BROADSTONE

WINTER PENSIONS INDEX

JANUARY 2016

CONTENTS

EDITOR:
DAVID BROOKS TECHNICAL CONSULTANT

1 THE GOVERNMENT

1.1. Pension Freedoms in force

From 6th April 2015, the much discussed Pension Freedoms, for people with 'flexible' benefits, went live.

In summary, members with flexible benefits, Defined Contribution (DC) or cash balance, can now use these funds from the age of 55 by:

- Taking 25% tax-free
- Buying a conventional annuity.
- Buying a flexible annuity (one that can increase/decrease in payment with no limit)
- Receiving them as a lump sum, Uncrystallised Funds Pension Lump Sum (UFPLS), or a series of them
- Entering income drawdown with no limits on income.

Any excess beyond the tax free amount will be taxed as income on the member.

People will be able to access free and impartial guidance on their decisions, via the Government's Pension Wise service. The Pension Wise service is being delivered via The Citizen's Advice Bureau for face to face sessions and The Pensions Advisory Service for web-based and telephone sessions. Trustees and scheme providers have new legal requirements to signpost members to the Pension Wise service.

Members of Defined Benefit (DB) pension schemes that wish to access the Freedoms will have to transfer their benefits to a flexible arrangement. However, if the transfer value is more than £30,000 the person will need to prove they have received Appropriate Financial Advice before the Trustees are able to release the transfer value.

Anti-Avoidance

The Government has introduced new measures to prevent manipulation of tax reliefs under the new flexibilities by introducing a lower ongoing Money Purchase Annual Allowance (MPAA) for those who take a taxed income from a DC pension in line with the new flexibilities.

This will reduce these individuals future MPAA from £40,000 to £10,000. This does not apply to those taking benefits from DB Schemes and only applies to future DC payments and contributions.

This will no doubt be an area of increased complication for Trustees, employers and individuals, with disclosure requirements on all involved.

Permissive Statutory Override

Legislation has been drafted to allow schemes with flexible benefits to ignore their scheme's rules and pay benefits in line with tax rules, if they wish. This is being described as a permissive statutory override, so while still down to Trustee's discretion, it makes flexible payments much easier to implement, such as, flexible use of Additional Voluntary Contributions (AVCs) in DB schemes.

Statutory Right to Transfer

The Government has extended the statutory right to transfer from flexible benefits, so that all flexible benefits can be transferred up to a member's Normal Retirement Age. DB benefits are still restricted, although schemes may permit non-statutory transfers in the year to Normal Retirement Age.

1 THE GOVERNMENT

1.2. Summer Budget 2015

It doesn't seem like a moment has passed before another Budget comes along with more challenges for pension members, Trustees and administrators to deal with.

The Chancellor has announced a number of measures to change the way pensions operate for pension members now, with the possibility of massive changes in the future.

The headlines are:

- A very open-ended consultative Green Paper on the future of pensions tax relief. This has the potential to fundamentally change the way pensions operate, moving away from the Exempt Taxed regime to Taxed Exempt. It remains to be seen what direction the Government will be influenced by the competing priorities of reducing the level of tax relief to support ongoing austerity measures, whilst still retaining an incentive for individuals to save for their retirement
- As stated in their election manifesto, the Government has introduced a tapering method to reduce the available Annual Allowance for those earning over £150,000 although those earning over £110,000 pa will have to be aware of the issues. The rules are somewhat complicated and has also necessitated the need to align ALL Pension Input Periods for all open schemes to the tax year and introduced transitional rules from 8th July to achieve this. The rules are convoluted, but are designed to align the dates without opening the door to any tax relief abuse. This will impact all open schemes and the impact on administration and communication will need to be assessed. This has the potential to be disruptive to schemes not already aligned to the tax year
- The Government also wants to ensure that people can access the new flexibilities easily, and at reasonable cost. The Government will consult before the summer on options aimed at making the process for transferring pensions from one scheme to another quicker and smoother, including in relation to any excessive early exit penalties. If there is evidence of such penalties, the Government will consider imposing a legislative cap on these charges for those aged 55 or over
- The Government wants existing annuity holders to have the freedom to sell their annuity income. The Government will set out plans for a secondary annuities market in the autumn, and agrees with respondents to the recent consultation that implementation should be delayed until 2017 to ensure there is an in-depth package to support consumers in making their decision
- Pensions Wise – The Government is extending access to the successful Pension Wise service to those aged 50 and above, and launching a new comprehensive nationwide marketing campaign. This will ensure more people can access high-quality, impartial guidance on making the most of the new pension flexibilities
- The Budget also confirmed the plan to reduce the Lifetime Allowance to £1m from April 2016. This has planning and protection issues for many members who may not intuitively believe they are impacted by this limit and we urge schemes to address this. HMRC have also announced that the protection regimes will work in a similar manner to the Individual and Fixed protections used in 2014, although they may remove the deadlines to apply, and are consulting on this.

