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What's Happening in Pensions

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Abolition of contracting-out

GMP revaluation issue

The Government has announced that it will introduce a statutory amendment power to help schemes provide for GMP revaluation after April 2016 in the manner envisaged by the amended legislation and without having to apply an underpin.

The legislation abolishing contracting-out after 5 April 2016 requires the GMPs of members then still in contracted-out service to continue to be revalued in line with national average earnings (NAE) whilst the member remains in pensionable service, and allows a switch to fixed rate revaluation when pensionable service ends.

Scheme rules may, however, reflect the current law that NAE revaluation must apply during contracted-out service and that a switch to fixed rate revaluation can only be made when contracted-out service ends.

The scope of the proposed statutory power is unclear and is not expected to be available until after 6 April 2016. Schemes with members still in contracted-out service with accrued rights to GMPs should therefore

consider amending their rules before 6 April 2016:

- to ensure that a switch to fixed rate GMP revaluation can be made when pensionable service ends after 5 April 2016 (if this option is to be used); and
- to avoid having to give the better of NAE revaluation and fixed rate revaluation from 6 April 2016 until pensionable service ends.

For more detail, please see our **briefing note** on this issue.

The abolition of contracting-out and the introduction of the single-tier state pension might make other rule changes necessary or desirable before 6 April 2016. See our briefing note **State pension reform and the end of contracting-out**.

Reconciliation

The Pensions Administration Standards Association (PASA) has published **first** and **second** tranches of guidance for schemes on the process for reconciling contracting-out records.

Pension scams: High Court decision

The High Court has overturned the determination of the Pensions Ombudsman in the complaint by Miss D-M Hughes against Royal London (see **WHiP Issue 53**). It held that she was entitled to a transfer to a scheme that was suspected to be a pension liberation scheme.

Miss Hughes requested a transfer from a Royal London personal pension scheme to a single-member, registered small self-administered scheme (SSAS) named after her home address and set up by a new company with which she had just entered into an employment agreement. The company was dormant and no salary was paid to her. Miss Hughes' evidence indicated that she had been cold-called by First Review Pension Services, which had introduced her to the company that set up the scheme, Bespoke Pension Services Limited. A Gibraltar-based investment company was to have been used to invest in property in Cape Verde. Royal London suspected a scam and refused to make the transfer.

The Ombudsman rejected Miss Hughes' complaint. He found that the proposed receiving scheme was an occupational pension scheme but that Miss Hughes was not an earner in relation to it. The transfer would not, therefore, be to secure transfer credits under the scheme, as required by the transfer legislation, so there was no statutory transfer right. However, the scheme had a discretionary power to make a transfer.

The High Court decided that the Ombudsman was wrong to say that "earner" for these purposes meant an earner in relation to the employment to which the scheme related. The legislation did not say that and it was not clear that it was meant to say that. It could not, therefore, be interpreted as meaning anything other than an earner in relation to any employment. Miss Hughes had earnings from another source, which made her an earner. She therefore had a statutory right to take a transfer to the SSAS.

Royal London did not oppose Miss Hughes' arguments on this point but its counsel did put forward arguments on the issue after the judge expressed concern that he was being asked to decide an important point without argument. (It would have opposed her second ground of appeal, relating to its discretion to transfer, but that point did not need to be decided.) One imagines that Royal London's main concern was to receive a clear judgment about whether or not it should make a transfer in a case such as this.

Incentive exercises: revised code of good practice

A revised version of the voluntary **code of good practice on incentive exercises** has been published. The

code applies where exercises are undertaken to offer DB members options not normally available to them such as enhanced transfer values, pension increase exchanges or full commutation. For background, see **WHiP Issue 34**.

Key changes to the code are as follows:

- Offers of a cash alternative to accrued DB rights, ie, full commutation exercises, are now clearly within the scope of the code.
- A proportionality threshold now applies to determine whether advice or guidance is appropriate. Where the threshold is not exceeded, the advice requirement does not apply but guidance should be made available (but does not need to be taken). The threshold is applied cumulatively and varies depending on the type of offer being made:
  - Transfer exercises - transfer values of £10,000 or less;
  - Full commutation - payments of £10,000 or less; and
  - Pension increase exchange exercises – where the pension that can be modified is £500 pa or less.
- Where advice is provided, the adviser should consider and advise on the impact of the offer on the member's spouse or dependants.

A separate "boundary examples" document has been issued as a guide to the application of the code.

Annual allowance: information requirements

HMRC has laid **draft regulations** which would impose new requirements for the compulsory issue of pension savings statements following the introduction of the tapered annual allowance from 6 April 2016.

See our briefing note **Pension input periods and the tapered annual allowance** for background.

