PENSIONS NEWS

FEBRUARY 2014

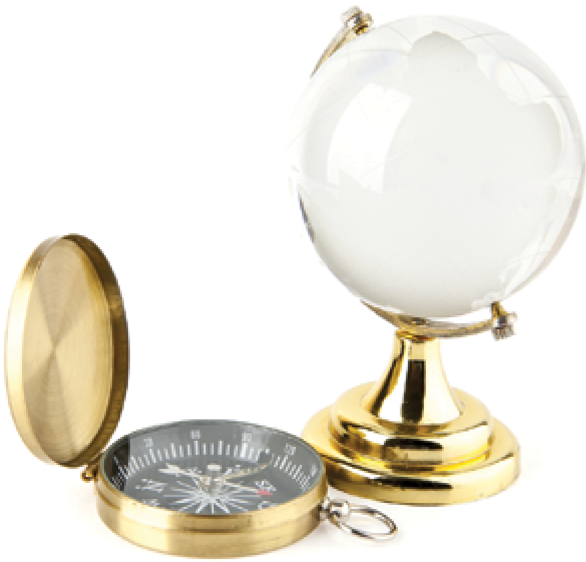
IN THIS ISSUE

INTRODUCTION

Welcome to DLA Piper's Pensions News publication in which we report on recent developments in pensions 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 February 2014 including the following.

- **Automatic enrolment:** the response to the part of the March 2013 consultation on technical amendments to the legislation that addressed the possible introduction of exceptions to the duties; and the publication of draft regulations amending the legislation on revaluation of average salary benefits and to clarify the position on the phasing in of contributions to hybrid schemes.
- **The Pensions Regulator:** the publication of a scheme assessment template and governance statement template which trustees can use to assess their scheme against the 31 DC quality features and report compliance.
- **PPF:** a booklet about how to reduce the pension protection levy; and FAQs on asset-backed contributions.
- **Legislation:** the addition of clauses to the Pensions Bill (i) to state that the statutory override allowing employers to adjust contributions or accrual to offset additional National Insurance costs following the end of contracting-out cannot be used in relation to protected persons; and (ii) to provide for disclosure of transaction costs.
- **Case law:** the outcome of the Employment Appeal Tribunal hearing about whether schemes can restrict benefits payable to civil partners to service on and after 5 December 2005.
- **HMRC:** an update to HMRC's policy on reclaiming VAT on investment management services in light of a July 2012 decision of the Court of Justice of the European Union.
- **Other News:** an update from the Pensions Ombudsman about the complaints it has received concerning pension liberation; the final version of new guidance on Statutory Money Purchase Illustrations to reflect changes to the disclosure regulations; and the outcome of the Financial Conduct Authority's thematic review of annuities.



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 on page [24].

AUTOMATIC ENROLMENT

EXCEPTIONS TO THE DUTIES

Introduction

In the January 2014 edition of Pensions News, we provided an update about the further consultation expected on exceptions to the automatic enrolment duties, reporting that the DWP had stated the consultation was due to be issued in early 2014.

As we noted, this issue was raised in the DWP's March 2013 consultation on technical amendments to the automatic enrolment legislation. On 12 February, the DWP published the Government Response to that part of the consultation which states that the responses received reinforced representations already made that there is a strong case to permit employers not to enrol workers in the following four categories, all of which had previously been mentioned in the DWP consultation.

Workers with tax protected status

The Response states that there is a strong case for an exception from automatic enrolment and re-enrolment for such workers, but the practical issue of how the employer will know the worker has tax protected status needs to be considered. One suggested approach included in the Response is to provide an exception only where the employer is aware of the individual's status, with responsibility for informing the employer resting with the individual.

The Government rejected the suggestion that those who are approaching their lifetime allowance but have not yet applied for or been granted protection should also be included in this exception on the basis that it would place too great an onus on the employer to decide whether or not they should enrol the person.

Workers on the brink of leaving employment

The Government considers that there is a strong case for an exception for this category of worker. However, there are practical issues to consider as some employers may find it easier to automatically enrol workers in the usual way and the Government does not want to add complexity to the administration of automatic enrolment.

In setting out such an exception it will also need to be considered how leavers might be defined the relevance of resignation, dismissal or redundancy and timing. However, the Government does not agree with a response to the consultation that suggested those who are at risk of redundancy at some point in the future should be included within the exception.

Workers who have given notice of retirement

The Government considers there to be a case for exclusion of those who have given their employer notice of their intention to retire from employment.

However, it considers this to be a relatively small group and rejected suggestions from respondents to expand this area to include other groups of workers, such as, those who have reached maximum accrual in their employer's scheme or are drawing benefits from a previous employment pension or the current employer's scheme. In relation to this last category, the Response notes that whilst sometimes further pension saving may not be necessary, it is not the case that a pension in payment is always good enough and therefore the onus should be on the individual to opt out if they do not want to make any further savings.

Workers who have recently cancelled membership after being contractually enrolled

The Government previously consulted on a proposed amendment to the legislation in this area which would have created an exception from the automatic enrolment duty for anybody who had ceased active membership of a qualifying scheme in the 12 months prior to the duty arising (such an exception already exists for automatic re-enrolment).

It was previously concluded that this proposed amendment did not work as needed, would increase the monitoring burden and make the enrolment process more complicated. However, there is still thought to be a strong case to address this issue and the Government will develop proposals.

Other categories of worker

Respondents to the consultation also suggested other categories of worker who should be exempt from automatic enrolment. The Response looks at some of these categories (which include those absent from work because of long-term serious ill-health, non-UK residents and new starters, short-term and casual hires) in turn and sets out the Government's rationale as to why it is not appropriate to make exceptions.

Overall the Government states that it remains confident that the right to opt out remains the most suitable option for all workers other than those in the four categories in respect of which proposals will be developed.

Next steps

The Government will now develop proposals for exceptions and bring forward final proposals, together with draft regulations, in due course.

A note on the power in the Pensions Bill

The Response also points out that any regulations setting out exceptions will be subject to the Pensions Bill currently before Parliament (which contains the power to make exceptions) receiving Royal Assent.

In February an amendment was made to this clause in the Bill to specifically state that the power can not be used to provide for an exception for employers of a particular size. This amendment was made in recognition of concerns that, whilst the Government had stated it would not use the power to exclude employers based solely on their size (and indeed that was not suggested as a possible category in the March consultation), the power is so broadly worded that in theory it could have been used to do so.

We would expect the introduction of exceptions to be an area of interest for many employers, not only those who have yet to reach their staging dates but also those who have already complied with the duties but are hoping for some of these tricky issues to be resolved by the introduction of exceptions in advance of their automatic re-enrolment dates.

Whilst there have been no changes to the categories of workers that are being considered since this issue was first raised, for now it remains the case that there is no guarantee that the exceptions will be introduced (of, if they are, what form they will take) and therefore it is important that employers continue to comply with their duties in respect of these categories of worker.

