SLAUGHTER AND MAY

Pensions and Employment: Pensions Bulletin

12 July 2016 / Issue 10

Legal and regulatory developments in pensions

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Find out more about our pensions and employment practice on the Slaughter and May website.

Details of our work in the pensions and employment field are on the Slaughter and May website.

For more information, or if you have a query in relation to any of the above items, please contact the person with whom you normally deal at Slaughter and May or Bridget Murphy.

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I. Watch list

The Watch List is a summary of some potentially important issues for pension schemes which we have identified and where time is running out (or has recently run out), with links to more detailed information. New or changed items are in **bold**.

No.	Topic	Deadline	Further information/ action
1.	Reduction in annual allowance for high income individuals Note: Up to £80,000 annual allowance for tax year ending 5th April, 2016	Applies for tax years starting on or after 6th April, 2016	Summer Budget 2015 Supplement
2.	Severance payments and tapered annual allowance pitfall	From 6th April, 2016	Pensions Bulletin 16/06 2.1 Since 6th April, 2016, the £40,000 annual allowance for high income individuals is reduced by way of a taper to a minimum of £10,000 for those with income of £210,000 or more. 2.2 For the taper to apply, the individual must have UK taxable income in 2016/17 of: – £110,000 "threshold" income, and – £150,000 "adjusted" income. 2.3 Any taxable element of a termination package counts towards both threshold and adjusted income. A taxable termination payment could therefore catapult an individual over the £150,000 limit, resulting in a tax charge for the member on pension provision already made. 2.4 There may be scope for timing taxable termination payments to straddle tax years but care would be needed in view of anti-avoidance provisions. Termination procedures should be reviewed to build in a process to identify and manage this point.
3.	Reduction in Lifetime Allowance from £1.25 million to £1 million	6th April, 2016	Pensions Bulletin 15/19
4.	Members who intend to apply for Fixed Protection 2016 ("FP 2016") must have stopped accruing benefits	6th April, 2016	Pensions Bulletin 15/16
5.	Abolition of DB contracting-out: practicalities	6th April, 2016	Pensions Bulletin 15/16 5.1 Employers to notify affected employees of change in contracted-out status "at the earliest opportunity" and in any event by 6th May, 2016. 5.2 Schemes to notify affected members before, or as soon as possible after, 6th April, 2016 and in any event by 6th July, 2016. 5.3 Change template contracts of employment for new joiners to remove references to contracted-out employment. 5.4 Update, where applicable, pensions section of employee handbook to cover consequences of contracting-out ending.

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6.	Abolition of DB contracting-out: Rule amendments needed Note: Statutory power to amend, retrospective to 6th April, 2016, expires on 5th April, 2017	6th April, 2016	If your scheme was contracted-out on 6th April, 2016 and currently has active members accruing benefits (and who continued to accrue benefits after 5th April, 2016 in the scheme), then your scheme will, more likely than not, require a rule amendment effective from 6th April, 2016 to prevent the inadvertent addition of an additional underpin to the accrued GMPs of those active members. See further Pensions Bulletin 16/03
7.	Abolition of DB contracting-out: Compliance with auto-enrolment requirements	6th April, 2016	If employer is using COSR as a "qualifying scheme" for auto-enrolment purposes, scheme will need to satisfy either: • "test scheme standard", or • alternative "cost of accruals" quality test if it is to continue as a "qualifying scheme". Pensions Bulletin 16/05
8.	Requirement to provide risk warnings when member provided with means of accessing DC benefits	6th April, 2016	Pensions Bulletin 16/04
9.	Put in place register of persons with significant control ("PSC") for trustee company where trustee is a corporate	6th April, 2016	Pensions Bulletin 16/03
10.	Ban on member-borne commissions in DC schemes used for auto-enrolment	5th July, 2016 at the latest	Trustees must notify "service providers" if the scheme is being used as a "qualifying scheme" for auto-enrolment purposes and some or all of the benefits are money purchase. Pensions Bulletin 16/04
11.	Cyclical re-enrolment	Within 6 month window by reference to third anniversary of employer's staging date	For example employers with a 2013 staging date must complete cyclical re-enrolment process between December 2015 and June 2016. Publication available to clients on request from usual pensions contact.
12.	First Chair's annual governance statement	Within 7 months of end of scheme year (for scheme years ending on or after 6th July, 2015)	For example, schemes with a 31st December year end must submit statement by 31st July, 2016. Client note dated June, 2015 available from Lynsey Richards
13.	DC Code of Practice 13 on governance and administration takes effect	18th June, 2016	Schemes must familiarise themselves with the revised Code.
14.	"Brexit"	Referendum held on 23rd June, 2016	Consider potential impact on pension schemes. Client publications available on Slaughter and May website
15.	Data protection: New Regulation	25th May, 2018	Pensions Bulletin 16/05