1 THE GOVERNMENT

1.3. Tax on pension death benefits

The way flexible pension benefits are taxed on death before and after age 75 have changed with effect from 6 April 2015.

The table below gives the broad position:

Death before the age of 75

	EXISTING RULES	PROPOSED RULES
Benefit as Lump sum	Tax free or 55% if in income drawdown	Tax free
Income	Tax as income (annuity or continuation of drawdown) to qualifying dependents	Tax free – via drawdown taxed as income – via annuity to any beneficiary

Death after the age of 75

	EXISTING RULES	PROPOSED RULES
Benefit as Lump sum	55% tax charge	45% tax charge (marginal rate from April 2016)
Income	Taxed as income to qualifying dependents	Taxed as income to any beneficiary

Note though that death benefits may also be subject to a Lifetime Allowance Tax (LTA) charge where they are in excess of the lower of £1.25 million or the available LTA (depending on previous Benefit Crystallisation Events (BCEs) and levels of protection). As pensions are usually held in trust outside of the deceased's estate, inheritance tax isn't usually applied. This is the case under existing and the proposed new rules. The death benefits also don't cease with immediate next of kin and can 'cascade' down the generations. Members of a DC scheme will be able to nominate someone to inherit the unpaid pension fund as a 'nominee's flexi-access drawdown account'. This nominee can be any person (not necessarily a dependant) with no age restrictions. Therefore, adult children could also be nominated. On the nominee's death, should funds remain in the pension, these too can be passed on to another nominee (successor).

Nominees and successors are defined as:

The nominee of a member is someone nominated by the member or, where no nomination was made and in the absence of any dependant of the member, someone nominated by the scheme administrator.

Successor of a member is someone nominated by a dependant, nominee or successor of the member (in relation to their own death) or, where the beneficiary has not made a nomination, someone nominated by the scheme administrator.

This is a significant tax break for passing wealth on after death and may yet be curbed by this or the next Government.

1 THE GOVERNMENT

1.4. Individual Protection 2016 and Fixed Protection 2016

HMRC have provided some detail on the forms of protection which will available from 6 April 2016 when the Lifetime Allowance reduces to £1m:

- The rules will work as per the 2014 regimes, although HMRC will do away with the deadlines for application. Note that as the rules for Fixed Protection specify no 'accrual', action will still need to be taken from April 2016 to avoid invalidating that form of protection straight off the bat if it is intended to be used in the future. While there are no deadlines, protection should be applied for before benefits are taken
- The rules will be included in the Finance Bill 2016, which will come into force in July 2016. Therefore, members need to be up-to-speed with their Fixed Protection 2016 planning before it is law
- People will be able to apply online from July 2016
- HMRC are also considering an online service for administrators to check whether a member has protection.

