

Current Pensions Issues

VAT on pension scheme costs

Her Majesty's Revenue and Customs (HMRC) has confirmed that employers and trustees will not need to rush into restructuring agreements with providers of services to their pension scheme so that VAT can continue to be recovered on fees.

Current arrangements can continue until 31 December 2016 while HMRC continues to work towards a solution – we had been expecting transitional arrangements to end on 31 December 2015 (see [Current Pensions Issues – Spring 2015](#)).

In their [latest update \(RCB 17/15\)](#), HMRC discuss the issues with some (but not all) of the potential solutions that have been considered so far:

- **Tripartite agreements:** HMRC concedes that these may not be as tax efficient as they initially thought. In particular, where the employer pays the costs under a tripartite agreement, the employer may inadvertently trigger a corporation tax charge.
- **Corporate trustee joins employer VAT grouping:** it has been [suggested](#) that setting up the trustees as a corporate body (rather than a group of individuals) and then joining the employer's VAT group may have been a workaround for the VAT issue. However, whilst HMRC does give reassurance that they would be unable to recover VAT from scheme assets unless "the relevant VAT is attributable to the operations of the pension scheme", it nevertheless remains to be legally tested whether trustees would be held jointly and severally liable for the all the group's VAT.
- **Subcontracting services to the trustees:** HMRC suggests that an arrangement could be established where trustees contract third party suppliers (for example actuaries, legal advisers and administrators) themselves - as they largely do already - but having first contracted with the employer to supply them with the service of running the pension scheme. The VAT charged by the trustee to the employer could then be deductible by the employer.

The Association of Pension Lawyers (APL) had suggested that a simple amendment to the scheme's trust deed and rules could be sufficient to establish a "direct and immediate link" between the employer's business and the operations of the pension scheme. HMRC does not however directly refer to this proposal in its latest update.

HMRC promises that "further guidance will be published later this year".

TO DO LIST

This edition of Current Pensions Issues includes several actions for trustees. You can review the non-exhaustive checklist below with your advisers, following the links for background information:

- [Returning surplus to employers:](#) Ensure s251 resolutions and member communications in place.
- [End of contracting-out \(April 2016\):](#) Has the employer considered increased NI costs and possible courses of mitigation? Trustees should review progress of reconciling GMPs with HMRC's records.
- [State Pension reform \(April 2016\):](#) Is the new State Pension appropriately reflected in the scheme's rules? In particular, have the rules been reviewed for unintended consequences?
- [VAT:](#) Have employers engaged with their tax advisers regarding reclaiming VAT on pension scheme costs?
- [Pension Freedoms:](#) Have trustees and employers considered how and whether to allow members with DC benefits to access them flexibly? Have trustees considered whether to offer 'non-statutory' transfers of DB pensions?
- [Abolition of DC refunds:](#) Trustees of DC schemes should check whether a rule amendment is needed to reflect short-service refunds being limited to 30 days' service.
- [Confirm scheme's Last Man Standing](#) status with legal adviser.
- [Prepare governance statements](#) and Chair of Trustees' report if required (DC schemes).

TPR guidance: Employer covenant

The Pensions Regulator (TPR) has published [new guidance](#) for trustees of defined benefit (DB) schemes on assessing and monitoring the employer covenant - ie "the extent of the employer's legal obligation and financial ability to support the scheme now and in the future".

The guidance sets out TPR's expectations and good practice in relation to covenant assessment and includes case studies and suggestions to help manage covenant risk. It is aimed primarily at trustees of schemes undertaking a scheme funding valuation but will also be helpful in understanding trustees' ongoing monitoring requirements, and the action required in the event of a corporate restructuring.

- TPR recommends all trustees read at least **the introduction**, which sets the scene and includes key points for consideration such as current and likely future profitability, affordability of deficit contributions and plans for growth.
- A separate section details how trustees might go about **assessing the covenant** themselves and contains examples regarding the employer's legal obligations to the scheme, the funding needs and investment risk of the scheme, and the financial support from the employer and any other entities.
- The section on **monitoring the covenant and taking action** details key aspects of ongoing monitoring such as changes to the group structure, dividend payments above a specified level and governance and key personnel changes.
- The **improving scheme security** section covers contingent assets and other security that might be provided to schemes by employers. For example, TPR suggests that security over cash or other financial assets is more suitable than a charge over property to support a higher-risk investment strategy, as it could provide for an immediate increase in funding in the event of adverse investment performance.

TPR's guidance also contains specific sections for trustees of schemes of not-for-profit employers and of non-associated multi-employer schemes.