DRAFT AMENDING REGULATIONS

The draft Occupational and Personal Pension Schemes (Automatic Enrolment) (Amendment) Regulations 2014 were laid before Parliament in February proposing two amendments to the automatic enrolment legislation to come into force on 1 April 2014.

Money purchase benefits in hybrid schemes

The legislation does not currently permit an employer who is certifying the money purchase section of a hybrid scheme on the basis of one of the sets of alternative requirements to phase in contributions over the transitional period from the staging date to October 2018. (The alternative requirements are those which apply where pensionable pay is measured from the first pound, a different definition of pensionable pay is used rather than the definition of qualifying earnings under the standard requirements and different contribution rates apply.)

Updated guidance on certification which the DWP issued in September (reported in that month's edition of Pensions News) stated that this does not reflect the policy intention and therefore an amendment would be made to the legislation.

That amendment is included in these draft regulations which, if made, will mean that hybrid schemes which certify the money purchase benefits against one of the alternative requirements will be able to phase in contributions in the same way as a scheme which provides only money purchase benefits.

Average salary benefits

Under the automatic enrolment legislation, a scheme that provides average salary benefits will not meet the quality requirement unless benefits are revalued while the jobholder is in pensionable service at least at a minimum rate (that is, whichever is the lower or least of the increase in CPI, RPI or 2.5%). However, where the scheme instead provides for revaluation on the exercise of a discretionary power, the scheme can still be a qualifying scheme if:

- the funding of the scheme takes account of the exercise of the discretion on the assumption that the revaluation will be at least at the minimum rate; and
- such funding is provided for in the scheme's statement of funding principles.

The draft regulations introduce similar provision for cases where the scheme rules provide for revaluation at a rate lower than the minimum rate. In those cases the scheme would still be able to be a qualifying scheme if:

- the funding of the scheme is based on the assumption that accrued benefits would be revalued at or above the minimum rate; and
- such funding is provided for in the scheme's statement of funding principles.

The accompanying draft Explanatory Memorandum states that this amendment will ensure schemes are treated consistently and will also mean that schemes that revalue by reference to the increase in earnings will be able to meet the requirements to be a qualifying scheme.

Average salary benefits – public service schemes

The draft regulations also make amendments to ensure that new public service career average schemes will not be excluded from being qualifying schemes by virtue of the requirements on revaluation while in service, provided they revalue benefits by one of the relevant percentages to be set out in an HM Treasury Order made under the Public Service Pensions Act 2013.

We would expect the clarification on hybrid schemes to be welcomed by schemes using the alternative requirements for certification of the money purchase benefits who may already have been assuming that it was possible to phase in contributions in the same way as for money purchase schemes, particularly given this is stated to have been the policy intention.

Employers who have schemes which provide average salary benefits which they are assessing for qualifying scheme status should note the proposed changes here. If employers previously thought such a scheme could not be used for automatic enrolment because the rate of revaluation while in service did not meet the requirements, they may want to revisit this assessment.

However it should be noted that, as at the end of February, the regulations remained in draft form subject to the approval of Parliament. We will report again when the final form of regulations has been adopted.

REGISTRATION CHECKLIST

Under the automatic enrolment legislation, employers have to register with the Pensions Regulator by providing specified information within four months of the staging date. (This timescale will be amended to five months with effect from 1 April 2014.) For example, this includes the type of pension scheme used for automatic enrolment, the name of the scheme, the number of eligible jobholders automatically enrolled and the number of workers who were already active members of a qualifying scheme on the staging date.

To assist employers with this task, in February the Regulator published a checklist setting out the items of information that must be provided to it along with some guidance notes in relation to each item and a list of "*top ten tips*" for registration.

THE PENSIONS REGULATOR

DC GOVERNANCE STATEMENTS

Introduction

In the November 2013 edition of Pensions News we reported on the coming into effect of the Regulator's Code of Practice on the governance and administration of occupational defined contribution trust-based pension schemes, together with accompanying regulatory guidance.

These documents are linked to the Regulator's six DC principles and 31 underlying quality features, with the DC Code focusing on the quality features that reflect the requirements of pensions legislation and the guidance covering the features that reflect the Regulator's view of good practice.

In its DC regulatory strategy published in October 2013 (reported in that month's edition of Pensions News), the Regulator stated that: (i) it is asking trustees to assess their schemes and produce a governance statement explaining the extent to which the scheme has embedded the 31 quality features; and (ii) it would be publishing an assessment template to support ongoing assessment of schemes against the quality features and an example template of a governance statement. On 6 February the Regulator published those templates.

The scheme assessment template

The scheme assessment template has a section for each of the quality features, with space to input the status of the scheme in respect of that feature and to make notes explaining the status.

The accompanying press release from the Regulator notes that the template can also be used to monitor plans to improve scheme features to a 'best practice' or 'exemplar' level. This means that as well as a "green" status option in the template (which means either the feature is present or the trustees can explain how the scheme complies with the underlying law or meets good practice), there is also a "purple" status (which means the feature is present and an action plan is in place for achieving or maintaining 'best practice' level). There is also an "amber" status and a "red" status for cases where the scheme is not compliant.

Trustees can adapt the template according to the needs of their scheme or can use other ways to assess their scheme if they prefer.

Whilst the assessment information does not have to be published, the Regulator expects the information to be available to it and to employers and members on request.

Governance statement template

The results of the assessment should then be used to produce a governance statement. The template, which is to be signed by the chair of trustees or, if there is no chair, a trustee on behalf of the board, has five sections which cover the following.

- Confirmation that the trustees have reviewed and assessed that their systems, processes and controls across key governance functions are consistent with those set out in the DC Code and regulatory guidance.
- Confirmation that, based on the assessment (although possibly subject to information in the categories below), the trustees believe they have adopted the standards of practice set out in the DC Code and regulatory guidance.
- If relevant, an explanation as to why the trustees adopt a different approach to that set out in the DC Code and regulatory guidance.
- If relevant, an explanation as to why any systems and processes are not in place to demonstrate particular features.
- For trustees seeking to achieve or maintain 'best practice' level, an explanation of this.