1.5. VAT on Pension Costs – impact delayed

HMRC issued further guidance on this subject:

https://www.gov.uk/government/publications/revenue-and-customs-brief-17-2015-deduction-of-vat-on-pension-fund-management-costs

Most importantly, the 'transitional period' has been extended to 31 December 2016. This means that no immediate action is required, and scheme sponsors can continue to reclaim pension scheme VAT in line with past practice, for at least the next 14 months.

The new guidance raises issues relating to corporation tax relief, and also seems to hint at other solutions' that might provide an alternative mechanism to tri-partite contracts – HMRC has promised further guidance in due course.

1 THE GOVERNMENT

1.6. Consultation on early exit charges

The Government has issued (via the Treasury, rather than the DWP) a consultation on exit charges, pension transfers and financial advice. The consultation is light on proposals.

The focus on excessive charges is open-ended and acknowledges the problems of contract law and goes as far as to suggest many of those headline grabbing 'penalties' are actually outside the scope of the consultation. A cap, and three methods for introducing one, are discussed.

Pension transfers is no less open-ended and comes with the, frankly, bizarre suggestion that the receiving scheme should drive the transfer (much like a switch of utility provider). With the ongoing risk of pension scams, giving the whip to a dodgy scheme seems a little risky.

Financial advice is acknowledged as an area of discussion, but as the requirements for advice only applies where a transfer is more than £30,000, there seems little scope for movement.

1.7. Announcement confirms end of Pot Follows Member and slow death for CDC and Defined Ambition

Ros Altmann announced in a written statement that it is not the right time to pour more strain on the pensions industry already coping with automatic enrolment and the introduction of pension flexibilities.

"That is why we have decided that the time is not right to implement Defined Ambition, Collective Benefits and Automatic Transfers. The time is not right to ask the pensions industry to absorb the new swathe of regulation that would be needed to make such further reforms work effectively. The market needs time and space to adjust to the other reforms underway and these areas will be revisited once there has been an **opportunity** for that to happen."

2 PPF

2.1. The search for self-sufficiency

The PPF has announced an update to its journey to self-sufficiency by 2030, with the likelihood of success recently reduced to 88%. It has described self-sufficiency as:

- An amount of money at 2030 that is the PPF's best estimate of the amount needed to pay future benefits (so has a 50% chance of paying future benefits)
- A 10% additional margin, which is intended to have the effect of giving the PPF a 90% chance of being able to pay future benefits in full.

2030 isn't a date for the diary of employers to think "phew, no more levies". This is the date that the number of eligible schemes will be so small as to make the levy pointless (or at least in comparison to the assets and liabilities it holds). So rather than an aspiration, it is an acknowledgment of reality.

It is interesting to read their analysis of the market and future risks and those of such a mindset (all actuaries) should read their report in full here:

http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/Funding_Strategy_Review_2015.pdf

2.2. Pre-pack administrations – PPF Guidance Note

Background

The PPF's Restructuring and Insolvency team issued a Guidance Note this summer (July 2015) setting out its approach to pre-pack administration processes involving defined benefit (DB) pension schemes.

Pre-pack administrations are a type of bankruptcy procedure, where a restructuring plan is agreed in advance of a company declaring insolvency and in advance of an administrator (or Insolvency Practitioner) being appointed. The administrator then effects the pre-agreed sale shortly after their appointment. Pre-pack administrations are a powerful and legal way to structure the sale of a distressed business and get rid of any debts and any onerous contracts in the process.

The Guidance Note

In its guidance note, the PPF raises concerns about the possibility of pre-pack processes being used to 'dump' DB scheme liabilities, particularly where the new company set up in such proceedings retains strong links to (or in some circumstances may still be controlled by) the previous owners and/or company directors. The PPF also raises concerns about the lack of meaningful consultation with the pension scheme trustees/PPF prior to the appointment of an administrator.

