BROADSTONE

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CONTENTS

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CONTENTS

Defined Benefit Funding

In the corridors of power, down in Brighton and between actuaries across the country a debate is taking place about the future of Defined Benefit Pension schemes.

The debate is focussing on a few key areas:

- Are liabilities being valued appropriately? Should trustees be able to assume greater investment return (i.e. have larger discount rates) and so reduce the size of liabilities, and therefore, funding deficits?
- Should accrued rights be amended? In particular should schemes with indexation (increases in payment) or revaluation (increases in deferment) linked to RPI be able to override them with CPI?
- Does the Pensions Regulator have the requisite powers to deal with employers looking to distance themselves from the defined benefit scheme obligations? Should the Pensions Regulator have more powers during merger and acquisition.
- Is the Pension Protection Fund suitably protected by the current regulatory regime to ensure it remain's sustainable for the future?
- Are there too many DB schemes? Would there be benefits in merging and consolidating schemes for improvements in governance and investment returns?
- Should Defined Benefit pension schemes be able to access a wider range of investments to create a better return over the long term?

These questions are designed to address the problem of Defined Benefit Pension schemes and the perceived drain funding them has on investment by employers and returns for shareholders.

The Government is digesting a green paper to address these issues and it is likely that DB schemes are in line for some more regulatory change.

BHS enforcement

The much publicised case of BHS's collapse and pension scheme black hole has taken a new turn. Sir Phillip Green and his team have been negotiating on a solution to keep the scheme out of the Pension Protection Fund by an injection of funds into the scheme. However, the deal has, so far, been rejected by the Pensions Regulator prompting them to issue warning notices to Sir Phillip Green, Taveta Investments Limited, Taveta Investments (No. 2) Limited, Dominic Chappell and Retail Acquisitions limited. This the first step in the Regulator's process for dealing with situations where it believes those responsible for funding a Defined Benefit pension scheme have failed to do so. They are, in effect, a warning that the Regulator believes it has grounds to use its other powers I.e, a contribution notice (which will demand a specified amount to be paid to the scheme) or a financial support direction (which demands a plan for ongoing support is put in place and agreed with the Regulator.

The recipients of the notices have time to respond and make representations before the case is turned over to the Regulator's Determinations Panel who will decide on whether the Contributions Notice or Financial Support Direction can be used.

CONTENTS

Secondary Annuity Market halted

The Government's plan to allow people in receipt of annuities to sell these for a one off cash sum has been abandoned. The Government was concerned that it could not balance the creation of a market with a need to protect people's best interests.

Many people may be upset about this but across the pensions industry there is a general sigh of relief as there was a high risk of people being offered small amounts for their pensions which may not have been in their best interests.

General Data Protection Regulation

This EU regulation will become law on 25 May 2018 and replaces the Data Protection Act.

Key points:

- Increase in penalties up to €20 million (from £500,000) or 4% of global turnover if corporate.
- Data processor (service providers such as administration and payroll processors) will have direct liability for data protection breaches
- Data breaches will have to be reported to ICO within 72 hours (currently no obligation to advise)
- Schemes should have a breach response plan
- New contracts that will still be in force post May 2018 should references to new GDPR
- Member's should be communicated with to confirm what data is held and why.

This will have a significant impact on Trustees and employers and something Trustees should begin to plan for.

Pensions Dashboard

The Government has announced that a prototype of the Pensions Dashboard will be released in March 2017 and willl golive in April 2019. The Dashboard is intended to be the one-stop shop for individuals looking to see what their retirement provision will be. It is intended to include state pensions, defined contribution savings and defined benefit pensions. It is not clear at this stage how trustees will comply with this, but it is expected to be legislated for.

A growing group of pension providers and special interest groups, of which we are a member, are working on this together with the ABI.

GMP Equalisation

The Government has issued a consultation document on how schemes should equalise their GMP. This has been a long running issue and there is still a difference of opinion between a consensus of pensions lawyers (who believe GMP is exempt from equalisation) and the Government which takes the contrary view.

The Government issued a methodology in 2012, which was withdrawn in a wave of criticism from the pensions industry. The new method is designed to be a one-off exercise and will also include the ability to convert the equalised GMP into non-GMP benefits ensuring it does not need to be reviewed again.

We shall monitor the consultation and advise the outcome in due course.

CONTENTS

VAT deadline extended

The Government has announced that they are extending the transitional deadline by 12 months until at least the end of December 2017. This means that the existing practice for claiming VAT on pension costs can continue for another 15 months.

The VAT on Pension Costs problem has been a difficult conundrum for HMRC to reconcile – especially with other court cases, the complexity of pensions regulation and, although not explicitly mentioned, the Brexit vote.