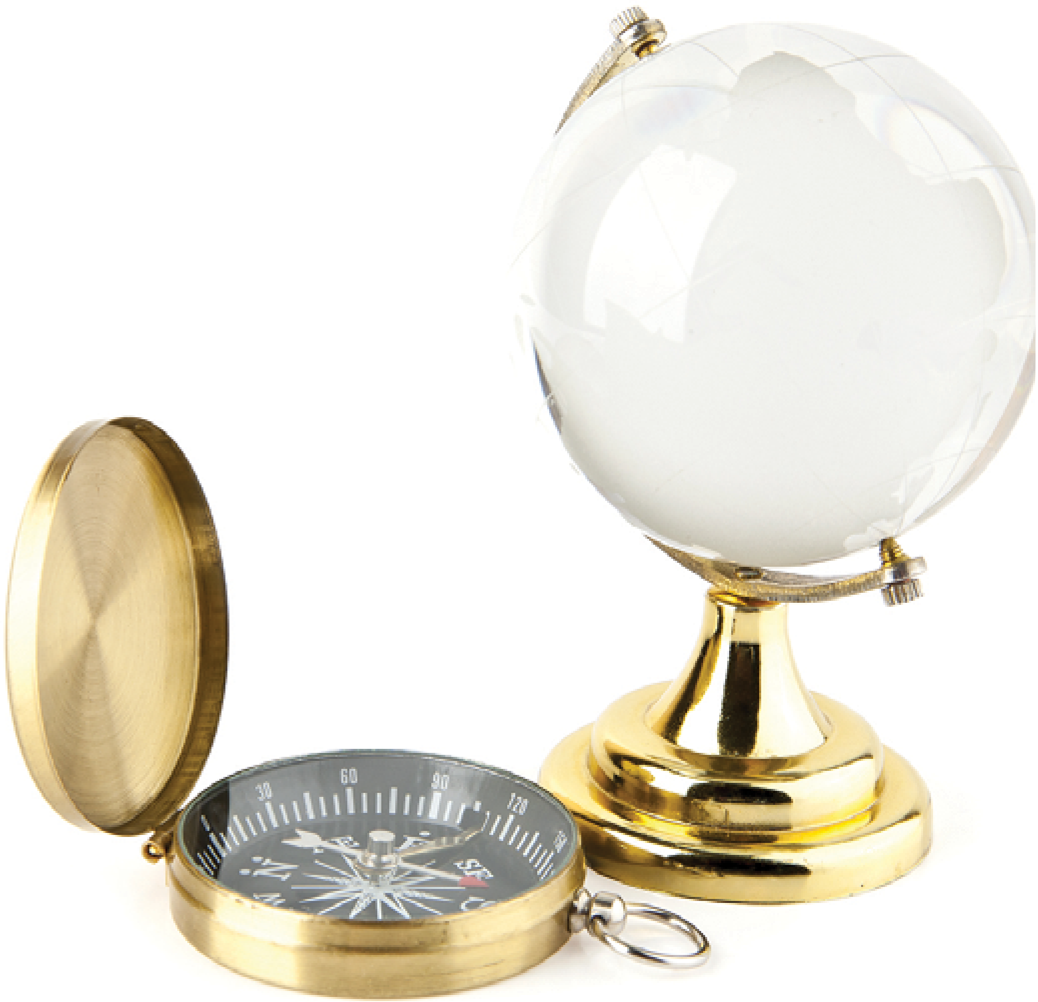
The Regulator states that the governance statement should be published either in the annual report and accounts or on the scheme's website or both.

Timing

The Regulator states that a governance statement should be published each year and it expects the first statement to be published at the end of the 2014/15 scheme year.

Whilst governance statements are voluntary, the regulatory strategy states that the Regulator expects trustees and the industry to fully embrace this 'comply or explain' approach. Now that the timing for the statements has been set out, trustees should start to consider how they will approach this task in order to complete the assessment and publish the template within the required timeframe.

If you would like any training on the requirements or assistance with completing the assessment, please get in touch with your usual DLA Piper pensions contact.



PENSION PROTECTION FUND

HOW TO REDUCE YOUR PPF LEVY

The PPF and CBI published a booklet entitled "*How to reduce your pension protection levy*". This notes that the multi-year approach taken to the levy since 2012/13 (whereby the levy rules are set for three years) encourages businesses to take risk reduction measures which will have a direct impact on the amount of levy charged. It sets out the types of measures that those with DB schemes might want to consider to reduce their risk, as well as practical steps that can be taken to reduce individual levy bills for 2014/15.

The section of the booklet entitled "*10 ways to reduce your pension protection levy*" covers the following.

- *Make sure the PPF and the Regulator hold the correct data on your scheme.* Within this section, it is noted that a significant number of schemes are reporting information on assets held that appears to be out of date which, given trends in asset allocations, means that in many cases risk is being overstated.
- *Check that D&B holds the right data on the sponsoring employer.* The booklet notes that D&B can be contacted to check the failure score and get information about how it can be monitored over time.
- *Understand your insolvency risk and discuss your failure score with D&B if you think it is wrong.* This section sets out some of the factors that the failure score takes account of and recommends contacting D&B now to ensure they hold the correct information on group structure and branch locations if it is thought that this information may be wrong.
- *Understand your scheme's investment risk and how most appropriately to report it.* The booklet states that assets reported as 'insurance' or 'other' will be treated as potentially high-risk and therefore it makes sense to break them down as much as possible. It suggests speaking to the investment adviser or fund manager if the scheme is unsure how to report individual asset classes held within pooled funds.
- *Certify any deficit reduction contributions.* The deadline of 30 April for certifying such contributions in order for them to affect the levy is noted here.
- *Use a group company guarantee.* This section provides information about type A contingent assets.
- *Pledge company assets to the scheme.* This section provides information about type B contingent assets.
- *Get a guarantee from a third party.* This section provides information about type C contingent assets.
- *Consider an out of cycle section 179 valuation.* The booklet states that if the scheme circumstances have changed significantly since the last section 179 valuation was submitted, it should be considered whether to submit a new one.
- *Get involved in the development of the levy.* This section notes the consultations issued by the PPF and that the PPF regularly speaks at and attends industry events which gives an opportunity to provide feedback on its policies and practices.

The booklet also contains sections providing background information on the levy, more information on contingent assets and information on what to do if a scheme still thinks its levy is too high.

FAQS ON ASSET-BACKED CONTRIBUTIONS

In the December 2013 edition of Pensions News, we reported that the Pensions Regulator had published a guide on changes to the scheme return for DB and hybrid schemes which included the addition of questions on asset-backed contributions (ABCs) covering: whether such an arrangement is in place which will provide payment(s) to the scheme; how the scheme's interest has been funded; the term of the income stream; and the net present value of the income stream in the scheme accounts.

In February the PPF added some new FAQ Answers to its website. It is noted in the questions that there is a new section on the scheme return in relation to ABCs, although they are not referred to in the Levy Determination. The answers to the FAQs confirm that:

- following feedback from external stakeholders, the PPF is monitoring ABCs, and will be collecting details on ABCs where they have been supplied on Exchange and therefore schemes with such arrangements should complete this section of the scheme return;
- for the levy year 2014/15, only the asset breakdown information will feed into the levy calculation; and
- for calculation purposes, ABCs will be included in the "other assets" category (and will therefore be stressed accordingly) because they do not fit within the definition of existing asset classes for the levy rules.

DEPARTMENT FOR WORK AND PENSIONS

SURVEY ON CHARGES

On 18 February the DWP published "*Landscape and Charges Survey 2013: Charges and quality in defined contribution pension schemes*".

The DWP states that the survey (the fieldwork for which was conducted during April and May 2013) was designed to:

- explore charging levels and structures in trust and contract-based pension schemes; and
- understand the characteristics of schemes that maximise the chance of better outcomes for members.

A short report on the findings of the survey relating to annual management charges (AMCs) was published in November 2013 (as reported in that month's edition of Pensions News) but this latest publication contains the full findings from the research.