Under the draft regulations:

- A pension savings statement must be provided if a member's "pensionable earnings" in a tax year exceed £110,000. This is in addition to the circumstances where the statement is already required to be provided (eg, where pension input to a single scheme exceeded £40,000).

  "Pensionable earnings", as defined in the draft regulations, means *"the member's salary, wages or fee in respect of the employment to which the [scheme] relates"*, which does not mean pensionable earnings at all. It is unclear what definition is intended here.

  Whether it is intended to mean pensionable pay or income from the employment in question, the threshold does not align with all circumstances where the tapered annual allowance will apply. That is because the tapering income thresholds also take into account other income, for example earnings from another employment, savings interest and rental income.

  The draft explanatory memorandum says that this new requirement is *"so the member has the information they need to determine whether or not they may be subject to a tapered annual allowance for 2016-17 onwards"*. However it will only tell them what their pension input is in case they are subject to the tapered annual allowance; they will not be able to work out from the statement whether they are or are not subject to it.

- The pension savings statement information that must be provided in relation to the 2015-16 tax year is spelled out as follows:
  - The pre-alignment and post-alignment tax years are treated as a single tax year (except as noted below).
  - (Ignoring the new pension savings statement requirement outlined above and situations where the money purchase annual allowance applies) the pension savings statement need only be given if the aggregate pension input to the scheme in that tax year exceeds £40,000.
  - Aggregate pension input amounts must be quoted for the pre-alignment and post-alignment tax years, both in the statement for 2015-16 and where that tax year is one of the three preceding tax years for which information must be given.
  - Members do not have to be told the annual allowance figure for 2015-16.
  - The annual allowance figure for 2015-16 need not be included in future statements where that year is one of the three preceding tax years.

Lifetime allowance: 2016 protections

HMRC Pension schemes newsletter 76 includes details of the interim process for applying for individual protection 2016 and/or fixed protection 2016. These are protections that individuals can claim against the reduction of the lifetime allowance from £1.25 million to £1 million on 6 April 2016. HMRC warns that some individuals may wish to delay retirement in order to claim protection.

HMRC is developing an online application system but it will not be ready until, HMRC expects, July 2016. The interim procedure is for individuals planning on crystallising benefits between 6 April 2016 and then.

Applications cannot be made before 6 April 2016 because declarations about savings values as at 5 April 2016 need to be given in the application. Individuals retiring on or shortly after 6 April 2016 will therefore not be able to register for protection in time. HMRC says:

> *"Members in this situation may wish to:*
>
> - *postpone taking their benefits until they have received a temporary reference number from HMRC or*
> - *take benefits up to the standard lifetime allowance and defer taking their remaining benefits until they have received a temporary reference number from HMRC.*
>
> *Alternatively scheme administrators can test members [sic] benefits against the standard lifetime allowance of £1m, pay the tax charge on the accounting for tax (AFT) return and the [sic] once the temporary reference number is obtained, re-calculate and then submit an amended AFT return to receive a repayment."*

Automatic enrolment

More easements proposed

The Government has proposed changes to various automatic enrolment regulations, as follows, designed to make automatic enrolment and re-enrolment easier. These easements are intended to be brought into force on 6 April 2016.

- **New exceptions: directors and LLP members**

  The Government proposes to make an exception from the automatic enrolment and re-enrolment duties in respect of **directors** of director-only-companies where two or more of them have contracts of employment. More significantly, it is also considering making an exception for all directors.

  Some directors are already excepted: the law currently only requires the enrolment of directors if they are employed under a contract of employment (which is often but not always the case) and there is at least one other person so employed.

  The Government proposes to make an exception for salaried **LLP members** if they are not employees for income tax purposes. This would make it easier for LLPs to determine which members they have to enrol. This proposal follows the case of *Clyde & Co LLP v Bates van Winkelhof* (see **WHiP Issue 47**), in which an LLP member was found to be a worker (for different purposes).

  LLP members who are workers are currently in scope but, depending on how they are remunerated, they may not have qualifying earnings.

  As for previous exceptions (see **WHiP Issue 51**), the duty to enrol becomes a discretion. If exercised, all the law then applies as if there had been a duty. Opt-in rights and rights to join (and the associated information requirements) nevertheless apply.

- **Workers with fixed protection 2016 and/or individual protection 2016**

  The exceptions that apply to members with lifetime allowance protections (see **WHiP Issue 51**) will be extended to workers who have registered for fixed protection 2016 and/or individual protection 2016.

