



Issue 63

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What's Happening in Pensions

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Pension advice allowance

The Government **has announced** that, from 6 April 2017, individuals will be permitted to access up to £500 from their DC pension savings to pay for "retirement financial advice", if their scheme rules allow. They may do this at any age, but only once in a tax year, up to a maximum of three times in all. The rules of some schemes do not currently allow such payments; some give the trustees a discretion; a small number will give members a right to withdraw the allowance from 6 April. There are also practical considerations for trustees to consider.

Please see our briefing note on the **pension advice allowance** for more details.

Spring Budget

The two significant pensions announcements in the **Spring Budget** were as follows.

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Money purchase annual allowance

The Government **has confirmed** (with a consultation response to follow) that it will go ahead with its proposed reduction of the money purchase annual allowance (MPAA) from £10,000 to £4,000 from 6 April 2017. (See **WHIP Issue 61**) for details of the consultation.)

The MPAA was introduced in April 2015, alongside the "freedom and choice" DC flexibility options. It applies to an individual who has accessed a DC pension in one of the flexible ways (eg, drawdown or UFPLS) and applies a separate annual allowance to his or her money purchase pension input (which is also counted towards his or her annual allowance). It cannot be carried over. The MPAA is designed to restrict the amount of double tax relief an individual can obtain by drawing benefits and then reinvesting them in a pension scheme. Note that it applies to the accessing of cash balance pension savings as well as "pure" money purchase.

The reduction of the MPAA to £4,000 limits further the amount of double tax relief that can be obtained. The reduction applies even to those who have already become subject to the MPAA because they have already drawn benefits flexibly.

Overseas transfer charge

A new 25% tax charge will apply to some overseas transfers formally requested on or after 9 March 2017. The "**overseas transfer charge**" will apply to a transfer to any qualifying recognised overseas pension scheme (QROPS) unless (broadly) both the individual and the receiving arrangement are resident in the same country or in different EEA countries, or the QROPS is provided by the individual's employer. The individual's residency requirement applies in the tax year in which the transfer was made and the following five tax years, so the charge can become due later if the individual moves. On the other hand, the tax is refundable if he or she becomes resident in the same country as the QROPS in that period.

The charge is to be deducted from the transfer payment and paid to HMRC by the transferring scheme or provider. If the charge applies later then payment is the responsibility of the QROPS manager. In either case, the individual is jointly and severally liable.

The charge can also apply to an onward transfer made by a QROPS to another QROPS in the tax year in which the original transfer was made or any of the following five tax years.

Trustees and providers making overseas transfers must inform HMRC about them (this is the case whether or not the overseas transfer charge applies).

A QROPS has until 13 April 2017 to undertake to HMRC that it will operate the overseas transfer charge and pay it to HMRC when due. Failing this, it will be removed from HMRC's ROPS list and will no longer qualify as a QROPS.

Transfers to an overseas scheme that is not a QROPS continue to be unauthorised payments: as such, they are subject to an unauthorised payments charge and a scheme sanction charge.

The new rules, including information requirements, have been published in draft and will be included in the forthcoming Finance Bill.

DB Green paper

The Government has published its **green paper** on "Security and Sustainability in Defined Benefit Pension Schemes". It contains almost no firm proposals. Instead it raises for discussion various possible changes to legislation. Responses are to be submitted by Sunday 14 May 2017. There is no implementation timetable.

The paper considers the pros and cons of making changes in four broad areas, as noted below. It asks questions about many of the proposals made by the Work and Pensions Select Committee (see **WHiP Issue 62**).

Funding and investment

The Government asks for views on introducing more prescriptive funding rules, with clear standards either in legislation or in a Pensions Regulator code or guidance. It is conscious, however, that over-prescription was seen as a problem with the minimum funding requirement regime.

The Government thinks that more might be done by both it and the industry to help individuals and commentators better understand scheme valuations and the measurement of deficits, in order to provide a better understanding of risk to members.

It is not convinced that schemes are, as has been suggested in some quarters, generally using overly pessimistic discount rates (ie, assumed investment returns).

The Government wishes to explore how trustees can be helped to make "more optimal investment decisions" and use alternative asset classes (eg, via pooling vehicles). Research will be commissioned on the quality of trustees' investment decision making and the factors that influence strategies and the choice of asset classes.