It is understood that, over the summer, the Government have consulted on some draft guidance, but it would appear this still left too many issues for the new rules to be implemented effectively.

Perhaps in an acknowledgement of the difficulty and uncertainty, HMRC have promised to come back towards the end of next year and review the situation with a view to extending the deadline again. It would seem that very little work will be happening on this in the meantime.

We suggest that schemes and employers put this back on to the "watching brief" and we'll see what transpires during 2017.

PPF compensation changes

A service related cap to the PPF Compensation Cap will be introduced from 6 April 2017.

For those with more than 20 years' service, the cap will increase by 3% for each full year of pensionable service above 20 years the member has in the scheme. There is a ceiling amount of twice the standard compensation cap.

The standard compensation cap is currently £37,420.

The DWP is currently consulting on:

- How this should work where members receive income from more than one entitlement within the PPF
- Whether any money purchase rights the PPF discharge should be increased in line with changes to the tax rules (increased to £10,000).

Those affected will have their PPF compensation recalculated at the original point of assessment as if the service-related cap in the PPF will operate as intended in all circumstances.

An equivalent cap will be introduced in the FAS.

PPF compensation adequate?

A case involving Hampshire v Board of the PPF has gone to the Court of Appeal. The case concerns Mr Hampshire, who suffered a reduction of 67% of his pension benefits when his scheme entered the PPF. Mr Hampshire has challenged the reduction, citing two previous cases (Hogan and Robins) and, while it isn't definitive, it seems that the Court of Appeal believes the correct application of the EU directive regarding protection of benefits creates a floor of a 50% reduction.

The case will be referred to the ECJ.

CONTENTS

Trustee prohibitions statement - "fit and proper" person

The Regulator can remove Trustees via a determinations panel if they think someone is not a "fit and proper" person. A recent updated statement explains the Regulator's policy for reaching this conclusion.

http://www.thepensionsregulator.gov.uk/docs/statement-prohibition-orders-july-2016.pdf

Automatic disqualification

A person is automatically disqualified from being a trustee on certain events, including where:

- A trustee has been convicted of any criminal offence involving dishonesty or deception.
- A company director has been disqualified from being such a director.
- Any person is subject to personal insolvency proceedings.

Those affected will have their PPF compensation recalculated at the original point of assessment as if the service-related cap in the PPF will operate as intended in all circumstances.

What is a "fit and proper" person?

When considering whether someone is fit and proper, the Regulator will consider any information which concerns the trustee's:

- Honesty
- Integrity
- Competence and capability
- Financial soundness

The Regulator will take into account:

- Any attempt to deceive
- Any misuse of trust funds
- Any breaches of trust or pensions law, particularly if these are significant, persistent, deliberate or contrary to legal advice received
- Whether a trustee's professional charges constitute a breach of trust or demonstrate a lack of internal controls
- Criminal convictions, not limited to those involving dishonesty or deception, so including (for example) money laundering, violence or substance abuse.

This list is not exhaustive, but it is indicative of what may be relevant.

What standards does the Regulator expect

- Honesty/Integrity: The Regulator will investigate any matter which raises concerns about a trustee's honesty or integrity, including matters that arise outside of their trusteeship.
- Competence and capability: Newly appointed Trustees have six months from their appointment to meet the TKU requirements. Trustees who significantly or repeatedly fall below the appropriate standards of TKU may be prohibited, particularly if no attempt has been made to attain the relevant learnings.

Professional trustees are expected to attain a higher level of understanding and expertise than lay trustees. A trustee, or firm of trustees consistently falling short of the standards that are expected from pensions professionals could also be prohibited.

- Financial soundness: The Regulator will not usually make enquiries into the financial standing of trustees, although they may do if financial soundness is brought into question (eg if the trustee were declared bankrupt, or made an arrangement with his creditors). There may be issues for professional trustees who for example, although not insolvent, may be unable to afford indemnity insurance.

CONTENTS

21st Century Trustee

The Pensions Regulator has issued a discussion paper on what it is to be a trustee of a DB or DC scheme in the 21st Century. The discussion papers ask some questions of the pensions industry as well as exploring ways of changing the communication methods used by the Regulator.