- **Automatic re-enrolment: registration (declaration of compliance) deadlines**

  As the law stands, different deadlines apply for registering (or declaring) automatic re-enrolment compliance, depending on whether or not there is anyone to be re-enrolled. If there is no one to re-enrol then the declaration date can fall before the re-enrolment window has ended. This is to be corrected by applying in all cases a re-enrolment declaration deadline of five months after the third anniversary of the employer's staging date. Subsequent re-enrolment declaration deadlines would then fall five months after the third anniversary of the employer's previous automatic re-enrolment date.

- **Bringing forward staging dates**

  It will be easier for small employers who have not yet had their staging date to bring forward that date. There will be no need for them to have obtained the agreement of a scheme (as is currently required) if there is no one to be enrolled. Also, the requirement to give the Pensions Regulator one month's prior notice is to be replaced by a one day notice requirement. Finally, the new date need not be the first of a month if the employer reasonably believes that there is no one to enrol.

- **Contracted-out schemes with more than one benefit scale**

  After contracting-out ends on 5 April 2016, employers can no longer satisfy the DB scheme qualifying scheme test simply by being contracted-out. They must therefore meet either the "test scheme" standard or pass the test that looks at the cost of accruals. For more detail, see our briefing note **State pension reform and the end of contracting-out**.

  Most employers are expected to apply the latter test. Where the scheme has more than one benefit scale, a proposed transitional easement may allow them to apply this test, for existing members only, at scheme level rather than at benefit scale level.

Peripatetic workers

The High Court has ruled in judicial review proceedings concerning whether cruise ship workers ordinarily worked in Great Britain and so were covered by the automatic enrolment legislation. There were different answers for workers in different positions.

The Pensions Regulator had issued a compliance notice to Fleet Maritime Services (Bermuda) Ltd, which employs workers on P&O and Cunard cruise ships around the world. This concerned the failure to enrol permanent workers who live in Great Britain and who either (a) join and leave ships in Britain or (b) travel to another country to join ships. In both cases, the workers' duties are mainly undertaken in international waters. The Regulator had taken the view that in both these cases, the worker "ordinarily works" in Great Britain and so is covered by the automatic enrolment duties.

The Regulator did not take the same view in respect of fixed term workers whose single tour begins and ends outside the UK, even if they lived in the UK. There was no evidence from their contracts to lead the Regulator to conclude that their work began and ended in the UK.

The Court held as follows:

- The test must be whether an individual is working with their base in the UK. "Ordinarily works" does not mean "works for the majority of their time": that would penalise a worker sent on a lot of overseas business trips and there was nothing to say over what period this should be measured.
- A seafarer engaged for only a single tour of duty cannot be said to have a base anywhere and so may not be ordinarily working in the UK (or anywhere else).
- The Regulator was therefore correct that a seafarer who joins and leaves a ship in the UK ordinarily works in the UK. The Regulator is entitled to assess a worker's work patterns and decide if the test is satisfied. Such a conclusion, if reasonable, cannot be challenged by judicial review.
- The Regulator was, however, wrong to consider a worker whose tour of duty begins outside the UK, but for whom travel arrangements from and back to the UK are made, as in scope. The contracts here made it clear that the duties began and ended on the ship. Even though travelling time was paid and counted towards the accrual of leave, this was not part of their work but was commuting to work. (NB Differently worded contracts could have led to a different decision.)

Tax relief for low earners

In the context of automatic enrolment, the Pensions Regulator has been voicing concerns in the press about the use of "net pay" tax arrangements for low paid workers' pension contributions. Most occupational pension schemes use these arrangements, under which the employer deducts the employee contribution from their pay before deducting income tax via PAYE.

If a worker pays no income tax, because they earn less than the personal allowance (currently £10,600 pa), they lose out in comparison with the alternative "relief at source" method. Under that method, contributions are deducted from taxed pay and HMRC pays a sum representing basic rate tax relief to the scheme, even where the worker pays no income tax (but higher rate taxpayers must claim additional relief).

New data protection legislation

Important new EU data protection rules have been announced, to take effect in the UK in 2018. (These are likely to apply in some form regardless of the outcome of the “Brexit” referendum). They are set out in the “General Data Protection Regulation” (GDPR). They substantially update existing laws and some provisions

have been controversial and eye catching – eg, the "right to be forgotten" and much heavier maximum penalties for breach.

Some sectors will have difficulty adapting to the new rules but for pension schemes we think that the practical impact will be much less severe, since the new requirements build on the existing ones. There will, however, be relevant changes, which will need planning for (eg, in relation to record keeping and internal procedures, as well as the transfer of members' personal data to third parties). Some planning may need considerable lead times. In particular, anyone about to enter into a contract involving the transfer or processing of personal data should take immediate advice if the contract may continue into 2018.

