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News on Pensions

APRIL 2015

Budget 2015

The Chancellor of the Exchequer George Osborne delivered his 2015 Budget speech in the House of Commons on 18 March – the last Budget before May's General Election. We set out below the key pensions aspects and subsequent developments.

Shortly before the Budget, the latest Pension Schemes Bill (see our September 2014 newsletter) received Royal Assent, becoming the Pension Schemes Act 2015. The Act introduces further flexibility and innovation in the pensions market by allowing the establishment of Defined Ambition and Collective Defined Contribution arrangements (intended to sit in the 'shared-risk' environment between defined contribution (DC) schemes (where the employee bears nearly all the risk) and defined benefit (DB) schemes (where the employer bears the majority of the risk)).

Several aspects of this year's Budget speech built on themes already established in the new Pension Schemes Act.

Lifetime allowance

The Chancellor has announced that the lifetime allowance (LTA) – i.e. the maximum overall amount that can be saved into a tax-approved pension arrangement without attracting penal tax charges - will be reduced from £1.25 million to £1 million from 6 April 2016. Clauses codifying the reduction in LTA will form part of the next Finance Act.

Transitional arrangements will apply for individuals wishing to protect pension savings valued above the new LTA at April 2016. Full details have not yet been announced, but are expected to take a similar form to the protections introduced last time the LTA was reduced in April 2014. Individuals with existing protections – for example 'Enhanced Protection', 'Primary Protection', 'Fixed Protection' and 'Individual Protection 2014' – are expected to retain these when the new LTA comes into effect.

The Chancellor also announced that, with effect from April 2018, the LTA will be indexed in line with Consumer Prices Inflation (CPI). The last time the LTA increased was in April 2010.

HMRC has published, via the Association of Consulting Actuaries (ACA), two fact sheets on the LTA change; one aimed at the public and the other at those working within the industry. HMRC expects that these can be used to answer queries on the change and actively encourages the use of the former when communicating with members.

DB to DC transfers

The Treasury confirmed that employer-funded advice to members on transferring DB pensions to DC schemes, and on converting benefits from DB to DC, will not be taxed as a 'Benefit-in-Kind' and will also not be subject to National Insurance.

In light of the Government's announcement last year that it will not ban transfers from private sector DB to DC schemes, and the new requirement that members receive independent financial advice on transfer values over £30,000, the Financial Conduct Authority (FCA) intends to make advice on such transfers a 'Regulated Activity'.

The FCA already regulates advice on transfers to personal pension schemes but not to occupational DC schemes. Furthermore, the FCA intends that all such transfers are provided or checked by a 'Pension Transfer Specialist'.

In their consultation document, the FCA echoes comments previously made by TPR, that transfers from DB to DC are "unlikely to be in consumers' best interests". However, they accept that there are some circumstances where a transfer will be appropriate.

The FCA estimates that the number of transfers from DB schemes will increase from 20,000 each year (current estimate based on Office for National Statistics (ONS) data) to around 29,000 transfers, with up to 35,000 individuals requiring advice from a Pension Transfer Specialist.

Guidance Guarantee

Additional funding to the tune of around £19.5m in 2015/16 will be made available for Pension Wise and the Guidance Guarantee in relation to members retiring from DC arrangements from April 2015.

Creating a secondary Annuity Market

As part of Budget 2015, HM Treasury and the DWP launched a call for evidence on 'creating a secondary annuity market'. The consultation had been pre-announced by the Treasury ahead of the Budget, and is intended to extend the pensions flexibilities originally revealed as part of the 2014 Budget to those who have already retired from DC schemes.

In the consultation, the Government says it is considering amending tax rules so that those who have previously purchased an annuity are able to assign the income stream to a third party from April 2016.

On the sale of the annuity income stream, the proceeds could be taken as a taxable lump sum, or converted into a flexi-access drawdown (FADD) arrangement or flexible annuity. The assignment would not attract the penal tax charges that currently apply, but would instead be taxed as income.

