PENSIONS NEWS

AUGUST 2015

IN THIS ISSUE

INTRODUCTION

Welcome to DLA Piper's Pensions News publication in which we report on developments in pension legislation, guidance and case law, as well as keeping you up to speed on what to look out for in the coming months.

This edition brings you the developments from August 2015 including the following.

- **DC flexibility reforms:** regulations amending the legislation which prevents members of unfunded public service DB schemes from transferring to a scheme in which they can access their benefits flexibly in order to close a loophole.
- **The Pensions Regulator:** updated guidance for trustees of DB schemes about assessing and monitoring the employer covenant; and information to help trustees understand the charge controls and governance standards introduced in April 2015.
- **HMRC:** the latest pension schemes newsletter which covers issues including pension savings statements, and further information about the list of Recognised Overseas Pension Schemes notifications.
- **Public service pension schemes:** the publication of information by GAD and an update from the Pensions Ombudsman following the May determination in the lead complaint concerning the review of commutation factors in the police and firefighters' pension schemes.
- **Other news:** the launch of a Financial Advice Market Review which will examine how financial advice could work better for consumers.

If you would like to know more about any of the items featured in this edition of Pensions News or how they might affect you, please get in touch with your usual DLA Piper pensions contact or contact Cathryn Everest. Contact details can be found at the end of this newsletter.

DC FLEXIBILITY REFORMS

TRANSFERS FROM UNFUNDED PUBLIC SERVICE DB SCHEMES

Background

When the Government published its response to consultation about the new DC flexibilities in July 2014 it confirmed that it would remove the option for members in unfunded public service DB pension schemes to transfer to schemes from which they could access their benefits flexibly. This is because of the cost to taxpayers and other scheme members that could arise from increased requests for transfers from unfunded public service schemes.

This was given effect by the Pension Schemes Act 2015 which provides for amendments to the transfer legislation so that transfers can only be made from such schemes to another scheme if: the benefits that may be provided under the other scheme by virtue of the transfer credits are **not** flexible benefits; the trustees are able and willing to accept the transfer; and the other scheme satisfies requirements prescribed in regulations. These provisions came into force on 6 April 2015 although they do not have effect in relation to applications to transfer under the legislation made before that date.

The need for further regulations

The amended legislation also provides that a transfer can be made from an unfunded public service DB pension scheme for the purpose of subscribing to other pension arrangements which satisfy requirements set out in regulations. The Pension Schemes Act 2015 provides that, until regulations are made and come into force under this provision, existing regulations will apply for these purposes.

It has been identified that this left a loophole in the legislation because those existing regulations permit transfers to be made to a qualifying recognised overseas pension scheme (QROPS).

This means that, without amendment, an unfunded public service DB pension scheme would be able to transfer to a QROPS in order to access their benefits flexibly.

The regulations

In August, the Unfunded Public Service Defined Benefits Schemes (Transfers) Regulations 2015 were therefore made to close the loophole by making new regulations to prescribe the circumstances in which a transfer can be made from an unfunded public service DB pension scheme for the purposes of subscribing to other pension arrangements. These circumstances are essentially where the scheme is a QROPS that may only provide benefits by virtue of the transfer that are **not** flexible benefits. (An additional criterion applies where the transfer contains section 9(2B) contracted-out rights.)

These regulations came into force on 7 September 2015 although they will have no effect in relation to an application for a transfer under the legislation made before that date.

A note on exceptions

It is also worth noting that the Pension Schemes Act 2015 amendments provide a general power to make regulations setting out exceptions to the general prohibition on transfers from unfunded public service DB schemes to schemes from which members could access their benefits flexibly. The Explanatory Memorandum to these latest regulations states that the Government has decided not to make any exceptions.

THE PENSIONS REGULATOR

GUIDANCE ON ASSESSING COVENANT

Background

In July 2014 an updated version of the Pensions Regulator's code of practice on DB funding came into effect. The updates to the code were prompted by the Regulator's new objective (which came into force on 14 July 2014 and is "*in relation to the exercise of its functions under Part 3 only [the scheme funding legislation], to minimise any adverse impact on the sustainable growth of an employer*"), the evolution of the Regulator's approach since it last consulted on this issue in 2005 and changing circumstances including changes to the DB landscape, economic conditions and longevity. Key principles in the code include working collaboratively, proportionality, an integrated approach to employer covenant, investment and funding risks, and seeking an appropriate funding outcome that reflects a reasonable balance between the need to pay promised benefits and minimising any adverse impact on an employer's sustainable growth.

In May 2015, alongside the publication of the Annual Funding Statement for 2015, the Regulator reported that it plans to publish practical guidance as part of its work to help trustees understand the DB funding code.

On 13 August the first of the Regulator's series of guides was published – "*Regulatory guidance for defined benefit schemes. Assessing and monitoring the employer covenant*".

This guidance is aimed at trustees and their advisers, although the Regulator notes that it will also be of interest to employers and their advisers. It replaces the 2010 guidance entitled "*Monitoring Employer Support*", with the Regulator reporting that whilst the content has been updated in light of the new DB funding code, the principles in the new guidance will be familiar to users of the 2010 guidance.

In this article we provide an overview of the new guidance, and highlight some of the key differences to the 2010 guidance.

The structure of the guidance

As was previously the case, the guidance is broadly divided into four main sections – introduction, covenant, security, and monitoring and taking action – although the ordering of the sections has changed and, as highlighted below, some of the appendices and the amount of detail in some of the sections has changed too.

In addition, the Regulator now includes an initial section in which it explains how the guidance can be used stating that:

- it recommends that as a minimum all trustees read the "*at a glance*" summary and the introduction section;
- trustees who assess their employer covenant themselves should read the whole of the section on assessing covenant, and other trustees may also find this section informative; and
- the final two sections on monitoring covenant and scheme security are relevant to all trustees.

