SPENCE & PARTNERS – INDUSTRY CHANGES

Your Quarterly Pensions Update – March 2016

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Introduction

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Welcome to your Quarterly Pensions Update

The purpose of this quarterly update is to keep sponsoring employers and trustees up to date with recent pension industry changes up to March 2016.

For your convenience Spence has summarised the key changes and highlighted the necessary actions employers and trustees may need to take as a result.

The format of our update combines brief written comment with links to further relevant information and highlights any deadlines you need to be aware of.

We trust you will find the update useful and informative. If you require further information about how any of the topics covered might impact on your scheme, please contact your usual contact at Spence, who will be keen to help.

NOTE

This document is aimed at providing you with generic information about recent developments in the pensions industry.

You should not take any action as a result of information included in this document without seeking specific advice in relation to the impact these matters might have on your scheme or company. Spence & Partners Limited accepts no liability for actions taken or not taken as a result of this document.

If you require specific advice about any of the matters mentioned in this document please get in touch with your usual Spence & Partners Limited contact.

Chancellor’s Autumn Statement

TAGS: BUDGET

The most significant announcement in George Osborne’s 2015 Autumn Statement and Spending Review was what wasn’t announced – i.e. ; confirmation on when the government would announce progress on the pensions tax relief consultation. Of the announcements that were made, the most relevant for employers was that the next two increases in the minimum level of contributions payable to DC auto-enrolment pension schemes will be delayed by six months, and aligned with the following tax years. This was discussed earlier in this update.

Other pension related announcements included development of existing pensions reform initiatives, and confirmation of the government's commitment to the "triple lock" for the state pension.

Helpful Links:
- Alan Collins gives an overview of the Autumn Statement
- Chris Robert’s Article for the PMI

ACTION

Employers should keeping a close eye on the March 2016 budget as any tax changes could materially impact the attractiveness and tax efficiency of providing pensions as an employee benefit.

Automatic Enrolment in the Autumn Statement

TAGS: AUTO ENROLMENT | TPR

The government published a joint Spending Review and Autumn Statement on 25 November 2015.

In this statement the government confirmed a 6 month delay to the next two scheduled increases in automatic enrolment minimum contribution rates.

The purpose of the delay is to align the contribution increases with the beginning of the tax year, to "help businesses with the administration of this important boost to our nation's savings."

The following table illustrates the minimum contribution requirements along with the revised dates:

	Minimum employer contribution	Minimum total contribution
Up until 5 April 2018	1%	2%
6 April 2018 to 5 April 2019	2%	5%
6 April 2019 onwards	3%	8%

The government also estimates that savings of £390m (in 2017-18) and £450m (in 2018-19) will be generated as a result of the revised contribution schedule. The industry view of this decision is that the government chose to delay the increases instead of delaying the onset of automatic enrolment for smaller employers, as some have already reached their staging dates.

Helpful Links:

- Spending Review and Autumn Statement 2015 Documents
- Pensions and the Pikachu Paradox - Alliteration at its finest

ACTION

Review contribution staging structure (if applicable)

Introduction

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Pension Freedoms Update

TAGS: PENSION FREEDOMS | ANNUITIES

The Association of British Insurers has released data showing that in the six months since the new pension freedoms came in to force in April 2015, £4.7bn of investment had been withdrawn under the new measures. It has been noted that overall, individuals are taking a common sense approach to the new pension freedoms, with small pots tending to be taken as cash lump sums, and larger pots being used to access retirement income in the long term, through products such as annuities or income drawdown policies.

Data also suggests that customers are behaving sensibly and shopping around to find the best deal, with 60% of individuals changing provider when choosing to purchase an income drawdown policy, and 40% of individuals changing provider when electing to purchase an annuity. It is worth noting that customers are often offered guaranteed annuity rates by an existing provider, so are less likely to change provider than when purchasing an income drawdown policy.

There are warnings that since the new Pension Freedoms were introduced, there has been an increase in the type of new scams that fraudsters are trying to implement in order to get at retirees' pensions. The primary targets are individuals that have recently reached the age of 55 and are able to make withdrawals from their pension pots for investment. It is believed that one in seven individuals over the age of 55 have been targeted since the new pension freedoms were introduced in April.