The Government is also proposing that:

- the annuity provider must agree to the assignment
- the sale must be to a genuine third party – i.e. the current insurers will not be able to buy the annuity back
- annuities purchased in the name of occupational scheme trustees (for example 'buy-in' policies) will not be assignable in this way
- the £10,000 revised money purchase annual allowance will apply to people who assign annuity income to a third party

The Government will consider what consumer protection measures will be required. They may legislate so that a free impartial guidance service is available (perhaps in the form of an extension to Pensions Wise), or that those assigning annuity incomes are given risk warnings or are required to take independent financial advice.

VAT on Pension Costs

The question of whether sponsoring employers can deduct VAT on services provided to a 'legally and fiscally separate pension scheme' was raised in the Court of Justice of the European Union (CJEU) by a Dutch company called Fiscale Eenheid PPG Holdings BV (PPG) in July 2013.

Previously, HMRC had been allowing sponsors to reclaim VAT paid on pension scheme invoices for 'administration services' but not for 'investment management services'. Where invoices covered both types of service, HMRC allowed a 70/30 split to be assumed as an administrative simplification.

Following the PPG case, and a series of updates, HMRC issued Briefing Note 43 (RCB 43) in November 2014 in which it set out its revised position (see our December 2014 newsletter), saying there are no grounds to differentiate between administration and investment management services (and therefore VAT could in theory be reclaimed on both), but it expects that the employer must be a party to the contract, pay for the services directly and be the recipient of those services, if VAT is to be reclaimed.

Following an 'informal consultation' with the pensions industry, HMRC has now issued an update (Revenue and Customs Brief 8) in relation to the deduction of VAT on pension fund management costs. In particular, HMRC says that VAT on investment manager costs can be reclaimed by an employer entering into a 'tripartite agreement' with the trustees and fund managers, provided the agreement meets certain criteria.

These criteria include that the agreement must stipulate that:

- The investment management services are provided to the employer (although HMRC recognises that the investment manager may be appointed by the trustees).
- The employer pays for these services directly and cannot recharge to the trustees. The fees can however be reflected in an adjusted Schedule of Contributions (so long as any adjustments do not relate directly to invoice amounts).
- The investment manager can only pursue trustees for payment where the employer is unlikely to pay.
- Both employer and trustees must be allowed to bring legal action against the provider for breach of contract.
- The employer must be allowed to terminate the contract (although this can be with trustee consent).
- Fund performance reports must be sent to the employer on request (although trustees will be able to withhold reports in certain circumstances).

Existing arrangements for reclaiming VAT, including the 70/30 rule, can continue until 31 December 2015.

HMRC has not yet clarified the position in relation to other pension scheme services provided to trustees and employers - in particular actuarial and legal fees. A further update is promised 'in the summer' on these other types of services, and also on whether VAT can be reclaimed by a corporate trustee joining the sponsoring employer's VAT grouping.

NAMES: Employer debt regulations

The DWP has published a call for evidence on the rules concerning Section 75 employer debt in non-associated multi-employer schemes (NAMES), in response to concerns raised by some employers that the current regime is overly onerous. The main easements that the government is considering include:

- Introducing flexibility around debt repayment, including allowing the trustees and employers to negotiate repayment of the debt over a significant period of time.
- Ceasing to employ active members could no longer trigger an employer debt – i.e. the employer would be required to continue to fund their existing liabilities on the Scheme Funding basis instead of being required to pay a Section 75 debt. A debt would still be triggered if the employer were to become insolvent or if the scheme were to wind up.
- Changing the way the liability is calculated. Section 75 debt is currently calculated as the employer's share of the scheme's deficit on a 'buyout' basis. The Government is considering whether liabilities could be calculated on a less prudent basis for stronger employers, or whether trustees may defer calling in the debt until the employer's financial health changes.

The government will use responses to assess whether the current arrangements are sufficient or whether changes might be helpful. The call for evidence will run until 22 May 2015.

Auto-enrolment update

Alternative quality requirement for DB schemes

The DWP has responded to an earlier consultation on technical changes to auto-enrolment with revised regulations which will be put in place in the next parliament. Included in these revised regulations is an alternative quality requirement for DB schemes used for auto-enrolment.

The new test is intended to help employers with schemes that are currently contracted-out on a salary-related basis. Employers will no longer be able to use the scheme's contracted-out status as the basis for satisfying the quality requirement when contracting-out is abolished in April 2016.