New Law

II. Brexit implications for pensions

A. Overview

We have published a number of briefings on Brexit. To read our broad-ranging analysis of the likely legal and business implications of Brexit, please click here.

B. Process for exit

The formal process of leaving the EU will be triggered only when the UK delivers its Article 50 notice to the European Council.

Delivery of the notice will trigger the start of a two year period to exit, which can only be extended with the unanimous agreement of the European Council. Without such an extension (and assuming

that agreement on the terms of withdrawal has not otherwise already been reached), the UK's membership of the EU will end automatically on the expiry of that two year period.

C. Possible pension implications

1. The long-term nature of pension schemes means that the lasting impact on scheme funding will not be known for some time, although trustees are likely to want to keep a very close eye on investments.

2. Defined contribution scheme members who are approaching retirement will want to know about what Brexit means for their pension pot. Schemes will need to consider what to communicate to members in that position and, possibly, more broadly.

3. Pension schemes are affected by the wider economy not just through the scheme investments but also through the strength of the sponsoring employer. Trustees of defined benefit schemes will be thinking about any impact that Brexit may have on the sponsoring employer covenant. A period of prolonged uncertainty is likely to make it harder for companies to raise finance and, for the moment, the impact on trading can only be guessed at.

4. There has been speculation about the possibility that certain aspects of European-led pensions legislation may be abandoned. However, this is most unlikely to have retrospective effect or affect adversely rights accrued prior to Brexit. The treatment of pensions under TUPE may be another area for re-examination post-Brexit. Where UK legislation exceeds the requirements of European laws, the removal of that UK legislation seems particularly unlikely.

5. In relation to data protection, the Information Commissioner's Office has said (in April, 2016) that:

   "The UK will continue to need clear and effective data protection laws, whether or not the country remains part of the EU."

   This statement was updated after the referendum:

   "Over the coming weeks we will be discussing with Government the implications of the referendum result and its impact on data protection reform in the UK."

   An ICO spokesperson has since said: *"If the UK is not part of the EU, then upcoming EU reforms to data protection law would not directly apply to the UK. But if the UK wants to trade with the Single Market on equal terms we would have to prove 'adequacy'. In other words UK data protection standards would have to be equivalent to the EU's General Data Protection Regulation framework starting in 2018."*

6. The implications for UK nationals living in EEA countries remain very unclear, for example in relation to the indexation of State pensions in payment.

III. PPF actuarial factors revised

The PPF has **published** revised actuarial factors on 31st May, 2016. The revised PPF actuarial factors will take effect from 1st October, 2016.

The new factors relate to:

- commutation of pension;
- early retirement; and
- the pension equivalent of lump sum

The Board carries out a full annual review of factors but also monitors market movements on a monthly basis. Where the PPF believes that the

impact of market movements is significant, new factors are issued.

Comment (1): There are five types of factor needed to administer the PPF and for the use in Section 179 (levy) and Section 143 (PPF entry) valuations. These factors are for:

- the compensation cap,
- the commutation of compensation,
- converting a lump sum into pension equivalent, and
- early and late retirement.

Please click here to see a revised note by the PPF, describing the principles behind the calculation of their actuarial factors.

Comment (2): Schemes in funding difficulties with a weak or financially stretched employer need to consider a range of options when addressing those difficulties. One option that needs to be taken into account is the impact on members if the scheme were to enter the PPF. The actuarial factors used by the PPF are therefore relevant not only to schemes in the PPF but also to schemes comparing the PPF's level of compensation with what might be offered under a deal with members.

