Budget March 11, 2020: Pensions-related announcements

The new Chancellor, Rishi Sunak, delivered his first Budget on March 11, 2020 with a backdrop of panic in world stock markets as the coronavirus continues to spread.

Pensions-related announcements are set out below.

**Tapered annual allowance thresholds lifted by £90,000 from April 2020**

The “taper relief problem” resulted in many senior medics in the NHS pension scheme receiving an annual allowance tax charge for exceeding the tapered allowance. With many consultants protesting that they were working overtime simply to pay a tax bill, the knock-on effect has been that they have reduced their overtime hours, leading to a lengthening of treatment waiting lists.

The Government has announced it will raise the two tapered annual allowance thresholds by £90,000 from the start of the 2020/21 tax year in a bid to reduce the tax impact on high-earning NHS staff. Individuals earning below £200,000 will not be affected. The annual allowance will then start to taper down for individuals with an "adjusted income" above £240,000. However, the minimum level to which the annual allowance can taper down to will reduce from £10,000 to £4,000, which will affect individuals with total income over £300,000.

An earlier proposal to offer senior doctors greater pay in lieu of pensions will not now be taken forward.

**Comment**

The increase of the taper allowances has been criticised by those who hoped for complete abolition of the taper as tinkering and not a real solution to the problem, as it simply shifts the issue further up the income scale. There are still calls for a thorough reform of the taper as it fails to provide those high earners in defined benefit schemes with any certainty, as they will not know in advance whether extra earnings and pension accrual might trigger a tax charge.

However, most doctors (and other high earners) will now be excluded from the tapered annual allowance.

**Call for evidence on pensions tax relief administration**

The Government has announced plans to publish a call for evidence on pensions tax relief administration – the "net pay problem". How individuals receive tax relief in practice depends on the system operated by their employer and the type of scheme to which they belong. There are three alternatives:

- Net pay arrangement – tax relief at the marginal rate is obtained by making the employee's pension contributions from gross salary before PAYE operates.
• Relief at source – by contrast, members of personal pension schemes (and occupational schemes which do not operate the net pay arrangement) have their contributions deducted from their net pay after tax has been deducted. These contributions are paid to the pension provider or the scheme, which must reclaim the available relief at the basic rate from HMRC. To obtain full relief at his or her marginal rate, a higher-rate tax payer must claim through self-assessment.

• Relief on making a claim – if neither the personal allowance do not obtain any tax relief as their contributions are made out of pre-tax income and there is no direct payment of basic-rate relief from HMRC into their scheme.

Comment
What has long been seen as an injustice for some of the lowest earners is to be addressed. However, by launching a consultation, the issue is unlikely to be resolved before 2021.

Lifetime allowance – is to rise in line with the Consumer Prices Indexation to £1,073,100 from 2020/21.

Comment
As expected.

In addition:
• New funding will be made available to ensure that individuals can derive or inherit a state pension from an opposite-sex civil partner.
• Legislation will be introduced to ensure that collective money purchase schemes, as introduced under the Pension Schemes Bill 2019-21, operate as registered pension schemes for tax purposes. This change will be effective after the Bill receives Royal Assent.
• The consultation on the future of RPI as the measure of inflation will run for six weeks until April 22, 2020. The consultation had been previously planned to start in January 2020 but the former Chancellor, Sajid Javid, delayed the launch to the same day as the Budget.

Pensions Regulator proposes huge shake-up for DB scheme funding regime: New options of “fast track” or “bespoke”

On March 3, 2020, the Pensions Regulator published the first of its two planned consultation papers on a revised DB funding regime. This first consultation focuses on its new regulatory dual approach for valuations and the eight principles underlying the new framework offering alternative “fast track” or “bespoke” routes to schemes for compliance. This consultation closes on June 2, 2020.

