CLIFFORD CHANCE

Briefing note

November 2016

UK PENSIONS UPDATE

Welcome to the November 2016 edition of the UK: Pensions Update.

In this edition we focus on a number of Regulator issues; including progress on the Select Committee's inquiry into defined benefit scheme regulation and the Pensions Regulator's enforcement action in connection with BHS; the PPF's 2017/18 levy consultation and an update on the PPF long service compensation cap. In this edition we also cover: (i) a number of key legislative and policy developments; (ii) recent case law; (iii) key Ombudsman determinations on a number of issues; (iv) tax-related developments; and (v) relevant developments in the investments / insurance sphere.

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Regulator issues

1. Work and Pensions Select Committee inquiry gathers momentum

The Work and Pensions Select Committee recently published a new tranche of evidence in its inquiry into defined benefit pension scheme regulation (see our August edition of UK: Pensions update for more information about the background to the Committee's inquiry).

The new evidence includes proposals from the Pension Protection Fund calling for "more interventionist" regulation of scheme funding and evidence from the Pensions Regulator calling for tighter regulation; including a mandatory clearance process for certain corporate transactions and the power to demand more regular scheme valuations where it has concerns.

The Committee's Chair said that the Committee would be considering these proposals in detail. There have been murmurs that the Committee's inquiry could lead to a reform / strengthening of the powers given to the Pensions Regulator (and/or the Pension Protection Fund) at some stage in the future, but for now, it is very much a case of 'wait and see'.

2. Regulator launches enforcement action in connection with BHS

On 2 November, the Pensions Regulator confirmed that it has formally begun enforcement action to seek redress on behalf of the BHS pension schemes.

According to a statement by the Regulator, it has sent Warning Notices to Sir Philip Green, two of his Taveta investment companies, Dominic Chappell and his consortium Retail Acquisitions Limited, setting out the Regulator's case for the use of its Contribution Notice and Financial Support Direction powers.

The Regulator's statement indicates that the Regulator would still be open to reaching a settlement with the parties, but that the issue of its Warning Notices reflected the outcome of its investigations and the fact that it had yet to receive a sufficiently credible and comprehensive offer in respect of the BHS schemes.

It will be interesting to see where the Regulator's investigation ends up. The Regulator has exercised its Contribution Notice and Financial Support Direction powers few times since these powers were introduced over a decade ago (although there are likely to have been many cases where settlement has been reached prior to a formal exercise of the Regulator's powers – for example, see item 3 below).

3. Regulator's threat of enforcement action leads to settlement

Last month, the Pensions Regulator published a report setting out its involvement with the Database Group and how threatening the use of its powers acted as a deterrent to ensure pension scheme members received their full benefits, following a sale of the scheme's sponsoring employer.

The Group had a closed defined benefit pension scheme with an estimated buy-out deficit of c£7.7 million.

In 2015, a proposal was made for the sale of the Database Group. A clearance application was made to the Regulator, proposing a restructuring of the Group to allow a sale free from the scheme – with the scheme to run on as a closed scheme and benefit from a c£1.7m cash injection, but without any trading covenant to support it going forwards.

In its report, the Regulator says it did not consider the initial proposal to represent a fair return for the scheme in the circumstances and so an anti-avoidance investigation was launched. Having explored a number of options with the parties, the Regulator concluded that the only sum that would adequately mitigate the detriment caused by the sale would be an amount sufficient to secure members' benefits in full. Following lengthy discussions, this was the agreed conclusion and members' benefits were bought out in full with an insurer.

The Regulator says this case demonstrates that it will consider using its anti-avoidance powers in respect of smaller schemes where appropriate.

4. PPF Levy consultation 2017/18

At the end of September, the Pension Protection Fund (**PPF**) published its draft levy determination for 2017/18, together with associated guidance, for consultation.

In line with the PPF's goal to keep the levy rules stable over each triennium[1], only limited, technical changes are being proposed and the levy rules remain substantially the same as for 2016/17.

One of the changes which is being made is an adjustment for accounts filed under FRS102 for the first time (used mainly by unlisted companies). The proposal is to allow levy-payers to notify Experian where they consider the switch to FRS102 would cause an artificial movement in their insolvency risk score so this can be taken into account. The PPF is also making some changes regarding the treatment of parent companies which file small companies accounts.