Some question areas:

- Exploring the role of the trustee Chair
- Awareness of trustee Knowledge and Understanding Framework
- Whether professional trustees should be required to be qualified or registered by a professional body,

The Regulator goes on to make a number of observations across a wide range of topics:

- Effective trusteeship and governance are key underpinning factors in achieving good member outcomes – it is essential that those responsible for running pension schemes and entrusted with members' savings are the right people with appropriate knowledge and skills and have the right scheme management processes in place.
- Trustee boards should reflect a diverse and balanced range of skills and experiences; this would include a balance of professional and lay trustees.
- The rise of professional trustees correlated with the rise in governance requirements is an area of focus from the Regulator.
- A more formal role for the Chair of a DC scheme's board of trustees has developed and the Regulator mulls over expanding the DB Chair's position. Standards may also be improved by the Regulator imposing a minimum level of experience, qualification or requirement the Chair is a member of a professional body.
- There are concerns around the awareness of the trustee Knowledge and Understanding programme. The Regulator is considering making it mandatory for Trustees to pass all relevant modules within 6 months of appointment or six-month probationary period for prospective trustees to complete the modules before the appointment is formalised.
- The Pensions Regulator does not expect all trustees to be professional but expects them to act professionally
- Conflicts of Interest remains a major issue, with a large number of trustees "volunteered" by the employer and half of Chairs selected by the employer. The area of conflicts of interest is up for review.
- Online tools will be reviewed to help trustees get what they need from their advisers. Small and medium schemes will also be assisted in getting more involved with administration, record keeping and investment governance.

What do Trustees have in store?

- More help to trustees to identify training needs.
- Help in setting investment strategies and identifying risks.
- Tools to help Chairs get more out of their advisers.
- The Regulator also makes a rather ambitious suggestion that sub-standard schemes (DB and DC) could be consolidated.

CONTENTS

Auto-enrolment and Uber

An employment tribunal has ruled that Uber drivers are "workers". This is significant because as workers they would be entitled to the national living wage and holiday pay. However, they may also be eligible for pension scheme membership under the auto-enrolment regulations.

Until now the drivers were thought to be self-employed. However, the tribunal felt that because of the provision of leads to the drivers Uber was a supplier of transportation services and the drivers the skilled labour. Uber also interviews and recruits drivers, sets routes, and controls passenger information.

The ruling may be appealed.

Master Trust - new statutory regime

The Pension Schemes Bill has been unveiled. Master Trusts are (in brief) multi-employer DC occupational pension schemes where the participating employers are unconnected. Since the launch of auto-enrolment the number of master trusts has grown to total 84 including 4 million members and around £8.5bn worth of assets.

There are concerns that the existing definition may impose some of the new requirements on industry wide schemes, charities and unions. The Secretary of State will retain the power to determine whether the requirements are appropriate if scheme's are inadvertently captured or excluded.

The Bill will introduce:

- Oversight and authorisation from the Pensions Regulator where the scheme will have to demonstrate it meets key criteria when established and ongoing.
- Actions trustees will need to take on wind-up or closure to protect members.
- Powers for the Pensions Regulator to use when criteria not met.

When schemes are being authorised they will need to demonstrate 5 requirements:

- Trustees, those establishing the scheme and those with power to appoint or remove trustees, power to amend the deed and rules including new terms "scheme funder" and "scheme strategist" must pass a fit and proper test.
- There is a sound business plan which includes sufficient resources to meet set up and running costs.
- The scheme funder is a separate legal entity.
- There are adequate systems and processes in place
- The scheme strategist must have a plan to protect members if a master trust has a triggering event – these include the scheme funder becoming insolvent, ending their relationship with the trust or decision to wind-up.

Scheme funder – is defined as a person liable to provide funds to or in respect of the scheme in circumstances where administration charges received from or in respect of members are not sufficient to cover the scheme's costs and can also receive profits where charges exceed costs.

Existing master trusts will have 6 months to get authorisation to continue. Failure to comply will result in fines in line with the Pensions Act 1995.

CONTENTS

Transfers as authorised payments

A transfer was being made by NHS to a QROPs. The scheme told the member they would make the transfer. However, in the meantime the QROPs list was revised, the scheme dropped off the list and so the scheme didn't make the payment as it would be an unauthorised payment.

The Pensions Ombudsman found in favour of the scheme but awarded £500 to the member as the payment was not made as the scheme had promised it would.

Trustees should consider including appropriate wording in transfer communications that a transfer may not proceed if it no longer constitutes an authorised payment at the point of transfer.

LISA details

Despite the rumours of low take up amongst pension providers and banks, the Government is pressing ahead with its intention to introduce the Lifetime ISA (LISA) from April 2017.

The Government has now published the Savings (Government Contributions) Bill 2016. This draft legislation outlines some of the key features of the LISA product.

So, from April 2017, if you are aged between 18 and 40 you will be able to open a LISA with an approved account holder.

