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Briefing note December 2015

1. Deadline for passing section 251 resolutions fast approaching

Section 251 of the Pensions Act 2004 provides that if, prior to 6 April 2006, a scheme's rules contain a power for the trustees to pay a refund of surplus to an employer, then unless the trustees pass a resolution to keep this power, it will fall away. The deadline for passing a resolution was originally 5 April 2011, but this was later extended to **5 April 2016**, although at least three months' notice must be given to members and scheme employers before this, meaning that schemes looking to take action will need to do so now.

When section 251 was first introduced, there was a question mark as to whether it only applied to ongoing surplus powers or also to powers to repay surplus on wind-up. Although apparent from commentary at the time that the intention was for section 251 to apply only to ongoing powers, schemes were generally advised to cover wind-up powers in their resolutions too "just in case".

The legislation, was, however, subsequently amended and it is now clear that it is not necessary to pass a resolution to retain a refund of surplus power on wind-up.

Employers will therefore only be concerned with this where they have an ongoing refund of surplus power which they wish to preserve. (Although, in practice, given the difficulties of repaying surplus where a scheme is ongoing, many employers may consider such a power to have little value).

Where an employer is keen to preserve its ongoing power, the deadline for the trustees to pass a section 251 resolution (if they consider it appropriate) is **5 April 2016**. However, members and scheme employers must be given at least three months' written notice before the resolution is passed – this means that the **latest date on which the notices can be given is 5 January 2016.**

2. Proposed changes to Financial Services Compensation Scheme (FSCS) Rules

The current FSCS rules provide that, while trustees of all occupational schemes (regardless of employer size) are eligible to make FSCS claims where the claim relates to long term insurance contract claims (e.g. annuities), for most other matters only trustees of occupational pension schemes where the employer is a **small company** are generally eligible to claim. This distinction seems

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arbitrary to many as the size of an employer is irrelevant in the case of money purchase benefits, given that the employer is not guaranteeing anything.

The Financial Conduct Authority has recently issued a consultation paper, which proposes to make a number of changes to the COMP Sourcebook (the rules relating to investment products). A key change being proposed (and which will no doubt be welcomed by the pensions industry) is the proposal to extend eligibility to the trustees of money purchase occupational pension schemes with large employers so that members of these schemes are entitled to the same protection from the FSCS as members of schemes with small employers (i.e. addressing the point above). The consultation ends on 29 February 2016 and it will be interesting to see whether this amendment is implemented.

3. Pensions Regulator publishes guidance on "integrating risk management"

Last week, the Pensions Regulator published new guidance for defined benefit (**DB**) scheme trustees on integrated risk management (**IRM**). This is the latest in a series of guides designed to help trustees apply the Code of Practice on DB funding.

IRM is intended to help trustees assess, prioritise and manage the three fundamental risks of (i) employer covenant; (ii) investment; and (iii) funding. The guidance includes lists of key principles / questions for consideration, together with several practical examples and an appendix setting out different potential risk assessment approaches to assist trustees in establishing an IRM framework.

The Regulator is clear the guidance should not be considered prescriptive – instead, it is designed to provide practical help on what a proportionate and integrated approach to risk management might look like. The Regulator says it believes that trustees of smaller schemes may find it of particular help.

The guidance sets out five key areas that trustees and employers should focus on:

1. **Initial considerations for putting an IRM framework in place**: there is no set formula for what IRM should look like and the guidance is clear that it should be proportionate to the scheme and employer's circumstances and needs. There is also a clear focus on the trustees and employer working together.
2. **Risk identification and the initial risk assessment**: this requires key risks to be considered both individually and together to see whether there are any causal links and/or interdependencies.
3. **Risk management and contingency plans**: consideration should be given to what steps can or should be taken to manage the risks identified. The guidance notes that IRM should not only take into account the impact and consequence of downside risks, but also enable stakeholders in the business to share in its success and upside opportunities.
4. **Documenting decisions**: this should not involve spending disproportionate time and resources. There is merit in using existing documents as much as possible (e.g. monitoring and contingency plans might be contained within a scheme's recovery plan).
5. **Risk monitoring**: the guidance is clear that if risk assessment is treated as a triennial, valuation-related task, this will limit the benefits of IRM. Frequency of monitoring depends on the materiality of risks and scheme resources, but the guidance urges trustees to consider conducting high level monitoring at least once a year, as a minimum.