Under the alternative requirement, a DB scheme would qualify for use as an auto-enrolment arrangement if 'the cost of providing the benefits' for members is at least a prescribed level (to be confirmed, but expected to be around 10-12% of total pay). The DWP anticipates that calculating the cost of benefits can be carried out as part of the scheme's usual 'actuarial' funding process.

Statistics and TPR warning

The DWP has reported that nearly 5.2 million workers have been auto-enrolled into a workplace pension since its launch in 2012. It is expected that 9 million people will be either newly saving or saving more by the time the roll out is complete in 2018.

This comes at the same time that The Pensions Regulator (TPR) has warned small and micro employers they must act now on auto-enrolment. The results of TPR's most recent survey of employers suggests that 41% of companies whose 'staging date' is in the second half of 2015 (i.e. those who have fewer than 50 employees), had yet to even consider which pension arrangements to use to auto-enrol staff.

DWP: End of contracting-out

Following a consultation on how employers can amend scheme rules without trustee approval to reflect the increase in National Insurance costs when contracting-out ends, the DWP has now published their response. The DWP has clarified the following points:

- The definition of principal employer is confirmed as 'anyone nominated to act on behalf of the employers participating in a multi-employer scheme to agree scheme funding matters with the trustees'. Effectively, this means that any such employer would be able to use the statutory override power on behalf of all employers.
- Required certification: It is no longer a requirement for the actuary to certify that the power is not being used to adversely affect members' subsisting rights (the power still cannot be used in such a way) and separate certification is no longer needed for different groups of members accruing benefits under different rules. However, it is expected that employers explain clearly to employees, as part of the consultation process, how different groups of employees are affected by the proposed amendments.
- Trustees must respond to information requests within a '…reasonable period as agreed with the principal employer or employee', rather than within four weeks set out in the earlier draft. 'Reasonable period' is not defined, but an estimate of eight weeks is given.
- Before amending scheme rules, employers must obtain actuarial certification that the value of member benefits is not reduced by changes. This value-based test must be carried out using assumptions adopted for the last scheme funding valuation, but with margins for prudence removed if so instructed by the employer. Employers can now choose which Scheme Funding assumptions they remove prudence from, rather than the previously proposed 'all or none' approach. The earnings to be used in the calculations have also been defined more clearly.
- The principal employer must now appoint an actuary other than the scheme actuary as it is thought there would be a conflict of interest.

The response on the draft Occupational Pension Schemes (Schemes that were Contracted-out) Regulations 2014 that will replace the Occupational Pension Schemes (Contracting-out) Regulations 1996 is due in summer 2015.

PPF Update

Actuarial factors

The Pension Protection Fund (PPF) has published revised actuarial factors to take effect from 1 April 2015. The new factors will be used for calculating PPF compensation and for Section 179 valuations.

- the PPF compensation cap remains unchanged at age 65 but has been amended at other ages
- rates of commutation of pension for cash have been increased (for example from £16.3 to £17.3 per £1 pa of pre-97 pension at age 65, and from £22.1 to £22.4 per £1 pa of post-97 pension at 65)
- adjustments for early retirement have been increased
- late retirement uplifts have been reduced

The PPF has also published a note describing the principles behind the calculations of the factors.