The PPF also makes some comments in the consultation document about its approach to levy charging where a scheme ceases to have a substantive sponsoring employer following a restructuring. The PPF says its position is as explained in its response to the British Steel consultation and that where a scheme's sponsoring employer is a shell company rather than a genuine business, the standard methodology for calculating the levy is not appropriate. This is because the risk of a claim being made on the PPF cannot be measured by considering the

[1] This year being the third year of the current triennium.

financial position of the shell, but is dependent more on the deterioration of the scheme's funding position over time to a point where it can no longer run on. As a result, the risk-based levy should be based on (i) the level of scheme underfunding which would trigger PPF entry; and (ii) the likelihood of that level of underfunding being reached. The PPF says that the immediate need for detailed rules on this is not yet clear and so for now, it is simply reiterating a commitment to ensuring the levy is calculated appropriately for such schemes. However, if necessary, the PPF will bring forward specific proposals for separate consultation.

The consultation closed on 31 October 2016 and the final levy rules are expected in December.

5. PPF long service compensation cap expected to come into force April 2017

A written ministerial statement published on 15 September confirmed that the PPF long service compensation cap is expected to come into force from 6 April 2017.

At the same time, a consultation on draft regulations designed to ensure the cap "will operate as intended in all circumstances" was launched. The consultation recently closed and is currently awaiting response.

Key points

- The main provisions regarding the new cap have been finalised for some time now and are contained in the Pensions Act 2014 (which amends the Pensions Act 2004) but are not yet in force. They provide that anyone with pensionable service over 20 years will get a 3% uplift in their PPF compensation cap for each full year of service above 20 years, up to a maximum of double the standard cap.
- The consultation which recently closed relates to changes to secondary legislation only and is not proposing amendments to the Pensions Act 2014 provisions, substance of the long service cap, nor when and how this is to be brought into force.
- The Government is also intending to introduce an equivalent long service cap for the Financial Assistance Scheme[2] from April 2018.

Legislative and policy developments

6. Pension Schemes Bill 2016/17

The draft Pension Schemes Bill 2016/17 was recently published and introduces a new regime for the regulation of master trusts.

Specifically, the Bill imposes a prohibition on operating a master trust scheme unless the scheme is authorised. (This will apply to both new master trusts and existing master trusts).

To be authorised, trustees will need to apply to the Pensions Regulator. The Regulator will then decide whether it is satisfied that the scheme meets the 'authorisation criteria'.

The authorisation criteria

- **The persons involved in the scheme are fit and proper persons**. This covers people carrying out a wide range of roles including the person who establishes the scheme, the trustee, a 'scheme funder' (see below) and a 'scheme strategist' (anyone responsible for making business decisions relating to the commercial activities of the scheme). Details of what constitutes 'fit and proper' are to be specified in regulations.
- **The scheme is financially sustainable**. This requires the Regulator to be satisfied that the business strategy is sound and the scheme has sufficient resources to meet the costs of setting up and running the scheme and complying with any duties in connection with a 'triggering event' – see below.

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[2] This helps eligible schemes that were affected before the PPF was established.

- **The 'scheme funder'[3] meets specified requirements**. Specifically, the scheme funder must be constituted as a separate legal entity and the only activities it carries out must directly relate to the master trust scheme.
- **The systems and processes used in running the scheme are sufficient to ensure that it is run effectively**.
- **The scheme has an adequate continuity strategy**.

The Bill specifies a number of triggering events (including withdrawal of authorisation; an insolvency event occurring in relation to a scheme funder and the master trust being wound up) which require action to be taken to the resolve the event or transfer benefits to a compliant scheme.

The Regulator will be required to maintain and publish a list of authorised master trust schemes.

One important point to flag is that the definition of "Master Trust scheme" in the current version of the Bill is widely drafted and goes further than what might typically be thought of as a master trust. For example, as drafted, it would also appear to catch multi-employer schemes with non-associated employers (to the extent they provide money purchase benefits). In addition, the Bill introduces a number of requirements with backdated effect to 20 October 2016; a number of which seem unworkable in practice. It is hoped that these issues will be ironed out as the Bill progresses.

It should also be noted that much of the detail backing the Bill is to be set out in regulations which are yet to be published. For example, details around the authorisation process and the 'fit and proper' test and details of the other authorisation criteria.

7. Draft Bill and regulations on new 'LISA' published

In March's Budget the Government announced it would be introducing a new Lifetime ISA (**LISA**) from April 2017.

Designed as a new form of long-term saving, the LISA is aimed at individuals aged between 18 and 40 with the aim of incentivising saving for retirement and/or the purchase of a first home.