Whilst noting that the guidance is about how to assess the covenant for the purposes of the funding legislation, the Regulator also states that, more generally, following the approach will be useful for trustees when they are assessing the covenant in other circumstances such as before agreeing to flexible apportionment arrangements or when there is a change in the corporate group structure affecting the employers.

There are a lot more examples in the new guidance compared to the 2010 guidance – taking just the main body of the guidance not including the appendices there are 23 examples in the new guidance compared to 5 in the 2010 version. The format of the examples has also changed. In the 2010 guidance the examples were worded in a way that described the scenario followed by the action that had been taken by trustees. In the new guidance the scenario is set out followed by guidance which covers, for example, things trustees could or should do or consider. The Regulator states that the examples in the new guidance are used to illustrate key concepts and relevant issues that trustees could consider, and that not all examples will be relevant to every scheme, with the extent to which they apply depending on the specific circumstances of each scheme and employer.

General points (introduction section)

In principle, the explanation of the role of the employer covenant and approaching covenant assessments is similar to the 2010 version, although reflecting recent annual funding statements and the updated code, the need to take an

integrated approach to covenant, investment and funding is emphasised. At the outset the new guidance notes that the employer covenant underwrites the risks to the scheme and an understanding of the covenant should underpin the trustees' approach to investment (for example, the level of risk that can be taken) and funding (for example, the overall level of prudence), and that if there is any material change in covenant, trustees should reconsider whether their funding and investment strategies are appropriate.

Each of the following issues addressed in this section also feature in the 2010 guidance (albeit not all are in the introduction section), but in general the descriptions in the new code are more detailed.

The features of inadequate and good analysis in covenant reports

In the 2010 version, one of the appendices contained a list of what, in general, will be the characteristics of a suitable report. Whilst some of these features are apparent in the new guidance, they are presented differently with the new guidance illustrating this point by way of a practical example. This example (which is based on a scheme facing significant challenges) demonstrates how a covenant assessment can have a very different outcome in terms of the score that the employer is given if some of the relevant factors are not analysed.

Frequency and detail

Whilst proportionality is a key theme in the new code, it was a concept also seen in the 2010 guidance which set out a short list of considerations which could mean that less detailed measurement or monitoring is required, for example, where the scheme is fully funded based on conservative technical provision assumptions. The list of factors is now more detailed and there are two lists (which are essentially opposites of one another) – one is a list of factors suggesting a less detailed approach and/or a less frequent review, and the other is a list of factors suggesting a more detailed approach and/or a more frequent review. For example, factors in the first of these lists include if the structure of the employer is straightforward, and if the scheme has a low deficit on a prudent basis in the context of the employer's profitability and cash flow.

When to commission an external covenant assessment

The section on when to commission an external covenant assessment is also more detailed. In terms of relevant factors for this decision, the 2010 guidance focused on whether the trustees have the relevant expertise and whether there is a conflict of interests. The new guidance also refers to these factors but also mentions other potentially relevant factors such as: the scheme being highly reliant on the covenant; the covenant being complex (for example, if there is a complex legal or operating group structure or an asset-backed contribution structure); the covenant is undergoing significant changes; and the employer and the trustees not having a good relationship.

The new guidance makes it clear that if trustees decide not to obtain professional advice and to perform their own assessment, they should be comfortable that they are able to perform adequately the steps set out throughout the guidance. As explained more fully below, the new guidance is much more detailed about what the process of assessing the covenant entails.

Similarly to the 2010 version, the new guidance notes that trustees should consider the costs of commissioning external advice in the context of the benefits it could bring, and notes that standardised reviews based on limited information are likely to be of little added value.

Working with the employer

Like the 2010 version, the new guidance refers to the importance of employers and trustees working together. However, this issue is now addressed in more detail including to note the approach for trustees where investing in the sustainable growth of the business is prioritised at the expense of scheme contributions. Essentially in this situation, the employer will need to justify why the investment will benefit the scheme and the trustees' approach to understanding the growth plans should be appropriate and proportionate to the circumstances.

Assessing the covenant

One of the key changes in the new version of the guidance is that there is a lot more detail about the process of assessing the covenant. The 2010 version had sub-sections about assessing the employer's legal obligations and assessing the financial position together with a short appendix on assessing financial strength of employer covenant.

In the new guidance this section is now 31 pages and is divided into three main sections.

Assessing the employer's legal obligations

The key point remains that trustees need to understand the covenant from a legal perspective to determine the nature and enforceability of the obligations to support the scheme. There are also now several examples in relation to this assessment, as well as a sub-section about multi-employer schemes where all employers are under common control and their obligations to support the scheme are treated collectively. This sub-section considers the approach for last man standing schemes, formally segregated schemes, and schemes with partial wind-up provisions.

The new guidance also notes that it is not prudent to rely on informal support from entities that are not legally obliged to support the scheme (such as parent companies of the employer) in the long run and that such assurances should be disregarded in the scheme's medium to long term when assessing covenant strength. However, it goes on to state that it may be reasonable to place reliance on informal support in the short term where this is expected to continue and there are plans for the support to be provided. Further information is provided on the weight to give to such support and when to consider obtaining a suitable contingent asset to underpin the support.

Assessing the funding needs and investment risk of the scheme

In this sub-section it is stated that in particular trustees should consider the size of the scheme's deficit relative to the size of the employer, the level of investment risk, and the maturity of the scheme's membership.

Assessing the financial support from the employer

This is the longest sub-section and it starts by noting that the covenant assessment should look forward rather than backward (a point also included in the 2010 version). The new guidance states that the financial assessment of the employer should cover the financial support the employer can provide in the short-term (within two years), medium term (two to five years), long-term (beyond five years) and in the event of employer solvency.