2 PPF

In response to these concerns, the PPF's Guidance note states that in pre-pack proceedings where the same administrator intends to execute the subsequent liquidation or compulsory voluntary arrangement (CVA) of the distressed company, it will examine the extent to which the pension scheme trustees/PPF were consulted before the appointment of the administrator. If there is no consultation, or it is deemed that any concerns raised have not been properly taken into account, the PPF may seek to replace the administrator that undertakes the liquidation or CVA proceedings.

Comment

If a DB scheme is in deficit, the trustees are effectively an unsecured creditor of the sponsoring company. A key issue for unsecured creditors is that they could be unaware a pre-pack is planned until after it is triggered and they will then have very little opportunity to protect their interests.

The guidance published by the PPF appears to show hardening of their approach to pre-packs processes and strongly encourages earlier and more open consultation with pension scheme trustees and/or the PPF around any planned pre-packs.

3 THE PENSIONS REGULATOR

3.1. Employer Covenant Guidance

The Regulator has refreshed and vastly expanded the Guidance for Trustees and employers on assessing the Employer Covenant, aimed at defined benefit schemes.

The Guidance is long, detailed and at times feels a long way from being pensions related and 'way into the undergrowth' could be viewed as corporate jargon (this may be deliberate though).

The Guidance clearly weighs heavily towards the importance of the covenant, but does emphasise a proportionate approach where possible and appropriate.

Summary

The concept of assessing the employer covenant is not in itself new, but the general tone of the guidance echoes tPR's previous views on employer covenant reviews and the new DB funding code emphasising proportionality.

The Regulator recommends that Trustees review the employer covenant at each actuarial valuation and that steps are in place to monitor the covenant should things change quickly. The assessment should not just cover employer strength, but the extent of the legal obligation present to support the scheme.

Where Trustees lack the 'objectivity or expertise required to perform an appropriate assessment' then appointing an independent external covenant assessor should be considered. It is clear that the Regulator has some concerns about Trustees who make their own assessment of covenant, without external help.

What does the guidance suggest?

The position of the employer covenant as part of the integrated risk management is central to the guidance. To be able to achieve an appropriate assessment of the risks, a sound understanding of the covenant is integral.

The Regulator does not expect or require an elimination of the risks involved with the schemes, but Trustees are expected to be able to understand and manage them. The Trustees must be able to understand the impact of various downside risks and the ability of the employer's ability to address them is central to the employer covenant assessment. This means that understanding the covenant acts as the grounding from which Trustees will be able to determine how they address:

- Investment strategy, when considering what is an appropriate level of investment risk that can be taken
- Funding, when setting the actuarial assumptions regarding what is an acceptable level of prudence to be included.

4 TRUSTEESHIP

4.1. Transfer deadlines

The Pensions Ombudsman has made a ruling in a transfer case, stating that 30 days should be enough to pay out a transfer value.

This has re-opened some wounds as, technically, the scheme has 6 months from the request date to pay the transfer value. However, while 30 days should be sufficient to disinvest and pay out funds, there are exceptions and there are concerns that this becomes a de facto deadline. There may be legitimate reasons for delay, including concerns around scams. Administrators and Trustees should ensure that they operate as quickly as possible, but be mindful that each case is different and sometimes further checks are needed before the transfer can be paid.

4.2. Refund of surplus – s251

One of those deadlines that felt like in the dim and distant past is returning and is making this writer feel old.

About 5 years ago, schemes were advised to pass a trustee resolution to ensure the existing right to refund a surplus that may exist in a scheme would continue. The original deadline was 5 April 2011 and this was extended to 5 April 2016.

2016 is looming on the horizon and, if a resolution is passed, members have to be advised 3 months before the effective date. Therefore, if a scheme has not passed a resolution, now is the time to act.

4.3. Inflation (negative)

Remember when negative inflation was called deflation?

CPI for September 2015 was 0.1%. RPI, meanwhile, increased by 0.8%. What does this mean?

