BROADSTONE

# SUMMER INDEX

MAY 2016

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**EDITOR:**
**DAVID BROOKS** TECHNICAL DIRECTOR

# 1 THE GOVERNMENT



## 1.1. Budget 2016

### Lifetime ISA (LISA)

Pension ISA is here under the guise of the Lifetime ISA (LISA). The key features of the LISA are:

- From 6 April 2017, anyone between 18 and 40 can open a LISA
- Can save £4,000 per year and receive 25% bonus from Government
- Can be used for first home (with Government bonus) up to a maximum house value of £450,000
- Can be used from age 60 (with Government bonus) – no tax to pay on withdrawals, just like an ISA.
- Early access would lose Government bonus and also incur 5% charge
- Government will consult on allowing borrowing on LISA

### Pensions Dashboard

Government will ensure a pensions dashboard, to be set up by the industry, exists by 2019 that will show all pension savings in one place. This is currently a DC solution (to help deal with the problem of abandoned pots, now pot follows members has gone).

**Advice and support**

FAMR review reported this week on the state of the advice market. On the back of this, the Government will:

- Consult on clear definition on what is financial advice
- Increase £150 Income Tax and NI relief for employer arranged pension advice to £500
- Consult on Pensions Advice Allowance. This will allow people before the age of 55 to withdraw £500 tax-free from their DC fund to redeem against the cost of financial advice

The Government will commence a consultation which will replace the statutory guidance providers, the Money Advice Service, The Pensions Advisory Service and Pension Wise with new bodies following a further review. The Treasury said it will introduce a new pensions guidance body and a new, slimmed down money guidance body in their place. It will be funded by a levy on the financial services and pensions sectors. The consultation runs into the summer, with the bodies likely to be up and running in April 2018.

### Salary Sacrifice

Salary sacrifice remains for the moment. However, the Government is considering limiting the scope of benefits included in salary sacrifice to pension, childcare, health care and cycle to work schemes.

From April 2018, other payments, currently exempt from salary sacrifice, of over £30,000 and currently subject to income tax, will lose their NIC exemption, including redundancy payments.

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## 1.2. 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, from age 50. 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 full transfer value is more than £30,000, the person will need to prove they have received Appropriate Financial Advice before the Trustees release the transfer value.

### 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 also 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.

## 1.3. High Earners Tapering of Annual Allowance

The Government has introduced a tapering method to reduce the available Annual Allowance for those earning over £150,000 per annum, although those earning over £110,000 per annum will have to be aware of the issues. The rules are somewhat complicated and have 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.

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Draft regulations have been laid to help administrators determine whether a member may be affected by the tapered Annual Allowance.

When these regulations come into force, in assessing to whom a pension savings statements should be issued, the scheme administrator will not necessarily need to determine whether a member has actually exceeded their AA or not (or is subject to the MPAA).

A new alternative criterion has been introduced, in that, any member whose pensionable earnings for that tax year exceed £110,000 will be due a statement. A definition of "pensionable earnings" for this purpose is also included:

""pensionable earnings" means the member's salary, wages or fee in respect of the employment to which the public service pension scheme or occupational pension scheme relates"

The regulations will also clarify what information the scheme administrator is required to provide to a member in relation to 2015/16.

## 1.4. Individual Protection 2016 (IP16) and Fixed Protection 2016 (FP16)

Protection from the reduced Lifetime Allowance from 6 April 2016 will be available from 6 April 2016 when the Lifetime Allowance reduces to £1m.

The rules will work as per the 2014 regimes, although HMRC have removed the deadlines for application. As the rules for Fixed Protection specify no 'accrual', action will still need to be taken from April 2016 to avoid invalidating this form of protection immediately, if it is intended to be used in the future. While there are no deadlines, protection should be applied for before benefits are taken.

HMRC has put in place an interim process for members to apply for temporary FP2016 and/or IP2016 until the new online self-service system is up and running (expected in July 2016).

Members need to notify HMRC in writing that they intend to rely on FP2016 and/or IP2016 and they will receive a reference number. Pro-forma letters are promised by HMRC, which will be helpful for those intending to use the protection between April and July 2016. Those not intending to rely on the protection before July 2016 should wait for the full system to be up and running. However, if an application for Fixed Protection 2016 is to be made, the rules of this (the most important being that all pension contributions and (broadly) all DB accrual should cease from 5 April 2016) would need to be complied with. If they are not, the protection would be invalid straight away.

When the new online self-service system goes live, members will need to make a full online application.

## 1.5. Secondary Annuity Market by April 2017

The Government are now committed to creating the space for people with annuities (bought before or after 6 April 2015) to sell these income streams. The price individuals receive can be taken as they see fit, but the resulting value will be taxed at their marginal rate.