4. The end of contracting-out: potential issue for without-consent transfers after 5 April 2016

The Government recently released another consultation in relation to the abolition of contracting-out in the form of the draft Pensions Act 2014 (*Abolition of Contracting-out for Salary Related Pension Schemes*) (*Consequential Amendments*) Order 2016.

Although most of the changes proposed by the draft Order are minor, tidy-up changes, there is a point which could cause issues for without-consent transfers of contracted-out rights after 5 April 2016. If implemented as currently drafted, the legislation means that it would not be possible use a new scheme created after April 2016 to accept a without-consent bulk transfer involving contracted-out rights because the receiving scheme must have been a contracted-out scheme itself at some point (and this will not be possible from 6 April 2016).

We suspect this may have been a mistake in the draft legislation (but it is possible it is intentional and a

reflection of the Government's policy intent). This concern has been expressed to the DWP (as it would have a wide-reaching impact if such a change were intended) and it is expected that we will have some clarity on this issue early next year, when the consultation response is published.

5. Time running out to register for HMRC's Scheme Reconciliation Service (SRS)

In light of the end of contracting-out, schemes are being urged to begin the process of reconciling their Guaranteed Minimum Pension (**GMP**) records with HMRC.

What does GMP reconciliation involve?

HMRC maintains a record of GMPs held under each scheme. It uses this to work out the contracted-out deduction from the additional state pension. The SRS involves importing HMRC's information onto a scheme's own administration system to check how the records compare. Queries are then raised with HMRC regarding any discrepancies, followed by correction of scheme data and, in certain cases, HMRC's records.

What's the deadline?

Schemes must register to use the SRS – they must send an "expression of interest" **before 5 April 2016**, otherwise they will not be able to use the service.

HMRC will continue to deal with queries under the SRS until December 2018, but will stop accepting queries in October 2018 to give enough time to resolve all outstanding queries.

How is HMRC going to help?

According to HMRC countdown bulletin 10, from 30 September 2015, a designated Customer Relations Team was established, which is designed to support scheme administrators with their registrations of "expressions of interest". They will also be contacting those scheme administrators yet to register for SRS.

What are the consequences of not reconciling?

We would expect trustees will want to undertake GMP reconciliation to ensure the correct benefits are being paid out. This is also likely to be preferable from an employer perspective because, although from 6 April 2016, HMRC will no longer track contracted-out rights, from December 2018, HMRC is planning to send individuals information about their contracting-out history, including details of their GMP entitlement.

If a scheme has not reconciled its data with HMRC, it will therefore open itself up to member queries and complaints from members who find their statement from HMRC does not match up with the scheme's data. The Pensions Ombudsman is unlikely to be sympathetic if a scheme did not even attempt to reconcile its data with HMRC.

6. High Court gives judgment in construction case

The High Court gave judgment earlier this month in a case relating to a Part 8 application by ***BCA Pension Trustees Limited*** under section 48 of the Administration of Justice Act 1985.

Section 48 provides that where a question of construction has arisen out of the terms of a trust and a written opinion by someone with a 10 year High Court qualification has been obtained by the trustees, the High Court may make an order authorising the trustees to rely on that opinion.

In this case, the trustees had obtained a QC's opinion on the correct interpretation of the scheme's pension increase rule. The rule provided for different increases to apply to different periods of service. However, as part of a consolidation exercise, the wording which identified which part of service each rate applied to had been deleted. The QC's opinion was that the wording in the consolidated rules now made no sense and the old wording should be reinstated.

The Judge agreed it was self-evident there had been a mistake both on the face of the rules and in light of the background and context and the trustee's application was granted. The Judge had originally proposed to make the order conditional upon the trustee giving notice to members and allowing members two months to apply for the order to be set aside. However, having considered the trustee's objections to this (namely that doing so would effectively encourage members to object), the Judge agreed that members should instead be notified of the order as part of the next routine member communication.

