SLAUGHTER AND MAY

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New Law

I. What's happening between now and 6th April, 2016

You may still be digesting the 6th April, 2015 changes but we have been looking ahead to the changes taking effect between now and 6th April, 2016.

The action list accompanying this update summarises the changes and suggests how you can prepare for them.

II. Policyholder protection: Increase in compensation limits for insurance policyholders

From 3rd July, 2015, the Prudential Regulatory Authority ("**PRA**") has increased the compensation limits under the Financial Services Compensation Scheme ("**FSCS**") for insurance policyholders in the event of an insurer failing to provide 100% cover for long term policies and claims arising from death or incapacity. The limit increases from 90% to 100% of the sum insured. There is no cap on the compensation.

Comment: This point is relevant to buy-ins/buy-outs, where it is necessary to consider the available cover from the FSCS in the event of the insurance company failing.

6th April, 2015 Changes

III. DB to DC transfers: Independent advice requirement: Pitfall in relation to "de minimis" exception

Where a member with "safeguarded benefits" (broadly, defined benefits), or a survivor of such a member, wishes to:

- transfer those benefits to a DC arrangement, or
- convert the DB benefits to DC benefits in the same scheme

the scheme trustees must check that the member or survivor has received "appropriate independent advice" (the "**independent advice**" requirement).

The independent advice requirement applies both to statutory transfers and to transfers made under scheme rules where applications for statements of entitlement were made on or after 6th April, 2015. There is an exception where the member's safeguarded benefits in the scheme are valued (on a CETV basis) at £30,000 or less.

Note that, where the transfer value of the defined benefits, **before any reduction for underfunding in the DB scheme**, is greater than £30,000, the exception will not apply and the trustee needs to check that the member has obtained appropriate independent financial advice. For example, where the member's transfer value in respect of DB benefits is £50,000 (before any underfunding reduction) but the scheme is only 60% funded, although the transfer value once the underfunding reduction applied is £30,000, the trustee still needs to check that the independent advice requirement has been complied with.

Failure to carry out the check does not invalidate the transfer, but renders the trustees liable to civil penalties of up to £5,000 for an individual and £50,000 for a company.

Comment: We expect the Regulator to be proactive in levying penalties in order to ensure compliance, as evidenced by its approach to breaches of auto-enrolment duties.

IV. DC charges and governance: Regulator's answers to FAQs

On 20th August, 2015, the Pensions Regulator published on its website answers to frequently asked questions about the new governance and charge cap requirements that took effect for DC schemes on 6th April, 2015.

Points to note are:

- the Regulator says it will consult on a revised draft of its Code of Practice 13: "Governance and administration of occupational DC trust based schemes" in Autumn 2015 and revised supporting guidance in Spring 2016,

- the Regulator confirms that the 40-page Money Advice Service Pension Choices Guide (which the Regulator's April, 2015 guidance on communicating the new flexibilities suggests should be provided to members to satisfy the new disclosure requirements) can be provided **electronically** to scheme members provided the scheme rules contain no restrictions,

- schemes were required to appoint a Chair of trustees before 6th July 2015. The identity of the Chair must be stated in the scheme return (or, where the Chair changes, using Exchange). Not informing the Regulator of a change of Chair is a breach of law. But given that scheme returns are only being issued from July 2015, the Regulator accepts that, for many schemes it will be reasonable for identification of the Chair to be made in the scheme return and then kept up-to-date via Exchange as and when necessary,

- for hybrid arrangements, 2015 scheme returns will not be issued until later this year. The Regulator does not expect to receive notifications of Chairs of such arrangements ahead of the scheme return cycle. But the Regulator does expect the requirement to appoint a chair to be complied with, and that this information will be readily available should the Regulator request it,

- for multi-employer schemes that are required to have non-affiliated trustees, so long as trustees met the definition of a non-affiliated trustee on 6th April, 2015, there is no requirement to reappoint them to fit the "open and transparent recruitment" criteria, and

- a reminder that the deadline for using the "adjustment measure" (for auto-enrolment qualifying schemes that conclude they cannot comply with the charge cap on default arrangements) is 6th October, 2015.