The Government's focus will be on consumer protection, mindful of the potential for bad outcomes for individuals. Pension Wise will be expanded to provide support. A financial advice requirement (akin to the one needed when transferring safeguarded rights) will also be introduced.

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The Government have also moved slightly on their position around "buy-backs" to the originating annuity provider. This may be permitted if the value is low (to be defined) or brokered via an FCA authorised intermediary.

Other issues on the agenda for consideration are an online rate comparison tool, a method for ensuring annuity payments cease on the death of the originating annuitant and protecting dependants who may lose death benefits.

## 1.6. DWP and COPE

The DWP have issued a factsheet explaining what COPE is. COPE stands for Contracted-out Pension Equivalent amount. It represents an estimate of the SERPS/S2P (additional state pension) the person will not receive as they were contracted-out. It is important to note it is not necessarily the same as GMP/s9 (2b) rights and certainly won't equal the annuity that could be purchased by the former protected rights.

The factsheet advises that this will be provided via the pension scheme they were a contracted-out member of.

## 1.7. VAT on Pension Costs

Late last year HMRC issued further guidance on the subject of VAT and costs related to the management of pension schemes, the guidance can be found here:

https://www.gov.uk/government/publications/revenue-andcustoms-brief-17-2015-deduction-of-vat-on-pension-fundmanagement-costs

Most importantly, the 'transitional period' for the status quo to persist 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, until then.

However, 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.

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## 2.1. 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 - 'way into the undergrowth' could be viewed as corporate jargon (although this may be deliberate).

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', 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.

## 2.2. Integrated Risk Management

TPR have issued guidance on improving the risk assessment undertaken by Trustees and sponsors.

Defined benefit pension schemes face three fundamental risks. They do not know:

- how long pensions will be paid for;
- how much these pensions will be; and
- the future investment return from the assets that they hold to fund these pensions.

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Given these risks, schemes can never be certain that they hold sufficient assets. This means that there will always be the risk of needing to seek further funding from the sponsor, even for what may appear to be a well-funded scheme. This gives rise to a fourth risk – will the sponsor be able to fund such additional contributions, if they are required?

These risks are not entirely independent. Management of these risks lies at the heart of the financial management of a defined benefit pension scheme, and the Pension Regulator's recent guidance (issued in December 2015) on "Integrated Risk Management" reflects this.

Integrated Risk Management includes:

- understanding the risks in the scheme;
- taking action to mitigate those risks; and
- planning actions that **might** be taken in the future, depending on circumstances

As stated in the previous guidance issued by the Pensions Regulator, there is a continued emphasis on an open and transparent relationship with the employer.

Some of the benefits of introducing Integrated Risk Management include:

- Better decision making resulting from greater trustee and employer understanding of risks.
- Better working relationships between trustees and employers because of open and constructive dialogue.
- More effective risk assessment, contingency planning and monitoring arrangements resulting from an evidence-based focus on the most important risks.
- Greater efficiency due to more effective use of trustee, employer and adviser resources.

Trustees should consider the following steps:

**Step 1:** Initial considerations for putting risk management in place

**Step 2:** Risk Identification and initial risk assessment

**Step 3:** Risk management and contingency planning

**Step 4:** Documenting the risk management framework and decisions reached

**Step 5:** Risk Monitoring

## 2.3. DC Code guides

The Pensions Regulator will shortly be issuing a new code for Defined Contribution Schemes and has issued guides for complying with each of the six sections of the Code. The guides cover:

- Trustee Board
- Scheme management skills
- Administration
- Investment Governance
- Value for Members
- Communicating & Reporting

The consultation closed in mid-May and the Code and guides are expected to come into force in July.

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## 2.4. Master-trusts

The Pensions Regulator is using the new DC Code to also review the standards in the master-trust arrangements set up to take advantage of the auto-enrolment programme. However, the rules may apply to multi-employer DC schemes. For these purposes a master-trust is "a trust-based DC scheme for employees of non-associated employers" The new rules effective 6 April 2016 are as follows:

- Minimum of three trustees
- The majority (including the Chairman) must be independent of the "provider" (non-affiliated)
- The non-affiliated trustees must not be affiliated with any company that provides advisory, administration, investment or other services to the scheme. Individuals who also sit on the providers' investment governance committee may still be considered non-affiliated Independent Trustees subject to minimum terms
- Open and transparent means of appointing them – the process could involve national advertising or a recruitment agency
- Trustees must also engage with members so their views are known
- Schemes will have to explain in an annual statement how these requirements have been met.