As suggested by the Select Committee, the paper asks for views on having shorter valuation cycles for high risk schemes and longer ones for lower risk schemes, and on reducing the 15 month period for completing a valuation.

Employer contributions and affordability

The Government is not persuaded that there is a general affordability problem for the majority of employers who have a DB scheme. Accordingly, no "across the board" option to reduce members' benefits is likely to be proposed.

Whilst the Government recognises that future service funding costs have increased significantly, it also highlights a significant increase in the amounts of dividend payments compared with deficit reduction contributions (DRCs) in recent years. (The Pensions Regulator estimates that, at the median, FTSE 350 companies paid around five times as much in dividends as they did in DRCs in 2010 but this ratio has since moved to 11 times.) The paper says that many employers could afford to clear their deficits if they wished and asks for suggestions of how this might be encouraged or otherwise achieved.

The Government will, however, consider new options for "outliers", ie, stressed schemes with struggling employers. It is concerned about moral hazard issues (ie, an employer deliberately neglecting a scheme in order to take advantage of an option to avoid or reduce its obligations). At this stage, however, it is only asking for views on possible options. They include:

- reducing indexation to the statutory minimum; introducing a statutory override to allow schemes to move from RPI to CPI (or perhaps something else); or conditional indexation (ie, suspending indexation in some circumstances);
- relaxing the criteria for a regulated apportionment arrangement or otherwise allowing the Regulator to approve the separation of a scheme from its sponsor;
- setting interim funding targets for severely underfunded schemes, with the employer having to stay in regular contact with the Regulator;
- increasing the circumstances in which members can commute small DB pensions for a lump sum; and
- a new winding-up power for the Regulator.

Member protection

The Government opposes a blanket requirement for Pensions Regulator clearance of prescribed corporate activities. It will, however, consider introducing a new clearance regime in narrowly limited circumstances but only if it would not affect the competitiveness of UK businesses or impede legitimate business activities. A question asks whether the Regulator should be able to impose punitive fines for corporate transactions that are detrimental to schemes (this looks like a reference to the Select Committee's suggestion of introducing a punitive element to financial support directions and contribution notices).

We may see the introduction of a new wide duty for various parties to cooperate with the Regulator and a power, supported by sanctions for non-compliance, for the Regulator to interview relevant parties.

The paper says that there may also be a case for strengthening trustees' ability to require certain information or engagement from the employer (eg, information about proposals for a restructuring or reorganisation before it is agreed). It also asks if a joint statement of pension scheme objectives would be useful (perhaps with objectives selected from a prescribed list) and if trustees of underfunded schemes should be consulted before the employer pays a dividend.

Consolidation of schemes

The Government favours voluntary, rather than compulsory, consolidation of small DB schemes. It asks for ideas about how this can be facilitated, including as to possible changes to the employer debt regime as it applies to multi-employer schemes.

The Government will not itself take forward the suggestion of establishing a "Superfund" consolidation vehicle but will consider providing structures or incentives to encourage the private sector to offer vehicles.

Contracting-out and GMP inequality

The Government **has responded** to its consultation on a possible method for schemes to resolve GMP-related inequalities, amendments to improve the contracting-out legislation and a reduction of the fixed rate for GMP revaluation. See **WHIP Issue 61** for details of the proposals.

Resolving GMP-related inequalities

The Government has again declined to offer trustees a statutory "safe harbour" so that if they were to use its proposed method of equalisation and GMP conversion they would be protected against claims that it does not comply with UK law.

Technical issues raised by respondents are being referred to the industry working group.

Amendments to contracting-out legislation

There have been no decisions on changes to contracting-out legislation, except that from 6 April 2017 HMRC will be able to extend the notification and payment periods for contributions equivalent premiums in certain circumstances, including following the reconciliation of contracted-out liabilities.

Fixed rate GMP revaluation

The annual percentage figure for fixed rate GMP revaluation will be 3.5% for leavers from 6 April 2017. It has been 4.75% pa since 6 April 2012. The Government had originally proposed a figure of 4.0%. In setting the rate at 3.5%, it has responded to criticism of the inclusion, until now, of a 0.5% premium to reflect the risk that earnings may increase at a higher rate than assumed.

Firefighters' age discrimination claims

Over 5,000 firefighters in England and Wales have been unsuccessful in their claims that transitional protections given to older members of the Firefighters' Pension Scheme discriminated unlawfully against younger members.