Key findings of the survey are said to include that:

- the average AMC for trust-based schemes was 0.75% of the fund per year which had not changed significantly since 2011 when it was reported as 0.71% overall;
- among contract-based schemes, the average AMC had fallen slightly from 0.95% in 2011 to 0.84% in 2013;
- the key determinants of the AMC were size of the scheme, whether a commission-based adviser was used, contributions and scheme age;
- 3% of trust-based and 10% of contract-based schemes reported using active member discounts, charging deferred members an average of 0.38% more;
- providers and advisers agreed that high charges could have a major impact on member outcomes over the lifetime of a pension; and
- most providers thought that charges in new schemes were at an historic low and argued against lowering them further except on older schemes with very high charges.

The research also explored the ways in which scheme governance, investment governance and scheme administration could drive better member outcomes.

LEGISLATION

PENSIONS BILL – ABOLITION OF CONTRACTING-OUT – PROTECTED PERSONS

Introduction

The Pensions Bill currently before Parliament makes provision for the introduction of the single tier state pension and, in consequence, the end of contracting-out. It contains a statutory power (sometimes referred to as the "statutory override") so that employers can change their scheme design without trustee consent to adjust for the additional National Insurance costs which will arise when contracting-out ends. The Bill states that the power may, subject to limitations, be used to increase employee contributions and alter future accrual of benefits. Further detail on what is permitted will be covered by regulations.

The January 2013 consultation

In the January 2013 edition of Pensions News, we reported on a separate consultation that the DWP had issued as to whether the statutory power should extend to "*protected persons*".

Protected persons are employees of former nationalised industries (such as railways, electricity and coal) whose benefits were protected on privatisation by legislation which prevents or limits the ability of employers to reduce future pension accruals or increase employee contributions.

The consultation sought views on whether it is fair and appropriate to allow employers to use the statutory power in relation to protected persons.

Response to consultation

On 12 February a Written Ministerial Statement was published announcing the outcome of the consultation and the DWP published the Government response to consultation.

The response document reports that strongly polarised views were expressed by respondents with:

- trade unions and trustees against allowing the override to apply, arguing that the Government should not renege on promises made to workers at the time of privatisation; and
- employers and pension advisers in favour of allowing the override to apply, arguing that protected persons and non-protected persons should be treated equally.

The Government states that it has had to consider the best and fairest course of action in an area where the strength of argument is finely balanced and, on balance, it has decided that:

- it should honour the promises made at the time of privatisation and therefore employers should *not* be able to use the statutory override to alter their schemes in relation to protected persons; and
- it is reasonable that issues arising from the end of contracting-out for this small group of workers (approximately 60,000) should be resolved through negotiation.

Amendment to the Pensions Bill

Amendments were subsequently made to the Pensions Bill which state that:

- the statutory power cannot be used to make amendments that apply to a member who is a protected person in relation to a scheme; and
- regulations must define what is meant by a protected person in relation to a scheme for these purposes.

This outcome will come as a disappointment to some employers who were hoping to be able to use the statutory power to make scheme amendments in relation to all members but who will now only be able to use it to make amendments in relation to those who are not protected persons. The Government response states that, for protected persons, this issue should be dealt with through negotiation and therefore such employers may want to consider this option.

PENSIONS BILL – DISCLOSURE OF CHARGES

On 24 February the DWP announced an amendment to the Pensions Bill to require pension providers to disclose transaction costs in DC workplace pensions which it states will enable those running DC schemes to see how much they are paying for asset management services.

The amendment states that regulations must be made requiring information about some or all of the "transaction costs" to be disclosed to some or all of: members and, in the case of occupational pension schemes, prospective members; their spouses or civil partners; people qualifying or prospectively qualifying for benefits under the scheme; and recognised trade unions in relation to the members and prospective members.

This is stated to be the latest step in the wider Government programme for fair charges for people who are automatically enrolled into workplace pensions.

The Written Ministerial Statement in relation to the amendment to the Pensions Bill also notes the October 2013 consultation (reported in that month's edition of Pensions News) on whether to cap charges in the default funds of schemes used for automatic enrolment and states that the Government "*remains committed to seeing this policy through during the life of this Parliament*".

The response to consultation on charges (as well as further proposals on quality and transparency) will be published soon and this will contain further details about the implementation and timing of the measures requiring the disclosure of transaction costs.

MARRIAGE – SAME SEX COUPLES

In the January 2014 edition of Pensions News we reported on the coming into force of the Marriage (Same Sex Couples) Act 2013 under which the first same sex weddings in England and Wales will be able to take place from Saturday 29 March 2014 (subject to some limited exceptions where weddings can take place from 13 March). That Act applies to England and Wales.

In February, the Marriage and Civil Partnership (Scotland) Bill – which makes provision for same sex marriage – was passed by the Scottish Parliament. As at the end of February, the Bill had not received Royal Assent or been formally commenced but during the final debate on it in the Scottish Parliament, the Cabinet Secretary for Health and Wellbeing stated that the priority is now for the necessary secondary legislation and amendments to the Equality Act 2010 to be made, following which, ideally, the first same sex marriages will take place in Scotland this year.

CASE LAW

BENEFITS PAYABLE TO CIVIL PARTNERS

Introduction

Paragraph 18 of Schedule 9 to the Equality Act 2010 provides that it is not unlawful discrimination relating to sexual orientation to prevent or restrict a person who is not married from accessing a benefit which is payable in respect of periods of service before 5 December 2005 (**"Paragraph 18 Exemption"**). On the basis of this provision, some pension schemes limit survivors' pensions payable to civil partners to the member's period of pensionable service on and after 5 December 2005. (This relates to benefits which are not contracted-out. Contracted-out benefits have to be provided based on service on and after 6 April 1988.)

However, as we reported in the December 2012 edition of Pensions News, in late 2012 the Employment Tribunal upheld a challenge made on behalf of a member of Innospec Limited's pension scheme to the lawfulness of such a restriction of benefits, concluding that:

- it is a breach of the non-discrimination rule that applies to pension schemes to treat a member in a civil partnership differently to a married member in relation to service prior to 5 December 2005; and
- the Paragraph 18 Exemption can and should be interpreted to be compatible with the European Directive on discrimination so that those who are in civil partnerships cannot be treated differently to those who are married in relation to service prior to 5 December 2005.

An appeal was made against that decision to the Employment Appeal Tribunal (EAT), to which the Secretary of State for Work and Pensions was added as an Interested Party, supporting Innospec's appeal. The judgment of the EAT was issued on 18 February.

Overall outcome of the appeal

In summary, the EAT allowed the appeal, concluding that:

- the Employment Tribunal was wrong to hold that the Paragraph 18 Exemption contravened European law; and
- even if it had *not* been wrong to do so, it could not properly have interpreted the Paragraph 18 Exemption as it did.

Some further detail of the EAT's reasoning is set out below.

The question of compatibility

An important factor in the EAT's rationale for the conclusion that the restriction in the Paragraph 18 Exemption is compatible with EU law was that pension is treated as deferred pay in European law. This means that, even though it does not come into payment until a later date, pension is pay which is earned through service with the employer in the same way as salary is earned and it will therefore be subject to the law relevant to such earnings at the time.