## 2.5. Scheme return compliance

From July, scheme returns will include extra questions for DC schemes. The Pensions Regulator will be monitoring the results to see how their efforts for improving DC governance is progressing.

Schemes must:

- Identify the chair of the Trustees
- Declare whether they have produced a Chair's statement
- Compliance with the charge cap

The Pensions Regulator has also prepared checklists and sample returns to assist. There are fines if the returns are not completed.

# 3 TRUSTEESHIP



## 3.1. 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.
- CPI revaluation calculations in 2016 will reflect the reduction.

## 3.2. 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.

## 3.3. PASA on 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.

## 3.4. Employer duty of care to employees

The Pensions Ombudsman has ruled that (in a particular set of circumstances) the employer had a duty of care to advise pension scheme members of the tax implications of certain activities.

Summary of facts:

- The case concerns protection pension age where, generally, the earliest age a pension can be accessed is age 55, unless a protected pension age exists.
- One condition is that the member cannot retire using the protected pension age and then be re-employed within 6 months (or the within one month on the same role).

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- 3 South Wales police officers accessed the pension benefits before age 55.
- They were re-employed within one month.
- Their benefits were subject to a tax charge.
- The Pensions Ombudsman upheld the complaints and the employer should pay the tax charge.

Pension Ombudsman cases do not set precedent and it can be argued that, in this case, the direct nature of the involvement of the employer to trigger the tax charges perhaps make this a unique set of circumstances where the conclusion is reasonable. A case in 2014, where a member accrued an annual allowance tax charge, was found in favour of the trustees, which meant they had no obligation to advise the member of the potential charge.

With increasing complication with regard to tax and pension (e.g. tapered relief for high earners) it is possible the Pensions Ombudsman will take a different view in cases such as these.

## 3.5. Scams

The High Court has ruled on the case of Hughes vs Royal London.

The member in this case wanted to transfer to a SSAS invested in Cape Verde islands. Royal London said no, as she didn't (in their view) have a statutory right to a transfer. They cited the "earner" link and that she wasn't employed by a body linked to the pension scheme. The Pensions Ombudsman agreed. However, the High Court didn't and ruled that she was an "earner" (albeit from a source unconnected to the scheme). This meant she was entitled to a transfer.

This is a major development, as the Pensions Ombudsman had 200 or so cases on his books which hinged on this point.

There would now be no reason to delay the transfer payment. We'll soon see a trickle of Pensions Ombudsmen rulings telling schemes to pay the transfer value.

This makes fraud much easier, and may prompt a change in emphasis in the narrative. If the scheme has complied with the Regulator's guidance and issued warnings about scams and fraud – if people still want to risk losing their money, perhaps they should be permitted to proceed. We have been discussing scams for years and we will be discussing it for years to come and it's a shame that one brick in the defensive wall for trustees to use has been removed.

## 3.6. European Disclosure rules

The much feared Solvency II rules that have loomed on the horizon for a number of years (the long and short that DB schemes would have to be fully funded at all times) appears to have receded. However, it has been replaced by a new EIOPA (European Pensions Authority) recommendation for a European framework for DB schemes to undertake greater risk assessment and transparency. Schemes would need to value assets and liabilities on a "market-consistent basis" with a "risk-free" interest rate used to discount liabilities. The calculation should also include an allowance for protection mechanisms, the employer covenant and any ability to reduce benefits. Effectively, this is the "holistic balance sheet" as previously proposed. From this base line, the DB scheme would need to undertake a risk assessment and undertake some prescribed stress scenarios.

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The results will be publicly disclosed and, if necessary, national regulators/supervisors would have the power to take action. It is also expected that there will be an allowance for proportionate approaches, for example, reporting would be every three years (rather than annual) and contain exemptions for small schemes. EIOPA estimate that this will cost UK DB schemes £165m to comply.

## 3.7. Persons with significant control (PSC)

New company law will require companies to keep a register of "people with significant control" aka PSC. This should be filed with Companies House by 30 June 2016. This must be maintained at all times and failure to do so is a criminal offence.

*this may not be people but also an entity. A person/entity should be on the register:

- if this person directly or indirectly owns more than 25% of the shares; or
- has more than 25% of the voting rights; or
- has the right to remove a majority of the board; and
- those who exercise (or have the right to exercise) control over the board; or
- where the trustees of a trust or the members of a firm (who are not legal persons) satisfy one of the first four conditions in their capacity as such, or would do so if they were individuals, any individual holding the right to exercise, or actually exercising, significant control over the activities of that trust or firm.

In many cases of Corporate Trustees, this will be the sponsoring employer (or related employer), but this will need to be determined.

# 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 Director
T: 020 7893 2262
E: david.brooks@broadstone.co.uk

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

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

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

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



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