The final text of the GDPR has not yet been published but it is expected in the next few months. Until then, it is probably premature to start definitive planning. We will keep you updated but please contact us if you require any assistance at this stage.

Pensions Ombudsman determinations

Policy of refusing consent to unreduced pension

In a complaint by Mrs V Layfield against the Johnson Controls UK Pension Scheme, **the Deputy Pensions Ombudsman determined** that the employer was entitled to have regard to its own financial interests when giving or withholding consent to a discretionary unreduced early retirement pension.

Here, the employer had a long-standing policy of always withholding consent based on the funding strain on the scheme and the employer's resources. As a result of this policy, it had not considered giving consent in Mrs Layfield's case. The Deputy Ombudsman was satisfied that this was not in breach of the employer's duty of good faith to its employees.

Employer was under a duty to give information about tax consequences

In the determination of a complaint brought against South Wales Police by Mr J Cherry, **the Pensions Ombudsman ruled** that the Police Commissioner, as employer, should have told the individual that his re-employment within one month of drawing his retirement benefits would mean the loss of his protected payment age and therefore the treatment of scheme benefit payments before age 55 as unauthorised payments.

Although the Ombudsman agreed that there was no duty on the employer to advise Mr Cherry, he said that this was about the provision of relevant information, not advice, which it was reasonable to expect the employer to have given.

No cases or legal principles are cited in the Ombudsman's determination. The employer was happy to pay the tax charge for Mr Cherry and the determination is mainly about the terms of the order. In other circumstances, the complaint might have been more vigorously contested and there might have been a different outcome.

Transfers and early exit charges

The Government's response to its July 2015 consultation on transfers and early exit charges (see **WHiP Issue 53**) has confirmed that:

- new legislation will require the FCA to introduce rules limiting early exit charges under contract-based schemes; and
- a "comparable" limitation will be introduced by legislation for trust-based schemes.

The evidence gathered showed that transfers between contract-based schemes took on average 16 days but between trust-based schemes they took 39 days. From summer 2016, trust-based schemes will have to report regularly on their performance in processing transfers but no further detail is given at this stage.

The Pensions Regulator's forthcoming DC guidance will include guidance for trustees on processing transfers quickly and accurately, addressing the issues raised in this consultation. Pension Wise will develop guidance for individuals.

DC member-borne commission ban

The Government has responded to its October 2015 consultation (see **WHiP Issue 55**) on how to implement the ban on member-borne commission payments in automatic enrolment occupational pension schemes that provide DC benefits.

The ban will be implemented in two phases. Regulations will ban new (or varied or renewed) member-borne commission arrangements from 6 April 2016. The Government will consult later in the year on draft regulations to implement a ban on member-borne commission arrangements entered into before 6 April 2016.

Scope of the ban

The ban will apply to all occupational pension schemes used as qualifying schemes for automatic enrolment but not small self-administered schemes, executive pension schemes and schemes with only one member. The regulations apply not just to DC schemes but also to any DC benefits (eg, AVCs) offered by non-DC schemes.

The ban applies in respect of all members of such schemes, not just those automatically enrolled, and continues to apply even after a scheme stops being used as a qualifying scheme.

Members will be able to choose to access and pay for advice on a commission basis but their prior written agreement must be obtained. That agreement must satisfy certain prescribed requirements.

Trustees will continue to be able to apply charges to pay for advice that they need, or are legally required to obtain, to run the scheme. However, employers will not be permitted to use member-borne charges to pay for any advice or service they obtain.

Compliance

The duty to ensure compliance is imposed on service providers but trustees will be required to notify their providers in writing within three months of the ban being triggered if their scheme is a qualifying scheme used for automatic enrolment.

The ban applies one month after that. During that month, the service provider must confirm in writing to the trustees that they are compliant (and then within one month if they cease to be compliant). A time extension can apply where a service provider needs to ask trustees about in scope deferred members.

Trustees will have to report in their scheme return whether or not their service providers have confirmed to them that they have complied with their duty. The Pensions Regulator will be responsible for enforcing the ban.

DC governance

The Government has responded to part of its November 2015 consultation on how to reduce regulatory burdens and amendments to existing regulations (see **WHiP Issue 55**). The response and final regulations

cover only DC governance matters: the Government will respond on other aspects of the consultation in due course.

Regulations due to come into force on 6 April 2016 will:

- provide that multi-employer group schemes are excluded from the additional governance requirements that apply to master trusts if they meet certain criteria, including that they are not promoted to unconnected employers (NB there are some changes here from the consultation proposals); and

- allow a deputy or acting chair to sign the chair's statement but only where the chair has ceased to hold office and a replacement has not yet been appointed.

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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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