There are then five separate parts to this sub-section looking at each of the following key points for consideration in detail.

- The employer's current financial resources.
- The employer's prospective financial performance.
  - Within this part it is noted that trustees and employers should focus on the employer's forecast cash flows rather than its profit or surplus, as this is a better measure of the ability of the employer to make cash contributions to the scheme.
  - There is also some guidance about assessing sustainable growth plans which includes that key points for consideration are whether investment in sustainable growth constrains the level of cash flow otherwise available to the scheme and, if so, how the growth plans will impact on covenant, when growth will be able to fund an increase in contributions, whether other stakeholders are contributing appropriately, and whether scheme security can be improved by contingent assets.
- The markets in which the employer operates, the medium and long-term outlook for those markets and the employer's competitive position in those markets.
- The estimated outcome for the scheme in the event of employer insolvency.
- The impact of the employer's wider group.

As for the 2010 guidance, for cases where the trustees are appointing an external covenant adviser, an appendix to the new guidance sets out a non-exhaustive list of possible questions and prompts to help trustees decide how to appoint a suitable covenant adviser. The main areas that this list covers have not changed – understanding the firm's experience and expertise, what process should be followed

for covenant assessment, and what the report should include – although trustees should note that there have been some changes to the specific questions.

Documenting the process

The guidance states that trustees should clearly document the assessment process and its conclusions, whether they commission independent advice or decide to assess the covenant themselves.

Monitoring covenant

In contrast to the section on assessing covenant, the section on monitoring covenant is shorter in the new guidance, although there is also some content in the code of practice on this issue. For example, the 2010 guidance states that in most cases it will be appropriate to review covenant strength annually once the financial results and annual plans of the sponsoring employer are known. The DB funding code now states that as a minimum an annual review should be conducted of the employer's performance and other areas which have changed significantly or may be expected to do so.

Whilst the 2010 version contained some specific guidance such as that trustees should have a standing item on their meeting agendas to note employer covenant, the new guidance simply states that trustees should monitor the covenant regularly between formal assessments alongside key investment and funding risks and that the frequency and depth of monitoring should be proportionate to the circumstances of the scheme and employer.

The guidance also notes that where monitoring identifies material changes in the covenant, trustees should have contingency plans in place so they can react appropriately and cross-refers to the relevant parts of the DB funding code on contingency planning.

A key point to note is the seemingly more definite requirement in relation to record-keeping. The 2010 guidance stated that trustees should consider establishing (or updating) a formal plan agreed with the employer and specifying the process by which changes to covenant will be monitored, but the new guidance simply states that trustees "*should clearly document their monitoring framework and contingency plans*".

Improving scheme security

This section states that trustees and employers should consider how the security of the scheme could be improved and notes some examples of ways to achieve this including a commitment to increase funding on certain events, provision of asset security, guarantees from other entities, and amending the scheme's trust deed and rules. This section also looks at considerations when valuing contingent assets and security which largely reflects principles included in the 2010 version. However, like the section on monitoring covenant, the new guidance on this section is shorter, in particular a sub-section about the relevance of security over assets to scheme specific funding and the recovery plan is shorter and a sub-section about the recognition of contingent assets in the PPF risk-based levy is not included with the guidance instead cross-referring to PPF guidance on contingent assets.

Special scenarios

There are two new appendices in the guidance which set out further considerations for:

- trustees of schemes sponsored by not-for-profit organisations; and
- trustees of non-associated multi-employer schemes.

Other publications

The Regulator explains that, in response to feedback, it has taken a practical approach breaking the guidance down into a series of user-friendly examples, checklists and scenarios available alongside the guidance. These documents are based on or simply extract certain sections of the guidance and cover: the 'at a glance' summary section; the scope of a covenant assessment; examples of inadequate and good analysis in covenant reports; taking a proportionate approach to assessing the employer covenant; deciding upon an internal or external employer covenant assessment; appointing a covenant adviser; ongoing monitoring of the employer covenant; and useful sources of information for trustees.

Looking ahead

The Regulator states that the covenant guidance is the first in a series of guides for trustees of DB schemes to help them apply the DB funding code, and that later this year it intends to produce further guidance to help trustees navigate the code including guides on integrated risk management and investment strategy.

Trustees should review the arrangements that they have in place for assessing and monitoring employer covenant to ensure that they comply with the new guidance including that their monitoring framework and contingency plans are clearly documented. Where trustees use external covenant advisers, it would also be sensible to ask them to confirm their compliance with the guidance.

DC CHARGES AND GOVERNANCE STANDARDS

On 20 August the Pensions Regulator issued a press release stating that it is calling on trustees of DC schemes to ensure they are on track to meet the new requirements on charges and governance standards introduced in April 2015.

The Regulator also noted that it has published a number of products to help pension schemes get to grips with the new requirements. These include an "*essential guide*" to the governance standards and charge controls (which was published in February 2015) and a guide to communicating with members about the flexibilities (which was published in final form in April 2015). There are also two new products – guidance relating to the "adjustment measure" relevant to the charge controls and some answers to frequently asked questions.

The adjustment measure

The legislation on charge controls makes provision for an "adjustment measure" which can be used if:

- the trustees have used their best endeavours to comply with the charge limits but have determined that they are unlikely to be able to comply for one or both of the current and following charges years; or
- an event happens which is outside the control of the trustees and they have used their best endeavours to mitigate the effect of the event on the scheme but have determined that, because of it, they are unlikely to be able to comply with the charges limits for the current or the following charges year in relation to one or more members.

In brief, the adjustment measure involves the trustees giving notice of an 'adjustment date' and from that date contributions are diverted into a compliant fund, and the existing arrangement is not subject to the cap from the 'adjustment date'. In relation to the first scenario, the mechanism is only available for six months after the regulations come into force so the 'adjustment date' must fall within that period.