Tax

IV. Scheme pays and the tapered annual allowance

1. Where a person is affected by the tapered annual allowance, statutory scheme pays is only available where (amongst other things) the input amount in a particular pension scheme exceeds £40,000 (being the **un**tapered annual allowance).

2. A further point to be aware of is that the maximum amount of annual allowance charge that such a member can require to be paid is limited. In that situation, scheme pays will only be available for the charge on the part of the input amount that exceeds the untapered annual allowance. This may well be significantly less than the total annual allowance charge due.

Cases

V. Implied contract contained Section 75 indemnity

A. Overview

The Court of Appeal has ruled that there was an implied contract between two companies in the same group (MF Global Holdings Europe). Both companies are in administration. The implied contract included a Section 75 indemnity.

B. Facts

One company, MF Global UK Services Ltd (the "**Service Company**"), employed staff and paid their wages. The other company, MF Global UK Ltd (the "**Operating Company**"), used the services of those staff. There was no express contract regarding the arrangement but there was a contract between the Service Company and the holding company regarding the provision of services to other companies in the group, for which the Service Company would be reimbursed.

C. Decision

The Court of Appeal examined whether the arrangements between the Operating Company and the Service Company were sufficiently

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certain. The way in which the Service Company and the Operating Company provided services and reimbursed the costs of that, respectively, could only be explained on the basis that there was a contractual foundation. There was nothing in the documentation or correspondence suggesting that the Operating Company was not legally liable to reimburse the Service Company for the staff costs. The Court of Appeal also found that the High Court was right to conclude that the implied contract obliged the Operating Company to indemnify the Service Company in relation to its Section 75 debt.

Re MF Global UK Ltd (In special administration).

Comment (1): The High Court ruled that references in the implied contract to an obligation in respect of "pension contributions" and the "aggregate costs" in respect of the employees were wide enough to include an indemnity from the Operating Company to the Service Company for the Section 75 debt. There was no evidence that the intention in establishing the Service Company had been to create a company that could not meet its debts without some external form of support. There was a difference between the commercial risk of a debtor defaulting, and a company incurring a liability it could never meet. It was "no answer" that the Regulator could have imposed a financial support direction on another group company to satisfy the liability.

Comment (2): Each case is decided on its facts and the court's willingness to imply a Section 75 debt will depend heavily on the circumstances. Companies using service company staff should ensure that they are aware of all the terms, express or implied, relating to such an arrangement.

VI. PIE offer not made to pensioner

A. Overview

The Deputy Pensions Ombudsman has decided that the decision to exclude a pensioner from a pension increase exchange (**"PIE"**) offer was taken by the employer, not the insurance company. The employer had discretion to reach that decision under a deed setting out the process for making PIE offers.

B. Facts

N was a pensioner member of a pension fund. The fund had carried out a buy-in of pensioner liabilities followed by the PIE exercise and finally full buy-out of the fund. N complained that:

- the buy-in was carried out without consultation and consent,
- the decision to exclude him from the PIE exercise had been made by the buy-in insurance companies, and
- the trustee should have refused to sign the PIE deed.

C. Decision

1. The Deputy Ombudsman dismissed the complaint.
2. Trustees do not have to consult members before effecting a buy-in or making any investment choices. The Trustee had exercised its discretion in accordance with well-established principles for exercising a discretion. The Trustee had acted correctly and not perversely. Members' benefits were, it could be argued, more secure following the buy-in.
3. The employer confirmed that it took advice from the insurance companies involved in the earlier buy-ins because they had information on the pensioners, but it was the employer's ultimate decision which pensioners to exclude. The PIE offer was made to those members where it was anticipated the largest savings could be made in order to reduce the anticipated total cost of the buyout.

Mr N - PO- 10167

Comment (1): The range of powers involved in running a pension scheme is unlikely to be fully understood by most members.

Comment (2): The Incentive Exercises Code of Good Practice was updated on 1st February, 2016 (Pensions Bulletin 16/02). The Code covers enhanced transfer value exercises and PIEs, as well as full commutation exercises. One-off small lump sum exercises are covered by the Code but not where the exercise is a "business as usual" activity offered on an ongoing basis.

