Baker McKenzie.

Pensions Update

March 2017

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Spring budget

The Spring 2017 Budget did not contain many pensions related items and those it did contain generally dealt with matters which had previously been raised in the 2016 Autumn Statement. These included the reduction in the money purchase annual allowance from £10,000 to £4,000 with effect from 6 April 2017 for those who have flexibly accessed their pension savings and amendments to the tax registration process for master trust pension schemes from October 2018, to better align this system with the Pensions Regulator's new authorisation and supervision regime.

However, **a new announcement was the introduction of a 25% tax charge on transfers requested on or after 9 March 2017 to a to a qualifying recognised overseas pension scheme (QROPS)**. Exceptions will be made to the charge, allowing transfers to be made tax free where people have a "genuine" need to transfer their pension, where:

- both the individual and the pension scheme are in countries within the European Economic Area (EEA); or
- if outside the EEA, both the individual and the pension scheme are in the same country, or
- the QROPS is an occupational pension scheme provided by the individual's employer

The Government will also legislate in Finance Bill 2017 to apply UK tax rules to payments from funds that have received UK tax relief and have been transferred, on or after 6 April 2017, to a QROPS. UK tax rules will apply to any payments made in the first 5 full tax years following the transfer, regardless of whether the individual is or has been UK resident in that period.

An overview of tax legislation and rates in the Spring 2017 Budget can be viewed by clicking here.

PPF: Consultation on levy rule for scheme with no substantive employer

The Pension Protection Fund's consultation on a levy rule for schemes with no substantive employer has been published. This consultation sets out the PPF's thinking on how it would charge a levy to a scheme that, following separation from its sponsoring employer, continues to run on without a substantive sponsor under the terms of an ongoing governance arrangement.

The PPF view is that as the primary risk of such a scheme is the risk of failure in the scheme's investment strategy (and not the likelihood of a sponsoring employer becoming insolvent) a different approach is needed with the two key actions being:

- charging methodology to be based using a pricing model for assessing put options, as the PPF views this as the financial instrument most closely comparable to the risk presented by a scheme with no substantive sponsor; and
- the levy calculation will always charge as a minimum the amount that would be due under the PPF's standard rules assuming the scheme was sponsored by the weakest possible employer.

This new rule will only apply to schemes that continue to run on without a substantive sponsor as a result of arrangements put in place after the start of this calendar year.

The consultation can be viewed by clicking here.

Work and Pensions Committee make recommendations in response to BEIS green paper on corporate governance reform

The Work and Pensions Committee has published its response to the Department for Business, Energy and Industrial Strategy (BEIS) green paper on corporate governance. The BEIS green paper was published after the collapse of British Home Stores which was widely seen as being precipitated by failures of corporate governance.

The Work and Pensions Committee report responds to the BEIS consultation in relation to the green paper based on its own BHS inquiry and subsequent work on pensions. As such, the comments in the report are restricted to areas relevant to pensions.

The three recommendations in the report (which are stated as needing to be read in conjunction with the more substantial proposals in the December 2016 Report on Defined Benefit Pension Schemes) are:

- the Financial Reporting Council Corporate Governance Code, which currently applies only to public listed companies, should be extended to large private companies and those with over 5,000 defined benefit pension scheme members;
- pension scheme members should be added to the list of stakeholders to whom company directors must have regard under section 172(1) of the Companies Act 2006; and
- future Insolvency Service reports should be published when there is significant public interest in publication

The report can be viewed by clicking here.

Government response to consultation on a proposed changes to contracting-out legislation including GMP equalisation

The DWP response to the consultation was published on 13 March 2017.

In relation to GMP equalisation, it was stated that there was broad agreement that the proposed methodology, which seeks to achieve equal benefits in private sector pension schemes using a one-off calculation followed by GMP conversion, was an improvement on the previous 2012 proposal as it avoided ongoing administration costs and potential “gold plating” of benefits. However, it was confirmed that, whilst it continues to believe that the proposed method meets the equalisation obligation derived from EU law, the Government has not asserted that the proposed methodology is the only means by which schemes can equalise benefits for the effect of GMPs, and does not propose to do so. **It will continue to be for the trustees of a scheme to decide what if any action is needed for their scheme to provide equal pension.**

The DWP confirmed its intention to give further consideration to the responses received on the proposed methodology including what further changes might be necessary to the methodology and what further changes might be required to legislation to enable schemes to convert benefits more easily.