One of the new products from the Regulator is brief guidance about using the adjustment measure which reminds trustees that if the measure is being used they must notify employers, members and the Regulator at least one month before the date on which the measure will take effect (which means a deadline of 5 September 2015 where the measure is being used in relation to the first scenario set out above). The Regulator also provides a form that trustees can download and use to inform it that they are using the adjustment measure.

Frequently asked questions

The frequently asked questions cover a range of issues including the requirement to take financial advice before transferring safeguarded benefits, and the requirements for relevant multi-employer schemes to have non-affiliated trustees and for those appointments not to exceed specified durations (essentially these are schemes in relation to which some or all of the "participating employers" are not "connected employers", or which are promoted as a scheme where participating employers need not be connected).

Of particular note, are the following.

The charge cap and DB schemes with AVCs

A question asks whether a DB scheme has to comply with the charge cap if there are AVCs and the DB scheme is used for automatic enrolment but the AVC element is not. The Regulator states that generally the charge controls do not apply where the only money purchase benefits provided are those attributable to AVCs but that trustees should seek advice to understand how their particular scheme is affected.

DC code and guidance – timing

The Regulator states that it is working closely with the industry to seek input from trustees and advisers as it updates its DC code and supporting guidance. The Regulator will consult on a revised draft DC code in autumn 2015 and revised supporting guidance in spring 2016.

Governance statements

In December 2011 the Regulator set out six principles for good design and governance of workplace DC schemes, and the publication of 31 underlying quality features followed. These principles and quality features are reflected in the current DC code of practice and accompanying guidance. In February 2014, the Regulator set out its expectation that trustees should assess schemes and produce an annual governance statement explaining the extent to which the scheme has embedded the DC quality features, with the first statement to be published at the end of the 2014/15 scheme year.

It has not been clear how the Regulator's expectations in relation to governance statements interacts with the new statutory requirement introduced in April 2015 for trustees to produce an annual report signed by their chair about compliance with the statutory governance standards. However, in its Annual Report and Accounts for 2014/15 published in July 2015 the Regulator stated that in light of the legislative changes in relation to DC schemes, compliance with and measurement against the six principles was not actively promoted. The Regulator also stated that it has not altered its stance that the DC code and quality features remain relevant but the focus needed to shift to the incoming legislative requirements.

Some further information in relation to the interaction of the two sets of requirements is provided in the answer to the question "*Are trustees required to complete a governance statement and a chair's statement?*".

In this answer the Regulator states that trustees should regard their legal duty to prepare a chair's statement as a starting point for how they think about improving the quality of their scheme, and that the voluntary governance statement is "*a powerful tool*" to use to assess and demonstrate the quality of the scheme. It goes on to state that:

- trustees should first and foremost ensure that they comply with the law and then consider what further quality features best suit the needs of the scheme membership;
- beyond the strict legal requirements, the Regulator's approach has always been based upon the principles of 'comply or explain' which gives trustees flexibility to adopt "*different approaches based upon emerging best practice and market innovation*"; and
- the Regulator's engagement with the market in the lead up to and during its formal consultation about the new DC code will enable it to develop a joint understanding with trustees and other stakeholders about best practice now and how to demonstrate it.

This update is useful in making it clear that the primary action for trustees is to ensure that they comply with the statutory requirement for an annual statement signed by the chair. However, trustees should still consider the quality features and whether they need to make any changes to the scheme to ensure compliance and also consider whether a voluntary governance statement would be useful in this process. The Regulator's answer notes that it is engaging with stakeholders in relation to the update of its code and it will therefore be interesting to see whether any further guidance on this issue is contained in the draft code to be published later this year.

Notifying the Regulator of the appointment of a chair

The statutory governance standards include requirements for affected schemes to have a chair and for the name of the chair to be registered with the Regulator. In June the Regulator published information about new questions in the DC scheme return including asking schemes to confirm whether they are exempt from the requirement to have a chair of trustees. If the requirement does apply, the scheme has to enter the name and contact details of the chair, but if it is exempt it can enter the details of either the named contact or the chair.

The frequently asked questions include some more detailed information about notifying the Regulator of the appointment of a chair of trustees including the following.

- Where an individual trustee is the chair, trustees should be able to populate that information in Exchange before the scheme return is issued and the Regulator encourages them to update Exchange promptly. However, given that scheme returns started to be issued in July the Regulator accepts that for many schemes it will be reasonable to provide the information via the return and then keep it up to date via Exchange where changes occur.
- Where the chair of a corporate trustee board needs to be identified this facility will only be available once the scheme returns have been issued so reporting is not expected to take place before then, although after this trustees will be able to keep the information up to date via Exchange.
- The Regulator does not expect to receive any notifications outside of Exchange or the scheme return cycle where the ability to report via Exchange is not yet available.
- For hybrid arrangements the facility to identify a chair of trustees will not be available until the issue of the 2015 scheme return later this year and therefore the Regulator does not expect to receive notifications ahead of the scheme return cycle, although the Regulator would expect the information to be readily available should it be requested.

LEGISLATION

Whilst there were no new legislative developments in August, in this section we report on a significant upcoming development.

ABOLITION OF SHORT SERVICE REFUNDS FOR DC MEMBERS

On 1 October 2015 the legislation about how schemes deal with those who leave pensionable service after a short period of DC membership will change. Trustees of occupational pension schemes with DC members will therefore need to take action including to amend their scheme rules and to ensure that administrative processes and member communications are updated. In this article we provide an overview of the current legislation, explain what is changing and set out some key points for trustees and employers to consider.

Background – the current position

Under the legislation the position is currently as follows.