The key principles underpinning all valuations

The Regulator has identified eight core principles which it believes should underpin all valuations:

• Compliance and evidence – When demonstrating how risks are managed, trustees should be able to compare the risks they have taken to a tolerated risk position and then demonstrate the mitigation and/or support available.
• Long-term objective – The Regulator expects schemes to set a long-term objective so that when they are significantly mature, they have a low level of dependency on the employer and the scheme’s assets are invested with high resilience to risk.
• Journey plans and technical provisions – The Regulator expects trustees to develop a journey plan to achieve their long-term objective and to plan for investment risk to decrease as their scheme matures and reaches low dependency.
• Scheme investments – Over time, the actual investment strategy and asset allocation should be broadly aligned with the scheme’s funding strategy. Trustees must ensure their investment strategy has sufficient security and quality to satisfy liquidity requirements based on expected cash flows, as well as a reasonable allowance for unexpected cash flows.
• Reliance on employer covenant and covenant visibility – Schemes with stronger employer covenants can take more risk and assume higher returns in their technical provisions. However, trustees should assume a reducing level of reliance on the covenant over time, depending on its visibility. The Regulator thinks such reliance should not extend beyond the short- to medium-term and suggests a limit of three to five years.
• Reliance on additional support – Where trustees opt for the bespoke approach, they can account for additional support (such as contingent assets and guarantees) when carrying out their scheme valuations, on condition that it provides sufficient support for the risk(s) being run, is appropriately valued, and is legally enforceable and realisable at its necessary value when required.

• Appropriate recovery plan – Technical provision deficits should be recovered as soon as affordability allows, while minimising any adverse impact on the sustainable growth of the employer.

• Open schemes – Members’ accrued benefits in open schemes should have the same level of security as members’ accrued benefits in closed schemes.

The dual approach: “Fast” or “bespoke”?
The Regulator seeks to introduce a previously trailed twin-track compliance route which will enable schemes to choose between:

• “Fast-track” - Available to schemes able to demonstrate compliance with a range of funding and risk criteria set by the Regulator.

• “Bespoke” - Applying to schemes which either cannot meet all of the fast-track criteria or which choose to take additional risks where they can demonstrate the additional support of contingent assets or company guarantees.

It is anticipated that the twin-track approach should introduce greater clarity to trustees and employers as to why the Regulator may have concerns about their funding arrangements and what can be done to reduce such concerns.

The fast-track framework
Although aspects of the eight principles above apply to either route, under the fast-track approach, trustees would be expected to submit a valuation that is compliant with the Regulator’s measurable guidelines. Trustees could expect to have to provide less evidence and for their valuation to receive less scrutiny. The aim is that this approach will ease the process for well-managed and well-funded schemes. With the clearer expectations of fast-track, the Regulator hopes to provide an easier route to compliance for trustees of smaller schemes.

The fast-track framework would represent a baseline of “tolerated risk” of scheme- and employer-related risks for schemes in different circumstances. However, the Regulator does not suggest that fast-track would be a risk-free framework and trustees would still be expected to exercise judgment and assess and manage their own scheme- and covenant-specific risks.

If trustees can demonstrate across-the-board compliance with all aspects of the fast-track framework, the Regulator is unlikely to raise any concerns regarding the valuation. However, any deviance from the fast-track compliance elements would mean that the valuation would be treated as bespoke.

The bespoke approach
The eight principles apply to the bespoke approach as well as the fast-track system, with the difference that the boundaries outlined above for fast-track will not apply. Where trustees opt for the bespoke approach, they will submit their valuation, together with supporting evidence, explaining why and how their position differs from that of fast-track and how any additional risk is being managed.

Where trustees wish to take additional risk to that outlined in the fast-track level, or where their funding solutions do not satisfy all the fast-track guidelines, the bespoke route may be a better fit for their scheme. However, because the valuation does not then meet some or all of the fast-track criteria, bespoke arrangements are likely to receive more Regulatory scrutiny.