The case studies suggest that some trustees may need to analyse their employer's covenant in greater detail than before. However, TPR maintains that a proportionate approach should be taken and that trustees "should focus on the factors likely to affect the employer's ability to provide long-term support to the scheme and the trustees' ability to determine an appropriate investment and funding strategy".

TPR has produced a number of [handouts](#) summarising key points from the guidance. The guide is the first in what will be a series helping trustees to apply the [funding code of practice](#). Future guides will include topics such as integrated risk management and investment strategy.

PPF: 2016/17 levies

In its consultation on the draft determination for the [2016/17 PPF levy](#), the Pension Protection Fund (PPF) has said that it expects to raise £615 million in levies – a reduction of £20 million compared with 2015/16. Whilst the levy amount to be collected is decreasing slightly, some employers may still see an increase in their own individual levy – most obviously where Experian perceives there to have been a deterioration in the finances disclosed in a company's accounts. It is important that employers check the information held by Experian to ensure they are not paying more than their fair share.

Although the PPF's approach is largely the same as last year, there are some proposed changes. For more information, see our recent [blog post](#).

Meanwhile, the PPF has said that it intends to review levy band boundaries after it became apparent that around 29% of the universe of sponsoring employers is now in the top levy band, compared with the 20% the PPF had intended.

Last Man Standing schemes

The PPF is proposing to re-invoice schemes that have, in previous years, been incorrectly identified as 'Last Man Standing' (LMS).

LMS schemes benefit from a reduction in their PPF levy due to the lower risk posed to the PPF. Schemes incorrectly identified as LMS in the past have been underpaying their PPF levy by up to 10%.

Schemes that have already informed the PPF they had erroneously claimed to be LMS (on previous scheme returns for example) may shortly expect to receive invoices recouping the past levy discounts. The PPF will write to other schemes early in 2016 asking why they have not certified they are LMS, if they had done so in previous years. The PPF may then invoice these schemes for past underpayments.

Trustees may need to obtain legal confirmation of their LMS status in due course, if they have not done so already.

Funding strategy update

The PPF has published its [Funding Strategy Update](#), which sets out the progress toward its funding target, and how the risks the PPF faces could influence this progress in future. Alongside the risk from claims, the PPF notes it also faces significant longevity risk, risk of material financial loss and a mismatching risk due to the lack of suitable investment options.

To address the particular risk that it will have insufficient assets to meet its liabilities, the PPF has several options at its disposal, including alterations to its investment strategy, restrictions on compensation increases and a reduction in the compensation offered. However, the PPF makes it clear that it would only consider these actions in exceptional circumstances.

TPR Research: TKU

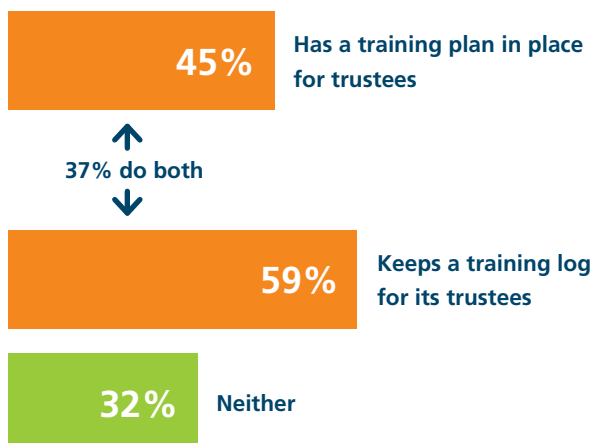
TPR has published the [results of a survey](#) of 816 trustees, carried out between March and May 2015, on the skills and knowledge required for running a pension scheme – with a particular focus on recent changes in the pensions environment.

TPR intends to use the survey to initiate discussion on what skills the modern trustee should be able to demonstrate, in order to give members increased confidence that their retirement savings are in a high-quality, well-run scheme. TPR already provides education via the [Trustee Toolkit](#), alongside guidance and other tools to help trustees, but wants to understand how it can provide further support for trustees.

The research shows that large schemes are more likely to be well governed compared to medium and small schemes. In general, it was also found that DB schemes were better governed than DC schemes, with trustees of schemes being used for auto-enrolment also more engaged.

The surveyed trustees admitted to gaps in their knowledge, particularly in relation to investment matters and pension law. However, they were more confident in their capabilities of negotiating with the employer on funding matters and assessing employer covenant.

Somewhat surprisingly, 10% of respondents had not even heard of the Trustee Knowledge and Understanding (TKU) Code of Practice, and nearly a third of trustees that responded had neither a training plan in place, nor a training log.