- If members have less than three months' service, they may be entitled to an opt out refund under the automatic enrolment legislation or the scheme rules.
- If members have at least three months' but less than two years' qualifying service they can elect to receive a refund of employee contributions (known as a short service refund) or transfer their benefits. If members do not make an election within a certain period, trustees can choose to pay the short service refund.
- If members have at least two years' qualifying service, the scheme must make provision so that they are entitled to benefits under the scheme (this is known as "short service benefit"). The statutory transfer rules also apply. In practice, scheme rules could provide that members become entitled to benefit under the scheme more quickly than two years and, if so, the right to a short service refund would come to an end at that earlier date.

If a member has more than one period of service, the general principle is that these are aggregated for the purposes of assessing the length of service.

The changes from 1 October 2015

An overview

The change is part of the Government's recent focus on boosting pension saving. In summary, the period of qualifying service needed for the member to be entitled to benefits from the scheme is being changed to 30 days instead of the current two years for DC members who first join the scheme on or after 1 October 2015. This means that short service refunds are abolished for such members.

What schemes does the change apply to?

The Explanatory Notes to the updated legislation refer to the new provisions applying where all of the benefits "*to be provided by a scheme*" are money purchase, which suggests that the changes are only relevant to schemes which are purely DC.

However, the updated legislation itself refers to the changes applying to members for whom all of their benefit "*would necessarily be money purchase*". In our view, this catches not only DC schemes but also cases where a scheme has a DB and a DC benefit section but the person in question has only ever been a member of the DC section. For example, this could arise where a scheme has a closed DB section and an open DC section.

The change is therefore relevant for schemes which are open to new members who will only accrue DC benefits. The changes do not have an impact for DB benefits for which the current legislation will continue to apply.

What is the position for active DC members who joined the scheme prior to 1 October 2015?

The changes will not apply to members who leave pensionable service on or after 1 October 2015 but who joined the scheme prior to that date. For these members, the existing legislation will continue to apply and therefore they will continue to be entitled to short service refunds if they leave pensionable service with at least three months' but less than two years' qualifying service. This means that short service refunds may still be payable for members leaving the scheme up to the end of September 2017.

What is the position for new DC members with a pre-1 October 2015 period of DC membership?

In summary:

- if the member received a short service refund or made a transfer in respect of the previous period of membership of the scheme, the new rules will apply in the same way as for those who are brand new members on or after 1 October 2015;
- if the previous period of membership counts towards the member's qualification for benefits, then the new requirements will not apply.

What is the position for members who leave with less than 30 days' qualifying service?

If the members were automatically enrolled they should be entitled to a refund under the automatic enrolment legislation. In other cases, the position will depend on the scheme rules.

Is it possible to continue to provide short service refunds for post-1 October DC members?

Yes, but it would be an unauthorised payment. In order for a refund to be an authorised payment (a "short service refund lump sum") the member cannot be entitled to short service benefit. Because DC members who join on or after 1 October 2015 will be entitled to short service benefit after 30 days' qualifying service, after that point a refund would be an unauthorised payment (unless permitted by the automatic enrolment legislation).

How do the changes interact with automatic enrolment?

The opt out window under the automatic enrolment legislation is one month from the later of the person becoming a member of the scheme and being given enrolment information, and in some cases is extended to six weeks. This means that a right to an opt out refund may continue to apply after a member reaches 30 days' qualifying service and becomes entitled to short service benefit. The two sets of legislation are not therefore perfectly aligned, but schemes will need to continue to comply with any opt out requests that meet the requirements of the automatic enrolment legislation.

The position is less clear for cases where scheme rules provide for an opt out window of longer than 30 days, for example, if members who are contractually enrolled are given a right to opt out and be treated as though they were never a member on the same terms as apply under the automatic enrolment legislation. We recommend that trustees check to see whether their scheme rules include such a provision and, if so, seek further advice on this point.

The legislative requirement to provide short service benefit once affected members have 30 days' qualifying service is not overriding. Trustees will therefore need to consider whether their scheme rules need to be amended to reflect this, which will depend on whether, under the current drafting, the amendments to the legislation will automatically filter through to the rules.

Administrative processes will also need to be updated to ensure that the different scenarios that could arise can be identified and dealt with appropriately. For example, the administrative processes will need to take into account the differing position for active members who joined the scheme before 1 October 2015, and the impact of any previous periods of membership for those who join on or after 1 October 2015.

Trustees and employers will also need to review the communications which are sent to early leavers to ensure that these reflect the correct position and update the relevant sections of their scheme booklets.

Under the legislation short service refunds only have to relate to member contributions, and therefore the corresponding employer contributions could remain in the scheme and be used in accordance with the scheme rules, for example, to cover future employer contributions or to meet administration costs. Employers should therefore note that the abolition of short service refunds will mean less funds will be available to them in this way.

Looking ahead – automatic transfers of small pots

Looking ahead, linked to the abolition of short service refunds, the coalition Government proposed to introduce a system in October 2016 whereby small DC pension pots will be automatically transferred when workers change employment. The intention is that the system will be introduced in two phases, and that in phase 1, the number of schemes to which the system applies will be limited and, for members, it will be operated on an opt-in basis. In February 2015 it was reported that further detail and a consultation on draft legislation would be published later this year.

HMRC

On 13 August HMRC published its latest pension schemes newsletter which provides updates on a number of issues and in this section of Pensions News, we provide a summary of some of the key items covered in the newsletter.

ANNUAL ALLOWANCE CHARGES FOR 2014/15

The newsletter notes that scheme administrators will soon be issuing pension savings statements for 2014/15 to all scheme members contributing more than the £40,000 annual allowance to the scheme. HMRC asks scheme administrators to remind their members that it is important that those who have exceeded the annual allowance for 2014/15 declare this on their Self Assessment tax return. It also notes that these individuals will have to pay a tax charge and explains where to find further information on the gov.uk website about paying tax charges.

