of Lords during December and received Royal Assent on 17 December.

During the final stages in the House of Commons, amendments which had been published in draft in November were incorporated into the Bill. The key amendments were to the Part of the Bill setting out requirements for the provision of information. The purpose of this Part is to ensure that members are aware



that they have flexibly accessed their pension rights and the consequences of having done so, and that the scheme administrator for every scheme of which they are a member is also aware. Some of the requirements to provide information apply to scheme administrators and others apply to members. The amendments relax the requirements that apply to members in the following ways.

- Rather than have to provide the information to **all** schemes of which the person is or becomes a member, the member will only have to provide information to schemes in which they are an “accruing member”. Essentially this means: (i) schemes in which there are arrangements for the accrual of benefits to or in respect of the member under a cash balance or hybrid arrangement; and (ii) schemes in which contributions are being made to a money purchase arrangement (other than a cash balance arrangement) by, on behalf of, or in respect of the member.
- The member will have 91 days (rather than 31 days as was originally proposed) to provide this information. This 91 days will commence on whichever is applicable of the date that the member receives notification that they have flexibly accessed their benefits, or the date that they become an accruing member in the relevant scheme. (31 days remains the time limit for the provision of information requirements that fall on the scheme administrator.)

*The Act receiving Royal Assent is a significant milestone in the implementation of the reforms. It contains the majority of changes required to the tax legislation to give effect to the reforms including the introduction of flexi-access drawdown, the payment of uncrystallised funds pension lump sums allowing members to access their benefits flexibly without first designating the funds to drawdown, the statutory power for trustees to make flexible payments, relaxations of some of the criteria that annuities have to meet, the introduction of the money purchase annual allowance, requirements for the provision of information, and the changes to taxation of death benefits in relation to uncrystallised funds and funds in drawdown.*

*Changes to the pensions legislation continue to progress through Parliament in the Pension Schemes Bill which received its second reading in the House of Lords on 16 December and will commence Committee stage in the House of Lords in January 2015.*

*We have reported on the Taxation of Pensions Bill several times as it has progressed through Parliament and been amended. Now that the Act is in its final form, we will shortly be publishing a Pensions Alert which reports on all the key elements of the Act in one place and looks at some of the practical issues for schemes to consider.*

## DRAFT REGULATIONS

On 19 December, three sets of draft regulations were published by HMRC which are connected to the April 2015 DC reforms and to changes to the legislation in relation to pension liberation that were announced at the Budget. Comments can be sent to HMRC on the draft regulations until 16 January 2015, and it is proposed that the regulations will come into force on 6 April 2015.

## Annuities and transfers

The Taxation of Pensions Act 2014 (“**Act**”) includes provision to relax some of the criteria that annuities must meet in order to be authorised payments under the Finance Act 2004. These relaxations include the removal of the criterion that an annuity cannot decrease aside from in certain specified circumstances. However, the relaxations only apply to annuities that the person becomes entitled to on or after 6 April 2015.

The draft Registered Pension Schemes (Transfer of Sums and Assets) (Amendment) Regulations 2015 remove scope to take unintended advantage of this new flexibility by transferring an old annuity to one issued on or after 6 April 2015.

The draft Explanatory Memorandum explains that the regulations ensure that an annuity acquired on or after 6 April 2015 following the transfer of sums and assets from an annuity that was originally acquired before 6 April 2015 will only be treated as a “lifetime annuity” where it is issued



on a 'like for like' basis, that is, where the terms of the annuity do not allow it to be reduced beyond the limits that applied to the original annuity. Similar amendments are made in relation to dependants' annuities, short-term annuities and dependants' short-term annuities.

## Provision of information

### Tax free death benefits

The Act makes provision in relation to the taxation of death benefits so that, essentially, if a person dies before the age of 75 with unused drawdown funds, any payments to beneficiaries (whether as income withdrawal or a lump sum) will be tax free. It also provides that where a member dies under age 75 with uncrystallised funds, the designation of those funds within two years as available for drawdown will be a Benefit Crystallisation Event (BCE 5C).

The draft Registered Pension Schemes (Provision of Information) (Amendment) Regulations 2015 make amendments:

- to introduce new reporting requirements on scheme administrators where a beneficiary receives payments from a drawdown fund that can be paid tax free and the drawdown fund is transferred to another provider; and

- so that the reporting requirements in connection with the payment of death benefits that are tested against the lifetime allowance includes any designations into drawdown which will be subject to new BCE 5C.

### Pension liberation

Following an announcement in the Budget, changes were made by the Finance Act 2014 to the circumstances when HMRC can refuse to register a pension scheme, with the intention of the changes being to help combat pension liberation.

However, the draft Explanatory Memorandum to the regulations notes that these changes did not prevent a scheme being set up legitimately and then changing its structure to become a scheme that is more likely to be the target of pension liberation. The draft regulations therefore amend the information that must be provided to HMRC when a scheme changes its structure or range of number of members, in order to enhance HMRC's compliance activities to combat pension liberation.

### Overseas Pension Schemes

The draft Overseas Pension Schemes (Miscellaneous Amendments) Regulations 2015 make amendments

to align the provisions for overseas pension schemes more closely with those for registered pension schemes following changes made by the Act. For example, the draft regulations include the following.

- The removal of the requirement that, in order for UK tax relief to be available, some overseas schemes must provide in their scheme rules that at least 70% of UK funds must be used to provide the individual with an income for life. This is being removed because otherwise it would not be aligned with the legislation for registered pension schemes once flexibility is introduced.
- Provision is made so that in order to be able to accept transfers of UK tax-relieved pension savings free of UK tax, all schemes will need to provide that pension benefits from the transferred funds are payable no earlier than they would be under the rules of a registered pension scheme. The draft Explanatory Memorandum explains that this is intended to discourage people from transferring to overseas schemes so that they can access their UK tax-relieved pension savings before they would be able to under a registered pension scheme.



- The information requirements that arise from pension flexibility for registered pension schemes are mirrored so that members of registered schemes and of overseas schemes where UK tax relief has been provided will receive similar treatment for tax purposes.

## HMRC NEWSLETTER

On 17 December HMRC published the latest of its Pension Schemes Services Newsletters which includes information, including the following, on some of the practical aspects of administering flexible payments under the new regime.

## PAYE

- Normal PAYE rules will apply to flexible payments, and where the fund is not extinguished with the first payment, it will be treated as an ongoing PAYE source. Further information is provided as to what tax code to use in different circumstances.
- Where the fund is extinguished the scheme administrator must issue a P45 which will enable the member to claim any tax refund that might be due in-year. Where the member decides to receive their money over more than one payment, the P45 should only be issued once the final payment is made.

## In-year repayments

- HMRC has now agreed a process for members to claim an in-year repayment in circumstances where funds have been fully extinguished, with this process mirroring the current in-year trivial commutation repayment process. The newsletter sets out scenarios to illustrate how the process will work.

## Commutation

- From April 2015 only DB schemes will be able to make trivial commutation payments and the current 'basic rate' PAYE regime will remain unchanged meaning that pension providers will continue to deduct tax at the basic rate from these lump sums before paying them. The tax treatment of small pots lump sums will continue unchanged.

## Real Time Information (RTI)

- The Newsletter notes flexible payments that must be flagged under RTI. Further detail is provided as to the position in different scenarios, for example, where the fund is exhausted in one payment, and cases where the member has both money purchase and DB rights in one scheme.





## PENSION PROTECTION FUND

### LEVY DETERMINATION 2015/16

#### Introduction

Following consultations in May and October, on 18 December the PPF published its final levy rules for 2015/16. The PPF reports that the final levy rules are “very substantially” as published in draft in October. As well as the final levy rules, the PPF published a Policy Statement and six documents providing guidance for schemes on issues such as contingent assets and asset-backed contributions.

#### Levy estimate

In October the Levy Estimate for 2015/16 was given as £635 million but the PPF stated that, based on expectations of how the funding position of schemes will improve over the second triennium, it expects that levy collections will fall in each of the succeeding two years, although the exact path of the levy is uncertain as it will move with changes in measured risk.

The PPF reports in its Policy Statement that there were very few comments from respondents on the Levy Estimate or the parameters. Whilst the PPF has now seen the first set of scores collected by Experian and movements in smoothed underfunding, it states that it is unlikely to have a materially clearer picture of expected collections until after it has complete data in summer 2015.

The PPF is therefore implementing the levy parameters as consulted on, and will keep the impact of the move to Experian and other factors under review for the second and third years of the triennium.