- Schemes with LPI and post 88 GMPs will not increase these elements
- No inflation allowance for Annual Allowance calculation
- Revaluation calculations in 2016 will reflect this drop.

4.4. Same-sex marriage discrimination lawful

The Walker vs Innospec case was heard in the Court of Appeal where the Judge ruled that the discrimination in benefits is lawful.

The case hinged on three points:

- The refusal of Innospec Trustees to confirm that Mr Walker's husband would be entitled to a survivor's pension is an act that took place after the equality directive came into force and, consequently, the 'future effects principle' in EU law applies
- The ECJ decided in previous cases (Maruko and Romer) that a claim such as Mr Walker's is permitted by the equality directive, even though his period of service ended before it came into force
- The prohibition on discrimination on the grounds of sexual orientation is a fundamental principle of EU law and so the 2005 limitation must either be read in such a way as to make it compatible with the equality directive or, if that's not possible, it must be disapplied.

The appeal rejected the arguments and, in particular, cited Barber as an example where a previous ruling has not had retrospective effect.

4 TRUSTEESHIP

4.5. PASA make pronouncements on GMP and Transfer Code

GMP Reconciliation

The Pensions Administration Standards Association have added their weight to the call on Trustees to begin reconciling their GMP as soon as possible via the Government's reconciliation service. There will be a great deal of pressure on the system by the time it closes in 2018 and while that feels like a long time away, the exercise can be a long drawn out process and one that should be started sooner rather than later.

Transfer Code

PASA's code on transfers has been designed as a voluntary code for scheme administrators to sign up to when transferring data from one provider to the other.

For new TPA appointments, PASA expects the Client Agreement to include a section which covers transition, as set out in the PASA Standards. This section should clearly state what the client can expect on exit and this should reflect the PASA Code of Conduct on Administration Provider Transfers. For existing clients, PASA expects administrators to explicitly confirm their commitment to the protocols in this Code applicable to a ceding administrator in writing through a side letter (unless they have already done so in their Client Agreement). An administrator may wish to include a copy of this Code, for reference, in the side letter.

Sources downloadable from here: http://www.pasa-uk.com/5

4.6. Bankruptcy and pension benefits

The case of Horton v Henry has thrown the perceived wisdom of the status of pension benefits on bankruptcy into chaos. The issue concerns the extent to which an Income Payment Order (IPO) can be used to access a member's pension.

The consensus (that was backed up by the Raithatha v Williamson case) was that, if the member became entitled to a pension, by asking for it, this would be subject to the IPO. However, the judge in the Horton v Henry case has taken the opposite view and the pension would be subject to the IPO only where the member has already chosen to take it. The judge believed that there isn't sufficient power in the legislation to require an individual to take their pension.

The case has very real implications for those over the age of 55 that go into bankruptcy after April 2015, where there is the possibility to access all their pension funds, should they ask.

The case has now been supported by updated instructions for those dealing with bankruptcy cases.

CONTACT US

If you would like to discuss any of the items covered in this edition of the BROADSTONE Index please call or email your usual BROADSTONE contact or one of the people listed below:

Editor: DAVID BROOKS
Technical Consultant
T: 020 7893 2262
E: david.brooks@broadstoneltd.co.uk

JEREMY FISHER
Actuarial Services Director
T: 020 7893 3220
E: jeremy.fisher@broadstoneltd.co.uk

PAUL NOONE
Client Services Director
T: 020 7893 3574
E: paul.noone@broadstoneltd.co.uk

VANDA COX
Director – Corporate Benefits
T: 020 7893 3076
E: vanda.cox@broadstoneltd.co.uk

SIMON NICOL
Pensions Director
T: 020 7893 2339
E: simon.nicol@broadstoneltd.co.uk

GEOFF CARR
Corporate Benefits Director
T: 020 7893 3105
E: geoff.carr@broadstoneltd.co.uk

BROADSTONE

BS100231

December 2015

www.broadstone.co.uk

contactus@broadstone.co.uk