Suggested timeline for the development of the new DB funding regime
The current consultation closes on June 2, 2020. Following Royal Assent for the Pension Schemes Bill, the DWP will consult on draft regulations on new powers for the Regulator, probably during the summer and autumn of 2020. Following the Regulator’s second consultation, the finalised new DB funding code and the revised funding regime are likely to come into force in late 2021.

For more detail, see our March 2020 Stop Press.

Comments
While the Regulator does not expect the new approach to be too onerous for schemes, there have been estimates that the proposals to curtail the lengths of recovery plans could cost companies sponsoring DB schemes as much as £5 billion. This tough line on tackling scheme deficits could see schemes with strong employer covenants being expected to bring schemes to solvency funding levels within a much shorter timeframe.

In allowing schemes to vary from the fast-track, low-risk approach to compliance, the Regulator has attempted to avoid the pitfalls of an entirely compulsory framework such as that which applied to the minimum funding requirement, which was ultimately scrapped as unworkable in 2005. However, where companies with strong covenants have sought to stretch the limits of the current regime by putting in place unreasonably long recovery periods, they may find the Regulator seeking assurance that their plans to reach future low dependency are credible.

In setting the parameters for the fast-track regime, the Regulator has sought to tread the line between it being an easily accessible route attracting most schemes and being so strict that it is rarely used. However, the choice for schemes as to which option to take may not be as binary as it first appears. On the one hand, some schemes may find it difficult to satisfy all the fast-track criteria in respect of each of the eight principles. On the other hand, where schemes opt for the bespoke route, whilst there will be flexibility for instance (as now), in putting in place a longer recovery period where there are stronger contingent assets the additional costs of evidencing compliance could outweigh the benefits.

View the DB funding consultation paper (175 pages).

View the Regulator’s quick guide – recommended for everyone (15 pages).
DWP sets out views on integrating climate change risk and opportunities into the Pensions Regulator’s activities

In our February 2020 update, we outlined the proposed new provisions in the Pension Schemes Bill 2019/20 relating to trustees’ governance duties in relation to climate change risk. There were initial concerns that some of these new amendments appeared to go significantly beyond current scheme disclosure requirements on investment around climate change and could have given unprecedented new powers to Government bodies to interfere and request changes to private sector schemes’ investment strategies. However, the DWP’s supplemental memorandum issued on February 11, 2020 went some way to allaying these concerns that the proposed changes could have affected trustees’ fiduciary duty and freedom to invest in members’ best interests.

The DWP has now published a letter from Pete Searle, its Director of Private Pensions and Arm’s Length Bodies, to Charles Counsell, Chief Executive at the Pensions Regulator, setting out the DWP’s views on integrating climate change risks and opportunities into the Regulator’s activities.

A joint statement published by the Regulator, the Financial Conduct Authority, the Prudential Regulation Authority and the Financial Reporting Council in July 2019 recognised that climate change presents far-reaching financial risks from both physical factors and transition risks from the process of adjustment to a carbon neutral economy. According to the letter, mitigating and managing climate change risks fits within several of the Regulator’s statutory objectives. For example, the DWP suggests that in the context of its duty to protect the benefits of members under occupational pension schemes, trustees should take account of the impact of climate change on their assets and liabilities.

While noting that the Regulator has already taken certain steps, such as including questions on climate change in annual governance surveys of DC schemes, the DWP says that in the coming months it envisages the Regulator will wish to set out a strategy for dealing with the financial risks arising from climate change. The DWP expects the Regulator to make clear how this strategy will be resourced and implemented and to plan for continued engagement with the industry-led Taskforce on Climate-related Financial Disclosures.

The DWP will work with the Regulator to develop guidance for pension funds on how pension trustees can address climate-related financial risks as part of their governance processes. This will be included in due course in the revised internal controls code of practice, as required under the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018.