TAPERED ANNUAL ALLOWANCE

HMRC states that with the introduction of the tapered annual allowance in April 2016 and the transitional provisions, the existing requirement for scheme administrators to send an annual allowance pension savings statement to members whose pension savings exceed the annual allowance in that scheme may no longer be appropriate.

The level of the tapered annual allowance will depend on the member's income for the tax year and, given that it is not expected that scheme administrators will know what any individual's income is for any tax year, HMRC reports that it is considering how the current rules could be adapted to help individuals who are affected by the tapered annual allowance work out any annual allowance charge due. HMRC provides an e-mail address that can be used to submit views on how the current rules could be changed to help individuals but without over burdening scheme administrators.

LIFETIME ALLOWANCE

It was announced in the March 2015 Budget (and reiterated in the Summer Budget 2015) that from 6 April 2016 the lifetime allowance will reduce to £1 million and transitional protection will be introduced, and that from 6 April 2018 the lifetime allowance will be indexed annually in line with CPI.

In its last newsletter issued in July, HMRC stated that legislation will be included in the Finance Bill 2016 and there will be two protection regimes which will have the same conditions as the previous fixed and individual protection regimes. However, HMRC also reported that individuals will not need to notify it in advance where they want to rely on fixed protection, or have three years to apply for individual protection and that it is considering options around removing the deadlines and will discuss this informally with stakeholders so that it can publish full details later this summer.

In the August newsletter, HMRC states that it aims to provide more detail around the new protection regimes in its next pension schemes newsletter which it plans to publish around September. It also states that the relevant legislation is expected to be included in Finance Bill 2016 which is likely to be published in draft before the end of this year.

HMRC states that, in the meantime, scheme administrators should consider what communications they need to remind members about the conditions on benefit accrual for fixed protection and on saving levels for individual protection.

PENSION FLEXIBILITY STATISTICS

HMRC reports that, as part of its monitoring of the impact of pension flexibility, it continues to review the number of pension flexibility payments made and in future will publish statistics on a quarterly basis from autumn 2015 on the official gov.uk statistics website. HMRC aims to provide more information on the specifics of the publication in its next newsletter.

ROPS AND QROPS

In previous editions of Pensions News we reported that:

- in June 2015 HMRC suspended the list it publishes of certain overseas pension schemes and stated that it would return in an updated form by 1 July; and
- on 1 July HMRC published the List of Recognised Overseas Pension Schemes (ROPS) notifications which is stated to contain pension schemes that have told HMRC that they meet the conditions to be a ROPS and have asked to be included on the list.

The August newsletter explains that HMRC held a forum with stakeholders on 21 July to discuss operational issues relating to qualifying recognised overseas pension schemes (QROPS). HMRC states that it received a lot of feedback about recent changes, and therefore in the newsletter provides a more detailed explanation of the ROPS notifications list including the following points.

- A pension scheme is a ROPS if it meets certain requirements set out in legislation. To be a QROPS the scheme must meet the ROPS requirements and the scheme manager must notify HMRC that the scheme meets those requirements and undertake to provide information and to notify HMRC if it ever ceases to be a ROPS.
- The published List of ROPS notifications shows that the scheme manager has notified HMRC, wishes to appear on the list and has undertaken to provide information. However, this is all it shows and it does not show that the scheme meets the ROPS requirements.
- A transfer from a registered pension scheme to a QROPS can be made tax free "*but care must be taken to check that the scheme is a QROPS*".
- It is the responsibility of the individual and scheme administrator making the overseas transfer to check that the receiving scheme meets the requirements to be a QROPS.
- Checking the published list the day before the transfer will confirm whether the scheme has notified HMRC but will not confirm that the scheme meets the ROPS requirements. Checks to confirm whether a pension scheme meets the ROPS requirements should be carried out as part of an individual's and scheme administrator's due diligence when making a transfer.

PENSION LIBERATION

The newsletter contains a brief article about the issue of pension liberation, which includes noting that there is a range of information available to members who might be thinking about what to do with their pension savings and asks administrators to signpost their members to this information on the Pensions Regulator's website wherever possible.

PUBLIC SERVICE PENSION SCHEMES

REVIEW OF COMMUTATION FACTORS

Background

In the May edition of Pensions News we reported on a determination of the previous Pensions Ombudsman in relation to a complaint (which was the lead of a number of complaints on the same issue) against the Government Actuary's Department (GAD) concerning the review of commutation factors in the firefighters and police pension schemes.

The issue arose from the fact that in the early 1990s GAD changed from instigating reviews to waiting to be asked to do so. The May determination concerned the Firefighters' Pension Scheme and an Applicant who was employed in Scotland and retired in 2005. However, the previous PO noted that firefighters are similarly affected by the issue, whether they retired from employment in England, Northern Ireland, Scotland or Wales, and that a connected issue arises in relation to the Police Pension Scheme.

The previous PO concluded that there was maladministration by GAD in acting inconsistently with the scheme's rules without having first properly considered whether it was permitted to act as it was.

The previous PO stated that the obvious remedy is that the Applicant should be put in the position he would have been in had the missed reviews taken place, that is, had his cash lump sum been calculated using the commutation factor that would have applied on his retirement. He directed GAD to notify the scheme administrator of the factor that would have applied to the Applicant if the tables had been reviewed in December 2004, and stated that if the factors are changed in the Applicant's favour, unless the relevant authority resists, this will result in an automatic payment.

The previous PO also:

- directed that certain payments be made by GAD – if HMRC states that any additional lump sum will not be tax free, GAD should pay the Applicant a sum equivalent to the tax liability; and GAD should pay the Applicant simple interest on any additional lump sum; and
- expressed the hope that the relevant bodies will swiftly take steps to deal with the position of other affected retired firefighters and police so that it will not be necessary for their complaints to be pursued.