The best protection against such attempts from outsiders to access a pension pot is to simply decline to provide any information to them if you do not know who they are, and they cannot provide proof of their identity and/or who they work for. It is recommended that employers should educate their employees to be aware of potential scams and risks in order to increase their knowledge and safety

Helpful Links:

- Association of British Insurers – 6 month update

ACTION

Trustees: Individuals and customers coming up to retirement should be aware of and educated in regards to the options available to them upon retirement, including spending options, investment options, and provider options.
Employers: Employers should educate employees to try and protect their pensions from fraudsters.

Introduction

Practical Impact of Impending Changes to Lifetime Allowance ("LTA") and Annual Allowance ("AA")

TAGS: BUDGET | CONTRIBUTIONS | ANNUAL ALLOWANCE | LIFETIME ALLOWANCE

In the Summer Budget, it was announced that the standard LTA will reduce from £1.25m to £1m from 6 April 2016, and will also be indexed annually in line with CPI from 6 April 2018.

It was also announced that from 6 April 2016, all pension input periods ("PIPS") are to be aligned with the tax year. To achieve this, changes are being made to the AA calculations for the current tax year.

It is also worth noting that with effect from 6 April 2016, there will be a reduction in tax relief for people whose income plus pension savings exceeds £150,000. The AA of £40,000 will be reduced on a sliding scale by £1 for each £2 of adjusted income in excess of £150,000, down to a minimum of £10,000 for those earning above £210,000.

Pension schemes need to amend calculations to ensure that the correct pension input amount is calculated and tested against the correct AA. Changes will also be required to calculations determining whether members need a Pension Savings Statement, once the tax year is completed.

Helpful Links:
- HMRC Newsletter 74

ACTION

Sponsoring employers and scheme trustees should consider what information needs to be issued to members potentially affected by the reduction in LTA. In particular, communications should include an alert to members who are intending to rely on fixed protection in 2016, stating that they will need to stop accruing benefits by 5 April 2016.

Employers should review the total remuneration package for high earners in light of the reduction in tax efficiency of pension contributions. Consideration should be given to whether alternative forms of remuneration (e.g. cash) might be more attractive to such individuals.

Consultation on Tax Relief EET – TEE

TAGS: TAX REFORM | BUDGET

The consultation period on the Chancellor's tax consultation, 'Strengthening the incentive to save', ended at the close of Quarter 3 in 2015. Following responses from the industry, sources close to the Treasury have hinted that the government plans to set aside the idea of introducing pension ISAs.

It is understood that many responses to the consultation were received by the Treasury. The National Association of Pension Funds ("NAPF"), now known as the Pensions Lifetime Savings Association ("PLSA"), urged the government to "abandon its proposals for pensions tax reform" as they believed it would "further undermine pension saving in the UK without achieving its desired policy objective." They instead suggested the government maintains the current system but with a radical reduction applied to the annual allowance.

Previously, it was expected that George Osborne would release details of possible reforms following the consultation in his Autumn Statement. However this has now been delayed until the 2016 Budget and it is intended that this will take the form of a Green Paper. The industry view is that the changes will therefore be significant, following this careful consideration by the Treasury.

Although the government is currently remaining tight-lipped on the subject, it is expected that the pension tax system will undergo some reforms. This may take the form of contributions being paid from taxed income, the government adding a top-up of between 25% and 33%, investment returns remaining tax-free or pension payments remaining taxable – presumably with 25% still being tax-free. In essence, this suggests a movement from:

- **Exempt -> Exempt -> mostly Taxed ("EET")**

  to

- **Taxed -> Topped Up -> Exempt -> mostly Taxed ("TET")**

This appears counter-intuitive to many in the pensions world, especially as the objective of the consultation was to be "simple and transparent." The expected transformation would undoubtedly make the pension tax system even more confusing and complicated for members than it currently is.

It may also be argued as being misleading to advertise the government's top-up as a bonus, since the member's pension income at retirement will also be subject to tax.

Consultation on Tax Relief EET – TEE continued…

Furthermore, it is expected that moving to a system of deducting contributions from taxed income would prove unpopular.