Source: *The Pensions Regulator*

Trustee boards of DC-only schemes appeared least likely to demonstrate good governance. For those schemes with a DB and DC element, less emphasis was placed on the governance of the DC than on the DB section.

TPR has confirmed that it will set out next year what it believes to be an “effective 21st century trustee” and what it will do to further support trustees. Meanwhile, details of our 2016 [introductory Trustee Training](#) programme will be published on our [website](#) shortly.

End of contracting-out

Background

Contracting-out for salary-related schemes will be abolished in April 2016. Employers with open, contracted-out DB schemes should consider possible options to mitigate rising National Insurance (NI) costs if they have not already done so. [Research](#) among our clients tells us that many employers are not making any changes to scheme benefits and plan to absorb the additional NI costs. Others plan to increase member contributions or to make minor changes to scheme benefits, and some have planned a fundamental review of benefits.

It is not expected that trustees will have to go through the process of physically surrendering contracting-out certificates next April. Schemes will, however, be required to notify members of the abolition of contracting-out by virtue of the Disclosure of Information Regulations 2013.

Schemes should have begun the process of reconciling GMP records with HMRC. In December 2018, HMRC will cease tracking GMPs and write to all members with details of their GMP entitlement.

Regulatory update

The government has now released another [consultation](#) in relation to the abolition of contracting-out. The draft regulations address some of the issues raised by previous consultations.

These latest amendments will ensure that contracted-out rights being transferred between two formerly contracted-out salary-related schemes after 6 April 2016 are adequately protected. Contracted-out benefits can still be transferred to a scheme that was never contracted-out, provided that the member accepts that the benefits provided by the receiving scheme may be in a different form.

Schemes will no longer be required to inform members “which relevant employment is, and which is not, contracted-out employment” from 6 April 2017. However, by then, schemes must have notified members that contracting-out will end, in accordance with current disclosure regulations.

The regulations also clarify that employers will be required to keep contracting-out certificates for a period of six years after the abolition of contracting-out, as this may be useful evidence that the scheme met the relevant quality standards in relation to automatic enrolment.



Treasury and FCA launch a review into financial advice

HM Treasury and the Financial Conduct Authority (FCA) have [launched a Financial Advice Market Review](#), which will look at how financial advice could work better for consumers, in particular the less wealthy. The review will examine the 'advice gap' ("for those people who want to work hard, do the right thing and get on in life, but do not have significant wealth"), ensure the regulatory and legislative environment encourages innovation and growth to include affordable and accessible financial advice and consider ways to encourage people to seek financial advice. The review will cover all types of retail financial products including pensions, savings, mortgages and insurance and will report before the 2016 Budget.



Section 251: Deadline looming for employer refunds

Section 251 of the Pension Act 2004 concerns trustees' power to return surplus to sponsoring employers, while the pension scheme is ongoing. If trustees wish to retain such a power, a formal resolution needs to be made before 6 April 2016 to avoid losing the power permanently.

Under pre-2006 legislation, trustees would have been obliged to reduce large funding surpluses which, in certain circumstances, could have been through refunds to sponsoring employers. Many schemes' rules therefore reflect this, by granting trustees the power to make such refunds. However, since 5 April 2006, effective limits on funding surpluses have been removed. Section 251 was intended as a transitional arrangement giving trustees time to consider whether it was appropriate to retain the power before it otherwise lapsed.

When the Pensions Act 2004 was originally drafted, trustees were given until April 2011 to make a formal resolution to retain the power to refund surpluses. However, this deadline was extended because of concerns over the drafting of section 251 – in particular, it was unclear whether the trustees would still be able to return surpluses on winding-up a scheme if no resolution was made. The transitional deadline was therefore delayed until 6 April 2016, once it had been clarified that section 251 related only to refunds while a scheme is ongoing.

As there is a legal requirement to give three months' written notice to sponsors and scheme members of the intention to pass a section 251 resolution, trustees who intend to retain the power will need to act before January 2016. However, before deciding whether to retain the power, trustees should seek legal advice and consider whether it would be appropriate to negotiate the terms under which a refund can be made.

Employers may be concerned that if trustees have no power to make refunds, there could be an impact on how the costs of pension provision are reported in the company accounts – and that it could increase the likelihood of a 'trapped surplus' in future.

HMRC: Fixed and Individual Protection 2016

HMRC has published [Pension Schemes Newsletter 73](#) which, amongst other things, details the process for applying for the new lifetime allowance (LTA) protections. Fixed Protection 2016 (FP16) and Individual Protection 2016 (IP16) will enable individuals to protect their pension savings when the LTA reduces to £1m from 6 April 2016 (as announced in the [Budget 2015](#)).

