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NORTON ROSE FULBRIGHT

Pensions – Developments in 2017

Ten things you need to know

Briefing

January 2017

Introduction

Once again, several significant changes in pensions regulation are likely over the coming year. In our January briefing, we consider the likely principal developments over the next twelve months.

01 | Changes for defined benefit (DB) schemes

Green Paper on DB pension reform

The Government's promised Green Paper on reforms to the law governing DB schemes is likely to be published in the first quarter of 2017. The report of the House of Commons Work and Pensions Committee follows the failings in high profile schemes, including BHS, and suggests that appropriate lessons should be drawn, with solutions being put in place to address them. The scope of the review is potentially very wide and may include the following options:

- Giving the Pensions Regulator (TPR) the power to add punitive fines (trebling the initial demand – the "nuclear deterrent") to financial support directions or contribution notices where employers seek to avoid their pension responsibilities
- Making TPR nimbler and ensuring a stronger regulatory focus is placed on the scheme's valuation process. The frequency of valuations should be flexible to reflect the funding risk, and recovery plans exceeding 10 years should be exceptional
- The possible introduction of a mandatory clearance regime, which would apply when a DB scheme's sponsoring employer is acquired on a corporate transaction and where the changes in corporate structure could damage the scheme and
- Reviewing the Pension Protection Fund (PPF) risk-based levy so that it is improved regularly to accurately reflect risk and incentivise good scheme governance.

Once published, we will report on the Green Paper in detail.

02 | Changes for defined contribution (DC) schemes

Capping early exit charges

Legislation implementing a cap on early exit charges in both trust-based and contract-based pension schemes is planned for 2017.

In contract-based schemes, the changes will come into force on March 31, 2017. From that date, any early exit charge in a contract-based scheme

- Will be capped at 1 per cent of the value of a member's benefits being taken, converted or transferred from a scheme
- Cannot be increased in existing schemes that currently have early exit charges set at less than 1 per cent of the member's benefits under a scheme
- Zero per cent for new contracts after March 31, 2017.

In trust-based schemesthe early exit charge cap will be set at 1 per cent for existing members of occupational schemes and zero per cent for new members but this change will not be implemented before October 2017. The DWP's intention is that the cap will apply to early exit charges levied on a member who wishes to draw flexible benefits under an occupational pension scheme and has reached normal pension age, but not yet attained the scheme's normal retirement age.

DC pension flexibility: GAR valuation and advice requirement

The DWP plans to make changes to the valuation of pensions benefits containing guaranteed annuity rates (GARs) for the purpose of ascertaining whether the statutory "advice requirement" applies.

New regulatory provisions will require providers to give members or survivors with safeguarded-flexible benefits "risk warnings" on the occurrence of certain trigger events (such as a request for information about how to transfer to a scheme providing flexible benefits). The aim is to highlight to members what they may be giving up by making the transfer. The DWP hopes to bring the regulations into force on April 6, 2017.

Bulk transfer issue

The DWP is consulting on no-consent bulk transfer issues in DC schemes, with the consultation period running until February 21, 2017.

Currently, a DC to DC transfer requires

- An actuarial certificate that the rights the members will have in the receiving scheme are "broadly no less favourable"
- The satisfaction of a "relationship condition" test applied to the employers.

The DWP asks whether both of these tests can be changed to make transfers easier.

The DWP also asks for views on issues relating to pension rights on TUPE transfers. Currently, a transferee employer can satisfy its obligations under the TUPE regulations by providing transferring employees with access to a stakeholder pension, but not to a group personal pension scheme and there have been suggestions that this should be changed.

03 | The regulation of master trusts

The Pension Schemes Bill 2016/17, which is currently making its way through Parliament, will set up a new system for regulating master trusts in the UK. Under the new legislation, a master trust will be able to operate only with authorisation from TPR, with the criteria to be satisfied including that

- Trustees and others involved in running the scheme are “fit and proper persons”
- The scheme is financially sustainable
- The scheme has in place a “continuity strategy” for dealing with certain “triggering events”. These include losing authorisation or an insolvency event occurring in relation to the scheme funder.

Regulations are expected to be published for consultation in Autumn 2017.

Transitional provisions will apply to existing master trust schemes in operation on October 20, 2016. Existing schemes will have six months after the Bill’s commencement date to apply for authorisation.

04 | Auto-enrolment

DWP review of auto-enrolment

A review of the auto-enrolment regime will be led by the DWP and supported by an external advisory group made up of experts within the pensions industry and those representing member and employer interests. The Government is due to announce membership of the advisory group and the terms of reference in early 2017, with a report setting out policy recommendations expected by the end of 2017.