The EAT referred to the judgment of the European Court of Justice in the *Barber* case on equal pay and sex discrimination and its judgment in the later case of *Ten Oever* which concluded that equality of treatment in occupational pensions could only be claimed in relation to benefits payable in respect of periods of employment subsequent to 17 May 1990 (the date of the *Barber* judgment). That is, the judgment did not apply to the pension earned at a time before the unequal treatment became unlawful.

The EAT concluded that there is no good reason to think that European law would treat discrimination on the ground of sexual orientation as creating any wider rights. The *Ten Oever* case demonstrates the principle that where a pension accrues on a discriminatory basis at a time when the discrimination is not unlawful, but the discrimination is unlawful by the time the pension comes into payment, the past discrimination does not have to be remedied. The EAT went on to provide further examples of European case law which support this conclusion.

The EAT stated that whilst it would be possible for a national law to specify that the requirement of non-discrimination had retrospective effect, the relevant European Directive does not purport to have retrospective effect and therefore does not make any such retrospective effect mandatory. Rather, the Directive is a basis for ensuring equal treatment after the latest date for transposition of the non-discrimination requirement into national law. (In this case the period for transposing the Directive expired on 2 December 2003. However, civil partnership was not possible in the UK until 5 December 2005.)

This means that the restriction of benefits to service on and after 5 December 2005 in the Paragraph 18 Exemption does not infringe the European Directive.

The question of interpretation

The interpretation that the Employment Tribunal concluded needed to be taken of the Paragraph 18 Exemption in order to make it compatible with European law essentially involved reading it so that the restriction could only be applied to members who are *not* married or in a civil partnership.

Essentially the EAT's reason for concluding that the Employment Tribunal could not properly interpret the Paragraph 18 Exemption as it had done in its November 2012 judgment was that it impermissibly crossed the line between interpreting and legislating. The rationale for this included the following.

- Where Parliament creates a specific exception (as it had done here) it shows that Parliament intended there to be an exception of the type identified and therefore this is less likely to be amenable to being written out of the legislation by the process of interpretation.
- The words which the Employment Tribunal suggested reading in to the Paragraph 18 Exemption would prevent it from having the effect it was clearly intended to have of restricting benefits to civil partners.
- If the EAT interpreted the Paragraph 18 Exemption as requested it might retrospectively invalidate benefits accrued on a basis that it was legitimate to adopt at the time and this would be likely to have far reaching consequences. This shows that this is a question of policy rather than interpretation and is something that it is the role of Parliament to decide.

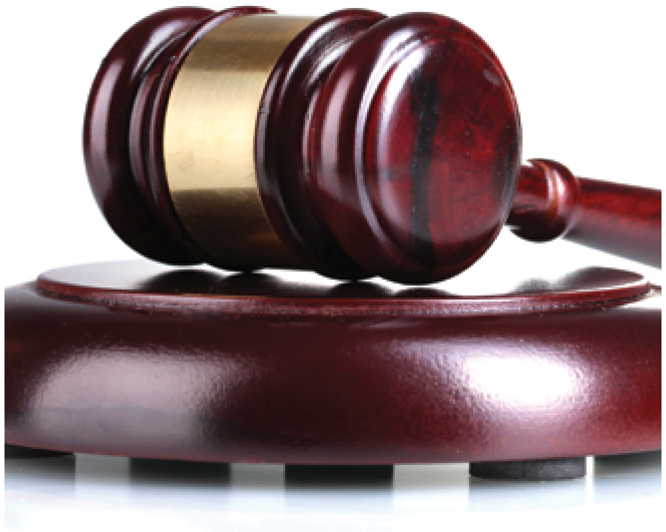
Other points to note

Other points in the judgment include the following.

- Whether the discrimination is viewed as direct or indirect, the restriction of the benefits payable to a civil partner was discrimination which, but for the Paragraph 18 Exemption, would have entitled the Claimant to know his civil partner would receive a full survivor's pension if he predeceased him. However, because of the EAT's conclusion that the Paragraph 18 Exemption is compatible with European law, Mr Walker's claim cannot succeed.
- On the question of indirect discrimination, the Employment Tribunal had concluded that objective justification had not been proved, noting the absence of evidence as to the potential liabilities that would result if the Paragraph 18 Exemption was not applied, with the Respondents instead seeking to rely on generalised assertions. The EAT rejected the element of the appeal which disputed this conclusion. The EAT acknowledged that Innospec's case on this point had been that the aim of restricting benefits to civil partners was to exclude further uncertain risks. The EAT thought that the Employment Tribunal: (i) was aware that the issue was risk; and (ii) was entitled to have sufficient evidence of the general boundaries of that risk. This evidence was not provided and therefore the Employment Tribunal was entitled to conclude as it did on this point.

For schemes which restrict the benefits payable to civil partners and intend to apply the same restriction to same sex married couples, it is important to note that the EAT decision in this case is not the end of the question of retrospective effect. This is because (as we reported in the July 2013 edition of Pensions News) there is a requirement in the Marriage (Same Sex Couples Act) 2013 for the Secretary of State to arrange for a review of differences between same sex survivor benefits and opposite sex survivor benefits provided to widows and widowers, as well as differences between opposite sex survivor benefits provided to widows and those provided to widowers. The review will also look at the extent to which same sex survivor benefits are provided in reliance on the Paragraph 18 Exemption.

The outcome of the review must be published by 1 July 2014 and, if the Secretary of State concludes that changes should be made for the purpose of eliminating or reducing differences, a power in the Act can be used to make an Order to achieve these changes. For schemes which rely on the Paragraph 18 Exemption to restrict the benefits payable to civil partners and same sex married couples, it should therefore be borne in mind that whilst the restriction is currently lawful, depending on the outcome of the review, at some point in the future this may change and the schemes' rules may need to be revisited on this issue.



HMRC

PENSION LIBERATION

In its latest Pension Schemes Services Newsletter published on 14 February HMRC provided an update on the changes it made to its processes in October 2013 to try and combat pension liberation.

Scheme registration

In relation to scheme registration, HMRC reports that in many cases it is writing to the scheme administrator for further information to help it decide whether or not to register the scheme. It goes on to state that, while it is too early to draw any firm conclusions because many new applications remain under review, early indications suggest that the number of new schemes applying for registration has fallen compared to the same period last year.

The Newsletter includes figures which, for example, show that:

- in the period 21 October 2012 to 30 January 2013, 4,067 schemes were received for registration; and
- in the period 21 October 2013 to 30 January 2014, 2,717 applications were received to register new schemes – to date about 75% of those have been registered and registration has been refused for about 5% of applications.

In the future, HMRC will look to publish these figures twice yearly.

Transfer process

An e-mail address has now been introduced that can be used for requests for confirmation of the status of a proposed receiving scheme. The Newsletter sets out the e-mail address and the information that should be provided when a request is sent.

