1. Changes to the cash equivalent transfer value legislation

As a result of the additional flexibilities given to members in the context of accessing their defined contribution (**DC**) pension savings from 6 April 2015 (which include the ability to take benefits as an annuity, full fund withdrawal or flexi-access drawdown), changes have been made to the existing cash equivalent transfer rules.

Currently, a member of an occupational scheme who wishes to transfer out must transfer all benefits under that scheme (subject to an exception for contracted-out benefits). A DC member who wishes to transfer to a personal pension must transfer any defined benefits as well.

However, from 6 April 2015, a member's statutory right to take a transfer is being extended to apply in respect of different categories of benefit. Members will have a separate statutory right to take a transfer-out in respect of (i) money purchase benefits (ii) so-called "flexible benefits" which are not money-purchase benefits (which would include cash-balance benefits) and (iii) other benefits which are not flexible benefits (e.g. salary-related benefits). The rights under (i) and (ii) would be extended up until normal pension age.

Key issues

1. Changes to the cash equivalent transfer value legislation
2. Update on holiday pay
3. VAT treatment and pension funds
4. Guidance guarantee
5. The FCA and the "second line of defence"
6. Abolition of contracting-out
7. European developments

Where a member has "safeguarded benefits" (i.e. benefits which are not money purchase or cash balance benefits), there will also be a new requirement to obtain independent financial advice before converting these to "flexible benefits" (i.e. money purchase or cash balance benefits) or taking a transfer of safeguarded benefits to a scheme in which the member will acquire flexible

benefits. This will therefore impact on defined benefit (**DB**) to DC transfers and internal DB to DC conversion. This requirement will not apply where the transfer value associated with a member's safeguarded benefits does not exceed £30,000.

Members with a DC fund will be entitled to receive guidance (free of charge) at the point of retirement about their benefit options (see item 4 below).

It is recommended that the terms of any key contracts currently in place with providers (for example, administrators/investment providers) are checked to see whether these may be impacted as a result of offering additional flexibilities. For example, the contract's charging structure may be based on a requirement that funds held with the provider are maintained at a certain level over the longer term.

2. Update on holiday pay

Last year we had two important cases regarding employees' contractual entitlements to overtime and commission and whether they should be included in the calculation of holiday pay which, in turn, could have an impact on pension contributions and benefits.

The extent to which the rulings will affect pension schemes will depend on whether overtime and commission payments are included within the definition of pensionable pay under the scheme rules.

Background

In the October 2014 edition of our Pensions Update we reported on a recent ruling by the Court of Justice of the European Union ("**CJEU**") on **Lock v British Gas Trading Ltd** which could lead to employers facing potentially substantial bills for miscalculated holiday pay. The CJEU ruled that contractually entitled commission needs to be included within the calculation of holiday pay but did not say how this should be done. The case was remitted the case back to the Employment Tribunal (scheduled to be heard in February 2015) to determine whether UK law, interpreted in the light of EU law, does this.

In **Bear Scotland Ltd v Fulton**, the Employment Appeals Tribunal (**EAT**) ruled that payments for overtime which a worker is required to work but which an employer is not required to offer (i.e. non-guaranteed overtime) constitute 'normal remuneration'. Accordingly, these overtime payments should be taken into account when calculating holiday pay for the purposes of the minimum four weeks' statutory annual leave required by EU law (the EU Working Time Directive). The ruling does not apply to the additional 1.6 weeks of holiday under regulation 13A of the Working Time Regulations.

With regard to time limits for backdated claims, the EAT held that any claim for backdated holiday pay is normally only valid if the 'unlawful deduction from wages' (i.e. where the holiday pay was paid at a lower rate than it should have been) was made in the past three months or was one of a series of deductions, the last of which occurred in the past three months (with no more than three months passing between each deduction in the series). In other words, the EAT effectively limited claims for back pay for underpaid holiday by saying that, where there has been a gap of three months or more between underpayments, the claim can only go as far back as that gap.

Although leave to appeal to the Court of Appeal was granted, Unite announced in November 2014 that it would not be appealing the ruling.

A taskforce was also set up by the Department for Business, Innovation & Skills to assess, as a matter of priority, the impact on business. The taskforce does not include any union or employee representatives.

Government action

On 18 December 2014, the government announced that it had taken action to limit the potential costs to employers and give certainty to workers on their rights following these recent court decisions on holiday pay. Changes have been made to regulations under the Employment Rights Act 1996 that will mean that claims to Employment Tribunals on this issue cannot stretch back further than 2 years.

Workers can still make claims under the existing arrangements for the next 6 months which will act as a transition period before the new rules come into force. The new rules apply to Employment Tribunal claims made on or after 1 July 2015.