When the Government reformed public service pensions in 2015, it gave transitional protections against the changes to firefighters within 14 years of their normal pension age. A full exception was given to those within ten years, with a taper for those between ten and 14 years. Thousands of younger firefighters claimed that this amounted to unlawful age discrimination.

A test case was heard by the Central London Employment Tribunal. This is the same Tribunal (but with a different presiding Employment Judge) that recently upheld very similar claims by judges (see **WHIP Issue 62**). Employment Tribunal judgments are not binding in other cases: here the decision in the judges' case was deliberately disregarded. The judgments are difficult to reconcile and both are expected to be appealed.

In this case, the Tribunal ruled that the Government had objectively justified the age discrimination. It had established a legitimate aim, this being a social policy designed to:

- protect individuals who had the least time to adjust their financial affairs;
- take account of the greater legitimate expectation for those closer to retirement that their entitlements would not change significantly;
- have a tapering arrangement so as to avoid a "cliff edge" between fully protected and unprotected workers; and
- apply a consistent approach across the public sector.

The method of achieving the aim was found to be proportionate. The Tribunal noted that when applying transitional protections, a line had to be drawn somewhere and inevitably some individuals would be disadvantaged.

Some firefighters also complained of indirect sex and race discrimination. The Tribunal rejected these claims on the basis that the differing treatment was entirely due to age. There was therefore no need for the discrimination to be objectively justified (but if there was then it was justified on the same basis as described above).

Pension Protection Fund

Pension protection levy: schemes with no substantive sponsor

The PPF has published its expected **consultation** on a separate levy rule for schemes without a substantive sponsor. The new rule will apply for the 2017/18 levy year where the arrangements to operate without a substantive employer were put in place on or after 1 January 2017 and before 1 April 2018.

This relates to schemes that are separated from their sponsor, normally through a regulated apportionment arrangement (RAA) (which, as well as needing Pensions Regulator approval, also requires the PPF not to object). This enables the business to avoid likely insolvency and continue without the encumbrance of DB pension liabilities.

In these circumstances, the primary risk of a call on the PPF is not employer insolvency but rather poor investment returns. These could lead to a significant deterioration in the scheme funding level, which in turn

leads to the scheme being wound up and the scheme entering a PPF assessment period. That means that the standard levy formula, in particular its significant employer insolvency risk element, is not considered appropriate.

The PPF's proposal is to base its charging methodology on a commonly used pricing model for assessing put options, "the Black-Scholes formula". It views a put option as the financial instrument most closely comparable to the risk presented to levy payers. The levy due will be subject to a minimum of the levy payable under the standard rules on the assumption that the employer is in the weakest solvency band.

Long service compensation cap

The Government **has responded** to its consultation (see **WHIP Issue 60**) on the increase of the PPF compensation cap for members with at least 21 years' service. The provisions of the Pensions Act 2014 (see **WHIP Issue 46**) that implement the increase are being brought into force on 6 April 2017. **Regulations** make some technical changes to the calculation of PPF compensation, including as to the adjustment of future payments for long service members already being paid compensation.

Unmarried dependants' pensions

The Supreme Court **has held** that an unmarried dependent partner who had not been nominated for a survivor's pension by the member (in accordance with a requirement of a public sector scheme's rules) was nevertheless entitled to a full survivor's pension. The decision was based on the European Convention on Human Rights, which is binding on public sector bodies but not private sector entities. There are therefore no direct implications for private sector schemes or employers, though they may wish to consider whether the same unfortunate situation could arise for them.

Denise Brewster did not receive a survivor's pension from the Northern Ireland Local Government Pension Scheme when her unmarried partner died suddenly at Christmas 2009. She lived with him and they had got engaged only two days before his death. If the scheme had received a completed nomination form from him, she would have been entitled to a pension as if they had been married. The scheme regulations included no discretion for her to be paid such a pension. The Supreme Court unanimously ruled that she should be paid the pension.

This was a judicial review case brought under the European Convention on Human Rights. The right in question was the right to the peaceful enjoyment of possessions. There was no discussion of whether a contingent right to a pension is a "possession": none of the parties chose to argue that it is not. Rights under the Convention must be given without discrimination "on any ground".