The answers to FAQs are on the Regulator's website

Comment: For detailed information on the new governance requirements see our:

- checklist for 6th April, 2015 changes, and

- briefing note on the DC charging and governance requirements

both of which are available to clients on request.

V. Meaning of "AVCs" in the Charges and Governance Regulations 2015

We have been corresponding with the DWP about the scope of the exception from the new governance requirements for a scheme which provides no money purchase benefits other than benefits which are attributable to "additional voluntary contributions".

The DWP has confirmed that the exception will apply where payments are made to the AVC arrangement by either irregular or regulator contributions so long as these are **in addition** to contributions required under scheme rules and/or legislation. Accordingly it will apply to AVCs made under salary or bonus sacrifice arrangements (which are, technically, employer rather than employee contributions).

Comment: This is a helpful confirmation: the policy intention is that DB schemes where the only money purchase benefits are attributable to AVCs should not be subject to the new governance requirements.

VI. Pension Wise website

We have updated our Pension Wise guidance map to reflect changes made to the Pension Wise website.

The "map" provides an "at a glance" summary of the contents of the various online guidance topics covered on the Pension Wise website. It may be useful for schemes deciding how to comply with their “signposting” duties and how to cover particular topics in member communications. In many cases, a link or cross-reference to the Pension Wise website may suffice.

For a copy of the “map” please get in touch with your usual pensions contact at Slaughter and May.

VII. HM Treasury consultation on pension transfers and early exit charges

This was published on 30th July, 2015, following concerns that individuals attempting to access pension flexibility were facing potential barriers. These barriers have been identified as:

- early exit charges,
- the process for transferring pensions from one scheme to another, and
- the provision and need for financial advice when making certain transfers.

The consultation focuses only on issues relating to pension transfers where the April, 2015 pension flexibilities apply.

In relation to **transfers**, the Government seeks views on adopting a separate process for transfers of flexible benefits. It also seeks evidence of circumstances where receiving schemes are not accepting transfers-in or are putting in place procedural barriers. The Government says it wants to put in place an efficient standard process for transfers that works for the majority of pensions savers, and seeks views on whether this can be done on a voluntary basis (like the 7-day switching scheme for current accounts that the banking industry put in place).

The consultation paper notes that industry and consumers may still be unclear on specific circumstances when **independent financial advice** is required. It wants to understand whether the process for ensuring individuals understand the need for, and importance of, independent financial advice is operating as intended, and seeks views on this.

In some cases schemes and providers are requiring individuals to take independent advice in relation to a particular product even though there is no statutory requirement to do so. The Government says it does not want such requirements to become a barrier to accessing products.

The consultation paper, on which responses are invited by 21st October, 2015, is on the Gov.uk website.

Comment (1): HM Treasury’s latest consultation is primarily directed at contract-based pension schemes. The Pensions Regulator is also gathering evidence about barriers to accessing DC flexibility (Pensions Bulletin 15/12). The Regulator is expected to publish the results “in the summer” but nothing has yet materialised.

Comment (2): Simplifying and speeding up the transfer process to allow access to DC flexibility may be a good thing from the member’s perspective but is less likely to be good for the transferring scheme. The scheme needs to ensure it gets a good discharge on the transfer out to avoid having to pay twice when members who find they have transferred to a scam scheme seek reinstatement.

Comment (3): In our experience, delays in effecting transfers are primarily due to the transferring trustees having doubts about, and conducting investigations into, the legality of the receiving scheme.

Tax

VIII. Proposed reduction in annual allowance for high income individuals and alignment of pension input periods: Briefing notes

Our briefing notes on the Summer Budget 2015 proposed reduction of the annual allowance for high income individuals and consequential alignment of pension input periods (“**PIPs**”) (see our Budget Supplement dated 15th July, 2015) are available to clients on request.

The note on the tapered annual allowance looks in detail at the "adjusted income" £150,000 test, above which the reduction will apply, and the "threshold income" £110,000 test, below which it is not necessary to include employer pension provision unless provided under post-8th July, 2015 salary sacrifice.

The note on PIP alignment looks at how pension input amounts are calculated for the 2015/2016 tax year, including worked examples.