The DWP also notes that the Regulator plans to produce a report on climate change adaptation in the occupational pensions sector under the government’s climate reporting regime by December 2021. The DWP suggests this should cover:

- Financial risks and opportunities from climate change that affect the Regulator and trust-based occupational pension schemes.
- How the Regulator and those running pension schemes are responding to and managing the financial risks and opportunities associated with climate change.
- The Regulator’s policy and regulatory approach to adapting to climate change.

Accredited professional trustees – An update

In the light of the majority of responses to the recent consultation, the Regulator has decided it would not be feasible to require that a professional trustee sits on every trustee board. It is possible, however, that this decision may be revisited in future if the consistency and quality of scheme governance does not improve.

The Regulator intends to launch an industry group to discuss trustee diversity and best practice guidance on how boards can make the most of the pool of potential trustees available. In relation to member-nominated trustees (MNTs), the Regulator states that it believes a selection process (rather than election) could help to improve diversity and skills, though it recognises that schemes might choose an election process where knowledge and skills gaps are not an issue.

On the question of whether sole trusteeship is to be restricted or more heavily regulated, the Regulator continues to have some concerns. It plans to “keenly scrutinise” schemes that use sole trustees and will commission further research.

Regarding trustee knowledge and understanding (TKU), much has changed since the Regulator’s TKU Code of Practice was published in 2005 and last updated. The Regulator has understandably decided to review and update this Code and related materials. Its plans are to simplify how it presents TKU expectations, differentiating them by trustee role type (lay trustee, chair, professional trustee) and type of scheme (DB, DC and public service). A new TKU consultation is planned for early 2021.

Trustee qualifications for lay trustees will not be mandatory. Instead, acceptable training methods are likely to include the Regulator’s trustee toolkit, other industry-based training and work experience.

For professional trustees, the Regulator will expect accreditation to be gained in line with the standards set out by the Professional Trustee Standards Working Group (PTSWG). Unexpectedly, the Pensions Management Institute (PMI) and the Association of Professional Pension Trustees (APPT) have announced separate accreditation
programmes for professional trustees, rather than working together on a single programme. The PMI’s programme was opened for registrations from February 24, 2020 and the APPT’s is due to launch in April 2020. Both programmes will follow the PTSWG standards and both appear to have been welcomed by the Regulator. Professional trustees should note further details of each accreditation programme, and consider which to take.

Comment
Where trustees currently use an MNT election process, they may wish to look into using a selection process going forward. This is not mandatory but the Regulator believes trustee diversity and skills could be improved.

For now, trustees should identify any gaps in their TKU and seek to fill them. Regular training sessions could be built into meetings. Specific training could be sought from various advisers where knowledge could be improved, particularly where Regulatory codes of practice and guidance are revised, as planned, in future.

The Regulator has already suggested that a reasonable minimum level of annual CPD is 15 hours for lay trustees and 25 hours for professionals, and these should be documented, so that a clear record is kept.

DWP announces earnings auto-enrolment trigger and qualifying earnings band for 2020/21

The DWP has announced the outcome of its annual review of the auto-enrolment earnings trigger and qualifying earnings band.

For the 2020/21 tax year, the following limits will apply:

- The earnings trigger will remain fixed at £10,000.
- The lower end of the qualifying earnings band will rise from £6,136 to £6,240.
- The upper end of the qualifying earnings band will remain £50,000.

The changes to the qualifying earnings band will maintain the band's alignment with the lower and upper earnings limited for paying National Insurance contributions.

The DWP confirms that the Government intends to consult on removing the lower earnings limit “in the mid-2020s” following its 2017 review of automatic enrolment.

DWP confirms increases in 2020/21 pension scheme general levy

On March 4, 2020, the DWP published a response to its October 2019 consultation on proposed increases to the general levy on pension schemes.

The levy is intended to recoup the DWP’s funding of the Pensions Regulator, Pensions Ombudsman and the pensions-related activities of the Money and Pensions Service. The levy is payable by both occupational and personal pension schemes, with charges varying according to the number of scheme members. Exact levy rates have remained the same for most schemes since they were last set in 2012/13.