The DWP also confirmed that it aware that the pension industry has been calling for urgent changes to be made to the arrangements for transferring contracting out rights to schemes that have never been contracted out, and hopes to consult on any proposed changes by Autumn 2017.

The response can be viewed by clicking here.

Changes to long service PPF compensation cap

We previously covered the proposed changes to the long service PPF compensation cap in our September 2016 Update. These were intended to introduce an enhanced long service cap (with the PPF compensation cap, currently set at £37,420.42 for the 2016/17 year, determined at age 65 and actuarially reduced if a person takes their benefits at an earlier age, to ensure that individuals who take their benefits at different ages are treated in a similar way).

The proposed changes were for the cap to be increased by three per cent for each full year of pensionable service above 20 years, subject to a new maximum of double the standard cap.

The draft Pension Protection Fund (Modification) (Amendment) Regulations 2017 have now been laid before Parliament and make changes to secondary legislation to ensure that the new cap on Pension Protection Fund compensation will recognise long service worked as intended in specific situations.

The response can be viewed by clicking here.

Response to consultation on General Levy Rate confirms approach

The response to the consultation on the draft Occupational and Personal Pension Schemes (General Levy) (Amendment) Regulations 2017, which would make changes to the rates of the General Levy for the year 2017/18 onwards, has now been published.

The response set out why it is considered necessary to restructure the levy rates and confirms that the Government has decided to proceed with the recommended approach as set out in the consultation document. This was:

- the introduction of a new levy rate for pension schemes with 500,000 members or more, set at a level 25% lower than the current levy rate applying to schemes with 10,000 members or more.
- the levy rates for schemes with fewer than 500,000 members to remain unchanged which would maintain for such schemes the freeze in the levy rates that has been in place from 2013/14 following a reduction in the levy rates of 13% for the preceding year.

It was stated that this was the preferred approach as it would recognise that the portion of the levy paid by the largest pension schemes is inappropriately high but would not place an additional burden on smaller pension schemes.

The response can be viewed by clicking here.

Response to consultation on technical changes to auto-enrolment

The DWP response to the consultation on technical changes to auto-enrolment has been published.

The consultation was in relation to two changes to the process for newly created employers which will become subject to auto-enrolment duties during the course 2017. These changes were:

- a change to the auto-enrolment duties trigger set out in legislation for these employers (known as post-staging employers); and
- extending to these employers the option to defer auto-enrolment for their new workers.

The DWP has confirmed that it will bring forward the Employers' Duties (Implementation) (Amendment) Regulations 2017 which are due to come into force in April 2017.

The response can be viewed by clicking here.

NEST: Evolving for the future - Government response confirms proposals

The National Employment Savings Trust (NEST) was established in 2010 to support the introduction of automatic enrolment. Since then there have been significant changes in the pensions landscape and this led the Government to publish, on 7 July 2016, a Call for Evidence paper "NEST: Evolving for the future" which sought evidence and views from a wide range of stakeholders on:

- whether or not to allow NEST to provide additional decumulation services for its members; and
- whether or not there is a case for expanding the opportunities for individuals, employers and other schemes to access NEST's services.

The Call for Evidence closed on 5 October 2016 and, in summary, the Government response was:

- on the basis of reassurance received on the intention of the pension industry to innovate, the Government does not propose that NEST should begin to offer additional decumulation services at this time. The Government will continue to monitor the market and, if the market is not developing in line with the needs of NEST members, it will consider the most appropriate response at that time.
- **it will take forward proposals to allow employers to contractually enrol workers into NEST. Other changes to extend access, including opening the scheme to individuals and transfers from other schemes without a link to automatic enrolment, will not be pursued at this time.**

The response can be viewed by clicking here.

The Pensions Regulator publishes report on valuations since updated DB code

The Pensions Regulator has published a report on the first schemes undertaking actuarial valuations since the revised defined benefit code of practice and its new statutory objective came into force.

The new defined benefit code came into force in June 2014 and sought to take into account the experience of the Pensions Regulator up to that date and to reflect the new statutory objective to minimise adverse impact on the sustainable growth of an employer.

The report focuses on schemes whose valuation dates fell between September 2013 and September 2014 (referred to in the report as Tranche 9 schemes) and sets out conclusions on how trustees and employers have behaved in light of the revised code. In particular, the report focused on schemes facing an increased deficit relative to their previous valuation, and the approaches they have taken to manage these increased deficits.