Drafts of the legislation necessary to introduce the new LISA have recently been published; with the draft *Savings (Government Contributions) Bill 2016* published in September and draft regulations[4] published for consultation last month.

What the Bill says

- When a 'qualifying addition' is made to a LISA within the 'relevant period', HMRC will pay a Government bonus.
- Specified withdrawals from a LISA will not trigger a tax charge, including withdrawals made: (i) once an investor has reached a specified age; (ii) for the purposes of a 'first-time residential purchase'; (iii) when the investor is suffering from a terminal illness; (iv) after the investor's death; (v) by way of transfer to another LISA.
- Any other withdrawals will trigger a tax-charge payable to HMRC.
- Penalties will apply for material inaccuracies in bonus claims that are either careless or deliberate, or where the claimant knew about an inaccuracy but did not inform HMRC.

What the Regulations say

- The draft regulations recently published for consultation cover further details of how the LISA will work. In particular:

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[3] It is not clear, but this seems to be intended to refer to the master trust provider.
[4] *The Individual Savings Account (Amendment No. XX) Regulations 2017.*

- Eligibility conditions for opening and paying into a LISA (subject to specified exceptions, an account can only be opened by an eligible individual aged between 18 and 40 years old and contributions can only be made up to age 50);
- The amount and type of payments which can be made to a LISA (a maximum of £4,000 can be paid in each year);
- What type of investments can be held in an LISA (investments which currently qualify to be held in a cash or stocks and shares ISA);
- Details of how the Government bonus will work (to be paid at a rate of 25% on contributions made to the LISA in each tax year);
- Circumstances in which sums can be withdrawn without a charge (on reaching age 60, on buying a first home (subject to certain conditions), transferring savings to another LISA or becoming terminally ill);
- The imposition of a 25% tax charge on all other withdrawals.
- An increase in the overall ISA subscription limit from £15,240 to £20,000.

What's next?

Timing wise, the Bill needs to progress through Parliament and the regulations governing the detail of the LISA also need to be finalised.

The legislation is expected to be finalised in time for the LISA to be available to consumers from April 2017. It remains to be seen whether providers will have time to get ready for this – at this stage, a number of potential providers have indicated that they do not intend to offer the LISA.

8. New £500 pensions advice allowance

At the end of the Summer, HM Treasury launched a consultation seeking views on a new "pensions advice allowance", which will come into force from April 2017 and allow people nearing retirement to take up to £500 out of their pensions tax-free for funding financial advice. This will be introduced alongside a proposed increase in the tax exemption for employer-arranged financial advice to £500 (allowing savers up to £1,000 of tax-free advice).

The details are yet to be finalised, but the key principles include that:

- The allowance would enable people to take £500 tax-free from their defined contribution (**DC**) fund to redeem against the cost of financial advice on retirement options. It would apply only to advice and not to guidance.
- The advice itself does not have to relate only to the pension from which the allowance is taken – it can be 'holistic advice' across a saver's entire retirement provision. This means that while the allowance can only be taken from a DC fund, it can be used to provide advice which also covers any defined benefit retirement savings.
- It is unclear (and HM Treasury is asking for views on) how the allowance would work for a DC product which provides some form of guarantee as this raises difficulties around what an appropriate reduction to the benefits would be in exchange for the £500 allowance.
- To be an authorised payment, the funds would need to be paid directly from the scheme to the financial advisor.
- The allowance would be made available before age 55, but views are being sought on what would be an appropriate age specifically.
- The allowance would be limited to £500 per use, but the government is considering allowing multiple uses (up to three times per person).

- Offering the allowance would not be mandatory for providers / schemes and so members would not have a statutory right to it. Schemes would need to consider whether offering the allowance is possible under the terms of their rules – rule amendments could be required.

The consultation closed last month and a response is currently awaited.

9. "Pensions dashboard" prototype to be developed by Spring 2017

The Treasury recently announced that a prototype of the "pensions dashboard" is being targeted for March 2017.

The dashboard is a platform that will allow savers to see all their private pension pots in one place and is designed to be an aid to retirement planning. It also aims to provide a link to 'lost' pension pots with previous employers.

17 of the largest pension providers will work together to build the prototype by March 2017; with the end goal for it to be up and running for consumers to use by 2019.

Specific details of the dashboard's scope and how it will work are yet to be published.