In its consultation paper, the DWP put forward four options for increasing the levy, noting that without any increases an accrued deficit of over £50 million would arise in 2020/21.

Twelve of the 23 responses received to the consultation were in support of the DWP’s preferred option, which entails increasing levy rates for most schemes by 10 per cent on April 1, 2020, with further increases from April 2021 informed by a wider structural review of the levy.

In addition, the DWP proposes a one-off increase in the flat-rate levy paid by small schemes with between two and 11 members. For occupational schemes in this category, the annual levy would rise from £29 to £75 per scheme, while for personal schemes the annual levy would increase from £12 to £30 per scheme. There was general approval among respondents for these increases.

The DWP proposes to progress its preferred option (including the increases for small schemes), with the necessary changes being implemented in the Occupational and Personal Pension Schemes (General Levy) (Amendment) Regulations 2020. These regulations were laid before Parliament on March 4, 2020 and are due to come into force on April 1, 2020.

The DWP will conduct its structural review of the levy "by summer 2020", and intends to hold a subsequent consultation exercise in autumn 2020. That will, in turn, inform decisions about the levy from April 2021 and for subsequent years.

Carter v Chief Constable of Essex [2020] – High Court rules that provision in Police Pension Scheme excluding post-retirement widows from spouses' pension is lawful

On January 21, 2020, the High Court handed down its decision in Carter v Chief Constable of Essex [2020], with Judge Pepperall has rejecting a complaint by a retired member and his wife that a rule excluding widows from entitlement to a widow’s pension if they were not married to the member before the member retired as a police officer was unlawful.

Background
The member, who was 95 years old, had remarried in 1981 after retiring from the Police Pension Scheme in 1977. Under the rules of the scheme, no widow’s pension would be payable to his wife if she survived him, because she was not married to the member before he retired as a police officer. The claimants sought to rely on section 3 of the Human Rights Act 1988 and argued that the relevant rule unlawfully discriminated against the member's wife as a post-retirement widow.
Decision

The Court held the member’s wife was not entitled to rely on section 3 of the Human Rights Act 1998 (which came into force on October 2, 2000). This was because the claim sought to challenge the effect of legislation that extinguished the right to a widow’s pension many years before the passage of the Act. The same conclusion applied in relation to EU law since the claimants were seeking to give retrospective effect to the Framework Directive and the Employment Equality (Age) Regulations 2006 in order to challenge a situation that was permanently fixed long before such provisions came into force.

The Court considered that in Brewster v Northern Ireland Local Government Officers’ Superannuation Committee [2017], Langford v Secretary of State for Defence [2019] and Walker v Innospec Ltd [2017], “the die was not cast” until the claimants’ partners had died. By contrast, in the Carter case, the exclusionary rule extinguished any right to a widow’s pension decades earlier, when Mr Carter retired following his first wife’s death. Whilst in Brewster, Langford and Walker there remained a theoretical possibility of the payment of a survivor’s pension in accordance with the respective schemes’ rules, there has been no prospect in this case of a widow’s pension for 40 years.

That conclusion was not affected by the decision in O’Brien v Ministry of Justice 2017. In that case, Mr O’Brien’s pension rights were still in the course of being accrued right up until his retirement and after the implementation of the legislation on which he relied. In contrast, in the Carter case the pension entitlement was “set in stone” upon Mr Carter’s retirement and there was no post-2000 service during which Mr Carter continued to accrue pension rights.

As for the age discrimination point, although the Court accepted that the exclusionary rule was a provision, criterion or practice that was applied neutrally to all officers employed before 1978, the claimants’ argument that a retired officer in his 90s was more likely than an officer in his 60s to have remarried was flawed.