#### The PPF-specific model

The PPF previously confirmed that it would be moving ahead with the new PPF-specific model. As a result of responses to the consultation, the PPF has made a number of minor changes in areas where it believes this will enhance the model, such as amending the entry conditions for one of the scorecards and better reflecting the impact of part time employees.

#### Asset-backed contributions (ABCs)

Some amendments have been made to the proposals for the recognition of ABCs, including the following.

- As proposed, the PPF’s approach focuses on ensuring valuation of the ABC is on an appropriate basis and that valuers recognise a duty of care to the PPF in their reports. Whilst a minority of responses objected to the principle of such a duty of care arguing that it was unnecessary because the PPF is protected by the duty of care to the trustees or alternatively that it could be in conflict with that duty, the PPF remains of the view that if the trustees’ advisers are not willing to stand behind their valuation it is reasonable that the

ABC will not be recognised. As a result of responses raising questions about how the duty of care will operate, the final form of the ABC guidance contains a revised form of the wording of this duty of care, which focuses more explicitly on the levy impact of the ABC.

- The ABC guidance has also been updated to clarify that when valuing ABCs a balanced and realistic basis for calculating the insolvency value does not mean using the lowest possible insolvency value, except where the circumstances warrant it.

#### Contingent assets

The PPF will be implementing the proposals made in October which include that:

- schemes will be required to certify contingent assets with a fixed sum (the “Realisable Recovery”) which they are confident the guarantor could pay if required, and a new form of wording will be adopted for the certification;
- the PPF will apply an adjustment to guarantor scores based on the change in gearing implied by the contingent liability were it to fall due, except where the guarantor is the ultimate parent and files consolidated accounts; and



- surety bond arrangements can be recognised as Type C (ii) contingent assets, although some adjustments have been made to the standard form agreement as a result of responses to the consultation.

The PPF also reports that guarantees will only be recognised where it is possible to score the guarantor based on its own financial strength. This means that it will not recognise a guarantee where the guarantor would receive an industry average or based on the accounts of a subsidiary. In its Policy Statement, the PPF states that, as this has not been flagged previously, the relevant levy rule has been drafted to allow ultimate parent company reports provided up to 31 March to be used for prior months' scores where appropriate.

## Last man standing schemes

The PPF confirmed in October that it will implement the approach it consulted on in May in relation to last man standing schemes. The Policy Statement explains that for the 2015/16 levy year such schemes will be required to confirm that they have legal advice confirming their structure. It goes on to state that, accordingly, after 31 March 2015, all schemes that have been classified as last man standing on their scheme returns will receive an email

from the Pensions Regulator requiring them to confirm that they have received "appropriate legal advice" from an "appropriate solicitor" confirming that the current scheme rules do not contain any requirement or discretion for the trustees to segregate assets on cessation of participation of an employer. Schemes will have until 29 May 2015 to respond to the email (the PPF had previously stated that the deadline would be 31 May but this has been amended because 29 May is the last working day of the month).

## Deadlines

The Policy Statement also sets out the key dates that will impact on PPF levies for 2015/16. The deadline for submission of information to be taken into account in the levy calculation is 5pm on Tuesday 31 March 2015 aside from a few exceptions, for example, certification of deficit reduction contributions.

## Looking ahead

The PPF states that its intention is to maintain the new rules for a three year period. However, it recognises that the move to the PPF-specific model, while being well-received, is a significant change and it will therefore keep the performance of the model under review.

***Schemes will need to ensure that the relevant deadlines are complied with and that if any contingent assets are to be certified or re-certified, or if a scheme intends to seek recognition of an ABC that all of the relevant requirements of the rules and guidance are complied with. The points set out above provide only a brief overview of the key points noted following the October consultation and therefore if you are intending to seek recognition of any contingent assets or ABCs and would like further information or advice on the legal requirements, please get in touch with your usual DLA Piper pensions contact.***





## DEPARTMENT FOR WORK AND PENSIONS

### AUTOMATIC ENROLMENT – TECHNICAL AMENDMENTS

#### Introduction

On 1 December the DWP published a consultation on draft amendments to the automatic enrolment legislation which have the overarching policy intention of simplifying the process for employers. In this article we provide a summary of the key proposals. The consultation closes on 9 January 2015, and the DWP intends to publish a response to consultation in January with a view to the regulations being made in February and coming into force in April 2015.

#### Exceptions to the duties

For some time now the DWP has been considering the introduction of exceptions to the duties, and the detail of those proposals is set out in this consultation. Essentially the draft regulations operate to turn the duty to enrol into a power to do so in the following circumstances, meaning that the employer can choose whether or not to enrol the relevant workers.

- The worker is in a notice period or notice is given at any time up to six weeks after the duty has arisen. This will apply equally to resignation, dismissal or retirement, but will **not** apply to people who are merely at risk of dismissal or redundancy or to those who are on fixed-term contracts. It is also proposed

that the statutory opt in rights will not apply during a notice period. The draft regulations state that, if notice is withdrawn for any reason, the automatic enrolment duty will effectively be turned back on and will apply from the date of the withdrawal.

- Workers who have ceased to be active members of a qualifying scheme because of their own act or omission, or who have opted out under the legislation, in the 12 months prior to the automatic enrolment or automatic re-enrolment date.
- Workers who the employer has reasonable grounds to believe have primary protection, enhanced protection, fixed protection 2012, fixed protection 2014 or individual protection. The consultation states that it is for the employee to make the fact of the protection known to the employer and the DWP thinks that the employer having a copy of the relevant HMRC certificate will be one way to ground a reasonable belief. In the case of tax protections, it is proposed that the statutory opt in rights will continue to apply because there are some cases of protection where a worker can still accrue further rights.
- Workers to whom the employer has paid a winding-up lump sum and since that payment was made the worker has ceased to be employed and been re-employed by that employer. (The reason for this exception is that at the time the winding-up lump sum is paid, the employer

has to undertake to HMRC that it will not make any further tax-relieved payments into a pension scheme for the next 12 months in respect of that member, and the automatic enrolment obligations therefore create a mismatch between DWP and HMRC legislation.)

If the employer does choose to automatically enrol workers in these circumstances, the relevant legislation is to be read as if the employer was discharging a duty so that the employer can be enforced against in relation to those duties.

*Whilst large employers will already have reached their staging dates and therefore had to implement the reforms without the benefit of the exceptions, they may nevertheless be useful to such employers as they start to reach their first three yearly automatic re-enrolment date.*

*It is also useful for employers that the proposal is that the duty will be turned into a power, rather than switched off altogether, so that if they would prefer not to have the task of identifying those to whom the exclusions apply, they will not need to do so.*

*It is important to remember that the regulations remain in draft form and could therefore still be subject to change before coming into force in April and therefore employers should ensure that they continue to comply with the current duties in the meantime.*



## Information requirements

Part of the automatic enrolment duties on employers involves the provision of information to workers, with the specific information to be provided depending on the circumstances. The DWP notes that there are five different pieces of information that an employer must give to different types of employee about what is happening to them under automatic enrolment. It states that more than one communication or notice can be required to be given to the same employee in quick succession and that this has led to a degree of confusion for the employee and imposes an unnecessary burden on employers. The Government is concerned to reduce the administrative burden on employers, particularly having regard to the small and micro employers that will be staging from 2015 onwards.

It is therefore proposed that the information requirements will be reduced in order to achieve the following policy intentions:

- reduce the employer's obligation to make an assessment of all categories of employees;
- facilitate one individualised communication which suits all circumstances; and
- reduce the information requirements to a basic minimum that would be appropriate for all types of employee.

Specific proposals include the following.

- Removing the need for a separate communication to a worker who is entitled to opt in and receive an employer contribution, and a worker who earns less than the lower limit of the qualifying earnings band so is entitled to join a scheme but is not entitled to an employer contribution.
- Amending the regulations so that all the relevant information is given to those whose employer decides to postpone the date of automatic enrolment, rather than different requirements applying for different cases of postponement.
- Removing the requirement to provide information to those who are already active members of a qualifying scheme.
- Simplifying some of the enrolment information so that it is suitable for any employee (whether a jobholder or worker) to be told that they are being enrolled into a pension scheme.

To supplement the changes, and as a further aid to employers, the DWP will work with the Pensions Regulator to review the existing letter templates on their website, and will consider the need to develop other communications assets that could be of benefit to an employer.