Unlike their predecessors FP14 and IP14, where registration remains open only until 5 April 2017, there is no time limit for registering for FP16 or IP16, and applications can only be made online. However, individuals wanting to rely on FP16 or IP16 after 5 April 2016 must apply before taking their benefits. The new online self-service will be ready from July 2016 with an interim process for individuals wanting to draw benefits before then.

HMRC is also introducing an online service for scheme administrators to check the protection status of their scheme members. HMRC is exploring options for how this will work and will provide more information in due course.

As with FP14, individuals who want to rely on FP16 should not make any further pension savings or join a new pension arrangement after 5 April 2016, other than to accept a transfer, or they will lose their protection. If they are auto-enrolled in a pension scheme, they will lose FP16 if they do not opt out within a month of auto-enrolment.

Individuals will be able to apply for IP16 if they have pensions savings of £1m or more as at 5 April 2016 and will have a personalised LTA equivalent to the value of their pension savings as at 5 April 2016 (up to an overall maximum of £1.25m). Individuals with IP16 can carry on pension savings without losing their protection.

Government delays tax relief changes

The Chancellor of the Exchequer, George Osborne, has announced that the government will wait until the Budget 2016 to respond to the [consultation](#) on pensions tax relief announced in the Summer Budget 2015 (see [News on Pensions August 2015](#)). Responding to a question from Tory MP Richard Graham, Osborne said: "It is a completely open consultation that will lead to a genuine Green Paper and we are receiving a lot of interesting suggestions on potential reform. We will respond to that consultation fully in the Budget."



News in brief

TPR determination: late valuations

TPR has [published](#) details of a funding investigation of the Docklands Light Railway (DLR) Pension Scheme. The scheme's trustees had failed to meet statutory deadlines for their 2009 and 2012 valuations and the trustees eventually took the employer (DLR franchise operator Serco Limited) to court over contributions. The trustees and Serco agreed a £37m recovery plan in November 2014 as part of a settlement of the court proceedings.

TPR has made it clear that trustees of a scheme in deficit should seek to reach an appropriate funding plan as soon as possible, and that it may use its powers where valuations are not completed by the deadline. It also expects trustees to understand their contribution rule and use any powers they have to demand contributions. If the regulator does get involved, it will seek to ensure that the scheme is put back in the position it would have been in had the recovery plan been agreed in a timely fashion.

HM Treasury: exit charges and barriers to flexibilities

HM Treasury has launched a [consultation](#) looking at exit charges and other barriers to members accessing pension flexibilities, and whether these can be cut, capped or removed altogether. The stated aim of the consultation is to ensure that everyone has "the opportunity to transfer their pension at a reasonable cost and within a reasonable timeframe". The government has said it may consider imposing a cap on exit charges for members aged 55 and over.



High Court: RPI vs CPI

A High Court judge has placed a slightly different interpretation on the pension increase rule of the Barnardo's pension scheme compared with some previous court cases (for example QinetiQ and Arcadia – see [News on Pensions: August 2014](#)).

In particular, the Barnardo's scheme rules link pension increases to the Retail Prices Index (RPI) or "any replacement adopted by the Trustees". The judge noted that 'replacement' should be interpreted much more broadly than just in the context of this particular scheme – i.e. that it meant that the index itself would have to be replaced, rather than the trustees deciding to use another.

The judge's decision rested on a number of scheme-specific factors, including that the intention behind the drafting of the rules at the time of their adoption was to allow for the possibility that the RPI might become obsolete (RPI was the only official inflation index at the time the rules were written). This new ruling highlights the importance of taking legal advice considering specific elements of each scheme's rules.

Court of Appeal: Same-sex couples

The Court of Appeal has [upheld a decision](#) allowing pension schemes to limit survivor pensions for same-sex couples to benefits accrued after 5 December 2005 (see [Current Pensions Issues: Spring 2014](#)). The original case was brought by a member of the Innospec pension scheme because his long-term civil partner would receive only a small pension on his death, compared with what would be paid out if he was married to a woman.

Occupational Pension Schemes Survey

The Office for National Statistics (ONS) has published the results of its [Occupational Pension Schemes Survey](#) for 2014. The survey shows that, over the year, there was a 2.5 million increase in membership of occupational pension schemes to 30.4 million - the highest ever recorded. The number of members contributing into a scheme also rose from 8.1 million in 2013 to 10.2 million in 2014, although the average contribution rate for private sector DC schemes fell from 9.1% to 4.7% over the same period, which the ONS expects is linked to having more individuals contributing at the minimum levels under auto-enrolment.