This is an interesting case as it indicates that where a mistake is not in dispute, there may well be value in pursuing a Part 8 claim under Section 48 rather than pursuing formal rectification proceedings, noting that a Section 48 order can, in principle, be dealt with by way of a paper hearing – suggesting that this may be a quicker, simpler and more cost-efficient route.

7. Chancellor delivers Autumn Statement

The Chancellor's Autumn Statement was delivered at the end of last month. No major pensions-related developments were announced, but key points include:

- Confirmation that the next two phases of auto-enrolment contribution rate increases will be aligned with the tax years (the increases scheduled for October 2017 and 2018 are being postponed to April 2018 and 2019 respectively).
- The full rate for the new single-tier State Pension (which will be introduced in April 2016) will be set at £155.65 a week.
- The Government will legislate to ensure a charge to inheritance tax will not arise when an individual designates funds for drawdown but does not draw all of the funds before death. This will be backdated to apply to deaths on or after 6 April 2011.
- Legislation will be introduced to simplify the test that takes place when a dependant's scheme pension is payable.
- Concerns about the growth of salary sacrifice arrangements were reiterated and the Government confirmed that it is considering what action, if any, is necessary.
- Confirmation that the Government will publish its response to the consultation on pensions tax relief reform at the March 2016 Budget.

8. Draft Defined Contribution (DC) Code of Practice published for consultation

The Pensions Regulator has published a new draft DC Code of Practice for consultation. The consultation will run until 29 January 2016 and it is expected that the new Code will come into force in July 2016.

The first point to flag is that the draft Code is shorter than the existing Code and references to the previous "quality features" have been removed, on the grounds that they "are now well established and should be business as usual for trustees". Although shorter than the existing Code, the new Code will be supported by a number of guides providing practical guidance, so there is more information yet to come. (The Regulator intends to consult on these guides separately in spring 2016).

As well as simplifying the content in the existing Code, the new Code includes guidance on a range of new issues including guidance relating to the governance and charges requirements and the DC flexibilities.

In terms of key messages, there is a clear focus on trustees being expected to treat maximum statutory timescales for certain tasks and transactions (e.g. appointing a trustee chair) as an absolute maximum – not equivalent to "prompt" and instead, matters should be progressed as quickly as possible. The Code also focuses on trustee knowledge and understanding; stating that it is "vital" trustee boards possess and are able to demonstrate the right level of knowledge and understanding in relation to their scheme. This aligns with what the Regulator has said recently about trustee competence coming under closer scrutiny in the future – with the Regulator's vision of the "21st century trustee" to be communicated next year.

The Regulator says it recognises that different approaches may be appropriate for different schemes and so the Code is not prescriptive about all the specific actions trustees should take to meet their duties. Trustees will often need to make judgment calls as to what is a reasonable and proportionate method of ensuring compliance.

9. HMRC extends deadline for new treatment of VAT recovery

As covered in our April 2015 briefing note entitled "*VAT and Pension Fund Management – the new guidance*" (accessible by clicking on the above link), in March of this year, HMRC published updated guidance relating to the deduction of VAT on DB pension fund management costs.

The basic premise of the guidance is that an employer can only recover VAT on scheme administration or investment management costs where there is evidence that the relevant services are provided to the employer and, in particular, there is a tripartite agreement between the supplier, the employer and the trustees. The deadline for putting in place these agreements was originally 31 December 2015.

Given the difficulties this approach is likely to cause in practice, the Association of Pension Lawyers (**APL**) wrote to HMRC over the summer to suggest an alternative route (which would involve schemes making a simple rule amendment). It is understood that HMRC has since rejected this suggestion.

HMRC has, however, recently published Brief 17/15, which

confirmed a 12 month extension to the transitional period (meaning that the existing VAT treatment may continue to be applied until 31 December 2016 provided the employer and scheme trustees agree the same treatment). The Brief also says that some alternative options are being considered by HMRC. Namely: (i) a supply of scheme administration services by the trustees to the employer (essentially a back-to-back supply of services); or (ii) bringing the trustee within the employer's VAT group. However, neither of these alternatives is free from potential issues, particularly regarding corporation tax and the application to investment services fees.