The Code is not intended to apply generally in relation to exercises associated with winding up, but a consultation during 2016 on whether to include winding up lump sums is expected. The Code is voluntary but has generally been followed since its inception. Although it is not statutory and so not considered by the courts, the Pensions Ombudsman and the Financial Ombudsman Service have regard to it where appropriate.

The party initiating the offer, typically the employer, is responsible for following the Code and seeking to ensure that other parties follow it.

Points in Practice

VII. Regulator's first governance fine

1. The Pensions Regulator has issued its first fine for failure to comply with the requirement to prepare an annual governance statement signed by the Chair of trustees.

2. The requirement applies to schemes with money purchase benefits but does not apply to schemes where the only money purchase benefits are AVCs.

3. The trustee of the Abbey Manor Group Pension Scheme was fined £500 (fines for this breach may reach up to £2,000). The minimum fine was imposed because the trustee notified the Regulator of the breach promptly and quickly went on to prepare the governance statement, 23 days after the breach.

4. Scheme returns must now include confirmation that the trustees have prepared a governance statement. The Regulator has confirmed in its press release that scheme return notices requiring the revised form of scheme return will be sent out from July, 2016.

Comment (1): Schemes with money purchase benefits (other than schemes where the only money purchase benefits are AVCs) must prepare an annual statement signed by the Chair within 7 months of the end of the scheme year. This requirement was introduced under the Occupational Pension Schemes (Charges and Governance) Regulations 2015, effective since 6th April, 2015.

Comment (2): Trustees must tell the Regulator about any breaches via the scheme return. The Regulator confirms in its press release that it will act if a scheme return is not completed. The current number of warning notices for this stands at 22.

Comment (3): Trustees of schemes within scope of the Charges and Governance Regulations will need to ensure that they meet the requirements promptly if they are to avoid or minimise a fine. There are situations where it is less clear whether a scheme falls within the exemptions set out under the legislation. AVCs are not defined in the regulations and in some instances careful thought will need to be given to the question of whether a scheme would be classed as providing money purchase benefits only via AVCs.

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VIII. Regulator's prosecution policy

1. The Pensions Regulator published a consultation on its draft prosecution policy on 8th January, 2016. The policy sets out how it will use its prosecution powers in relation to criminal offences under pensions legislation. The prosecution policy has now been finalised.

2. The Regulator confirms in its response to the consultation that it has decided to publish the policy as a reflection of its desire to be transparent and consistent in its decision-making.

3. As regards the relationship between criminal and civil regulatory action, the Regulator intends to consult on a separate policy 'in due course'. That policy would explain its approach where it would be open to the Regulator to bring criminal proceedings and use its civil regulatory powers.

4. When deciding on what action to take in England and Wales, the Regulator will consider the Code for Crown Prosecutors, which requires:

   – sufficient evidence to provide a realistic prospect of conviction and

   – that any public interest reasons not to prosecute do not outweigh those in favour of a prosecution.

5. For Northern Ireland cases, the Regulator will liaise with the Public Prosecution Service and will consider and apply the PPS Code for Prosecutors, which applies broadly the same principles as the Code used in England and Wales.

6. As regards Scottish cases, the decision to prosecute rests entirely with the Procurator Fiscal, although the Pensions Regulator will liaise with The Crown Office and Procurator Fiscal Service.

   Comment (1): The Regulator confirms that the approach covered in the prosecution policy is not new. The policy is based on the section on criminal proceedings in its Automatic Enrolment Compliance and Enforcement Policy (that section has now been removed).

   Comment (2): The annex to the policy sets out a useful list of the specific criminal offences created by workplace pensions legislation which the Pensions Regulator has the power to prosecute. The equivalent legislation for Northern Ireland is also set out.

IX. Value for members

1. To accompany the DC Governance Code of Practice, a number of 'how to' guides were published in April, 2016 for consultation. The Code and draft guides reflect the new governance requirements for defined contribution schemes.

2. One of the draft guides relates to value for members. That draft guide includes a statement that trustees should consider the potential for producing a summary of the key outcomes of a value for members assessment and either send it to members or publish it on the scheme's website.