10. Bill proposed to safeguard EU-derived workers' rights post-Brexit

A private members' Bill was introduced into the House of Commons on 7 September under the 'ten minute rule'.[5]

The Bill; the *'Workers' Rights (Maintenance of EU Standards) Bill 2016-17'*, has been proposed to make provision for the safeguarding of workers' rights derived from EU legislation after the UK's exit from the EU.

At this stage, only the speech proposing the Bill has been published. This calls on the Government to take proactive steps to protect employment rights that are not contained in primary legislation and therefore risk falling away post-Brexit. In particular, the speech mentioned areas including rights for agency workers, information and consultation of employees, health and safety and TUPE[6]. The speech urges the Government to do everything in its power to protect the rights UK workers already have in these areas.

While the speech did not make any specific reference to pensions rights (apart from in connection with TUPE), the Bill may also look to cover these. Although most EU derived pensions-related protections are already ingrained in UK legislation (and therefore would not automatically fall away if the UK were suddenly no longer bound by EU law), principles which the Bill may seek to preserve could include the proposed requirement to equalise GMPs, as well as any additional requirements imposed by the IORP II Directive, to the extent these have not already been transposed into UK law by the time the UK leaves the EU.

The Bill's second reading is currently scheduled for 13 January 2017.

11. Government reforms to public sector exit payments confirmed

In our February edition of UK: Pensions Update we reported on the Government's consultation on reforming public sector exit payments.

The consultation closed in May and the Government's response has now been published. In its response, the Government confirms that it intends to take forward the proposals set out in the consultation. Namely:

- a maximum tariff for calculating exit payments of three weeks' pay for each year of service;
- a cap of 15 months' salary on redundancy payments;
- a maximum salary on which an exit payment can be based;

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[5] This allows an MP to make a call for a new Bill in a speech lasting up to ten minutes.
[6] Protection afforded to employment terms on transfers under the *Transfer of Undertakings (Protection of Employment) Regulations 2006*.

- a taper on the amount of lump sum compensation an individual is entitled to receive as they get closer to their normal pension age;
- action to limit or end employer-funded early access to pensions. Proposals include: (ii) capping the amount of employer-funded pension 'tops-ups' to no more than the amount of the redundancy lump sum to which that individual would otherwise be entitled; (ii) removing access to such top-ups altogether; (iii) offering greater flexibility to employers as to the circumstances in which they are available; and (iv) increasing the minimum age at which an employer-funded pension top-up is available.

The Government expects public departments to produce packages consistent with the above framework and consult on these where appropriate. Amendments to exit arrangements are then expected to have been made within nine months of the consultation response's publication (i.e. by the end of June 2017).

12. Call for evidence on application of advice requirement to overseas transfers

The Department for Work and Pensions has launched a call for evidence to gather information on how the requirement to take advice on transfers is working for pension scheme members who are resident overseas.

The advice requirement was introduced from April 2015 and requires that where a member has "safeguarded benefits" (e.g. salary-related defined benefits), and the transfer value associated with these benefits exceeds £30,000, the member must take independent financial advice from an adviser authorised by the UK Financial Conduct Authority (**FCA**) before converting such benefits into "flexible benefits" (e.g. defined contribution benefits) or transferring them to a scheme in which they will acquire flexible benefits.

The call for evidence has been prompted by concerns that the advice requirement is causing difficulties for individuals who wish to transfer their pension savings to an overseas scheme on the basis that UK FCA-authorised advisers may not be willing or able to offer specialist advice covering the tax and pension rules of the relevant overseas jurisdiction. This could mean that members resident overseas have to seek two sets of advice (one from a FCA-authorised adviser and one from a local overseas adviser); or that they are simply unable to transfer in circumstances where they cannot find an FCA authorised adviser willing or suitably qualified to provide advice on an overseas transfer.

The purpose of the call for evidence is to gather information on how the advice requirement is working in practice and whether the current process should be maintained or adapted to work better for individuals who are moving or already resident overseas.

The call for evidence period runs until Friday 23 December 2016.

Case law

13. Appeal dismissed in Barnardo's RPI/CPI case

This month, the Court of Appeal handed down judgment in the ***Barnardo's***[7] case; the latest in a series of cases on the RPI/CPI issue (following in particular, the High Court cases of ***QinetiQ***[8] and ***Arcadia***[9]). Essentially, it confirms the position taken in those previous cases, in saying that schemes may be able to move from RPI to CPI without infringing section 67 of the Pensions Act 1995, but whether they can will depend on the wording of their particular rules.