*The consultation states that employers will be able to continue with the existing information requirements if they wish to do so, for example, if making changes to their systems would cause additional costs. However, employers may wish to take advantage of the changes once introduced in order to streamline their processes.*





## Quality requirement for DB schemes

Whilst employers with DB schemes may not be using them as the vehicle into which workers are automatically enrolled, those DB schemes may nevertheless be an important part of the employer's compliance with the automatic enrolment legislation. This is because in cases where the scheme is open to future accrual, provided the scheme meets the quality requirement, no automatic enrolment duty will arise in respect of existing active members. The general principle is that a DB scheme will meet the quality requirement if it is contracted-out, but if it is not, a complicated "test scheme standard" has to be met. Without action, the end of contracting-out in 2016 would therefore mean that many employers would have to assess whether the scheme meets the test scheme standard. In order to prevent this, the DWP is therefore proposing to use a power in the Pensions Act 2014 to make regulations to specify an alternative quality requirement for DB schemes.

The overall intention is, where possible, to keep the alternative test as simple as possible and for it to run parallel to existing requirements in relation to scheme funding so that actuarial work required for scheme funding purposes can be relied upon for this test as well.

Essentially it is proposed that the alternative quality requirement will be met if the cost to the scheme of the future accrual of active members' benefits is equal to at least 10% of qualifying earnings, or 9% if the scheme does not provide dependant pension benefits. (There are also variations to the test as the percentage may differ in cases where the scheme pays contributions based on a definition other than qualifying earnings.) Other features of the proposed alternative quality requirement are as follows.

- Schemes will have flexibility to assess the cost over a period that is appropriate to the cost of accrual that already exists within scheme documentation. For private sector schemes, it is proposed that the period should be either 12 months, or determined by reference to the most recent scheme documentation valuing the scheme's assets and determining its liabilities.
- The test should apply at the level of benefit scales rather than at the scheme level, meaning that the cost of providing benefits to active members of parts of a scheme that provide for different benefits would be tested separately.
- The methods and assumptions to be used under the test will not be prescribed, but will be left to the discretion of scheme actuaries.

- Actuarial certification will not be required for the purposes of the alternative test, with the DWP noting that the test relies on work already certified for scheme funding purposes. Whilst the DWP wants to allow the option of voluntary actuarial certification, it also wants employers to be able to determine themselves whether or not the test is satisfied by examining the work carried out for funding purposes.

*We expect it to be welcome news for employers whose schemes are currently contracted-out that they will not have to meet the test scheme standard when contracting-out ceases in 2016. However, employers will still need to ensure that they are satisfied that from April 2016 this alternative test is met and therefore, employers should include consideration of this issue in the work they undertake in preparation for the end of contracting-out.*



## **AUTOMATIC ENROLMENT – EARNINGS THRESHOLDS**

On 17 December the DWP issued the Government response to its October consultation confirming its intentions for the automatic enrolment earnings thresholds for 2015/16.

### **Qualifying earnings trigger**

This is the trigger which jobholders have to exceed in order to qualify for automatic enrolment and for the current tax year it is set at £10,000 in line with the threshold for paying income tax. In the October consultation, the DWP set out four possible options for the trigger for 2015/16: (i) freezing the trigger at its current level; (ii) increasing the trigger by indexation; (iii) increasing the trigger to remain in line with the threshold for paying income tax (expected to be £10,500 at the time of the consultation but subsequently announced as £10,600); and (iv) using the Pension Commission benchmark replacement rate (that is, the ratio of income in retirement to income in work).

The option that the Government proposes to take forward is to retain the threshold of £10,000.

The response notes that there was no clear consensus from the consultation but a number of key themes emerged including the need to reduce complexity as far as possible whilst ensuring the best overall outcomes for savers. The Government believes the proposed trigger of £10,000

strikes the right balance between ensuring that the people brought into pensions saving are likely to benefit and administrative simplicity, and also notes that it is very close to the Pension Commission's replacement rate of 80%.

It is acknowledged that the disadvantage of this option is that it will break the link between the earnings trigger and tax relief, meaning that workers earning below £10,600 whose employers use net pay arrangements will not be able to benefit. However, it is also noted that a number of respondents to the consultation predicted that as automatic enrolment extends to smaller employers, the number of individuals who could benefit from Relief at Source arrangements will increase.

### **Qualifying earnings band – lower limit**

This is the lower limit of the band of qualifying earnings on which the minimum contribution requirements are measured, and is also the earnings threshold which workers who are eligible to opt in rather than be automatically enrolled must exceed if they are to be entitled to an employer contribution. The figure for the current tax year is £5,772.

In line with the October consultation, the final proposal is to continue to use the National Insurance Contributions Lower Earnings Limit to determine the value of the bottom of the qualifying earnings band in 2015/16. This will mean an increase of the lower limit to £5,824.

### **Qualifying earnings band – upper limit**

This is the upper limit of the band of qualifying earnings on which the minimum contribution requirements are measured. The figure for the current tax year is £41,865.

In line with the October consultation, the final proposal is to continue to use the National Insurance Contributions Upper Earnings Limit to determine the top of the qualifying earnings band in 2015/16. This will mean an increase to £42,385.

*The Government intends to lay an Order before Parliament containing these thresholds to come into force on 6 April 2015. Employers will need to ensure that they adapt their processes in relation to the thresholds that are changing in order to ensure compliance with them from 6 April 2015.*



## CONSULTATION ON NEST RESTRICTIONS

### Background

Following an announcement in September 2014, on 9 October the DWP published a technical consultation on two draft statutory instruments – the National Employment Savings Trust (Amendment) Order 2015 and the Transfer Values (Disapplication) (Revocation) Regulations 2015. The consultation sought views on whether the two draft statutory instruments achieve the policy intention of removing NEST's annual contribution limit and transfer restrictions from 1 April 2017.

### Response to consultation

On 16 December the DWP published the Government response to the consultation reporting that eight responses were received but there were no comments on the drafting of the statutory instruments and a majority of respondents agreed that they achieved the policy aim.

The Government's response therefore concludes that the proposed statutory instruments achieve the policy aim and therefore the Government intends to lay before Parliament the draft National Employment Savings Trust (Amendment) Order 2015. This statutory instrument was laid before Parliament in December. The other statutory instrument – the draft Transfer Values (Disapplication) (Revocation) Regulations – is noted to be subject to

the negative resolution procedure and not to need Parliamentary approval. As such, subject to the approval of the Amendment Order laid before Parliament, these Transfer Values regulations will be made in spring 2015.

## AUTOMATIC TRANSFERS

When the Government's intentions in relation to the NEST restrictions were announced in September 2014, the Government was also stated to have retained the option to remove the individual transfer restrictions from 1 October 2015 to coincide with the introduction of automatic transfers of small pension pots. The October 2014 consultation had stated that confirmation received from the European Commission that the lifting of these restrictions from 1 October 2015 would be compatible with State aid meant that the Government could bring forward the timing of the removal of these restrictions, subject to the relevant Parliamentary procedures.

However, in a press release issued on 11 December announcing that the number of employees who have been automatically enrolled has passed the 5 million mark, it was also announced that autumn 2016 will see the launch of the system of automatic transfers. The press release goes on to state that the autumn 2016 timetable is designed to bring in the scheme as soon as possible while also giving sufficient time for industry to develop the new systems required.

*The Pensions Act 2014 currently only contains a framework for the system of automatic transfers with much of the detail to follow in regulations, albeit that an April 2013 White Paper indicated the Government's intentions in relation to some aspects of the system such as the pot size limit. The DWP states that the Government will publish further information about the implementation model and timetable in early 2015, ahead of consulting on draft regulations. We would expect employers and trustees to be relieved that with so many changes already on the horizon for 2015, the system of automatic transfers will not be introduced until 2016.*



## LEGISLATION

### IORP DIRECTIVE

The draft updated Directive on the activities and supervision of institutions for occupational retirement provision first published in March 2014 has continued to progress, with the Council of the European Union publishing an updated version in December. The accompanying Council press release states that:

- the Permanent Representatives Committee has agreed, on behalf of the Council, its negotiating stance on the draft Directive; and
- this now enables negotiations with the European Parliament, with the aim of adopting the Directive at first reading.

Some points to note in relation to this latest version of the draft Directive are as follows.

- The requirement for the technical provisions of schemes undertaking cross border activity to be fully funded at all times is included in the draft. A previous version had replaced this with a requirement for schemes to be fully funded “at the start of every new cross-border activity”.
- The requirements for those running the scheme to be fit and proper have been amended.