In summary, the Pensions Regulator found that:

- Whilst deficits have increased for these schemes, sponsor affordability has also improved for around half of the schemes, which demonstrates that many of those employers with increased deficits who also had an improvement in affordability but did not increase their deficit recovery contributions nevertheless had the ability to do so.
- A majority of these schemes have made use of the flexibilities to manage the impact of their

increased deficits to carry risk in the scheme and prioritise investing in the sustainable growth of the employer, rather than increasing their deficit recovery contributions.
- A minority of schemes have not used or fully utilised the flexibilities highlighted in the 2014 Annual Funding Statement.
- There has been an increase in the proportion of trustees and employers employing an integrated approach to risks.

The report can be viewed by clicking here.

PLSA teach in on RPI/CPI

Partner Arron Slocombe gives a summary of the PLSA's first teach-in of 2017, RPI to CPI switches. He speaks about why the switch is such a hot topic for employers, trustees and scheme members, and the points to consider before making a switch. You can view the teach in at https://youtu.be/IlZq2bVfrBs.

Comments from our Pensions Disputes Group

Determination in a referral from the Trustees of the Massey Ferguson Works Pension Scheme

This determination dealt with the PPF's rejection of an application for a parent company guarantee to be used as a contingent asset in order to reduce a scheme's PPF levy.

In this case, the parent company guarantee did not meet the full realisable recovery The PPF has been ordered to provide detailed reasons to a pension scheme's trustees to explain its decision not to grant partial recognition of a "type A" contingent asset. Type A guarantees such as this that are not able to meet the full realisable recovery amount will usually be completely rejected. However, the PPF has discretion to allow partial recognition in some circumstances (paragraphs 5.3 and 9.4.2, 2017/18 Contingent Asset Guidance).

Broadly, the guarantee was rejected because the PPF considered that the guarantor's assets were comprised of investments in its subsidiaries, including the scheme employers, so an insolvency event would reduce the value of the guarantor's investments and it would not be able to fulfil the guarantee. After exhausting the PPF's appeal process, the trustees appealed to the PPF Ombudsman.

In response to an enquiry from the Ombudsman's office, the PPF stated that it did not consider partial recognition of the contingent asset. However, as part of a discussion with the Ombudsman's adjudicator it was noted that the PPF considers partial recognition as part of its initial financial assessment of type A contingent asset guarantors and, in respect of this scheme, the discretion was drawn to its notice. It stated that the grounds on which it based its decision concerning full recognition applied equally for partial recognition and so the committee did not consider the question of partial recognition further.

The Ombudsman noted that the PPF had a wide discretion to grant partial recognition, not merely where this was raised as a ground for review. He determined that the PPF's discretion "should be exercised in a proper manner" and that "the lack of transparency in its decision did not satisfy that requirement". By not making its consideration of partial recognition clear to the trustees the PPF had denied them the ability to query its decision.

The Ombudsman confirmed that the decision had not been reached correctly and that the PPF should provide the trustees with its detailed reasons and allow them to request a review and reconsideration as before.

Objective justification of age-related transitional provisions in pension scheme upheld

An employment tribunal has held that the age-related transitional provisions in the Firefighters' Pension

Scheme 2015 are objectively justified and therefore not discriminatory on grounds of age, race or sex. Under those provisions, anyone within 10 years of normal pension age (NPA) would remain on the old, more favourable pension scheme. Anyone more than 14 years away from NPA would transfer straight onto the new scheme, and there was a tapering of benefits for anyone with 10-14 years to go until NPA.

Although this transitional protection was age-related and therefore prima facie direct age discrimination against younger firefighters, it was a proportionate means of achieving legitimate aims. Those aims were to protect those closest to NPA (who had the least time to rearrange their financial affairs prior to retirement); to take account of their greater legitimate expectation that their pension entitlement would not change significantly; to prevent a cliff edge between the protected and unprotected groups, and to ensure consistency across the public sector (where similar changes were being made). Having decided to draw a line somewhere, it was a social policy decision for the government where to draw that line.

The race discrimination, sex discrimination and equal pay claims failed because, even though there was a statistical disparity in the ethnicity and gender of the protected and non-protected groups, the reason for that disparity was entirely due to age and not race or sex. There was therefore no need to justify the disparity, but if there was, it was justified for the same reasons as the age-related factors. (*Sargeant and others v London Fire and Emergency Planning Authority and others* ET/2202235/15.)

Contact us

If you wish to discuss any of these issues further, please contact your usual Baker McKenzie lawyer.

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