IX. Scope for increased VAT recovery on pension scheme expenditure: Update

A. Overview

1. Since the ECJ decision in PPG in 2012, HMRC has issued a succession of Briefs setting out its evolving views on the implications of that judgment for recovery of VAT borne on pension fund management and administration services.

2. An updated version of its Guidance 700-17 is expected to be circulated in the "autumn" in an attempt to resolve uncertainties regarding HMRC's approach.

B. Current position

1. The current way in which VAT is treated in relation to pension scheme incurred expenditure will change from 1st January, 2016 (at least based on HMRC's published statements).

2. Unless some action is taken, no part of the VAT inputs which relate to pension scheme expenditure (where the pension scheme expenditure is borne by the trustee but the VAT invoice in respect of that expenditure is addressed to the employer) will continue to be available as a VAT input to the employer.

3. But HMRC appears to be keen to help recovery of VAT in relation to pension scheme expenditure subject to correct structuring/restructuring of the way in which the expenditure is recorded from a contractual perspective and the way in which the pension scheme expenditure is paid for.

4 In relation to **investment management** fees, HMRC has stated that it will accept a variation to the existing investment management agreement between the trustee and investment manager so that it becomes a tripartite agreement between the trustee, the investment manager and the sponsoring employer under which:

   4.1 the sponsoring employer agrees to pay the fees of the investment manager (but the investment manager retains recourse to the trustee if the sponsoring employer fails to pay),

   4.2 the investment manager addresses its invoice (including the VAT invoice) to the sponsoring employer,

   4.3 the sponsoring employer pays to the investment manager the fee (plus VAT in respect of the fee), and

   4.4 the sponsoring employer then has an available VAT input in respect of the investment manager's fee.

5. So far as **management services fees** are concerned, HMRC is trailing the possibility of the trustee and the sponsoring employer entering into a management services agreement under which the trustee agrees to provide management services in relation to the pension scheme to the sponsoring employer (except in relation to the investment management functions delegated to third party investment managers (see **4**. above dealing with the tripartite approach)).

   The trustee then registers for VAT in respect of its VAT "outputs" supplied to the sponsoring employer in respect of management services for the scheme.

   Comment: There are a number of difficulties with this approach, not least the suggestion that it will affect the deductibility of payments by the employer for corporation tax purposes.

C. APL proposal: Scheme rule amendment

1. As an alternative to the contractual solution summarised in **B.**, the Association of Pensions Lawyers ("**APL**") has put forward a "rule amendment" approach under which scheme rules are amended to make it clear that services supplied in order to run the pension scheme are provided for the benefit of the employer.

2. The APL has also suggested that HMRC extend the deadline for the changes given the delay in HMRC providing further guidance.

   Note: A response from HMRC is awaited on both these points.

X. 6th April, 2016 restrictions on pensions tax relief: Pension Schemes Newsletter 71

This, published on 13th August, 2015, reminds scheme administrators of the forthcoming reductions in the annual and lifetime allowances and how to communicate these to members.

Annual allowance: Scheme administrators are required to issue annual allowance pension statements for the tax year 2014/2015 to all scheme members with pension inputs of more than £40,000 to the pension scheme during that tax year. HMRC asks administrators to remind members that those who have exceeded the annual allowance of 2014/2015 must declare this on their self-assessment tax return, the deadline for which is 31st January, 2016.

HMRC is considering how the current rules relating to annual allowance pension statements can be adapted to help individuals affected by the tapered annual allowance work out any annual allowance charge due given that it is not expected that scheme administrators will know what any individual's income is for a tax year.

Lifetime allowance: HMRC aims to provide more detail around the new protection regimes relating to the reduction in the lifetime allowance from £1.25 million to £1 million from 6th April, 2016 "around September". It suggests that administrators consider what communications they need to remind members that, for the new "fixed protection", they must have no benefit accrual after 6th April, 2016, and, for the new "individual protection", they must have savings of at least £1 million on 5th April, 2016.

Newsletter 71 is on HMRC's website

XI. Autumn Statement to take place on 25th November 2015

HM Treasury has announced that the Chancellor will deliver his Autumn Statement on Wednesday 25th November, 2015. He is expected to reveal the outcome of the Summer Budget 2015 consultation on reforming pensions tax relief.