- The existing IORP Directive requires that the scheme is effectively run by persons of good repute “*who must themselves have appropriate professional qualifications and experience or employ advisers with appropriate professional qualifications and experience*”.
- Earlier drafts of the updated Directive did not include the reference to advisers. This remains the case in the Council version, although further amendments are made to remove the reference to the qualifications being “*professional*” qualifications and to add a reference to the requirement being met collectively. The draft wording therefore now refers to the need for the “*qualifications, knowledge and experience*” to be “*collectively adequate in relation to the activities performed for the institution*”.
- Amendments are made to delete some of the areas that the new governance requirement of a “risk evaluation for pensions” must cover - the requirements for it to include assessments of the effectiveness of the activities undertaken by the internal control function, the internal audit function and the actuarial function have been deleted.
- The requirement for annual Pension Benefit Statements to be provided to members is still in the draft Directive, but some of the prescriptive detail has been deleted.

- The initial draft of the Directive published in March had stated that Member States would have until 31 December 2016 to transpose the changes into national law, but this date was deleted from a subsequent draft and not replaced by a new date. The Council’s draft proposes giving Member States two years after the entry into force of the Directive to transpose it into their national laws and regulations. The draft and the accompanying press release do not indicate when that date might be.

***The amendments to remove the reference to “professional” qualifications is likely to be welcomed, as it seems to address some of the concern that the removal of the reference to advisers could preclude the use of lay trustees. However, we would expect the reinstatement of the full funding requirement for cross-border schemes to be less welcome. In any event, the text of the Directive could still be subject to further change as it progresses through the European Parliament and therefore whilst it is useful to be aware of potential changes to European law on the horizon, there is no need for schemes to take any action at this stage. What will be key is the wording of the final version of the updated Directive and how it is transposed into UK legislation.***



## HOLIDAY PAY

### Background

In previous editions of Pensions News we have reported on significant employment law cases on the subject of holiday pay. In the November edition we reported on the outcome of a case in which the Employment Appeal Tribunal (EAT) held that non-guaranteed overtime (that is, overtime which the employer does not have to offer but which the employee must work if offered) is part of normal remuneration and must be included in holiday pay, as must any other payments which form part of normal remuneration including shift allowances and comparable payments. The EAT also held that it is possible to interpret UK law to produce this result.

However, the findings of the EAT also meant that the extent to which back payments of underpaid holiday pay could be claimed would be limited. Under UK legislation, 4 weeks of leave is derived from European law and an additional 1.6 weeks of leave is granted. The EAT concluded that the additional 1.6 weeks of leave will be the last leave taken in any year. It also concluded that, in order to claim for a 'series of deductions' there could not be a gap of more than three months between leave derived from European law. In practice, this finding should mean that in the majority of cases, claims for back pay will be limited to the current holiday year.

This judgment potentially has pension implications because, depending on the scheme's definition of pensionable pay, in cases where holiday pay has been underpaid, pension contributions might also have been underpaid and, in the case of defined benefit schemes, benefits may have been underpaid.

### Regulations limiting back payments

In December the Government took action in the form of regulations – the Deduction from Wages (Limitation) Regulations 2014 – to protect employers from the impact of large backdated claims.

The changes will apply to claims made on or after 1 July 2015 and will mean that claims to Employment Tribunals on this issue cannot stretch back further than two years. Until 1 July workers will still be able to make claims under the existing arrangements which will act as a transition period before the new rules come into force. In order to avoid the creation of unnecessary parallel regimes, the new limitation period will also apply to similar claims for unauthorised deductions from wages.

*Whilst the findings of the EAT will have limited many claims to the current holiday year, these regulations are useful in creating a statutory 'backstop' to claims and will protect employers against the risk of future litigation repealing the three month rule. The regulations also make an amendment to the legislation so that the right to payment in respect of leave does not create a contractual right. This may limit the scope for employees to bring breach of contract claims, although it does not extinguish the possibility altogether.*

*The next significant development expected in relation to holiday pay cases is the Employment Tribunal's consideration in February of a case concerning the treatment of commission and whether the UK legislation can be interpreted to give effect to a judgment of the European courts that held that commission should be included in holiday pay.*



## CASE LAW

### SECTION 75 DEBTS

Judgment was issued in the latter part of 2014 in a case concerning whether trustees of pension schemes are able to assign a section 75 debt. The trustee of the scheme was the claimant in this case and sought a declaration that the section 75 debt is assignable, and a direction that the proposed assignment (involving the sale of the debt by way of assignment) is one which in the circumstances a reasonable and properly advised trustee could enter into in the exercise of its powers.

#### Background

The scheme's sponsoring employer entered into administration on 8 October 2008. On 28 May 2009 the scheme submitted a claim in the administration for the section 75 debt, at which stage the amount claimed was an estimate. In April 2012, the Scheme Actuary certified the section 75 debt at £74.65 million. The debt is admitted by the administrators for the purpose of payments of dividends from the administration subject to an agreed set off (a 2013 judgment dealt with a dispute in relation to another potential set off which was resolved in the trustee's favour).

The trustee had received £60.26 million in dividend payments, which is 81.5p in the pound on the reduced sum of £73.94 million. The trustee wishes to wind up the scheme but could not commence this because of the

possibility of further distributions by way of dividends. The scheme is incurring expense whilst waiting for the administration to come to an end, which is not expected to happen before 2017.

An annex to the judgment notes that:

- the administrator's estimate of the final dividend was 85 to 86.5p in the pound;
- it was initially expected that the debt could be sold at about 90p in the pound, although subsequently the trustee was informed that the potential offer price had reduced to 88 or 89p in the pound; and
- the estimated extra cost of running the scheme until the end of the administration as opposed to winding up after selling the debt now was £305,000).

The Defendant to the claim is a representative beneficiary who supported the trustee's application for a declaration that the debt is assignable, but stated that he could not comment on a putative assignment, which is a commercial matter for the trustee to decide upon if it obtains directions from the court.

The claim form and supporting evidence were served on the Pensions Regulator who was asked to consider whether it would seek to be joined to the claim and make representations. The Regulator decided that it did not need to be joined on the application.

### The court's conclusions

The initial decision of the court was that the debt is assignable for the following reasons.

- The language used to create the debt in the first place gives no indication that it is anything other than a debt with the same characteristics as debts generally. The judge noted that normally debts are assignable and there is no express prohibition on assignment in the legislation.
- The wider considerations which led to the judgment in a 2002 case in which it was held that a section 75 debt can be compromised apply today as much as they applied then. The judge stated that being able to deal in the debt allows the trustees to further the interests of members by securing the largest amount available for the scheme.
- It was noted that there is an inconsistency with the moral hazard legislation which states that the Regulator can issue a direction to trustees not to take any steps to recover a section 75 debt pending recovery of all or part of what is due under a Contribution Notice. If a direction is issued after a trustee has assigned a debt, the trustee would be unable to comply with it because the debt would no longer vest in the trustee. However, the judge concluded that this inconsistency is "only a potential one which only arises in particular circumstances" and does not prevent the moral hazard regime as a whole from operating.





A draft judgment was issued on these terms but the judge stated that he then “*had second thoughts*” because a point occurred to him that had not been discussed before. That point was a concern that there could be double recovery to the detriment of the other creditors if a Contribution Notice is issued requiring a third party to make a contribution to the scheme and that contribution entirely makes up any deficit which had previously existed in the scheme. In these circumstances, if the debt had been assigned the Regulator would not be able to issue a notice preventing the trustees from taking steps to recover the debt and the scheme could end up being over compensated. It was stated that this may be said to show that the moral hazard legislation was drafted on the assumption that the section 75 debt is personal to the trustee.

However, having received and considered submissions on this point from Counsel for the Claimant, the judge ultimately concluded (in line with his initial conclusion) that the section 75 debt is assignable. In relation to the issue about double recovery, he noted that:

- other case law has shown that the moral hazard protection is not merely an addition to the existing section 75 debt but is an entirely distinct scheme; and
- the relationship between the moral hazard provisions and the section 75 debt system is complex, and the two sets of provisions give rise to potential anomalies whichever way they are looked at. The judge stated that

this is important because it undermines any attempt to construe the legislation in such a way as to avoid an anomalous result.

In relation to the second issue, it was noted that the trustee was not asking the court to ratify sale of the debt at any particular price or in any particular circumstances, but was seeking a declaration that assignment is something which a reasonable and properly advised trustee could enter into in the exercise of its powers. The judge was satisfied that such a direction should be given in this case.