Subsequent developments

Since the publication of the PO's May determination there have been a number of further developments in this case, including the following in July and August.

- On 3 July GAD published an update which stated that it and the Government accepted the previous PO's determination in full, and that GAD has complied with the required actions in relation to the lead complaint and is working with the relevant Government departments to facilitate redress in other cases.
- Documents prepared by GAD were issued in July and August for the affected schemes which include tables of factors to be used in calculating redress and detailed guidance for scheme administrators to aid them in calculating the amounts owed to individuals.
- On 24 August the current PO (who took office shortly after the determination in the lead complaint was issued) published an update setting out his response to a number of recurring themes in enquiries about these schemes including the following.
  - There are potentially some 34,000 individual cases to process and in theory every one of those retired members could complain to the Pensions Ombudsman Service (POS). However, the previous PO hoped that GAD, the Department for Communities and Local Government and all other interested bodies including those representing the fire and police authorities would quickly and jointly consider what steps should be taken. The PO is satisfied that this is being done but because complex actuarial, policy, funding and taxation issues have to be worked out and the numbers affected are so large, it will take a little time to sort out. The PO

has therefore decided that at present he will not deal with enquiries or complaints about the time it is taking or suggestions that the authorities will not pay.

- In relation to complaints that commutation figures produced by GAD in 1998 (and other dates) are incorrect, the PO states that in performing the function of calculating actuarial factors GAD is not an administrator for the purposes of his jurisdiction and in any event any complaint is likely to be out of time. Unless good reason can be shown, he will not therefore deal with enquiries or complaints suggesting that different factors could have been used.
- The update notes that GAD has said that new commutation factors will be produced for December 2001 and some members say the date is wrong for those who retired prior to that date. The PO considers that any selection of a date will result in a cliff edge which may lead to those retiring before the selected date to feel aggrieved. He notes that any decision he might make about the month chosen could have a detrimental effect on others who cannot make representations and are not bound by any determination made. Moreover, while a different month might result in an injustice for some, it does not follow that the exercise of judgment applied in choosing a month, amounts to maladministration. The PO states that there is nothing to suggest that the decision by GAD is one he should interfere with (assuming he could) and unless good reason can be shown, he will not deal with such enquiries or complaints.
- As to the direction in the lead complaint that simple interest should be paid on any additional lump sum due at the "*base rate for the time being payable by the reference banks, from the due date to the date the additional sum is paid from the Scheme*", the PO states that he believes that the rate for the time being quoted by the reference banks means the rate should alter as it changes over time, and that this is fair to all parties.
- The PO asks that individual complaints or enquiries are not sent to POS and states that, while he appreciates the importance of the case, he does not intend to respond to such approaches. He states that members should first liaise with the relevant people such as the employer or administrator and, if they are not satisfied with the response, the PO urges them to discuss the matter with the Pensions Advisory Service.

Legislation states that if the PO directs a person to make a payment in respect of a benefit under the scheme which, in the PO's opinion, ought to have been paid earlier, he may also direct the payment of interest. The legislation also states that the relevant rate of interest is "base rate for the time being quoted by the reference banks". Whilst it goes on to define the terms base rate and reference banks, it is not clear whether the phrase "for the time being" means the rate as at the point of payment or the rate as it has changed over the period of delay. Whilst it is specifically given in the context of these cases, it is nevertheless useful to see the PO's view as to what this means.

OTHER NEWS

FINANCIAL ADVICE MARKET REVIEW

On 3 August the Financial Advice Market Review was launched which HM Treasury states will examine how financial advice could work better for consumers, building on the Government's pension reforms which have allowed people choice and freedom over their savings and given them access to free and impartial guidance. The review will be co-chaired by the FCA and HM Treasury.

The Terms of Reference explain that 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;
- the regulatory or other barriers firms may face in giving advice and how to overcome them;
- how to give firms the regulatory clarity and create the right environment for them to innovate and grow;
- the opportunities and challenges presented by new and emerging technologies to provide cost effective, efficient and user friendly advice services; and
- how to encourage a healthy demand side for financial advice, including addressing barriers which put consumers off seeking advice.

The Review will consider all types of retail financial products including pensions, savings, mortgages, and insurance. The initial evidence gathering will request examples of problems in obtaining advice in certain markets including pensions and retirement income products.

Initial work and evidence gathering will be undertaken over the summer with a view to producing a consultation document in autumn 2015. The consultation will close by the end of 2015 with a view to producing proposals ahead of Budget 2016.

The HM Treasury press release announcing the launch of the Review also reports that, as part of the Government's plan to support working people at all stages of their lives, the Government intends to consult later in the year on how the current statutory arrangements for the provision of free and impartial financial guidance, including the Money Advice Service and Pension Wise, can be made more effective.