   Comment (1): Trustees should be aware that taking such a step may not be the wisest course of action. The Code itself recognises that different members place different values on the various services provided by a scheme. The Code also recognises that value for members does not necessarily equate to 'low cost'. Providing a summary of the key outcomes of a value for members assessment would be likely to raise an unnecessary level of communications from members querying the trustees' decisions on this. The Chair's statement would need to explain how the trustees' assessed value for members in any event.

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Comment (2): More generally, sending members communications that are not strictly required by law can expose trustees to the risk that members may bring a claim by reference to statements contained in such communications which overstate the position.

X. Member borne commission ban

1. Qualifying schemes for auto-enrolment purposes which include money purchase benefits must comply with regulation 11A of the Occupational Pension Schemes (Charges and Governance) Regulations 2015 (“the regulations”).

2. The regulations require trustees to inform their service provider(s) that they are a qualifying scheme for auto-enrolment purposes. Trustees must have done this by 5th July, 2016.

3. This requirement results from the new ban on member-borne commission, which applies to commission arrangements entered into, varied or renewed after 6th April, 2016.

4. Service providers are those entities providing administration services directly to trustees. Payroll and middleware services are not covered by the ban.

5. The service provider must then respond within 2 months of receiving the notification from the trustees.

6. There are 3 possible outturns:

   6.1 The service provider responds in time that it complies with the ban.

   6.2 The service provider does not respond in time.

   6.3 The service provider replies in time, confirming that it does not comply with the ban.

If outturns 6.2 or 6.3 occur, the trustees must tell the Pensions Regulator promptly by completing a breach of law report via Exchange.

Comment (1): Service providers are those entities providing trustees with scheme administration services. They are not advisers, such as auditors, actuaries and lawyers.

Comment (2): The requirement to notify service providers under the regulations applies to any scheme where all or some of the benefits are money purchase benefits. This means that schemes are in scope even where the only money purchase benefits being provided are AVCs.

XI. Financial Advice Working Group

1. A Financial Advice Working Group has been announced by the FCA. The Group has been set up following the recommendations of the Financial Advice Market Review (FAMR), published on 14th March, 2016.

2. The Working Group is tasked with taking forward 3 of the FAMR recommendations:

   – Working with employer groups to develop a guide to the top 10 ways to support employees’ financial health - the FCA and Pensions Regulator are planning to release a factsheet in early 2017;

   – Publishing a shortlist of potential new terms to describe ‘guidance’ and ‘advice’ by the third or fourth quarter of 2016; and

   – Designing a set of rules of thumb and nudges to increase consumer engagement by the first quarter of 2017.

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Comment (1): The FAMR was launched on 3rd August, 2015 to examine how financial advice could work better for consumers, building on the 6th April, 2015 pension flexibility reforms.

The FAMR recommended the above as well as the following:

1. Members of the FAMR expert advisory panel should form a Financial Advice Working Group to support progress over the next 12 months.

2. The FCA and the Pensions Regulator should develop and promote a new factsheet to set out what help employers and trustees can provide on financial matters without being subject to regulation.

3. H.M. Treasury should explore ways to improve the existing £150 income tax and N.I. exemption for employer-arranged advice on pensions.

4. H.M. Treasury should explore options to allow consumers to access a small part of their pension pot before Normal Minimum Pension Age, to redeem against the cost of pre-retirement advice.

5. H.M. Treasury should "challenge" the industry to make a pensions dashboard available to consumers by 2019 (Pensions Bulletin 16/09).

Comment (2): For many years, employers have had to pay careful attention to their communications so as to avoid falling foul of the restrictions regarding who may provide advice. It is to be hoped that the work outlined above will clarify matters for employers concerned about this issue.

XII. HMRC Countdown bulletin 18

HMRC's Countdown bulletin 18 includes:

- FAQs on the GMP calculation tool (called the GMP Checker);

- Details of HMRC Pension Forums scheduled for September, 2016, allowing 20 attendees to discuss issues informally regarding the end of contracting-out; and

- Reference to the DWP's new online Pension Tracing Service and to the blogs posted by the Minister for Pensions.

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If you would like to find out more about our Pensions and Employment Group or require advice on a pensions, employment or employee benefits matters, please contact **Jonathan Fenn** jonathan.fenn@slaughterandmay.com or your usual Slaughter and May adviser.

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