*It is notable that in this case the question of whether a section 75 debt is assignable was not disputed and it remains to be seen whether any subsequent case comes to court in which this point is disputed and fully argued.*

## PENSION LIBERATION

On 16 December the Pensions Ombudsman Service published its first determination in a case that relates to pension liberation. This case did not consider the key dilemma for trustees of whether to block transfers where the receiving scheme is suspected of involvement with pension liberation, with determinations on this subject due to follow in January. Rather, the December determination concerns a member who has already made a transfer out and now wishes to make a further transfer out of his new scheme.

### Background facts

The Applicant had previously been a member of the National Health Service Superannuation Scheme (Scotland). On 5 December 2012 he signed a declaration saying that he had decided to transfer to the Capita Oak Pension Scheme. The member had to opt out of membership of the NHS scheme in order to make the transfer.

The Applicant states that he was told that his investment in the Capita Oak Pension Scheme would be in Storefirst Limited, a large self-storage firm in the north of England, and that it was offering an 8% to 12% return on investments. The Applicant also states that he received a “non-repayable loan” of £17,500. The transfer value made was around £367,600 and a 5% initial charge of around £18,400 was deducted from the transfer value.



On 29 July 2013 the Applicant wrote to Imperial Trustee Services Ltd (“**ITSL**”) (the trustee/manager of the Capita Oak Pension Scheme and the Respondent to the complaint) stating that he was writing to facilitate a transfer value out of the scheme. A chasing letter was sent by the Applicant on 23 August 2013. Several further attempts were made by the Applicant to contact ITSL but he did not receive a response.

## **The PO’s decision**

Whilst it is noted that the NHS scheme required the Applicant to sign a declaration that he had been made aware of the implications of transferring to a UK non contracted-out DC scheme as well as a “pension liberation factsheet”, no comment is made on this because the complaint does not relate to the original transfer to the Capita Oak Pension Scheme. Rather, the complaint relates to the Applicant’s inability to get the money out of the Capita Oak Pension Scheme.

The PO stated that the primary question is whether the Applicant had a legal right to transfer out of the Capita Oak Pension Scheme. As no governing documentation for the scheme has been provided to the member or the PO, it was noted that it was not possible for the PO to conclude whether the Applicant has a freestanding right under the scheme to a transfer. However, in any event, the PO concluded that whatever the scheme rules state the member cannot be deprived of a statutory right to transfer if he has one.





The PO noted that the information provided to the Applicant states that the Capita Oak Pension Scheme is an occupational defined contribution scheme and therefore, on ITSL's own account, the Applicant is a member of an occupational pension scheme. The determination therefore considers the statutory right to a transfer as a member of an occupational pension scheme.

Whilst the Applicant's letter to the scheme did not strictly meet the criteria of an application to exercise the statutory right to transfer (because it did not request the transfer to be made to acquire credits in a particular receiving scheme), the PO concluded that it was "unquestionably maladministration" that ITSL did not respond to the Applicant and it was this lack of response that stopped the process. The PO stated that he had "absolutely no doubt" that the Applicant would have made a full transfer request, and acquired a statutory right to payment, had he not been ignored. The PO was of the view that had the Applicant received a response to his letter of 29 July 2013, he would have made a full request within a month.

Whilst the statutory time limit to make a transfer is six months, the PO concluded that an unwarranted delay could amount to maladministration and there were no particular features of this transfer request that might have caused ITSL to need further information or advice before complying with the request. The PO therefore could see no reason why the transfer could not have been paid by the end of September 2013.

## The PO's directions

The PO directed that, within 14 days of the Applicant requesting a transfer value to a named scheme, ITSL is to make such a payment, with the transfer value to be the higher of the cash equivalent transfer value as at 30 September 2013 plus interest and the value at the date of payment.

However, the PO stated that he made the direction "without any great confidence that it will be complied with immediately". If ITSL does not comply, it was noted that the Applicant may attempt to enforce the direction through the courts, but "sadly even if ITSL respond he may find that some or all of the money is no longer there".

## The PO's comments

In an update on its website announcing the publication of the determination, the PO takes the opportunity to warn members about pension liberation. It states that this case shows "how dangerous it can be to take advice to transfer to an unorthodox pension scheme on the promise of more freedom and high returns". The PO also cautions that anyone "who is approached by an unregulated adviser recommending they transfer to a pension scheme of which they have never been a member should act with extreme caution. The adviser is unlikely to have their best interests at heart, and may be a fraudster".

***This determination is notable in being the first to be issued in relation to pension liberation. However, more significant for trustees will be the approach that the Ombudsman takes in the determinations to be issued in January in relation to schemes that have blocked transfers to schemes suspected of involvement with pension liberation.***



## HMRC

### END OF CONTRACTING-OUT – HMRC BULLETIN

In December HMRC published the fourth edition of its Countdown Bulletin in relation to the April 2016 end of contracting-out, with this edition publicising and encouraging the use of the Scheme Reconciliation Service.

The Scheme Reconciliation Service relates to non active members and is designed to help pension schemes reconcile their records against HMRC records in advance of the end of contracting-out. The Bulletin highlights the following benefits of schemes reconciling their records:

- confidence that scheme records match HMRC records;
- knowing the total funding obligation of GMP liabilities;
- knowing that the scheme is meeting the obligation of paying the correct GMP;
- knowing that the scheme is not at risk of underpaying or overpaying the GMP; and
- reducing contact from members.

It is noted that schemes have until April 2016 to request the use of the Scheme Reconciliation Service and that queries will be dealt with until December 2018. HMRC states that it is aware that some schemes have been advised that HMRC has imposed a six month timescale for dealing with the reconciliation but that this is incorrect. Nevertheless, HMRC recommends that schemes request a run of the Scheme Reconciliation Service as early as possible so that they have more time to reconcile their records.

It is also reported that in December 2016 HMRC will identify and close all active member entries held on their records and will use the Scheme Contracted out Number (SCON) recorded by employers on their Full Payment Submissions. Schemes will be notified of all members where the records have been closed under their SCON and will have until December 2018 to agree/query their active membership.

HMRC notes that with both Scheme Reconciliation and closure scan queries to deal with in a short period of time, it is imperative that schemes act now and request the Scheme Reconciliation Service.

*HMRC has been reporting on the availability of the Scheme Reconciliation Service for some time now, with a previous edition of the Bulletin noting that the number of queries being raised suggested that schemes were requesting data from HMRC but not then taking action to reconcile that data. This latest Bulletin reports that the number of schemes to register an interest in the Service is 2,037 and that HMRC has identified a variance of 30% in members compared to membership numbers provided by schemes (although not all queries have yet been raised), which is said to highlight the additional work that scheme administrators and HMRC need to complete to resolve the discrepancies. The message from HMRC of the need to act on this issue is clear and therefore trustees should ensure that their scheme administrators have registered with the Service and check on the current status of the reconciliation exercise for their scheme.*



## ANNUAL ALLOWANCE ORDER

Following the July 2014 publication of a draft for comment, in December the draft Finance Act 2014 (Registered Pension Schemes and Annual Allowance Charge) (Amendment) Order 2015 (“**Draft Order**”) was laid before Parliament.

By way of background, the Explanatory Memorandum accompanying the Draft Order explains that alongside recent reductions in the annual allowance, a number of other changes were made by the Finance Act 2011 such as provisions reducing the need for deferred members’ benefits to be tested against the annual allowance, carry forward, and ‘scheme pays’. It goes on to state that, following these changes, a number of circumstances have been identified where administrative burdens can be further reduced and where other technical improvements could be made to ensure that the legislation works as intended.

The amendments made by the Draft Order are technical in nature covering some very specific scenarios including the following.

### Deferred members

- Amendments are made to extend the circumstances where deferred benefits are not tested against the annual allowance. For example, an amendment is made to allow schemes to increase the value of deferred members’ rights by reference to changes in RPI instead

of CPI without those increases counting towards the annual allowance. This is to cater for schemes that sought to maintain the position for deferred members by making a change to their rules to refer specifically to RPI rather than the ‘statutory rate’.

### Scheme pays

- An amendment is made to remove an unintended advantage whereby a member of a DB scheme who is subject to an annual allowance charge in the year they take all benefits from the scheme will be charged less if they use ‘scheme pays’ than if they pay the tax charge themselves. The amendment ensures that where the member uses ‘scheme pays’, the amount of the annual allowance charge payable is the same as if they had not done so.

### Transfers between schemes

- Amendments are included in the Draft Order to address the fact that, under the current legislation, unintended annual allowance input amounts may arise where an ‘underfunded’ DB transfer takes place.

### The current position

- Where the pension rights of a DB member are transferred, adjustments are made to the calculation of the rights under the transferring scheme and receiving scheme with the aim of making the effect of





the transfer broadly neutral across the two schemes. These adjustments are made to the extent that they are supported by reason of money or assets transferred from the old to the new scheme.