Employers may want to consider whether, if they face such claims, it may impact on pension liabilities, for example, whether any additional payments due to workers are likely to take them above the earnings trigger for automatic enrolment purposes. Conversely, trustees may want to ask employers about the potential for such claims in case they need to factor it into funding decisions.

3. VAT treatment and pension funds

HMRC has issued Revenue & Customs Briefs 43 and 44, revising its position in respect of the circumstances in which supplies of pension fund management services qualify for VAT exemption.

Historically, HMRC has made a distinction between the day-to-day administration of occupational pension schemes and the investment management of their assets: only VAT incurred in connection with the former was deductible by employers, regardless of whether the pension fund or employer paid for the services or contracted with the service provider to the pension fund (VAT Notice 700/17:"Funded Pension Schemes"). This was on the basis that these costs were normal business activities of the employer and were therefore directly and immediately linked to such activities. VAT on the investment management of the pension fund were regarded as relating solely to the activities of the pension fund and could only be recovered if the pension fund was a taxable person and registered for VAT: the VAT charged on investment management could not therefore be deducted by the employer.

However, if a single invoice received by the trustees covered both administration and investment management, HMRC would allow an employer's claim that 30 per cent of the VAT related to administration whilst the remaining 70 per cent would be treated as investment management, and therefore not deductible by the employer (the so-called 70/30 split).

The Briefs have been issued in light of the recent decisions from the CJEU in **PPG Holdings BV4** ("**PPG**") and **ATP Pension Service A/S v Skatteministerietn** ("**ATP**").

CJEU cases

In **PPG** it was decided that VAT charged on management services (day to day management costs and investment management fees) provided to a DB scheme could be deducted by the sponsoring employer, provided there is a "direct and immediate link" between the services and the employer's economic activities as a whole.

In **ATP** the CJEU ruled that an occupational DC pension scheme can, if certain conditions are met, constitute a "special investment fund" ("**SIFs**") in accordance with the VAT Directive (77/388/EEC), which exempts from VAT "the management of special investment funds as defined by member states". Essentially, an occupational DC pension scheme may constitute a "special investment fund" if the scheme is funded by the members, the funds are invested using a risk-spreading principle and the member bears the investment risk. Ultimately, whether a fund fulfils these requirements is for the national courts to decide.

Revenue and Customs Brief 43 (2014)

This deals with the **PPG** case and covers the circumstances in which an employer may deduct VAT charged on services provided in relation to certain occupational pension schemes.

HMRC has confirmed that an employer may now recover input tax in relation to the management of its pension scheme if (i) it is a party to the contract (ii) the services in question are supplied to it and (iii) it has paid for them.

HMRC will require contemporaneous evidence that the services were supplied to the employer. If the employer pays for the supply of services and recharges them to the pension scheme trustees, it will be liable to pay VAT as the transaction is deemed to be onward taxable supply.

Employers and trustees may wish to revisit their investment agreements in light of this, although care needs to be taken to ensure that any changes do not conflict with previous law.

To give businesses time to adapt, HMRC will continue to allow employers to claim VAT deductions based on the 30/70 split assumption until 31 December 2015.

Revenue and Customs Brief 44 (2014)

This briefing concerns ATP and considers the circumstances in which VAT is not chargeable on services to DC funds. HMRC now accepts that such pension funds can be SIFs, so that the management and administration services supplied to them are (and should always have been) exempt from VAT.

According to Brief 44, pension funds are SIFs if:

- they are funded solely (whether directly or indirectly) by the persons to whom the retirement benefits are to be paid (i.e. the scheme members);
- the scheme members bear the investment risk;
- the fund contains the pooled

contributions of several members; and

- the risk borne by the members is spread over a range of securities.

Whether a typical UK DC fund actually meets these requirements remains to be seen.

4. Guidance guarantee

HM Treasury has announced that the guidance guarantee service due to start in April 2015 will be delivered by the Citizens Advice Bureau (**CAB**) and the Pensions Advisory Service (**TPAS**). CAB will provide face to face guidance and telephone guidance will be provided by the TPAS.

The Treasury will be able to give financial assistance (in the form of grants or loans) to these bodies for the purposes of providing the guidance. Although TPAS and CAB have been selected as "*designated guidance providers*", HM Treasury will have the power to designate additional bodies to provide pension guidance subject to consulting with the Financial Conduct Authority (**FCA**). HM Treasury may also revoke a guidance provider's designation.

It will be a criminal offence for anyone who is not a designated guidance provider to falsely claim to be giving pensions guidance. It will be a defence if the accused shows that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.