Cases

XII. Pensions Ombudsman's determinations: June to September 2015

The new Pensions Ombudsman (Anthony Arter) has published a number of interesting determinations over the summer relating, among other things, to calculating CETVs, delays in effecting transfers-out and in distributing death benefits, and pensions liberation. They are summarised in the accompanying Focus.

News from the PPF

XIII. PPF guidance note on pre-packs

On 27th July, 2015, the PPF Restructuring and Insolvency team published a guidance note on the PPF's approach to pre-packs where the same insolvency practitioner intends to continue as the office holder in the subsequent liquidation or company voluntary arrangement ("**CVA**").

The PPF notes that it is often the case that the new company is controlled by or has strong links to the owners/management/investors of the old company that had built up the pension liabilities. This gives rise to the possibility that the pre-pack process can be used to "dump" the pension liabilities without "meaningful" consultation with the pension trustees and PPF".

The guidance note sets out the PPF's practice in relation to pre-packs, which is to:

- consider the extent to which the trustees and PPF have been consulted prior to the administrator's appointment and whether the consultation has been effective with the views of the trustees/ PPF taken into account, and
- to appoint an alternative insolvency practitioner where there has been no or ineffective consultation and there remain concerns over the process.

The guidance note sets out the factors that the PPF will consider in reaching any decision, which include:

- the nature of the underlying business, the underlying causes of the insolvency (including the prior conduct of the scheme and of the company/ directors) and the rationale for the pre-pack,
- any interaction with the Pensions Regulator,
- the method used to market the business and the outcome achieved, and
- the ongoing involvement of the original shareholders and management in the business post-administration.

The guidance note is on the PPF website

Comment: The guidance appears to show a hardening of the PPF's approach to pre-packs notwithstanding the introduction earlier this year of new self-regulating measures and a Statement of Practice by the insolvency industry.

XIV. Updated 2015/16 levy guide

The PPF has started to issue levy invoices for 2015/16. Invoices are accompanied by a guide explaining how the levy is calculated, how schemes can pay it, and how to query the invoice. The guide also explains changes from the previous regime and gives practical examples of the different calculation bases.

A full guide on how to challenge the levy invoice, taking into account the appointment of Experian, was published in May 2015.

The short and full guides are on the PPF website.

XV. Recognition of Type A Contingent Asset: PPF Ombudsman's determination in relation to the Land Rover Pension Scheme

On 29th July, 2015, the PPF Ombudsman rejected a referral by the trustees of the Land Rover Pension Scheme (the "**Scheme**") in relation to the PPF's refusal to recognise a Type A Contingent Asset for the 2013/14 levy year.

The PPF decided that the guarantee did not meet the requirements in Rule G2.3 of the 2013/14 levy determination about guarantor strength. These provided that the PPF could accept a guarantee as a contingent asset if it was satisfied the guarantee reduced the risk of compensation being payable from the PPF in the event of employer solvency and that the resulting reduction in the scheme's levy was reasonably consistent with the level of reduction in risk.

The PPF was concerned that the guarantor's net asset value related predominately to its investment in the employer and that if the employer became insolvent the guarantor was unlikely to have sufficient nonemployer related assets to meet its obligations under the guarantee.

In the absence of the guarantee, the scheme's risk-based levy was assessed at approximately £2.4 million.

The PPF's decision was upheld on both review and reconsideration.

On appeal to the Ombudsman, the trustees argued that the guarantor was only liable under the guarantee for the employer's outstanding liabilities under the Scheme, and that the PPF had failed to take into account the amounts the employer was able to pay, so that the PPF's decision was perverse.

The Ombudsman held that the PPF's decision to reject the guarantee was made correctly. He noted that he had no power to "go behind" the levy determination. At all stages the PPF had given full reasons for its decision and the decision was not beyond the bounds of reasonableness.

The key question for the PPF in applying the test under rule G2.3 was whether it could accept the trustee's certification that it had no reason to believe the guarantor could not meet its full commitment under the guarantee. Although the trustee had sought to explain how assets would be realised by the employer in the event of its insolvency, the PPF was correct to recognise that the extent of recovery by the Scheme was not evidence of the guarantor's ability to meet its obligations.