ON THE HORIZON

- **Equalisation for GMPs.** It had previously been expected that guidance on conversion of GMPs would be published in spring 2014 but, as at the end of August 2015, this had not been published. An HMRC Bulletin on the end of contracting-out issued in July 2014 reported that the DWP understands that schemes are waiting for GMP conversion guidance but it thinks it is important to develop fully considered proposals, and guidance will be published when this critical work is completed. A further Bulletin published in June 2015 stated that industry representatives and the DWP have been examining alternative approaches and are intending to re-consult on revised regulations in this Parliament.
- **Pensions Tax Manual.** In March HMRC published a draft version of the Pensions Tax Manual (PTM) which will replace the current Registered Pension Schemes Manual. The PTM is currently in draft form and HMRC intends to incorporate comments on it with a view to the guidance being updated in summer 2015.
- **Review of survivor benefits.** The review of different treatment of survivor benefits under occupational pension schemes required to be completed under the Marriage (Same Sex Couples) Act 2013 has been published, although no date has been given for when the Secretary of State will announce whether or not any amendments will be made to the legislation. The Employment Appeal Tribunal's judgment in the *Walker v Innospec* case concerning the restrictions placed on benefits payable to civil partners is the subject of an appeal to the Court of Appeal, the hearing for which took place at the end of June 2015.
- **Short service refunds.** Short service refunds will be withdrawn for new DC members from 1 October 2015.
- **DC code and guidance.** The Regulator intends to update its DC code of practice to reflect the April 2015 legislative changes. In August 2015 the Regulator reported that it will consult on a revised draft DC code in autumn 2015 and revised supporting guidance in spring 2016.
- **Consultation on DC flexibilities.** A consultation was published on 30 July 2015 which looks at options to address any excessive early exit penalties, and whether the process for transferring pensions from one scheme to another can be made quicker and smoother to help people make use of the new freedoms. The consultation closes on 21 October and the Government response is expected in autumn 2015.
- **The end of contracting-out.** The response to consultation and final form regulations about how to administer accrued contracted-out rights were published in July 2015. However, a number of areas are identified which will be the subject of further consultation/regulations – consequential amendments to the legislation on transfers of contracted-out rights and the disclosure regulations; payment of GMPs as lump sums; scheme alterations in respect of post-1997 contracted-out rights; and the Reference Scheme Test underpin.
- **DB guidance.** In August 2015 the Regulator published updated guidance on assessing and monitoring the employer covenant. This is the first in a series of guides for trustees of DB occupational schemes to help them apply the code of practice on funding defined benefits. Later in 2015 the Regulator intends to produce further guidance to help trustees navigate the DB code, including guides on integrated risk management and investment strategy.
- **Review of consumer price statistics.** Following the report of an independent review, a public consultation on the consumer price statistics was published in June 2015. In Autumn 2015, the UK Statistics Authority will publish a summary of the responses received and the Board of the Authority will consider the report carefully, alongside any advice from the Authority's regulatory function, before it issues its final response in early 2016.
- **Transparency of DC charges.** The April 2015 measures on charges include some reporting requirements in relation to charges and transaction costs. The DWP intends to build on this and on 2 March published a joint Call for Evidence with the FCA which closed for comments on 4 May 2015.

PENSIONS NEWS

- **Solvency.** Following its October 2014 consultation on further work on solvency of IORPs, on 15 May 2015 EIOPA published the feedback to the consultation and launched a quantitative assessment on solvency for occupational pension funds. The outcomes of the assessment will support EIOPA in further developing its advice to the European Commission on EU solvency rules for IORPs, which EIOPA expects to deliver in March 2016.
- **Transfers guidance.** In the response to consultation on the DB to DC transfers guidance, the Regulator stated that it will review its guidance on transfers in 2016 in light of experience and agrees that, through this process, the consolidation of material will be beneficial to trustees and their administrators.
- **Investment regulations.** A consultation in relation to some amendments to the investment regulations following recommendations made by the Law Commission in July 2014 closed in April 2015. It is expected that any changes to the legislation arising from the consultation would be made in 2016.
- **DC charges.** From April 2016, it is proposed that member-borne commission payments and Active Member Discounts will be banned from DC qualifying schemes.
- **End of contracting-out.** The reform of state pension which will result in the end of contracting-out is due to take effect in April 2016.
- **Defined ambition.** During the progress of the Pension Schemes Act 2015 through Parliament it was stated that it is envisaged that the provisions of the Act on Defined Ambition and collective schemes will be available in time for the end of contracting-out in April 2016.
- **Tapered annual allowance.** The Summer Budget announced that from 6 April 2016 a tapered annual allowance will apply to those with adjusted income over £150,000 and threshold income over £110,000. Transitional provisions are also introduced in connection with this change. The draft legislation to give effect to these changes is in the Finance Bill which was published on 15 July 2015.
- **Lifetime Allowance.** In the March 2015 Budget it was announced that the Lifetime Allowance will be reduced from £1.25 million to £1 million from 6 April 2016 and transitional protection will be introduced. HMRC is considering options around removing the deadlines for applying for these protections and will publish full details later in 2015.
- **Consultation on tax relief.** On 8 July 2015 the Government issued a consultation about whether there is a case for reforming pensions tax relief to strengthen incentives to save or whether it would be best to keep the current system. The consultation closes on 30 September 2015.
- **Flexibility for existing annuity holders.** In the March 2015 Budget it was announced that from April 2016 the Government will change the tax rules to allow people who are already receiving income from an annuity to sell that income to a third party, subject to the agreement of the annuity provider. In the Summer Budget 2015 the Government stated that it agrees with respondents to the consultation that implementation should be delayed until 2017. The Government will publish further details of its plans in autumn 2015.
- **Automatic transfers.** The system of automatic transfers is intended to be launched in October 2016. Following the publication of a framework document in February, further detail and a consultation are expected to be published later in 2015.
- **IORP II.** The draft updated IORP Directive published in March 2014 proposed that Member States would have to transpose the new IORP Directive into national law by 31 December 2016. An updated draft published in September 2014 deleted this date and did not replace it with a new date. A further draft published in December 2014 stated that Member States would have two years after the entry into force of the Directive to transpose it into national law, and this was amended to 18 months in a draft published in July 2015.
- **DC charges.** In 2017 it is proposed that the measures on DC charges and governance standards will be reviewed, in particular, the level of the charge cap and the question of whether any transaction costs should be included in the cap.
- **Lifetime Allowance.** In the March 2015 Budget it was announced that the Lifetime Allowance will be indexed annually in line with inflation from 6 April 2018.

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