Strategic Plan

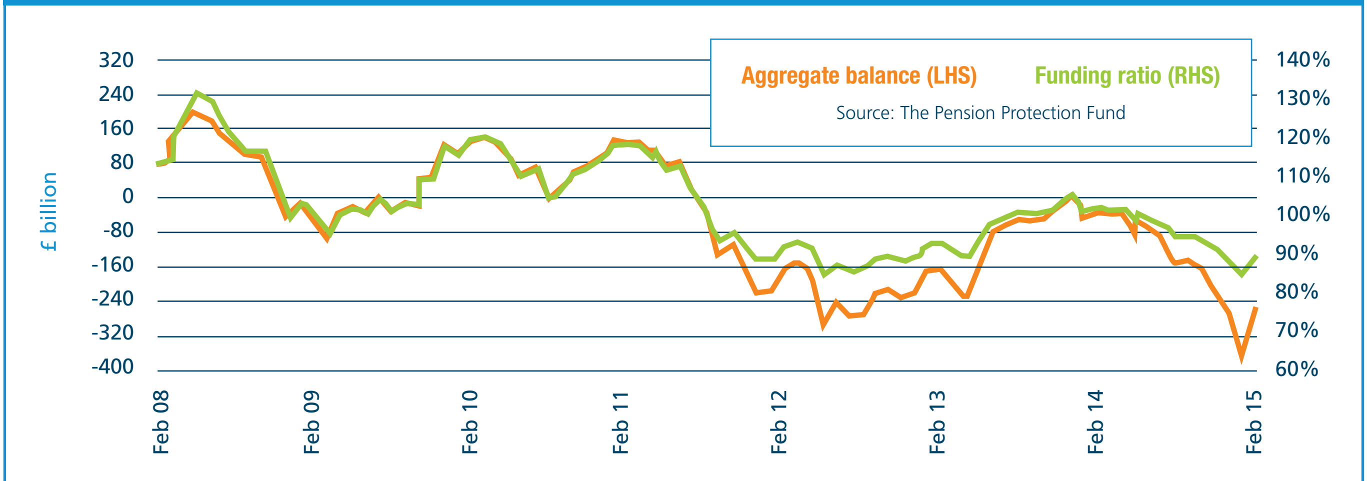
The PPF has published its Strategic Plan for 2015-18 which shows that they expect to remain on course to meet their long-term funding target of self-sufficiency by 2030. The plan looks back at the growth of the PPF since its launch in 2005 as well as how it proposes to continue to meet its business objectives as it continues in the future.

PPF 7800 Index

The latest update of the PPF's 7800 Index of schemes' funding (on the section 179 basis) has been published and shows an increase in the s179 funding ratio from 77.6% to 83.6% between January 2015 and February 2015.

The aggregate deficit of the 6,057 schemes in the PPF 7800 index is estimated to have decreased over the month to £248.7 billion at the end of February 2015 (there was a deficit of £367.5 billion at the end of January 2015). There were 4,849 schemes in deficit and 1,208 schemes in surplus.

ESTIMATED AGGREGATED BALANCE (ASSETS LESS S179 LIABILITIES) AND FUNDING RATIO OF SCHEMES IN THE PPF UNIVERSE



Other News

Single regulator called for

The Work and Pensions Committee of the House of Commons has issued a report calling for a single pensions regulator and a new independent pensions commission. The committee believes that the issues arising as part of the new flexibilities will be best met under this revised structure. TPR says it will work with the government to respond to the report.

Charge caps

Following a short consultation, the DWP have published amending regulations exempting arrangements solely receiving additional voluntary contributions (AVCs) from the default fund charge cap which took effect from 6 April 2015. New charge cap regulations have also been published.

State Pension Glossary

The DWP has published a glossary of words related to the New State Pension. The glossary is intended to aid public understanding by explaining the words and terms used in guidance about the new State Pension.

Pensions liberation fraud

TPR has refreshed it's 'scorpion' campaign to alert pension savers of potential scams, and published an 'action pack' for scheme administrators. The FCA has followed suit. Meanwhile, the Pension Liberation Industry Group has launched a Code of Good Practice on combating pension scams and HMRC has published a newsletter on pension liberation, providing an update on the action it has taken against pension scams.

TPR: Corporate plan

TPR has published its corporate plan for 2015 - 2018. The plan highlights how TPR will focus on supporting the recent market developments as well as its intentions to continue to improve the standards of workplace pension schemes and promote good outcomes for savers.

Contracting-out updates

HMRC has published its latest contracting-out Countdown Bulletin reminding us that there are now only twelve months before contracting-out will cease. The Bulletin covers issues including scheme reconciliation, maintaining member records and other useful links. The Office for National Statistics (ONS) has published Contracting out of Private Sector Defined Benefit Pension Schemes, 2013 which looks at membership and contribution rates. The report mainly looks at data during 2013.

Further information

You may find the following recent blog posts and information sheets interesting:

- VAT on pension costs – part two
- Current Issues in Pensions Financial Reporting 31 March 2015

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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