HMRC has confirmed that it's still considering representations which have been made recently and that further guidance will be published later this year. In the meantime, given the extended deadline, employers and schemes have some breathing space to consider the best approach for them – and it may be that other, more viable alternatives will become available before December next year (or, at the least, it is hoped that the issues identified with the current options will have been ironed out by then).

10. European Court decision on data protection could impact pension schemes and employers

The EU Data Protection Directive only permits transfers of personal data from the EU to countries outside of the EEA if the data is given "adequate protection" in the receiving country. The safe harbor regime is the way the US complies with this.

In October 2015, the European Courts ruled in the case ***of Maximillian Schrems v Data Protection Commissioner*** that the safe harbor regime is invalid with immediate effect and so can no longer be relied on for data transfers to the US.

The impact of this decision is likely to be widespread, although perhaps felt most significantly by organisations in the IT sector. However, in a pensions context, this could affect both:

(i) schemes / employers based in the EU which transfer data to the US (e.g. schemes which exchange member data with a US parent company, schemes which transfer member data to a US scheme on a cross-border transfer, or where the administration of the scheme is managed from a US-based company); and

(ii) schemes based in the EU which contract with third-party administrators who hold scheme data in the US.

Those who may be affected should check whether they are currently relying on the safe harbor regime in making data transfers to the US. If so, a replacement system of "adequate protection" will need to be put in place. Contracts with third-party administrators should also be checked.

In terms of what would constitute replacement "adequate protection", it is likely that this will take some form of data-transfer agreement, which incorporates standard contractual terms based on EU model clauses. It is understood that these contracts are generally relatively easy to implement (although regulatory filing or approval is required in certain member states). If in doubt, legal advice should be sought as there is potential to face significant fines for failure to comply.

For more detail on the background to this issue and future developments, please see the Firm's briefing papers accessible at the following links:

http://www.cliffordchance.com/briefings/2015/10/safe_harbor_declaredinvalidwhatitmeansfo.html

http://www.cliffordchance.com/briefings/2015/10/safe_harbor_declaredinvalidthefall-out.html

11. DWP consults on amendments to secondary legislation in light of DC flexibilities

DWP is consulting on proposed amendments to ensure the DC flexibilities introduced in April 2015 operate as intended. The proposed amendments are set out in three sets of draft regulations.

The consultation closes on 15 January 2016 and DWP expects the changes to come into force on 6 April 2016. Points of significance include the following:

- **Pension Sharing**: extending the independent advice requirement so that it also applies to rights acquired as a result of pension sharing.
- **Ear-marking Orders**: imposing new requirements on schemes to notify a member's former spouse where the member has flexible benefits which are subject to an ear-marking order and the member makes an application to access those benefits in a different way to that envisaged by the order. This is designed to give the spouse advance warning so they can return to court and have the order varied before the member takes their benefits. (It is

difficult to see how this would work in practice and the current proposal is likely to throw up a number of administrative difficulties. For example: (i) Will the spouse have the wherewithal/money to return to Court? (ii) Where trustees notify the former spouse, how long are they expected to/permitted to wait before proceeding with the member's request? However, DWP has asked for views on the suggested approach and it is likely there will be some clarity on this when the consultation response is published).

- **Pension Protection Fund (PPF) entry**: changes to the PPF entry requirements, which will have the effect of expanding the 'alternative route' into the PPF so as to avoid another **Olympic Airlines** situation.
- **Retirement risk warnings**: putting on a statutory footing the Pensions Regulator's current recommendation to provide generic risk warnings to members looking to access their flexible benefits.

At the same time, DWP is seeking views on whether changes are needed to the way in which benefits with guaranteed annuity rates are valued for the purposes of the independent advice requirement.

12. DWP consults on banning member-borne commission

DWP has published a consultation paper proposing a ban on member-borne commission payments. The consultation is a follow-on from the Government's announcement in March 2014 that it would introduce measures to protect members who have been automatically enrolled.