Such discrimination is nevertheless lawful if it is objectively justified but the Supreme Court ruled here that that had not been achieved. The reason for the scheme regulations including the nomination requirement was simply to mirror the England and Wales Local Government Pension Scheme. The Supreme Court said that attempts to justify discrimination on the grounds of objectives that were not considered at the time the relevant decision was made require greater scrutiny. Here, the court was not convinced by arguments including the need to establish certainty of the member's wishes and the need for formality in the absence of a formal change of status (ie, marriage or civil partnership).

Automatic enrolment: new exceptions

Amending regulations belatedly introduce new exceptions to the automatic enrolment and re-enrolment duties where the employer has reasonable grounds to believe that an individual has registered for fixed

protection 2016 and/or individual protection 2016. These are protections against the reduction of the lifetime allowance from £1.25 million to £1 million from 6 April 2016.

These new exceptions apply only from 6 March 2017. There were already exceptions in place in respect of the earlier lifetime allowance protections. Broadly, fixed (or enhanced) protection is lost if the individual has new contributions or accrual; individual (or primary) protection subjects the individual to the lifetime allowance charge on pension savings above his or her personal lifetime allowance.

Payment of a top-up pension commencement lump sum

In a complaint brought by Mr E against the Wildfowl & Wetlands Trust Pension Scheme, the Pensions Ombudsman **ruled** that the trustees were required to offer an additional pension commencement lump sum (PCLS) when correcting underpaid benefits, despite it being an unauthorised payment which they were not required to pay under the scheme rules. In doing so, he expressed an opinion on the likelihood of tax charges applying. This will be of interest to other schemes when they increase pensions following discovery of an error or after GMP reconciliation.

Mr E took an early retirement pension and PCLS in December 2012. In May 2015, the administrator informed him that he was entitled to higher benefits, as a result of a scheme closure rule amendment not having frozen pensionable salaries until members left service. He was informed of an increase to his pension and payments of arrears. Mr E complained that he was not offered an additional tax free PCLS in commutation of part of the additional pension.

The trustees explained that there would be an unauthorised payment tax charge on such a lump sum, because it was now too late for an authorised PCLS to be paid, and also perhaps a scheme sanction charge. They also argued that the scheme rules specifically state that they do not confer a right to an unauthorised payment on any party.

The Ombudsman:

- ruled that the incorrect payment of scheme benefits was maladministration, which had caused Mr E financial loss, and that the trustees had offered him only a partial remedy;
- directed the trustees to give Mr E the opportunity fully to reconsider his early retirement options on the correct calculation basis, enabling him to take an additional commutation lump sum (plus interest) in lieu of pension;
- considered it unjust for the trustees to expect Mr E to pay a tax charge caused by their misinterpretation of rules that they expect Mr E to abide by; and
- directed the trustees to pay any tax charges applicable to Mr E.

The Ombudsman pointed out that the tax legislation says that an unauthorised payment is exempt from being scheme chargeable if "it is being made to comply with an order of a court or a person or body with power to order the making of the payment" or "it is made on the ground that a court or any such person or body is likely to order the making of the payment (or would be were it asked to do so)". He therefore thought it "entirely possible" that there would be no tax charges payable by the scheme or by Mr E.

General levy

The Government **has announced** that the general levy (which occupational and personal pension schemes

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pay to the Government to fund the Pensions Regulator, the Pensions Advisory Service and the Pensions Ombudsman) will be reduced by 25% for schemes with 500,000 or more members. This will apply from the 2017/18 levy year, in order to reduce a £13 million surplus by around 2020.

NEST

The Government **has published** a response to its call for evidence (see **WHiP Issue 59**) on how NEST might be changed to respond to the changing pensions landscape.

It has concluded that NEST should not be allowed to offer a range of decumulation services (though this will be kept under review). NEST will remain unable to accept members other than in the context of automatic enrolment. It will, however, be allowed to admit members via contractual enrolment/re-enrolment. ("Contractual enrolment" refers to the enrolment of workers before the automatic enrolment duty applies.)

NEST can accept individual and bulk transfers from April 2017 (see **WHiP Issue 59**) but it will only be permitted to accept bulk transfers where the relevant employer is using it for automatic enrolment.

There will be no new category of charge applicable to transfers into NEST. The NEST trustee will be able to set the applicable charges within the existing structures. It **has confirmed** that only the 0.3% annual management charge will apply (ie, no contribution charge will be applied to transferred funds).

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If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Susie Daykin, Daniel Gerring, David James, Dan Naylor, Paul Stannard and Philip Stear.

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