The review will cover

- The existing auto-enrolment policy and whether any policies disproportionately affect different categories of employers or could be further simplified
- The coverage of auto-enrolment and the needs of those not currently benefitting, such as employees with multiple jobs who do not meet the criteria for auto-enrolment in any single job, and the self-employed
- The auto-enrolment thresholds (the earnings trigger and qualifying earnings band) and the age criteria for automatic enrolment
- The requirements relating to the statutory review of the alternative quality requirements for DB schemes and the certification requirements for money purchase schemes
- The level of the charge cap to assess whether it should be changed and whether some or all transaction costs should be covered by the cap.

Staging timetable

All large and medium-sized employers have now passed their staging dates for auto-enrolment, with small employers of fewer than 30 employees due to reach their staging dates by April 1, 2017.

NEST
Several changes to the rules governing NEST will come into effect on April 1, 2017. These include removing the existing limit on annual contributions and introducing new powers to permit individual and bulk transfers into and out of NEST under certain conditions.

Transitional period for DB schemes
The five-year transitional period for DB and certain hybrid schemes is due to end on September 30, 2017.

During this period, an employer can delay the auto-enrolment for specific groups of jobholders who must have been existing workers of the employer, and previously entitled to join a qualifying DB or hybrid scheme and remain able to do so.

An eligible jobholder can opt into his employer's qualifying DB scheme during the transitional period and if an employer closes its DB scheme, it must provide an alternative qualifying scheme.

05 | General pensions tax issues

Employer-arranged advice exemption
Provisions due to be included in the Finance Bill 2017 will introduce a £500 income tax exemption for employer-arranged financial advice provided to an employee, former employee or prospective employee in a tax year. For these purposes, "pensions advice" also includes advice on general financial and tax issues relating to pensions. This will replace the current £150 cap.

Lifetime allowance charge protection
An individual who wants to claim individual protection 2014 (IP2014) against a lifetime allowance charge must notify HMRC before April 6, 2017. IP2014 allows individuals to retain a personalised lifetime allowance equal to the value of an individual's pension saving on April 5, 2014, subject to a maximum of £1.5 million.

Savers whose pension(s) were worth more than £1 million at April 5, 2016 can still apply for IP2016 if they already have

- Enhanced protection
- Fixed protection
- Fixed protection 2014
- Fixed protection 2016

IP2016 will stay dormant until the previous protection is lost or surrendered. HMRC must be informed in writing if this happens.

IP2016 is not available to savers who have either

- Primary protection
- P2014.

There is no deadline for making an application for either FP2016 or IP2016, which must be done online.

Lump-sum death benefits
A new provision-of-information requirement is due to be introduced. Under the new requirement, where a scheme pays lump-sum death benefits to a trustee (other than a bare trustee) and the special lump-sum death benefits charge has been deducted, the scheme administrator will be obliged to give the trustee certain information within 30 days of payment. The information comprises the amounts of the lump sum and tax charge, details of the deceased member (including their date of death) and details of the scheme making the payment. The trustee will in turn be required to pass on this information to the beneficiary, within 30 days of payment to the beneficiary.

Consultation on the draft regulations closed on December 5, 2016, and a response is awaited.

Money purchase annual allowance
At the 2016 Autumn Statement, the Government proposed reducing the money purchase annual allowance (MPAA) from its current level of £10,000 to £4,000 from April 2017. The MPAA applies to savers who have already accessed some of their pension savings under the flexible regime, but wish to carry on saving on a tax-relieved basis.

HM Treasury suggested in its consultation paper that while an MPAA of £10,000 was helpful to ensure a smooth introduction of the pension flexibilities, it now believes that a reduced MPAA of £4,000 is “fair and reasonable”. The consultation seeks confirmation that a reduction would not adversely affect the auto-enrolment regime or otherwise disadvantage particular groups.

No other changes to the current MPAA regime are proposed. The consultation period closes on February 15, 2017 and the Government will confirm the revised level of the MPAA at the 2017 Budget.

Overseas pensions
Provisions due to be included in the Finance Bill 2017 will make changes to the current tax regime governing the UK tax treatment of overseas pensions. Amending legislation relates to the tax treatment of foreign pensions, including abolishing section 615 schemes and extending from five to ten years the period during which lump sums paid to non-UK residents from foreign pension plans that have benefited from UK tax relief are liable to UK tax. The aim is to achieve better alignment with the tax treatment of UK schemes.

06 | VAT on pension fund management costs
The High Court is due to hear a claim brought by United Biscuits (Pension Trustees) Ltd seeking repayment of VAT charged on supplies of pension fund management services received by it from 1974 to 2014. A pre-trial review is scheduled for July 24, 2017, with the full trial being listed for a five-day window from October 9, 2017.

A similar claim in *Wheels Common Investment Fund Trustees Limited and others v HMRC* [2017] was stayed in December 2016 pending the outcome in United Biscuits, after the First-tier Tribunal (Tax Chamber) accepted the claimants were free to amend their case to rely on the same fiscal neutrality points argued in United Biscuits.