RECLAIMING VAT ON INVESTMENT MANAGEMENT COSTS

Background

In the July 2013 edition of Pensions News and our Pensions Alert of 22 August 2013 we reported on a judgment of the Court of Justice of the European Union (CJEU) concerning a Dutch company, PPG Holdings BV, and whether VAT charged on investment management services provided to PPG, the employer, in relation to a defined benefit scheme, which it had set up for its employees, was deductible.

In summary, the CJEU held that an employer is entitled to recover the VAT charged by a service provider on the ongoing costs of the administration and the management of its employee pension fund where there is a direct and immediate link between those services and the employer's economic activities as a whole. The CJEU left it to the referring member state to decide whether there was such a link but implied that there should be such a link where there is a legal obligation to provide for the employees and where the costs in question form components of the charges made by the employer for its own goods and services.

As we noted, HMRC's guidance at the time stated that it was not possible for the employer to reclaim VAT on investment management services as these were provided to the pension fund itself, and it therefore remained to be seen whether it would change its guidance in light of the judgment or take a restrictive approach to the judgment and leave its guidance unchanged. It was also hoped that HMRC might give some practical guidance on when it would view the "cost component" test to be satisfied.

On 3 February HMRC issued Brief 06/14 announcing a change to its policy with immediate effect in light of the judgment.

HMRC's previous policy

HMRC's previous policy distinguished between general management (that is, administration) costs and investment management costs as follows.

- Employers could deduct VAT incurred in relation to administration on the basis that these costs were overheads of the employer and therefore had a direct and immediate link to their business activities.

- VAT on investment management costs was *not* deductible by the employer because they were costs of the fund itself (and therefore may only be deductible by the fund and/or the trustees).
- If a single invoice was received covering both administration and investment management services, HMRC would assume a 70/30 split so that the fund could claim 70% of the VAT as relating to investment management and the employer could claim 30% of the VAT as relating to administration.

HMRC's new policy

HMRC's new policy acknowledges the *PPG* judgment and states that whether there is a direct and immediate link between the investment management services and its own supplies of goods and services will depend on whether the cost of the input services is incorporated in the price of the supplies made by the business. HMRC goes on to note that if a cost has a direct and immediate link to a specific investment or investments owned by the pension funds, it cannot also be part of the employer's general costs.

In relation to "specific costs of investment management" which presumably means, in particular the costs of investment management services relating to specific investments, HMRC states that these will have a direct and immediate link to the supplies of the investments themselves, giving the example of the costs of managing a property within a pension fund. Only the pension fund can recover this VAT. HMRC's view is that such costs cannot therefore be general costs of the employer (and therefore the VAT cannot be recoverable by the employer).

However, if the services "go further" than the management of the investments, they may be general costs and therefore, if the supply is received by the employer, the VAT will potentially be deductible by the employer. This means that there may be some circumstances where employers may now be able to claim input tax that they were not previously able to recover.

HMRC gives no further examples as to when this "go further" test will be satisfied but does set out the following circumstances where it will *not* accept that VAT incurred on pension fund management/administration costs is deductible by the employer.

- Where the supplies were not in law made to the employer – even if the employer has commissioned and paid for the services.
- Where the supply is limited to investment management services only.

Where the employer receives the supply but the fund bears the cost of the services (whether by way of a reimbursement or set-off against pension contributions), HMRC states that it will require an equivalent amount of output VAT to be accounted for by the employer in respect of the amounts reimbursed and this amount is potentially deductible by the pension fund.

Transitional provisions

Where the pension fund is invoiced for services, during a transitional period of six months, the pension fund and employer may continue to agree a 70/30 split as applied under HMRC's previous policy. This is to allow employers time to adapt to the new policy.

Making claims

Where the employer has deducted VAT under the previous policy but would not now be allowed to do so under the new policy, HMRC does not intend to take any action to correct the position.

Where an employer can deduct VAT under the new policy but was not able to do so under the previous policy, claims for refunds can be made, however, claims for repayment will not be considered for periods ending more than four years before the date on which the claim is made. HMRC's Brief includes information on how to make a claim.

Looking ahead

HMRC will update its guidance on this matter – *Public Notice 700/17 Funded Pension Schemes* – but as at the end of February this had not been done.

The Brief from HMRC does not leave the position on reclaiming VAT entirely clear, in particular, what services "go further" than the management of investments, and what services are included within the term "specific costs of investment management" although in summary it seems to mean that:

- *VAT on supplies which are solely for investment management services will **not** be deductible by the employer. This will include in particular services related to specific investments.*
- *VAT on supplies which cover both administration and investment management services may be deductible by the employer and the amount that may be deductible is neither set at nor limited to 30% as under the previous policy. The amount deductible by the employer will depend on the application of the "cost component" test.*
- *VAT on supplies which cover only administration services will also need to meet the criteria set out in the new policy to be deductible which could result in a recovery that differs from that under the old policy.*

Exactly how this will apply to specific invoices is not clear but hopefully the updates to HMRC's detailed guidance 700/17 will provide further clarity. Employers should consider looking at the billing arrangements for their scheme costs to see whether they need to be amended in light of the new policy and also consider seeking advice as to whether they can make any claims for refunds of VAT already paid, noting the four year time limit. However, it may be difficult to come to a definitive view until the updates to 700/17 are available.

Whilst the CJEU has determined that management services supplied to defined benefit pension schemes are taxable (and do not benefit from the VAT exemption for management services supplied to special investment funds), a judgment in the case of ATP Pension Service A/S is pending on the liability of management services supplied to defined contribution pension schemes.

OTHER NEWS

PENSION LIBERATION

On 14 February, the Pensions Ombudsman (PO) issued "*Pension Liberation – update number 1*" stating that the PO has received a number of complaints about pension liberation and setting out some key information about the PO's approach to such cases.

Points made in the update include the following.

- In the opening section entitled "*About pension liberation*", the update states that "*pension liberation schemes are bad for people*" and briefly explains the problems with pension liberation.
- Most of the complaints to the PO are from those whose pension provider has not allowed a transfer and the PO has just under 40 complaints in this category. This figure has recently risen due to two groups of complaints about transfers to two different arrangements.
- The PO has a handful of cases of complaints from people who transferred into arrangements that were subsequently effectively "frozen" because of regulatory action.
- Those who complain to the PO insisting on the right to transfer will tend to be those who "*know what they are doing, and who believe that they are on the right side of the line*". Those who have been duped or are knowingly acting fraudulently are much less likely to complain about blocked transfers and therefore the PO's cases will not represent a true cross section of those affected by pension liberation.
- Those who complain about blocked transfers are likely to argue that what they are trying to do is not illegal or improper and may also say that the transferring scheme is mistaken in thinking the transfer is for the purpose of pension liberation.
- The PO is some way into investigations on a number of complaints that were received first but the timescale for publication of determinations is a little unpredictable as full enquiries have to be made and the parties have to be given a full opportunity to make their case. However, it is likely that the initial cases will be decided in April/May.

DISCLOSURE – SMPIs

In the November edition of Pensions News, we reported on a consultation issued by the Financial Reporting Council (FRC) proposing amendments to "*AS TM1: Statutory Money Purchase Illustrations*" (TM1) to reflect changes to the SMPI requirements being made by the new disclosure regulations.