An online service will also be designed by the Government as part of the guarantee service offered.

In addition to setting standards for the giving of pensions guidance by designated guidance providers, the FCA must monitor compliance with these standards and draft general rules that will require information about the availability of the guidance guarantee to be given by the trustees or managers of a relevant scheme to members with a right or entitlement to cash balance benefits or other money purchase benefits.

5. The FCA and the "second line of defence"

The FCA announced on 26 January 2015 its plans for “additional protection” for those accessing their DC pension savings from April 2015.

Under the new rules, pension providers will be required to ask consumers about certain key aspects of their circumstances relating to the decision they are making (such as health and lifestyle choices or marital status), and to give relevant "risk warnings" in response to the answers they receive. They will also be expected to highlight that the Pension Wise service or regulated advice, is a key part of protecting members and their families when making an important and irreversible decision.

The aim is to bring the rules into force on a temporary basis without consultation to provide timely additional protection. The FCA hopes to carry out subsequently the consultation required in order to determine whether to incorporate these rules as part of the review of all regulatory requirements around the customer’s interaction with providers in the run up to retirement, scheduled for the first half of this year.

The Government has also confirmed that the DWP is working with the Pensions Regulator to consider how this so-called “second line of defence” can be extended to trust-based schemes. Further information is expected regarding how this requirement would work in practice, for example, what questions trustees would be expected to ask, and if they will also be required to give "risk warnings". It is understood that the intention is to introduce this requirement for trust-based schemes at the same time as that relating to contract-based schemes.

6. Abolition of contracting-out

The DWP has issued updates on the draft regulations published in May 2014 regarding the abolition of DB contracting-out in April 2016.

Statutory override

The draft Occupational Pension Schemes (Power to amend schemes to reflect abolition of contracting-out) Regulations 2014 contained the "statutory override" power to allow employers to amend scheme rules, without trustee consent, to reduce scheme costs in order to offset the increase in NICs when contracting-out ends.

The DWP has confirmed that the final version of these regulations will be published "shortly" so that they can come into force before the end of this Parliament on 30 March 2015.

We remain of the view that many employers will want to seek trustee consent to changes to avoid some of the complexities associated with the statutory power.

Position after abolition

The draft Occupational Pension Schemes (Schemes that were contracted-out) Regulations 2014 set out the rules with which schemes will

need to comply following abolition. The DWP has confirmed that the final form of these regulations will not be published until after the general election on 7 May 2015 owing to the volume of pension changes currently underway.

7. European developments

IORP II

Last year, the European Commission published its proposal for a revised version of the IORP Directive (2003/41/EC) (known as '**IORP II**'). IORP II will require EU member states to implement minimum governance standards for pension schemes in their territories, including a 'fit and proper' test for those responsible for running an IORP (i.e. trustees).

The 'fit and proper' test requires that (i) the trustees' professional qualifications, knowledge and experience are adequate to enable them to manage the IORP soundly and prudently and to perform their key functions; and (ii) that they are of good repute and integrity.

While existing UK legislation appears to be largely compliant with the new provisions of IORP II in many respects, the modified 'fit and proper' requirements may be a cause of concern as there is some doubt as to whether non-professional trustees (such as lay 'member- nominated' trustees) in the UK would fulfil these requirements. Guidance is likely to be required from the DWP/Pensions Regulator on this and there is some suggestion that the Regulator's 'Trustee Toolkit' could form a suitable professional qualification.

EMIR

The EU regulation on OTC derivatives, central counterparties and trade repositories (*Regulation 648/2012*) provides a temporary exemption from the clearing obligation for certain contracts entered into by pension scheme arrangements (an obligation which applies directly to pension scheme trustees). The exemption is due to expire in August 2015. It is worth nothing that certain other requirements of the Directive are not covered by the exemption and are already in force.

On 3 February 2015, the EC published a report to the European Parliament and the EU Council in which the Commission recommended granting pension scheme arrangements a further two-year exemption from central clearing requirements. The exemption does not, however, apply to all derivatives, nor to all EMIR-related obligations.

The EC will continue to monitor this to assess whether the exemption should be extended by a further year.

EIOPA

The European Insurance and Occupational Pension Authority (**EIOPA**) has published[1] a Consultation Paper on portability of pension rights. It is possible that this may lead to a revival of the EU's proposed Directive on portability. This could be concerning, as previous proposals for such a Directive have been poorly drafted, and could impose onerous requirements on employers and schemes.

Data Protection

It is possible that a new Data Protection Directive could be agreed this year. It currently appears that the new requirements may be unrealistically burdensome, imposing a requirement for explicit member consent to process data, as well as requiring schemes to have a data protection officer.

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