The original application to the High Court was a claim from the pension scheme trustees asking for a view on whether or not they have power under the rules to substitute CPI in place of RPI as the index by reference to

[7] ***Barnardo's and others v Buckinghamshire and others [2016] EWCA Civ 1064***.
[8] ***Danks v QinetiQ Holdings Ltd [2012] EWHC 570 (Ch)***.
[9] ***Arcadia Group Ltd v Arcadia Group Pension Trust Ltd [2014] EWHC 2683 (Ch)***.

which increases to pensions in payment and deferred pensions are calculated. The principal employer (Barnardo's) argued that the trustees did have the power. The representative beneficiaries argued against.

There were two sets of rules under consideration, but the arguments focused on the following wording:

> *Rule 30 requires indexation and revaluation by the "**prescribed rate**".*
>
> *"**Prescribed rate**" = "the lesser of 5% and the percentage rise in the **Retail Prices Index** (if any) …".*
>
> *"**Retail Prices Index**" = "means the General Index of Retail Prices published by the Department of Employment **or any replacement adopted by the Trustees without prejudicing Approval**. Where an amount is to be increased "in line with the Retail Prices Index" over a period, the increase as a percentage of the original amount will be equal to the percentage increase between the figures in the Retail Prices Index published immediately prior to the dates when the period began and ended, with an appropriate restatement of the later figure **if the Retail Prices Index has been replaced or re-based during the period**."*
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> (emphasis added)

The key question was whether the definition in the rules essentially meant: (i) RPI or any index that replaces RPI and is adopted by the trustees; or (ii) RPI or any index that is adopted by the trustees as a replacement for RPI.

The High Court concluded last July that there is no "replacement" of RPI within the meaning of the rules so long as RPI remains an officially published index. As a result, the rules did not permit a switch to an alternative index. Barnardo's appealed.

Earlier this month, the Court of Appeal dismissed the appeal and upheld the High Court's original decision. The decision was not unanimous (it was decided by a 2:1 majority).

As the original decision was upheld, the section 67 issue[10] did not need to be decided, but the judges commented on this (obiter), with all three taking the view that a cross-appeal on the section 67 issue would have been rejected i.e. if the rules had given the trustees discretion to switch the index, doing so for future increases would not have been inhibited by section 67 (following the approach of the High Court in the earlier cases of ***QinetiQ*** and ***Arcadi***a).

It is understood that an application for permission to appeal to the Supreme Court has been made. It is therefore possible that on appeal (if permission is granted): (i) the Court of Appeal's decision regarding the ability to switch index under the rules could be overturned; and/or (ii) the section 67 point could be raised and decided differently.

14. Court of Appeal upholds holiday pay decision in British Gas case

The Court of Appeal recently handed down judgment in ***British Gas v Lock***[11]; a case which looked at the question of what an employer should include in its holiday pay calculations (which, in turn, could have an impact on the calculation of pension contributions and benefits, depending on how a scheme's rules define pensionable pay).

The case concerned Mr Lock; a British Gas employee who complained that British Gas had wrongly failed to calculate his holiday pay so as to include an element of results-based commission. The commission Mr Lock earned greatly exceeded his basic salary and while on leave he was paid any commission earned in previous

[10] Very broadly, the question of whether a switch from RPI to CPI (where permitted by the drafting of the scheme rules) would be voidable under section 67 of the Pensions Act 1995 for increases to benefits attributable to service prior to the switch. (Section 67 provides statutory protection for accrued rights; essentially preventing detrimental changes to benefits which members have built up prior to a change in the scheme rules (excepted in limited circumstances)).

[11] ***British Gas Trading Ltd v Lock and another [2016] EWCA Civ 983***.

periods that fell due for payment during his leave, but he argued that his holiday pay should have also included a commission element to reflect the fact that his remuneration normally included commission.

In a long-running case which has involved consideration by the Employment Tribunal, the Employment Appeal Tribunal and a reference to the ECJ; the Court of Appeal has unanimously upheld the Employment Appeal Tribunal's decision and confirmed that the Tribunal can read words into the UK Working Time Regulations to give effect to the ECJ's decision that holiday pay should include a representative element of results-based commission (in line with what is required by the EU Directive which the Working Time Regulations were designed to implement).

Unfortunately, the Court of Appeal has left a number of questions unanswered and exactly how the commission element of holiday pay should be calculated still remains somewhat unclear.

It has been reported that British Gas intends to appeal the decision to the Supreme Court and it is hoped that this will result in greater clarity for employers on the various issues the case raises.