The final form of the new TM1 (version 4.0) was published on 20 February. The FRC states that the text of version 4.0 is substantially the same as the version issued for consultation and, in summary, makes amendments to allow:

- cash lump sums to be taken out prior to the calculation of the illustrated pension;
- varying percentages of dependants' pension to be assumed; and
- different levels of pension increases to be assumed.

Alongside the updated TM1, the FRC published an analysis of the responses to the consultation. This notes that, in light of consultation responses, the FRC has updated the text to improve clarity in places and to:

- make it clear that where allowance is made for a lump sum, the lump sum should be shown in today's (inflation adjusted) terms alongside the illustrated pension on the SMPI; and
- make amendments in relation to the interest rate for determining the annuity rate for a non-increasing pension.

The analysis of responses also sets out a summary of all the changes in version 4.0 as compared to version 3.0 of TM1.

The new version of TM1 will be effective for illustrations issued on or after 6 April 2014, which is also the date when the new disclosure regulations come into effect.

Trustees may want to consider whether to take advantage of the flexibilities that will be permitted in relation to SMPIs from 6 April 2014. More generally on disclosure, you can read more about the changes in the new regulations in our recent alert on this subject – What the new Disclosure Regulations mean for your scheme documents and processes – which provides a summary of the key changes – both those which introduce flexibilities and those which impose new requirements.

THE OFT'S REPORT ON DC SCHEMES – AN UPDATE

In the September 2013 edition of Pensions News, we reported on the results of a market study by the Office of Fair Trading (OFT) which looked at whether the DC workplace pension market is working well and whether, in light of auto-enrolment, competition is capable of driving value for money and good outcomes for members. On 11 February the OFT published an update on the market study which includes the following.

Independent Project Board

One of the outcomes reported in September was that the ABI and its members that provide contract-based DC schemes had agreed to carry out an audit of 'at risk' schemes (that is, those sold pre 2001 which may therefore have higher charges and all post 2001 products with charges exceeding the equivalent of a 1% Annual Management Charge) and an Independent Project Board will determine, with the new Independent Governance Committees, what action needs to be taken in response to the audit findings.

The February 2014 update announces the appointment of the Independent Chair and Board members to that Independent Project Board, with the Board's membership including senior representatives from Government, the regulators, consumer enforcement, finance and the OFT.

Competition issues

In September the OFT reported that it had provisionally concluded that, even though it had identified some concerns with competition, it would not be appropriate to make a Market Investigation Reference to the Competition Commission at this stage because there are steps in place to address the concerns. This conclusion was the subject of a consultation which closed on 31 October 2013.

The February update sets out the OFT's final decision on this issue which is that it remains of the view that the package of remedies being developed are likely to impact on the persistence of the concerns identified and therefore a Reference will not be made. Alongside the update, a document was also published setting out further details of the consultation responses and the reasoning for the OFT's final decision which notes that whilst a Reference will not be made, the OFT will continue to maintain an active interest in how the remedies are implemented.

FCA – THEMATIC REVIEW OF ANNUITIES

On 14 February the Financial Conduct Authority (FCA) published the results of a thematic review on annuities that it started in January 2013. There are several elements to the results of the review and the next steps which are set out below.

Results of thematic review

The FCA states that the paper is directed at firms selling annuities and those who have existing DC pension customers, their representatives and consumer representative groups and that individual consumers may also find the results of interest.

Overall, the results of the thematic study were said to indicate that some parts of the annuities market are not working well for some consumers. More specifically, the FCA reported that the study found that:

- eight out of ten consumers who purchase their annuity from their existing provider could get a better deal on the open market;
- on average the benefit of switching is equivalent to having an extra £1,500 saved into a pension just before retirement; and
- this situation was found to be worse for those with pension pots of less than £5,000 as they have less choice, with only a handful of providers offering them annuities.

The review was focused on consumers with contract-based pensions who purchase an annuity from their existing provider or through a third-party arrangement. The FCA did not look at the similar decisions that members of trust-based occupational pension schemes make when buying annuities.

Next steps – retirement income market study

In terms of next steps, the FCA believes that it is appropriate for it to undertake a competition market study into retirement income to see whether competition in this market is working well for consumers.

Further details are set out in the Terms of Reference for the study which were also published by the FCA in February but, in summary, it will:

- look at products which are purchased from a pension pot that provide an income during retirement including annuities and income drawdown; and
- examine whether there are obstacles to competition working more effectively for consumers in this market by looking at the behaviour of consumers, the conduct of firms and the structural features of the market.

As part of the study, further supervisory work will be undertaken looking at how pension provider sales teams conduct themselves when selling annuities to existing customers.

The deadline for comments is 14 March 2014 and the FCA expects to publish a statement of its interim findings in summer 2014 and its final report within 12 months of the launch of the study.

Consultation on annuity comparison websites

At the same time as publishing the results of the thematic review, the FCA reported that it has carried out a thematic review of 13 annuity comparison websites to assess whether they were fair, clear and not misleading.

The FCA reported that whilst this review found good practice, all of the websites reviewed raised concerns, with key information and risk warnings often missing or insufficiently prominent.

The FCA has therefore published proposed guidance for consultation which it believes will make its expectations of firms clear, improve the level of compliance across the sector and ultimately lead to better consumer outcomes.

The deadline for responses to the thematic review and proposed guidance is 14 March 2014.

ON THE HORIZON

- **IORP Review.** Proposals to amend the IORP Directive in relation to governance and transparency were expected to be published in autumn 2013.
- **Employer debt.** The consultation on amendments to the "restructuring provisions" closed on 7 June 2013. The changes were originally proposed to come into force on 1 October 2013 but the final form regulations and response to consultation are awaited.
- **IORP solvency.** Further details of EIOPA's work programme on IORP solvency was due to be published in 2013.
- **Personalised lifetime allowance.** The deadline for comments on the draft clauses for the Finance Bill 2014 and the HMRC guidance was 4 February 2014. The Finance Bill will be published on 27 March 2014.
- **Exceptions to automatic enrolment duties.** A consultation is due to be published in early 2014.
- **PPF's insolvency risk provider.** New insolvency risk scores will be used for the 2015/16 levy year. The PPF is working with an industry steering group to evaluate the new methodology as part of a broader review of the levy. It had originally been intended that levy payers would be able to see their new scores in early 2014 but this will not now be the case. The PPF continues to work with Experian and will provide updates as necessary.
- **Simplification of automatic enrolment.** Some of the simplifications came into force on 1 November 2013 and the changes in relation to joining windows will come into force on 1 April 2014.
- **Automatic enrolment earnings thresholds.** Changes to the thresholds are proposed to take effect from 6 April 2014.
- **Pension protection following TUPE transfer.** The consultation on amendments to this legislation closed on 5 April 2013. The changes were originally proposed to come into force on 1 October 2013 but the final form regulations and response to consultation are awaited. A DWP update states that regulations on this subject will come into force on 6 April 2014.
- **Disclosure.** The new regulations will come into force on 6 April 2014. A new version (version 4.0) of the TM1 guidance on Statutory Money Purchase Illustrations which has been amended to bring it into line with the new regulations will be effective for illustrations issued on or after 6 April 2014.
- **Changes to the annual allowance and the lifetime allowance.** The lifetime allowance will be reduced to £1.25 million and the annual allowance to £40,000 for tax years 2014/15 onwards.
- **Money purchase definition.** Amendments to the definition of money purchase benefits are expected to come into force on 6 April 2014 with retrospective effect to 1 January 1997. Supporting regulations which provide some easements to the retrospective effect are also expected to come into force on 6 April 2014.
- **Pensions Bill.** The Minister for Pensions has stated that it is hoped that the Bill will receive Royal Assent by Easter 2014.
- **Equalisation for GMPs.** During the Parliamentary debate on the Pensions Bill, it was reported that guidance on GMP conversion (which will provide guidance on an alternative method by which schemes can equalise benefits including GMPs prior to conversion) is expected to be provided by spring 2014.
- **Master Trust Assurance Reporting.** The consultation on draft guidance on independent assurance reporting for master trusts closed on 16 December 2013 and final guidance is expected to be published in spring 2014.
- **Pension liberation.** The Pensions Ombudsman has reported that whilst the timescale is a little unpredictable, it is likely that the initial cases being considered on pension liberation will be decided in April/May.