On September 6, 2016, HMRC announced a further extension in the transitional period during which employers can obtain an input tax deduction for 30 per cent of the VAT element on single invoices covering administration and investment management services. This period will now run to December 31, 2017.

HMRC also republished its Revenue & Customs Brief 17 which sets out its view on the two available options allowing an employer to deduct input tax (other than tripartite contracts). HMRC is still considering representations which have been made, in particular in relation to asset management services and whether there are alternative tripartite structures that would enable a Corporation Tax deduction. Further guidance is awaited.

07 | PPF

"No substantive employer"

The PPF's planned levy rules for 2017/18 remain largely unchanged for the third year of the triennium and the levy estimate remains unchanged from 2016/17 at £615 million.

The PPF's determination remains in provisional form because a change is being considered to the current levy-calculation process to address situations where eligible schemes cease to have a substantive employer after a restructuring. The PPF's intention is that any new levy rule would, initially at least, only apply in relation to new arrangements. The PPF may consult further on its approach to charging a levy to such schemes early in 2017.

Long service compensation cap

On September 15, 2016 the DWP confirmed that the long-service element of the PPF compensation cap will come into force on April 6, 2017. Once effective, the long-service cap will, broadly speaking, increase the standard PPF compensation cap by 3 per cent for each full year of pensionable service above 20 years subject to a new maximum of double the standard cap.

08 | Standards of governance for all schemes: 21st Century trusteeship

A new initiative aimed at improving the standards of governance in occupational pension schemes will be launched by TPR in 2017.

On December 19, 2016, in the response to its July 2016 consultation on "21st century trusteeship", TPR set out the steps it will take including

- As part of a consultation on TPR's penalty policy during the first part of 2017, clarifying the definition of a "professional trustee" and setting out clearly what it means in practice by the higher standards it already expects of professional trustees

- In spring 2017, TPR will launch an education campaign signposting existing governance materials as well as producing further "practical tools" and consolidating existing guidance into "key overarching pieces of guidance to cover the principles or issues common to all pension schemes"

- Having reviewed the results of the education campaign, TPR will consider whether a "fit and proper" regime, including barriers to entry as a trustee, should be introduced

- As part of its guidance on investment policy, also due in 2017, it will focus on areas that are key to improving member outcomes, such as investment governance, conflicts of interest, administration and record-keeping.

The consultation response also confirms that TPR will be closely examining schemes that consistently fail to meet competence and governance standards and may use its enforcement powers more widely.

09 | Pensions and publicly available financial guidance

Pensions dashboard

Progress is likely to be seen during 2017 in the cross-industry pensions dashboard project. The Government announced its plans for the project at the March 2016 Budget. The intention is to set up by 2019 an online service that will allow individuals to see all their pension savings in one place.

On December 21, 2016, the Association of British Insurers (ABI) announced the identity of the six "FinTech" firms that have been chosen as technology development partners on the project. The ABI-led project group is reporting regularly to HM Treasury and working with the wider industry, government, regulators and trade bodies in developing a prototype pensions dashboard. The prototype is due to be ready for testing in March 2017, with the project completing in May 2017.

Single guidance body

The Government is likely to develop its plans for a single public financial guidance body. A consultation paper published by HM Treasury in December 2016 seeks views on proposals for a single body that will replace the Money Advice Service, Pensions Advisory Service and Pension Wise, delivering and commissioning specific services to ensure that as many consumers as possible receive high quality impartial financial guidance. Consultation on the proposals closes on February 13, 2017.

10 | Discrimination in pension benefit provision

In March 2017, the Supreme Court is due to hear appeals in two conjoined cases *(O'Brien v MoD and Walker v Innospec)* examining respectively how non-discrimination legislation affects part-time workers' and surviving civil partners' pension entitlements.

The Court of Appeal held that under European law, conduct which was lawful when it occurred could not retrospectively become unlawful. The claimants' pension entitlements were therefore limited to those relating to pensionable service completed since the relevant non-discrimination legislation came into force in the UK.

The European Court of Justice (ECJ) gave judgment on November 24, 2016 in *Parris v Trinity College Dublin and others*. Going against the opinion of the Advocate General (which was given in June 2016), the ECJ found that Dr Parris had suffered no discrimination on grounds of age or sexual orientation contrary to the Equal Treatment Framework Directive.

Dr Parris had argued that his same-sex partner should be entitled to receive a survivor's pension from his employer's scheme on his death. Dr Parris had entered into a civil partnership in the UK when aged 63 but he argued that compliance with the scheme's age 60 limit rule was legally impossible for him, given that his civil partnership was not recognised under Irish law until 2011, five years after he had attained the age of 60.

The Supreme Court appeal in *Walker v Innospec* was delayed until 2017, pending the outcome in *Parris* but it seems less likely now that Mr Walker will succeed in the light of the *Parris* decision.

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