15. Uber drivers deemed 'workers'

A recent Employment Tribunal judgment[12] has held that, contrary to the position of Uber (which runs the taxi application), two of its drivers are "workers" and therefore entitled to paid holiday and rest breaks, have the right to be paid the national minimum wage and the right not to be subjected to detrimental treatment for whistle-blowing.

Uber has said that it will be appealing the decision, which could lead to further guidance from the Employment Appeal Tribunal on the status of such individuals.

While the case concerned only two drivers who were selected as test claimants, the finding is likely to set a precedent for other so-called "gig" economy workers.

In the pensions context, the judgment is also likely to have auto-enrolment implications. Uber drivers have previously been considered self-employed (such that there is no requirement for them to be auto-enrolled). Following publication of the judgment in the Uber case, it has been reported that the Pensions Regulator will be looking closely at the judgment and considering whether Uber would be required to auto-enrol drivers.

Pensions Ombudsman determinations

16. Ombudsman limits investigation to UK schemes

A recent Ombudsman determination[13] gives an interesting insight into the Ombudsman's view of his jurisdiction to investigate complaints relating to overseas schemes.

Under the Pension Schemes Act 1993, the Ombudsman is able to investigate complaints about the administration and management of occupational which have their main administration either within the UK **or** outside the EEA.

The case concerned a member complaint against the individual's former employer; claiming entitlement to a pension from one of the employer's UK pension schemes. This was on the basis of a letter she had received on leaving employment more than 25 years' previous. The letter referred to the member having a 'vested pension benefit' as her pensionable service with the bank exceeded five years. The bank was unable to trace any record of the member's pension benefits.

The Ombudsman dismissed the member's complaint on the basis that: (i) the member had no other evidence to support her claim; and (ii) the bank had correctly asked HMRC about the member's national insurance records

[12] ***Aslam and others v Uber BV and others ET/2202550/15***.
[13] PO – 11020.

which showed that she had not been contracted-out of the state second pension during the relevant period. As a result, she could not have been a member of either of the bank's two UK schemes which were both contracted-out.

The bank also operated pension schemes in the US. As to whether or not the member could be entitled to benefits under these schemes, the Ombudsman took the view that an investigation of this was outside his remit, noting that:

- Any complaint about a UK pension scheme is within the Ombudsman's jurisdiction.
- Whilst, technically, it would be possible for the Ombudsman to investigate a claim about a US-based scheme (as a scheme with its main administration outside the EEA as per the requirements of the 1993 Act mentioned above), there is a requirement for in-depth knowledge and expertise of foreign pension law to fully investigate such a complaint.
- Further, even if he were to issue a determination relating to membership of the US-based scheme, this would have very limited value because there would be no way for the member to enforce it in the US.

As a result, the Ombudsman exercised his discretion not to investigate the complaint in respect of the US schemes and to limit his investigation to the UK.

17. Ombudsman determines TUPE-transferred employee had no right to additional years of pension on subsequent redundancy as this was a discretionary benefit

The Ombudsman has dismissed a member's complaint[14] that he was entitled to receive an enhancement to his pension on redundancy on the basis that it was a discretionary benefit rather than a right and it was at the new employer's discretion as to whether it should be granted to employees who had TUPE transferred from the local council.

The member had been employed by the Council from 1975 to 1995. During this period he was a member of the Local Government Pension Scheme (**LGPS**). In 1995, his employment was TUPE transferred to a private sector company; Atkins. In 2011, he was made redundant.

Under the terms of the LGPS, the member was entitled to receive a number of benefits on redundancy; including immediate payment of an unreduced pension and, at the employer's discretion, an "added years" pension enhancement[15]. The Council had an established policy that it would typically grant this enhancement.

On being made redundant from Atkins, the member received the immediate payment of an unreduced pension, but not the added years enhancement. The member complained.

The Ombudsman determined that this enhancement was a discretionary benefit and it was within Atkins' discretion to decide whether it should be granted to employees who had TUPE transferred across. Although the Council's policy to grant this enhancement has been in place for some time, this did not mean it was incapable of change and therefore the policy could not be construed as a contractual term – all the transferring employees could expect was for Atkins to consider whether the enhancement should be granted.

In the member's submissions to the Ombudsman, he sought to rely on the case of ***Beckmann***[16] as confirmation that enhanced pension benefits arising from redundancy must be protected on a TUPE transfer. This was not discussed in the Ombudsman's reasoning for the decision. However, the decision would seem consistent with the judgment in the subsequent case of ***Procter & Gamble***[17], which clarified, to some extent, the principles

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[14] PO – 6152.