- However, some schemes may be ‘underfunded’, meaning that in some cases transferring available funds to new schemes may not be enough to support a member’s promised benefits in a receiving scheme.
- This means that unintended annual allowance input amounts may arise even though the value of a member’s rights may be the same before and after the reorganisation. In addition, the Explanatory Memorandum notes that for these large scale ‘underfunded’ transfers, it is administratively difficult for schemes to determine the input amount, given that the amount of any such ‘underfunding’ may not be easily attributable to individuals.

## **The amendments**

- Under the new provisions a different treatment is applied for ‘underfunded’ DB block transfers where the value of scheme members’ benefits is virtually the same immediately before and after the transfer.

- The Explanatory Memorandum explains that this treatment will provide the same outcome as for transfers between ‘fully funded’ DB schemes, so removing the administrative burden of identifying the level of underfunding that may relate to each scheme member, and the potential for annual allowance distortions.

## **Next steps**

The Draft Order has been laid before Parliament and is subject to approval before it comes into force. Once brought into force, many of the amendments will have effect for 2011/12 and subsequent tax years, but where the amendments will increase a person’s liability to tax, they only have prospective effect.

An updated version of draft amendments to HMRC’s Registered Pension Schemes Manual has been published alongside the Draft Order explaining the changes being made and the different times from which they will take effect. It is intended that a final version of the amendments to the Manual will be issued closer to the time that the Order takes effect.

*The Draft Order is detailed and covers a number of scenarios with varying effective dates, and therefore if any of the issues are relevant for a scheme, it will be important to understand the detail of the relevant amendments and their effective date. If you have been experiencing any issues with the way that the annual allowance operates, we would therefore suggest that you consider seeking advice to see whether the provisions in the Draft Order may resolve this.*



## PUBLIC SERVICE PENSION SCHEMES

### RECORD-KEEPING REGULATIONS

#### Introduction

In April 2015 new public service schemes will come into operation under the Public Service Pensions Act 2013. One of the intentions of the public service scheme reforms is to improve the governance, regulation and administration of schemes and, as part of this, the Act gives the power for regulations to be made specifying the records that scheme managers responsible for running the new and connected (existing) schemes must keep. A consultation was published on draft regulations in December 2013 and the response was issued in July 2014.

#### Final form regulations

The final form regulations were laid before Parliament on 3 December and will come into force on 1 April 2015. The regulations set out the records which schemes will need to keep, which cover the following areas.

- Information about individual members and beneficiaries and information relating to the rights that each member or beneficiary has to different types of pension benefits. For example, name, date of birth, gender, last known postal address, national insurance number, formulas used for calculating benefits, and investment decisions and investments held in respect of rights to money purchase benefits.

- Information about the finances of the schemes, for example, contributions and benefits paid.
- Information in respect of meetings of each pension board and any committees or sub-committees of the board. For example, the date, time, place and attendees of the meeting and any decisions made at the meeting.

Pensions legislation contains a duty for the late payment of employee contributions by the employer to be reported to the member and the Pensions Regulator where this is likely to be of material significance to the Regulator. An exemption from this requirement is removed so that the late payment reporting duty will apply to the scheme managers of these public service schemes.

Looking ahead, the Regulator will provide guidance in a Code of Practice for public service schemes which will cover a range of matters including record-keeping duties and the duty to report certain late payments of contributions.

### LGPS CONSULTATION

As part of the reform of public service pension schemes, a new Local Government Pension Scheme started on 1 April 2014. On 5 December the Department for Communities and Local Government (DCLG) issued a consultation noting that as employers and administrators have now had day to day experience of applying the

regulations governing the new scheme, they have identified some areas in which clarification in the regulations is needed, as well as some drafting improvements.

#### Draft regulations

The consultation therefore seeks views on draft regulations which make the necessary revisions, although it is noted that the changes will not affect the operation of the scheme or the benefits payable.

The draft regulations cover areas such as member elections to pay reduced contributions, elections to pay additional contributions following a return to work from a period of absence, disallowing automatic aggregation for members who have opted out, the calculation of survivor benefits, and the payment of death grants.

The draft regulations also make provision about the independence of registered medical practitioners in response to a recent determination by the Deputy Pensions Ombudsman (DPO). The consultation explains that the DPO held that where an administering authority and a scheme employer had made use of two independent registered medical practitioners from the same occupational health provider, this could not be considered as “independent” when assessing a scheme member for ill health retirement. It goes on to state that the DCLG is not of that view and therefore a clarificatory amendment is proposed with the draft regulations providing that an independent registered medical practitioner is not to be



treated as having advised, given an opinion on or otherwise been involved in a particular case merely because another practitioner from the same occupational health provider has advised, given an opinion on or otherwise been involved in that case.

An amendment is also made to clarify that employers with historic liabilities to funds should pay contributions to meet those liabilities even if they are not currently employing any active members contributing to a particular fund.

## Other issues

The consultation also seeks views on the following issues.

- **Exit payments.** Whether greater flexibility should be introduced around exit payments when an employer leaves the scheme. For example, the consultation states that it may be the case that an employer is liable to make an exit payment when it has no active members in the scheme but there is a likelihood that it will gain some active members within a short period of time. Consultation questions are raised about whether there should be a period of time in which discretion could be allowed to defer the point at which an employer becomes liable for an exit payment.

- **Transfer of AVC arrangements.** The merits of requiring an administering authority to facilitate the unbroken continuation of a transferring member's AVC contract, by entering into arrangements with the member's original AVC provider when the member moves employment voluntarily or compulsorily.
- **Final salary link.** How the flow of information can be managed and if any supporting regulation is needed, for cases where members with deferred benefits return to work within five years and whose benefits are to be calculated by reference to final salary on retirement.

## Next steps

The consultation closes on 30 January and it is proposed that the regulations would have effect from 1 April 2014.

## DRAFT CONSEQUENTIAL REGULATIONS

In December a number of sets of draft consequential regulations were laid before Parliament which relate to the reform of public service schemes. The majority of provisions of the draft regulations are proposed to come into force on 1 April 2015. These include sets of regulations in relation to the teachers' pension schemes, the NHS pension schemes and the schemes for civil servants, which modify the effect of other statutory provisions in their application to these schemes.

Areas covered by the draft regulations include the following.

## Contracting-out

It is intended that the new schemes, like the existing schemes, will be contracted-out of the additional State Pension until contracting-out ends in April 2016. The draft regulations deal with contracting-out for the period from 1 April 2015 to 5 April 2016. They disapply certain procedural requirements such as the requirement to give formal notices to earners. However, schemes must still satisfy the Reference Scheme Test.

## Early leavers

Amendments are made in relation to existing members who will transfer into the new schemes but retain some benefits in the old schemes, with the objective of preventing such members from becoming deferred members and triggering rights that are inconsistent with them remaining in service with the same employer in a successor pension scheme. For example: the regulations provide that a person will not have access to short service benefit until pensionable service terminates in the new scheme, rather than when the person transfers into the new scheme; and amendments are made to ensure that the old scheme benefits are not effectively revalued twice.





## Ill health benefits

A 'single source model' has been adopted for the payment of ill health benefits in the new schemes, whereby all payments of ill health pension will be made from the new scheme during the period between retirement and the scheme member reaching normal pension age in the old scheme, and when the person reaches their normal pension age in the old scheme, the unenhanced or lower tier element of pension in respect of service in the old scheme will cease to be paid from the new scheme and will come into payment from the old scheme.

The regulations make amendments so that members will not suffer any unexpected tax consequences as a result of the way the Government has chosen to structure the ill health provisions of the new schemes, for example, to remove the payment of the unenhanced or lower tier element from the calculation of the pension input during the period in which the member takes ill health retirement.





## OTHER NEWS

### AMENDMENTS TO GUIDANCE ON SMPIS

#### Background

Under the Disclosure Regulations, Statutory Money Purchase Illustrations (SMPIS) provided in respect of money purchase benefits must be produced in accordance with relevant guidance. That guidance is “AS TMI: Statutory Money Purchase Illustrations” (“TMI”) which is produced by the Financial Reporting Council (FRC).

On 16 December the FRC published an updated version of TMI, which will be effective for SMPIS issued on or after 6 April 2015 although earlier adoption is permitted. Given the nature of the changes the FRC concluded that a formal consultation on the changes would be disproportionate and, because the changes are permissive, it does not envisage that the relatively short time for implementation should cause any difficulties.

#### Amendments

The amendments to TMI relate to three areas.