Comment (1): This determination illustrates the PPF's hardline approach to assessment of guarantor strength. Guidance published in January, 2015 sets out the PPF's requirements, first introduced in the 2012/2013 levy year, with accompanying case studies.

Comment (2): The requirements for guarantor strength were tightened in the 2015/2016 levy determination: discussions we had with the PPF revealed that, although the policy intent (that the guarantor's insolvency risk score should be substituted for the employer's only to the extent that the guarantor had available assets, excluding shares or inter-company loans or receivables from the employer) was clear, that intent was not supported by the wording in the levy determination. But, to avoid finding themselves in the same position as the Land Rover Scheme, schemes should ensure that they operate within the ambit of the PPF's policy on guarantor strength.

News from the Regulator

XVI. Regulator's guidance on assessing and monitoring the employer covenant

Regulatory guidance for DB schemes on assessing and monitoring the employer covenant was published on 13th August, 2015. The Regulator says it is the first in a series to help trustees to apply the Regulator's DB funding Code of Practice. It replaces the Regulator's 2010 guidance on monitoring employer support. Further guides are planned covering integrated risk management and setting investment strategies.

Although the document is primarily intended as good practice guidance on how to assess the employer covenant for the purposes of the funding requirements in Part 3 of the Pensions Act 2004, the Regulator says it will also be useful for trustees when they are assessing the covenant in other circumstances, for example, before agreeing to flexible apportionment arrangements or when there is a change in the corporate group structure affecting the employers.

The regulatory guidance includes a number of checklists and tables for trustees to use in the covenant review process and examples to illustrate key concepts and relevant issues. There are also examples of good and bad analysis in covenant reports.

Section 2, "Assessing the covenant", is aimed at trustees who assess their employer covenant themselves.

An appendix to the guidance sets out considerations for drawing up a brief for a covenant adviser for trustees who commission external advice.

Comment: The regulatory guidance should be required reading for anyone involved in a covenant review exercise. Note though that the guidance is just that: trustees are not obliged to comply with it, although it can be useful as a indicator of how to comply with general trustee duties.

The regulatory guidance is on the Regulator's website

XVII0 Scheme funding: Docklands Light Railway Pension Scheme

A. Overview

1. On 3rd September, 2015, the Pensions Regulator published details of its funding investigation into the DLR Pension Scheme (the "**Scheme**").

B. Facts

1. The trustees of the Scheme and its sole statutory employer, Serco Limited ("**Serco**"), were unable to reach agreement on the actuarial valuation with an effective date of 1st April, 2009. The dispute was in relation to the recovery plan and schedule of contributions.

2. The Regulator facilitated discussions between the trustees and Serco. But these were unsuccessful and the Regulator considered exercising its funding powers. It "reluctantly" issued a warning notice on 31st August, 2012. It subsequently suspended its regulatory action due to further negotiations between the parties. The Trustees then issued court proceedings against Serco seeking to recover contributions demanded under the Scheme Contribution rule. These proceedings were settled in November 2014.

3. Under the settlement, the Scheme's funding deficit shown in the 1st April, 2013 actuarial valuation (£36.1m) will be cleared by January, 2018, with £20m of that sum being payable by 1st January, 2016.

C. Points of interest

1. The Regulator says its decision to issue a warning notice reflected the Regulator's low tolerance for late actuarial valuations. There was disagreement between the parties and the Regulator about the scope of the trustee's power to seek appropriate contributions under the Scheme's contribution rule.

2. In this case Serco, the statutory employer, was a franchisee. The Regulator notes that the franchise arrangement forms part of the circumstances surrounding the scheme to be taken into account in funding decisions. Where there is a fixed term franchisee, it can be of particular importance that scheme valuations and funding plans are put in place in good time. The trustees should take into account the fact of any upcoming end of franchise as part of any covenant assessment or funding planning exercise.

Comment: The report highlights the importance of finalising actuarial valuations and funding documents within the relevant time limits. The Regulator also stresses that employers and trustees must understand the contribution provisions in their scheme's trust deed and rules.

The report is on the Regulator's website

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