[15] This was calculated as the lower of: (i) a period of 10 years; (ii) a period equal to the employee's total service in the LGPS; (iii) a period sufficient to bring the employee's reckonable service in that scheme to 40 years; or (iv) a period sufficient to bring the employee's pensionable service in the scheme to what it would have been had he remained in service until aged 65.

[16] ***Beckman v Dynamco Whicheloe Macfarlane Ltd [2002] IRLR 578***.

[17] ***The Procter & Gamble Company v Svenka Cellulosa Aktiebolaget SCA and another [2012] EWHC 1257 (Ch)***.

established ***in Beckmann***; with the High Court determining that only the right *to be considered* for early retirement under a discretionary power transferred under TUPE.

18. Ombudsman determines member not entitled to interest on arrears paid due to late closure of Barber window

The Deputy Pensions Ombudsman has dismissed a member's complaint that he should have been awarded interest on the arrears of pension he received due to his benefits being recalculated and increased during the scheme's assessment for PPF entry, upon discovery that the scheme's "***Barber*** window"[18] had not been closed until April 1999 instead of in December 1994 as originally thought.

The determination[19] was that the member's complaint should not be upheld because the member had "no absolute entitlement to interest" on the additional pension payment under the scheme rules or at law. The failure to close the "***Barber*** window" in December 1994 did not engage a right to interest.

When considering whether to award interest to the member, the trustees had considered that: (i) the scheme was in PPF assessment with no recourse to an ongoing sponsor for additional contributions; (ii) any payment from the scheme over and above the member's core entitlement could have a detrimental impact on the entitlement of the remaining membership; and (iii) the scheme rules made no reference to adjusting payments for interest. Furthermore, all members of the scheme in a similar position had been treated in the same way.

The Deputy Pensions Ombudsman concluded that the trustees' approach was "entirely reasonable".

It would seem that the scheme's impending entry into the PPF was a key factor in arriving at this decision.

Tax

19. HMRC extends transitional period for VAT treatment

As those in the pensions industry will be well aware, HMRC published guidance in 2014 and 2015 for defined benefit (**DB**) schemes making clear that the existing treatment for VAT recovery on pension scheme management costs (as outlined in VAT Notice 700/17) was no longer appropriate as a result of HMRC's interpretation of developing European case law in this area.

Various alternative options for the treatment of VAT on services to DB pension schemes were being considered by HMRC and while the details were being worked out, a transitional period was declared; allowing the VAT treatment outlined in Notice 700/17 to continue to be applied until 31 December 2016 (extended from 31 December 2015). (For more details, please see the previous edition of UK: Pensions Update.)

On 5 September, HMRC issued Brief 14/2016 extending the transitional period by a further 12 months to 31 December 2017. This means that VAT can continue to be accounted for on the basis set out in VAT Notice 700/17 until then.

According to the Brief, HMRC will consider whether a further extension is necessary towards the end of this extended period. (It is possible that HMRC may decide to extend this again in light of the UK's impending exit from the EU).

This extension will likely come as a sense of relief for schemes and employers alike; many of whom were waiting for finalised guidance from HMRC before putting in place alternative arrangements for VAT recovery. It means that the "wait and see" approach adopted by many can now continue for awhile longer.

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[18] The period between 17 May 1990 (the date of the judgment in the case of ***Barber v Guardian Royal Exchange***) and the date on which a scheme equalised its normal retirement ages for male and female members.

[19] PO – 9889.

For those who have already made changes to their structure and/or contractual arrangements to comply with the new rules, HMRC confirms that it is permissible to either continue with these arrangements or revert back to the previous treatment during the transitional period (provided the employer and scheme trustees are in agreement on the same treatment). HMRC does though issue a word of caution that adopting alternative structures to comply with the VAT requirements could have wider implications, in particular in respect of regulatory requirements and Corporation Tax deductions.

20. Transfers held to be unauthorised payments due to member holding funds for intermediate period, but unauthorised payments surcharge waived

A recent case[20] before the First-Tier Tax Tribunal had to consider whether transfers made to a registered pension scheme were 'recognised transfers' and therefore, authorised payments, under the Finance Act 2004.

The individual had applied to transfer funds totalling c£140,000 from two registered pension schemes into a SIPP[21] run by his new employer – St James' Place Wealth Management. The individual was a financial advisor who had experience advising on pensions and decided to handle the transfer himself.