This consultation focuses on how best to ban member-borne commission payments in certain schemes – broadly, occupational schemes which provide money purchase benefits and which are being used as qualifying schemes for auto-enrolment. It seems that the ban will apply to all money purchase arrangements within these schemes, including AVCs (even where these are the only money purchase benefits in a scheme).

The purpose of the ban is to prevent member-borne charges being used to pay for any advice or service the employer obtains from an adviser and the paper is clear that the ban is not intended to prevent member-borne charges in respect of advice or services the trustee obtains "***which the trustee needs or is required under law to obtain to run the scheme effectively***". The ban would protect both current employees and former employees who made a contribution to the scheme before the ban came into effect.

The consultation focuses on whether the duty to ensure compliance should be imposed on the trustees or the service provider (or potentially, both).

The consultation closed on 27 November 2015. A response is yet to be published, but, according to the paper, DWP is proposing a phased implementation of the ban as follows:

(i) the ban will apply to **new** commission arrangements from **6 April 2016**; and

(ii) DWP plans to consult on draft regulations to implement a ban on **existing** commission arrangements (i.e. those entered into before 6 April 2016) **later in 2016**.

13. Court of Appeal hands down judgment in same sex survivor benefits case

The Court of Appeal has handed down its judgment in the case of ***Walker v Innospec***; dismissing the appeal of Mr Walker that his civil partner should be entitled to a survivor's pension on his death in respect of service built up before 5 December 2005.

A European Directive prohibits differences of treatment because of sexual orientation in occupational pension schemes, but UK legislation provides an exception to this, providing that same sex partners (both civil partners and same sex spouses) must be provided with survivor benefits in the same way as opposite sex spouses but only for benefits which relate to pensionable service completed on or after 5 December 2005 (and for contracted-out benefits from 6 April 1988).

The Court of Appeal dismissed Mr Walker's case on the basis of the "no retroactivity" principle which means that conduct which was lawful when it occurred cannot retroactively become unlawful. Mr Walker retired before the European Directive came into force. UK legislation contains an exception which allows schemes not to pay survivor pensions in respect of service before 5 December 2005 and this is expressly designed to preclude a claim such as Mr Walker's from being made. To interpret this to allow his claim would be to make new law which is a question of policy and one for Parliament to decide – not the courts.

The decision is perhaps not surprising given the wide-reaching financial implications if Mr Walker had succeeded. For now therefore, the Court of Appeal's decision maintains the status quo (i.e. that the temporal restriction under UK legislation remains valid). However, it is worth

being aware of the following limitations to this:

- Mr Walker had accrued all of his service and retired before December 2005. The judgment therefore does not specifically deal with the issue of a member who was still in service and continued in service post December 2005. It is possible that a different decision could be reached on these facts.
- It is possible the case could be appealed further to the Supreme Court.
- There have also been murmurs that the European courts are moving in a direction which could end up concluding that the UK's temporal restriction is not valid.

14. PPF consultation on 2016/17 levy

At the end of September, the PPF published its draft levy rules and guidance for 2016/17. The consultation closed on 22 October and it is expected that the PPF will publish its conclusions and final form documents by the end of this year.

No major changes are being made to the PPF levy rules for 2016/17 due to the PPF's aim to provide stability over each triennium, although the following points came out of the consultation:

- **Last man standing schemes** – a number of schemes which previously benefited from the last man standing deduction have turned out not to be last man standing schemes after all. The PPF is planning to contact these schemes and, where appropriate, re-invoice them for previous years (although it's not clear how far the PPF plans to look back).
- **Asset backed contributions** – the PPF plans to introduce a simplified process for recertifying existing asset backed contribution arrangements which were certified last year.
- **FRS102** – the PPF is seeking views on the impact of the move to FRS102 on employer's accounts, which could have a potentially detrimental impact on insolvency risk scoring.
- **Deadlines** – minor changes are being made to deadlines, with the deadline for the submission of scheme data being moved from 5pm to midnight on 31 March. (Although this will not apply to the certification of deficit reduction certificates and block transfers – for these, the submission time will remain at 5pm on 30 April 2016 and 30 June 2016 respectively).

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