DWP: Defined ambition and automatic transfers delayed

In a [written statement](#) setting out the government's priorities on pensions, Ros Altmann, Pensions Minister, has confirmed that the government will put on hold reforms such as Defined Ambition schemes, and Automatic Transfers, although has left open the option of revisiting these reforms. In particular, it is expected that some form of risk sharing will be back on the table again once the market has had time and space to adjust to other reforms already underway.



Data protection:

Safe Harbor ruling

The Court of Justice of the European Union (CJEU) has [ruled](#) that US 'Safe Harbor' rules do not meet EU standards for the transfer of personal data. Trustees should consider how and whether they transfer data to the US, ensuring that an appropriate level of encryption and anonymisation of member data is applied, seeking legal advice where appropriate.

EU data protection authorities have since [called](#) on EU member states and institutions to work with the US to find a solution. The Information Commissioner's Office in the UK [has said](#) that "businesses that use Safe Harbor will need to review how they ensure that data transferred to the US is transferred in line with the law... it will take them some time for them to do this."

DC schemes: Abolition of short service refunds

Changes to short service refunds for DC schemes came into effect on 1 October 2015. The changes are intended to help members build up pension pots and bring the timescales for refunds into line with auto-enrolment opt-out periods.

Members joining a DC scheme after 1 October 2015 will therefore only be able to take a refund of their contributions if their qualifying service is less than 30 days (rather than two years at present). There may be tax consequences if a refund is paid outside of the 30 day period. As legislation is not automatically overriding, trustees of DC schemes should check whether rule amendments are needed in order to avoid making unauthorised payments.

Affected members should also be advised within three months of the change - i.e. before 1 January 2016.

Automatic re-enrolment

It has been three years since auto-enrolment first began for larger employers, who will now need to prepare for their cyclical automatic re-enrolment duties. Re-enrolment must happen within a six-month window (three months either side of the anniversary of the original staging date).

'Eligible jobholders' who have opted out or ceased active membership of the scheme less than 12 months before the re-enrolment date, who are serving their notice period, or who have protection from LTA tax charges, may be excluded from the re-enrolment exercise.

Once the re-enrolment exercise has been completed, the employer must declare compliance of their re-enrolment duties with TPR. For further information, see our [website](#).



Forthcoming events

Pensions Update Seminar

2 December 2015 – Glasgow

Our annual [Glasgow Pensions Update Seminar](#) and Christmas drinks will be held at the Corinthian Club this year. The evening will start with welcome drinks, followed by a short seminar covering an update on scheme funding and investment strategies, and developments in the DC market. Christmas drinks and festive bites will be provided swiftly afterwards.

Investment Conferences 2016

14 January 2016 – Birmingham* - NEW LOCATION

27 January 2016 – London

We are delighted to announce the dates of our [2016 Investment Conferences](#). The conferences will give delegates the opportunity to hear from industry experts and keep informed in an ever-evolving industry. It will be relevant to pension scheme trustees, employers and pension professionals.

These are full day conferences and are free to attend. Further information will be released soon.

* Please note the venue for our [Birmingham conference](#) will be The Belfry – a change from previous years.

WHAT ELSE IS ON? >



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- advice relating to DC pension schemes – trust, master trust and contract
- accounting for UK and international companies
- investment strategy reviews and advice on investment managers
- administration services including pensioner payroll, preparation of annual accounts, secretarial services and administration consultancy
- employer support regarding insurance arrangements (group life insurance and PHI), and education for senior executives regarding retirement options
- Analysis and modelling of mortality and longevity risk for insurance companies, reinsurance companies, investment banks and pension schemes.

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You may find the following Barnett Waddingham briefing notes and blog posts interesting:

Blogs

- [HMRC countdown bulletin 10: the letters and numbers you need to know](#)
- [VAT on pensions costs - part 3](#)
- [It's the final countdown... to the end of contracting out](#)
- [PPF Levy – have you thought of everything?](#)
- [The Workie in the room](#)
- [GMP rectification - the elephant in the eRoom](#)
- [All change in the bulk annuity market](#)
- [Easy, secure access to your pension scheme information online](#)

Briefings

- [Lessons learned from the 'market turmoil' of the third quarter](#)
- [Buy-outs and buy-ins - Autumn 2015](#)

This newsletter is intended as a summary of recent pensions-related events. Whilst we have taken care to ensure all information is correct at the time of going to press, the content of this newsletter should not be relied on as advice to act, or refrain from acting, in relation to any of the subjects contained herein. Before taking any such action (or deciding not to act) you must seek appropriate professional advice.

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

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