#### Future contributions under automatic enrolment

TMI requires providers to take account of future contributions when calculating the illustration but does not state the approach that should be adopted to the phasing





of contributions under automatic enrolment. The FRC understands that some providers are ignoring the phased increases but others are taking them into account.

On the basis that specifying the approach to take could lead to costs for providers in amending their systems, the FRC has amended TMI to allow providers to use their judgement to choose reasonable assumptions when they are not specified in TMI which will allow providers to adopt either of the two approaches currently being taken. The FRC states that it expects providers to ensure that the information provided alongside the SMPI is sufficiently clear to enable individuals to determine whether phased increases have been assumed.

### **Same sex marriage**

An amendment has been made to specify the age difference to be assumed for same sex marriages. The approach taken is the same as that for civil partnerships so that it is assumed that spouses of the same gender are the same age as each other. This is subject to the exceptions that apply in all cases whereby, at the provider's discretion the member may specify the spouse's or civil partner's age to be used, or the spouse's or civil partner's age shown in the provider's records may be used.

### **Guaranteed annuity rates**

Currently TMI states that providers should not take account of any guaranteed annuity terms which produce a higher amount of initial pension at the retirement date or a higher amount of pension in a subsequent year than would be produced using the assumptions in TMI.

The FRC considers that the presentation of an SMPI which allows for guaranteed annuity terms may improve their reliability and usefulness for individuals, and an amendment has been made to give providers discretion to take account of guaranteed annuity terms.

### **Possible future developments**

The FRC considers that SMPIs may remain useful for individuals but, following the changes announced in the Budget, additional information may be warranted. The FRC reports that it has discussed this with the DWP and understands that it may propose changes to the Disclosure Regulations in due course and that, if so, the FRC may need to make further amendments to TMI to reflect any legislative changes.

*Trustees should ensure that they update their systems in time for 6 April 2015 to reflect the assumption about age differences for those in same sex marriages. They should also consider whether they wish to make any other changes to reflect the other amendments to TMI, and ensure that their accompanying information makes clear what approach is taken to phased contributions.*

## **FCA REPORT – RETIREMENT INCOME MARKET**

### **Introduction**

In February 2014, the Financial Conduct Authority (FCA) issued the results of a thematic review which had found that the annuities market was not working well for most consumers. The FCA therefore launched a market study to look at the entire retirement income market, although following the reforms announced in the March 2014 Budget the terms of reference for the study were amended to shift the emphasis away from current market dynamics towards how market conditions might evolve after April 2015.



On 11 December the FCA published a report setting out the provisional findings of the study as well as the FCA's proposed remedies. The market study is noted to be one part of a wider package of FCA work that directly or indirectly impacts on the retirement income market which includes a thematic review of annuity sales practices which was also published on 11 December and is reported later in this newsletter. Other aspects of the FCA's work on the retirement income market includes its role in relation to the guidance service to be introduced as part of the Budget reforms and a wider policy review to commence in 2015 looking at the requirements on firms.

## Scope of the study

The study involved the FCA examining products purchased by UK consumers with their accumulated DC pension pots that provide an income during retirement, specifically annuities and income drawdown.

The FCA's work included two public calls for evidence, engagement with a wide range of industry stakeholders, consumer organisations and other Government departments, analysis of a range of information from firms, quantitative and qualitative consumer research, a "framing experiment" to explore how consumers react when choices are presented in different ways, the commissioning of an international comparative analysis of ten countries with experience relevant to the UK, and economic analysis of the value for money of annuities.

## Provisional findings

The FCA states that its provisional findings point to a retirement income market which is not working well for consumers. It reports that:

- many consumers are missing out on a higher income by not shopping around for an annuity;
- some consumers do not purchase the best annuity for their circumstances; and
- there was a common perception among consumers that annuities offer poor value, and this is despite the FCA's economic analysis showing that for people with average-sized pension pots, the right annuity purchased on the open market offers good value for money relative to alternative drawdown strategies and may therefore be a good option for those with low risk appetites.

Looking ahead, the FCA identifies developments it would like to see in the market but also identifies potential future risks. The FCA notes that following the Budget reforms, those reaching retirement will face a landscape that is more complex and will need more support in making choices. Whilst the FCA acknowledges that the guidance service will perform a vital role here, it goes on to state that this is just one part of the picture and that it is equally important that firms' own communications with customers support decision-making and that the market works well.

## Proposed remedies and recommendations

The report sets out proposed remedies, the objective of which is to increase the effectiveness of the information that is provided to consumers to help address consumer inertia and encourage shopping around (and, if appropriate, switching). The FCA notes that the remedies do not involve providing more information, but rather better quality information. As the market is on the brink of major change, the FCA has limited its proposed remedies to those issues that can achieve the most positive impact.

The proposed remedies, recommendations and actions which the FCA is minded to pursue are as follows, but these are now the subject of consultation.

- To require firms to make it clear to consumers how their quote compares relative to other providers on the open market.
- The FCA recommends that the pension guidance service and firms take into account framing effects and other biases when designing tools to support consumer decision-making.
- The FCA will work with Government to develop an alternative to the current wake-up pack. The FCA states that this should be behaviourally trialled to assess the impact on consumers' awareness of their right to shop around, and the proportion of people who switch.



- In the longer term, the FCA recommends the development of a 'Pensions Dashboard' which would enable consumers to view all their lifetime pension savings (including their state pension) in one place.
- The FCA will continue to monitor the market as it evolves using a combination of consumer research, market data and ongoing sector supervision.

## Next steps

The FCA is inviting comments on its provisional findings and proposed remedies, and comments can be submitted up to 30 January 2015. Once the FCA has considered the responses, it will produce its final report in 2015, and to the extent that any remedies to be implemented require changes to the FCA rules, these will be subject to a separate formal consultation and cost benefit analysis later in 2015.

## FCA – ANNUITIES SALES PRACTICES

### Introduction

At the same time as publishing its report on the retirement income market (which we report on in the previous article in this newsletter), the FCA published its findings from a thematic review of the non-advised sales practices of pension providers offering annuities to their existing customers.

The FCA's sample of firms covered 70% of this market and it looked at material relating to the period September 2013 to November 2013. The FCA reviewed customer literature, listened to telephone calls discussing retirement income options, and reviewed potential drivers of risk in firms' businesses.

### Findings

The FCA found evidence indicating that firms' sales practices are contributing to consumers not shopping around and switching, and at times to consumers potentially buying the wrong type of annuity. In particular, the enhanced annuities market was found to be an area of concern. Examples were also found where the ABI Code of Conduct on Retirement Choices is not being applied in practice.

### Next steps

The FCA is asking the majority of firms to do further work to determine whether the FCA's findings in relation to enhanced annuities are indicative of a more widespread problem and/or have led to poor consumer outcomes. The work will look at the period since the Financial Services Authority's previous thematic work on Open Market Options in 2008. Firms are **not** being asked to review all relevant sales since May 2008, but the work for individual firms may include gathering more evidence, on a statistically significant basis, to determine whether

customers with certain medical conditions or lifestyle factors missed out on a higher income in retirement by purchasing a standard, rather than an enhanced annuity, or not shopping around for an enhanced annuity.

Once the FCA has reviewed the additional evidence gathered by the affected firms, it will consider what further action, if any, to take.

Other actions to be taken by the FCA include that it:

- will work with firms where poor practice has been identified to make improvements to their annuities sales practices;
- will signpost the findings of its review more generally to the market through the publication of the good and poor practice examples in the report; and
- proposes to consult on replacing the ABI Code with its own rules.

## REPORT ON AUDIT OF LEGACY SCHEMES

### Background

In September 2013 the Office of Fair Trading published a report on its market study which looked at whether the DC workplace pension market is working well and whether, in light of auto-enrolment, competition is capable of driving value for money and good outcomes for members. The report concluded that, due to weaknesses



on the buyer side of the market and the complexity of the product, competition alone cannot be relied on to drive value for money for all those saving in workplace DC schemes. The report set out recommendations as well as noting action that it had already been agreed would be taken.

One of those actions was that the Association of British Insurers (ABI) and its members that provide contract-based DC schemes had agreed to carry out an audit of 'at risk' schemes, that is, those sold prior to 2001 which may therefore have higher charges and all post 2001 products with charges exceeding the equivalent of a 1% Annual Management Charge. It was also agreed that an Independent Project Board ("**Board**") would determine, with the new Independent Governance Committees, what action needs to be taken in response to the audit findings.