Instead of the funds being transferred directly into the SIPP, the individual paid the cheques into a newly established personal bank account in the name of "St James Place Re [individual's name]"; of which he had sole control. The individual left employment with St James' Place Wealth Management before the transfer was completed.

Some three years later, the funds were eventually transferred into a SIPP with TD Direct Investing (after HMRC had commenced its investigations). TD Direct treated the transaction as a fresh pension contribution rather than a transfer and applied to HMRC for tax relief on the funds. The member contacted TD Direct to request that this tax relief be urgently returned to HMRC as he was not entitled to it.

HMRC treated the transfers as unauthorised payments and therefore subject to the 40% unauthorised payments charge. HMRC also levied the 15% unauthorised payment surcharge on the transfers given their size.

The individual argued that, although he had control of the funds for the three year intervening period, he had at all times intended to transfer the funds to a registered pension scheme – on this basis they should be 'recognised transfers' and therefore authorised payments under the Finance Act 2004.

The Tribunal concluded that the transfers were not recognised transfers and so the 40% unauthorised payments charge applied. However, the 15% surcharge was quashed on the basis that it would not be 'just and reasonable' to make the individual pay this.

Key to reaching this decision was that:

- The wording of section 169 of the 2004 Act on recognised transfers does not allow an intermediate stage in the transfer process where the funds are not held for the purposes of another registered pension scheme, even if they later become so. This is important to protect the integrity of the tax reliefs and exemptions associated with registered schemes.
- This was not a payment made in error as the two paying schemes did not believe the member was entitled to the funds – they had sent the cheques in the belief they were being paid directly to a registered pension scheme.
- The 15% surcharge should be waived because at all times the member did intend to transfer the funds to another registered scheme (the most material fact being that the member kept the funds in the three year period – although the funds were moved around during this time).

[20] ***Browne v The Commissioners for Her Majesty's Revenue & Customs [2016] UKFTT 0595 (TC)***.
[21] Self Invested Personal Pension.

- Although it was a material error on the individual's part that he did not hand the cheques over to the SIPP in the first place, these errors were due to foolishness.
- The purpose of the surcharge is to penalise unauthorised payments where they are made in order to frustrate the purposes of the tax regime and abuse its reliefs – here, the member was just foolish and so it would not be 'just and reasonable' to impose it.

Interestingly, the Tribunal also commented that because the payments to TD Direct were not recognised transfers, it would seem that they may well be contributions attracting income tax relief for the member, but left this to the parties as a matter to consider further.

Investments / Insurance

21. Secondary annuity market proposals dropped

The Government's proposals to launch a "secondary annuity market" next year have now been dropped.

The original proposal was to introduce a framework from 6 April next year which would allow individuals to assign or surrender their annuity in exchange for a lump sum or choose for the proceeds to be transferred to a flexi-access drawdown fund or used for purchasing a flexible annuity.

However, on 18 October, HM Treasury announced that these plans had been cancelled as it had become clear that creating the conditions to allow a competitive market for annuity sales could not be balanced with sufficient consumer protections. The announcement reported that many firms had shown they would be willing to allow customers to sell their annuities, but the Government was clear that there would be insufficient purchasers to create a competitive market.

The announcement emphasised that consumer protection is a top priority and that the Government is not willing to allow a market to develop which could produce poor outcomes for consumers, such as receiving poor value for their annuity income stream and suffering higher costs.

22. Insurance Act 2015

On 12 August 2016, the Insurance Act 2015 came into force. The 2015 Act applies to new insurance policies taken out on or after 12 August, as well as policies which are renewed or varied after that date.

The changes will impact those involved in the insurance market – insurers, brokers and the insured. In the pensions context, this could include, for example, pension scheme trustees on the purchase of a bulk annuity buy-in policy or trustee liability insurance.

The 2015 Act reforms insurance law in a number of areas. In particular:

- It replaces the pre-existing duty of disclosure with a new duty on the insured to make a "fair presentation of the risk" to the insurer when taking out an insurance policy.
- If the insured fails to comply with the duty of disclosure and it can be shown that the insurer would not have insured / would have insured on different terms, then new remedies are available.

The Act permits parties to contract-out of the main requirements of the Act in certain circumstances.

The new Act codifies a lot of what policyholders will have already been doing, and in practice, the requirements of the new Act may well not add very much in the pensions context given the detailed data verification exercise which typically forms part of a pension scheme buy-in / buy-out process.

For more details about the Insurance Act 2015 more generally, please see the firm's briefing papers of August 2016 and March 2015.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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