Comment

It is easy to sympathise with Mrs Carter who, despite being married to the member for 38 years, was not entitled to a spouse’s pension. Nevertheless, the Court’s analysis of the issue demonstrates just how far pensions policy has developed since Mr Carter joined the Scheme in the post-war period. As the judge noted, until the 1970s, the Government’s prevailing view appears to have been that the employer’s obligation was to provide only for dependants acquired before or during the course of the member’s service. This policy changed in relation to the Scheme in 1978, but that was too late for the member in this case.

It is unclear how many private sector pensions may have similar spouse benefit provisions but trustees of schemes established many years ago may wish to check this point and consider any necessary amendments.

HMRC publishes Pension Schemes Newsletter no.117

On February 28, 2020, HMRC published the most recent issue of its Pension Schemes Newsletter. The publication includes:

- A reminder for administrators to submit various items of data to HMRC before the end of the tax year, including residency relief at source and annual return information.
- Links to the scheme transfer checklist and information published on pension scams by the Regulator.
- A link to the GMP Equalisation newsletter, which provides guidance on pension tax issues arising when equalising benefits for GMPs, to supplement that in the Pensions Tax Manual.

See the Pension Schemes Newsletter here.

VAT exempt treatment of DC pension funds - the Value Added Tax (Finance) Order, 2020

The Value Added Tax (Finance) Order 2020 provides for the VAT fund management exemption to apply to “qualifying pension funds”, and removes the requirement for certain funds to invest wholly or mainly in securities for the exemption to apply. The order comes into force on April 1, 2020.

A qualifying pension fund is a fund meeting the following conditions:

- It is solely funded, whether directly or indirectly, by the members.
- The members bear the investment risk.
- The fund contains the pooled contributions of more than one member.
- The risk borne by the pension members is spread over a range of investments.
- The fund is established in the United Kingdom or in an EU member state.

In the years following the 2014 decision of the CJEU in the ATP case, HMRC gave businesses the option either to exempt fund management services in accordance with EU law, or to apply UK VAT legislation.

In January 2019, the Government decided to align UK law with EU law in the Value Added Tax (Finance) (EU Exit) Order 2019. In June 2019, faced with uncertainty around the date of the UK’s exit and in order to give the industry more time to prepare, the Government revoked that order, confirming that its intention was to introduce the same changes in a new order, but with a certain commencement date of April 1, 2020.

This means that supplies to DC occupational pension schemes are exempt from VAT from April 1, 2020.

Comment

At first glance this seems to be good news for DC schemes, although the new Order removes the option for employers to choose how to treat VAT. From April, DC schemes are exempt, leaving little time for those schemes which had opted to treat VAT differently to accommodate the change.
Pensions issues in the pipeline

New or changed items are in *italics.*

January 31, 2020 – The UK withdrew from the EU and the transition period will last until December 31, 2020.

October 1, 2019 – New SIP requirements came into force relating to environmental, social and governance (ESG) factors.

**GMP Equalisation – GMPEWG**

conversion guidance has now been published and the first tranche of guidance has now been issued by HMRC.

**Revised Funding Regime** – *The first of two consultation papers was published by the Regulator on March 3, 2020, and the consultation closes on June 2, 2020.* A revised Code of Practice is expected by the end of 2021, after the Pension Schemes Bill 2019/21 becomes law. The Bill is currently in the Committee Stage of its passage through Parliament.

**New Pension Schemes Bill** – *The new Pension Schemes Bill includes provisions covering the Pensions Dashboard, the Regulator’s powers, and the revised Funding Regime. It underwent its third Committee Stage on March 4, 2020, with a date for the Report Stage yet to be announced.*

October 1, 2020 – New disclosure obligations apply for trustees in relation to scheme’s Statement of Investment Principles under the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 following the transposition into UK law of the revised Shareholder Rights Directive (SDR II).

**New Pension Schemes Bill**

October 1, 2021 – New requirements apply for trustees to publish information on a publicly available, free website relating to voting and capital structure of investment companies under the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 following the transposition into UK law of the revised Shareholder Rights Directive (SDR II).