- **Fiduciary duty.** The Law Commission's consultation on fiduciary duties in relation to investments closes on 22 January 2014 and a report (containing recommendations) is expected to follow in June 2014.
- **Review of survivor benefits.** Under the Marriage (Same Sex Couples) Act 2013, the Secretary of State must arrange for a review of different treatment of survivor benefits under occupational pension schemes to be completed and publish a report by 1 July 2014.
- **Consultation on regulation of DB scheme funding.** The Regulator's consultation on an updated Code of Practice on funding defined benefits, a draft regulatory strategy and a draft funding policy closed on 7 February. It is anticipated that the new Code will be in force by July 2014.
- **Public service schemes.** The Regulator's consultation on the draft Code of Practice and regulatory strategy for public service pension schemes and the DWP's consultation on record-keeping requirements for these schemes both closed on 17 February 2014. It is anticipated that the Code will be laid before Parliament in the autumn.
- **Defined ambition.** The DWP's consultation closed on 19 December 2013. A report summarising responses and the action that will be taken as a result will subsequently be published. The DWP aims to consult on draft legislation in this area in 2014.
- **Short service refunds.** It is intended that short service refunds will be withdrawn from money purchase schemes in 2014.
- **DC regulation.** The Regulator expects trustees of occupational pension schemes to assess the extent to which their scheme complies with the DC quality features and publish a governance statement in relation to this assessment at the end of the 2014/15 scheme year.
- **DC charges and scheme quality.** The DWP's consultation on DC charges closed on 28 November 2013 and, following this consultation, the Government will publish proposals on charges and scheme quality. The DWP has confirmed that any cap will not be introduced before April 2015.
- **State Pension.** The reform of state pension which would result in the end of contracting-out is proposed to take effect in April 2016.

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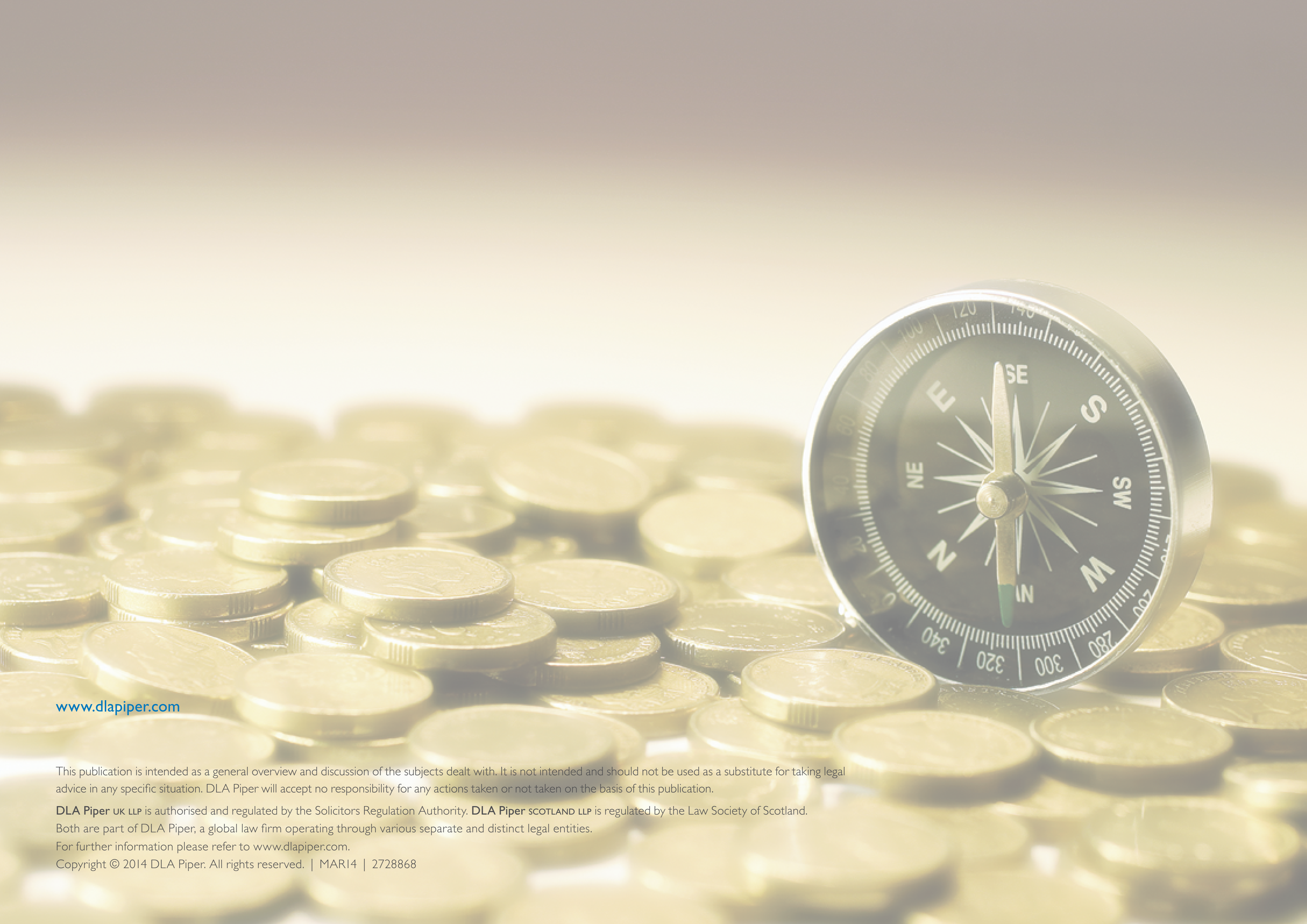

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