## The Board's final report

On 17 December the Independent Project Board published its final report. The Board collected data on charges and benefits from providers which enabled the future impact of charges on different types of saver, depending on their decisions and actions and the characteristics of the scheme, to be quantified. Based on this information, the Board has determined the current amount of savings where charges could have a high impact on savers in the future. For example, key findings of the audit include the following.

- Of the £67.5 billion of assets under management which were in scope of the audit (£56.9 billion of which is in contract-based schemes and £10.6 billion of which is in bundled trust-based schemes), £42 billion have charges of less than 1% in all scenarios including "worst case" scenarios.
- Between £23.2 billion and £25.8 billion is potentially exposed to charges of above 1% - around half of this is potentially exposed to charges above 1.5%, between £5.6 billion and £8 billion is potentially exposed to charges above 2%, and around £0.9 billion is potentially exposed to charges above 3%.
- The Board estimates that there are 407,000 savers that have joined schemes in the last three years who could be exposed to a charge of over 1% in the future, and of these, 178,000 could be exposed to charges over 2% and 22,000 to charges over 3%.

The report also includes a series of recommendations made by the Board including the following.

- The Board is writing to the provider of each scheme where savers are potentially exposed to high charges and is recommending that they should:
  - review their data in the light of any actions already taken to reduce charges and any qualitative factors that might justify high charges;

- identify what actions could be taken to improve outcomes for savers and what actions can be taken to stop new savers joining poor value schemes; and
  - provide the data and any further analysis and proposed actions to the relevant governance body by the end of June 2015 at the latest.
- It is recommended that governance bodies (Independent Governance Committees for contract-based schemes and trustee boards for trust-based schemes) agree remedial actions and an implementation plan with their provider by the end of December 2015 at the latest. (Guidance is also set out by the Board for the governance bodies which will have the task of evaluating whether the proposed actions are sufficient to ensure savers receive value for money in future.)
  - It is recommended that the DWP and the FCA should jointly review industry-wide progress in remedying poor value schemes and publish a report by the end of 2016.

## MONEY ADVICE SERVICE DIRECTORY

In August the Money Advice Service confirmed that its proposal to launch a new financial adviser directory was set to go ahead. The aim was to launch the directory by April 2015 to coincide with the guidance service being introduced as part of the Budget reforms, with an independent panel to be established to set the criteria for inclusion in the directory.



On 15 December MAS issued a press release confirming that the criteria had been agreed as follows.

- Financial advisers on the directory must have the ability to provide regulated financial advice in either the 'at retirement' or 'post retirement' market, and may concentrate on either or both areas.
- Financial advisers on the directory will offer regulated advice as their primary business model, which can be full, focused or simplified advice but at all times will include a personal recommendation appropriate to the individual client's needs. Advice must be covered by the Financial Ombudsman Service and the Financial Services Compensation Scheme.
- Firms with 'restricted' status due to the fact that they have chosen to focus on a particular market will be permitted entry to the directory, but will be asked to confirm that its advisers will consider all available providers within the market they have chosen to focus on.

The press release also reports that the panel recognised that including information on fees and charges is highly desirable but more work is needed to ensure fee information provided is accurate, meaningful and of real benefit to consumers. This work will continue after the directory is launched.





## ON THE HORIZON

- **Equalisation for GMPs.** It had previously been expected that guidance on conversion of GMPs would be published in the spring but, as at the end of December, this had not been published. An HMRC Bulletin on the end of contracting-out issued in July reported that the DWP understands that schemes are waiting for GMP conversion guidance but it thinks it is important to develop fully considered proposals, and guidance will be published when this critical work is completed.
- **The end of contracting-out.** The consultation on draft regulations in relation to the power for employers to increase employee contributions or alter future accrual to offset increased national insurance contributions closed on 2 July. It was expected that these regulations will come into force in the autumn but as at the end of December the response and final form regulations had yet to be published.
- **Public service schemes.** The Regulator's consultation on the draft Code of Practice and regulatory strategy for public service pension schemes closed on 17 February 2014. It is anticipated that the Code will be laid before Parliament in the autumn.
- **Investment regulations.** In late October 2014 the Government reported that it intends to consult at the earliest opportunity in relation to some amendments to the investment regulations. This follows recommendations made by the Law Commission in July 2014.
- **DB to DC transfers.** In light of the Treasury announcement that, following the Budget reforms, DB to DC transfers will continue to be permitted (save for in respect of unfunded public service schemes), the Regulator intends to consult on changes to its transfer guidance in the New Year.
- **DC reform guidance.** The Regulator intends to publish guides on DC reform (the Budget changes, governance standards and charges) in the New Year.
- **DC scheme quality and charges.** Statutory quality standards for DC schemes, a cap on charges for default funds in qualifying schemes, a ban on consultancy charges in qualifying workplace personal pension schemes and reporting requirements in relation to charges are proposed to come into effect in April 2015. Draft regulations to give effect to this are expected to be laid before Parliament in early 2015.
- **Solvency.** Following its consultation on further work on solvency of IORPs (which closes on 13 January 2015), EIOPA will consider the feedback received and expects to publish draft technical specifications by early 2015 for a quantitative impact assessment. Following this assessment, EIOPA will develop technical advice to the European Commission on EU solvency rules.
- **Automatic enrolment technical amendments.** A consultation on technical amendments to the automatic enrolment legislation, including the introduction of exceptions was published in December 2014. It is intended that the regulations will be laid in February and come into force in April 2015.
- **Review of survivor benefits.** The review of different treatment of survivor benefits under occupational pension schemes required to be completed under the Marriage (Same Sex Couples) Act 2013 has been published, although no date has been given for when the Secretary of State will announce whether or not any amendments will be made to the legislation. The Employment Appeal Tribunal's judgment in the *Walker v Innospec* case concerning the restrictions placed on benefits payable to civil partners is the subject of an appeal to the Court of Appeal, with a hearing due to take place on 23 or 24 February 2015.
- **Guidance guarantee – levy.** The FCA's second consultation in relation to the levy for the guidance guarantee closes on 2 February 2015, and the FCA intends to publish feedback on the responses and the final rules in March 2015.
- **Guidance guarantee.** In November the FCA published a Policy Statement and near final standards for guidance providers and rules for providers to





signpost the guidance service to customers. The final form of the standards and rules will be published after the Pension Schemes Bill receives Royal Assent.

- **DC regulation.** The Regulator expects trustees of occupational pension schemes to assess the extent to which their scheme complies with the DC quality features and publish a governance statement in relation to this assessment at the end of the 2014/15 scheme year.
- **DC reform.** The far-reaching DC reforms announced in the Budget will come into force in April 2015. The Taxation of Pensions Act 2014 received Royal Assent on 17 December and the Pension Schemes Bill is expected to receive Royal Assent around March 2015.
- **Automatic enrolment thresholds.** New automatic enrolment earnings thresholds for 2015/16 come into force on 6 April 2015.
- **SMPIs.** Updated guidance in relation to Statutory Money Purchase Illustrations that was issued in December 2014 will apply to illustrations issued on or after 6 April 2015.
- **Transparency of DC charges.** The April 2015 measures on charges include some reporting requirements in relation to charges and transaction costs. The DWP intends to build on this in 2015 with a consultation on regulations to introduce further transparency in 2016.





- **Short service refunds.** It is intended that short service refunds will be withdrawn from money purchase schemes in October 2015.
- **DC charges.** From April 2016, it is proposed that member-borne commission payments and Active Member Discounts will be banned from DC qualifying schemes.
- **End of contracting-out.** The reform of state pension which will result in the end of contracting-out is due to take effect in April 2016.
- **Defined ambition.** The Pension Schemes Bill which contains provisions to enable the development of Defined Ambition and collective schemes has been laid before Parliament and is expected to receive Royal Assent around March 2015. It is expected that the provisions on Defined Ambition and collective schemes will be available in time for the end of contracting-out in April 2016.
- **Automatic transfers.** An announcement in September about the restrictions on NEST and an announcement in October 2014 about the abolition of short service refunds indicated that the system of automatic transfers may be introduced from 1 October 2015. However, in December 2014 it was announced that the system will be launched in autumn 2016.
- **IORP II.** The draft updated IORP Directive published in March 2014 proposed that Member States would have to transpose the new IORP Directive into national law by 31 December 2016. An updated draft published in September deleted this date and did not replace it with a new date. A further draft published in December stated that Member States would have two years after the entry into force of the Directive to transpose it into national law.
- **DC charges.** In 2017 it is proposed that the level of the charge cap will be reviewed, as will the question of whether any transaction costs should be included in the cap.





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