Paying money in

- Individuals can pay in £4,000 per tax year
- At the end of the first tax year and thereafter monthly, the Government will provide a 25% bonus on savings made in respect of savers below age 50. This caps the maximum bonus at £1,000 per tax year
- Contributions count towards the overall £20,000 per annum ISA limit
- There will be penalties for dishonest claims of a bonus

Taking money out

Funds can be taken from a LISA without triggering a tax charge:

- When the account holder reaches age 60
- When buying a first home (worth up to £450,000)
- When suffering from a terminal illness
- After the death of the account holder

Money can be taken for other purposes before age 60. However, an exit penalty of 25% (government charge) is applied to the amount of the withdrawal." This is designed to return the government bonus element (including any interest or growth on that bonus) plus a small additional charge.

This charging structure has been criticised as harsh. For example, if someone contributed the maximum over ten years that would have a total investment of £50,000 (£4,000 x 10 plus £10,000 in top ups), with an assumption for growth this could be around £62,432 and exit charge of 25% (£15,608) leaving the investor with £46,824. This means that those with a LISA will have to be confident that they will use it later in life or for a house purchase only.

The processes, evidence and conditions for making the payments will be detailed in later regulations. But it should be noted that there has been controversy about the payment of the Government bonus or the Help to Buy ISA which meant it could not be used for a deposit and can only be used on completion. A serious flaw in the system which could yet be replicated here.

It was discussed whether the Government would allow access to the LISA with the Government bonus at other life events and whether it would be possible to borrow on the funds. The Bill is silent on these matters and so it is possible these have been set aside due to the relatively short timescale we have until the launch.

CONTENTS

LISA details...cont/

Transfers

Transfers from the Help to Buy ISA will be permitted in the 2017/16 tax year and, while these won't count towards the LISA contribution limit, they will attract a 25% bonus on the transferred funds. From 2018/19, transfers from Help to Buy will count towards the LISA contribution limit and will also attract the 25% bonus.

FCA criticism of the Asset Management Industry

The FCA is concerned that a lack of price competition and conflicts of interest could be having a detrimental impact on returns received by investors.

The FCA has published an interim report and in it they identify ways that asset managers could work better for investors.

These observations include:

- There is limited price competition for actively managed funds, meaning that investors often pay high charges. On average, these costs are not justified by higher returns
- There is stronger competition on price for passively managed funds, though the FCA did find some examples of poor value for money in this segment
- Fund objectives are not always clear, and performance is not always reported against an appropriate benchmark
- Investment consultants undertake valuable due diligence for pension funds but are not effective at identifying outperforming fund managers. There are also conflicts of interest in the investment consulting business model which require further scrutiny
- A strengthened duty on asset managers to act in the best interests of investors, including reforms to hold asset managers to account for how they deliver value for money
- Introducing an all-in fee so that investors can easily see what is being taken from the fund
- Requiring clearer communication of fund charges and their impact at the point of sale and in ongoing communication to retail investors
- Requiring increased transparency and standardisation of costs and charges information for institutional investors
- Exploring the potential benefits of greater pooling of pension scheme assets; and
- Requiring greater and clearer disclosure of fiduciary management fees and performance.

It is clear that the asset management, fiduciary and advisory areas will need to work to reassure Trustees that they are receiving good value without conflicts of interest and we welcome many aspects of the report. The FCA's final recommendations should ensure that they focus on the outcomes of better returns and transparency without creating a short-termism mindset with asset managers.

CONTENTS

The Autumn Statement

Philip Hammond gave his first (and as it transpired his last) Autumn Statement on the 23 November 2016 where the key announcements were:

- A change to the Money Purchase Annual Allowance for a member flexibly accessing their savings. Future Defined Contribution contributions will be capped at £4,000 pa for the rest of their lives. The change is designed to stop members recycling benefits from a pension to gain further tax relief.
- Changes to salary sacrifice arrangements will be made from April 2017 and mean that only pension contributions, childcare, cycle to work and ultra-low emission cars can be used. Arrangements in place before April 2017 will be protected until April 2018, and arrangements for cars, accommodation and school fees will be protected until April 2021.
- The government will shortly publish a consultation on options to tackle pension scams, including banning cold calling in relation to pensions, giving firms/trustees greater powers to block suspicious transfers and making it harder for scammers to abuse 'small self-administered schemes'. It isn't clear what more powers firms and trustees will have and this may result in more for work for trustees, including due diligence on receiving schemes or that the advice given to a member to transfer must be positive.

However, what was significant was that in the consultation document regarding the Money Purchase Annual Allowance the Government repeats the view that pensions tax relief is expensive and not properly focussed to incentivise low income earners to save in a pensions. There is a belief that the Government will yet return to the issue of pensions tax relief in 2017.

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