At present, the jury is still out on what form the changes might take. However, given the time spent by the government on this issue to date, when the changes to tax relief do come, they are expected to be radical.

Helpful Links:

- gov.uk - Pension Schemes Newsletter 70 July 2015
- Towers Watson Commentary on Pensions Tax Changes

ACTION

Employers should keeping a close eye on the March 2016 budget as any tax changes could materially impact the attractiveness and tax efficiency of providing pensions as an employee benefit.

Second Hand Annuities

TAGS: ANNUITIES

On 15 December 2015, HM Treasury and the DWP published a response to the March 2015 call for evidence on creating a secondary annuity market and set out the decisions the government has taken in the light of the responses received.

The government believes that individuals should be free to make their own choices about what to do with their annuity incomes. It is committed to creating a secondary market for annuities by April 2017, by which time it will work to develop an effective package of measures to protect consumers.

Helpful Links:

- Mike Crowe, from our sister company Dalriada, discusses Second Hand Annuities in this 'Professional Adviser' article.

ACTION

Trustees: Individuals and customers should be aware of, and educated in regards to, the options available to them.

Employers: Educate employees to help protect their pensions from fraudsters.

TPR Integrated Risk Management

TAGS: TPR | RISK MANAGEMENT | DB SCHEME FUNDING

December 2015 saw the publication of The Pensions Regulators' Integrated Risk Management ("IRM") guidance. The guidance highlights the importance of an integrated approach to risk management and it is expected that the guidance will become an important tool for managing the risks associated with DB scheme funding going forward.

The guidance sets out what a proportionate approach to risk management may look like and how such an approach can be implemented. It seeks to identify the risks affecting the prospect of meeting the scheme funding objective, with a view to identifying relationships between the risks faced by the employer and the scheme. Furthermore, IRM provides advice on what trustees can do should the identified risks materialise.

The anticipated benefits of implementing an integrated risk management approach include:

- Risk Identification
- More informed decisions
- Improved collaboration between trustees and employer
- More efficient use of all stakeholders' time
- Greater transparency for third parties

Helpful Links:
- TPR Guidance-Integrated Risk Management.pdf
- Spence and Partners Full Scheme Service

ACTION

Trustees should read the guidance provided by TPR and consider how IRM could be incorporated into their Scheme.

TPR Purple Book 2015

TAGS: TPR | RESEARCH

The Purple Book is compiled annually by the Pensions Regulator as part of their research on DB schemes within the UK. In this year's edition, the changes to DB schemes, both since the previous issue and since its inception in 2006, are outlined. The proportion of all schemes that are open to new members and future accrual has dropped from 43% in 2006 to 13% in 2015. This trend is reflected further in the 2% increase since last year (to 34%) in schemes that are closed closing to future accrual. Despite continued economic recovery in the UK over the course of the year, a significant drop in gilt yields has contributed to adverse movement in scheme funding levels.

Between 2006 and 2015, there has been a notable reduction in the equity share of total assets of DB schemes. In fact, the share has almost halved over this period, reflecting the continuing trend towards de-risking of schemes. Despite this fall in overall equity share, the overseas equity proportion of total equity assets held has increased from 62.4% to 65.4% since last year.

It seems then that companies are becoming more aware of the market in which their schemes are invested and the effect that market movements have on its scheme's liabilities.

Helpful Links:
- TPR Purple Book

ACTION

Employers with open schemes will note that they are fast becoming a dying breed – they should review their rationale for retaining DB pension provision as well as measure and take action if necessary on the risks posed by their schemes.

DC Code of Practice

TAGS: TPR | DC GOVERNANCE

Update of Frequently Asked Questions on the new DC duties

The Pensions Regulator updated its list of *Frequently Asked Questions on the new DC duties* ("FAQs") in relation to the governance and charge control measures for occupational DC pension schemes that came into force in April 2015.

The new questions provide further detail on various issues, including:

- **Charge controls**: Clarification of when the default fund charge controls may apply to a scheme, which schemes may be exempt and the recommendation to notify the Regulator as soon as possible about any periods of non-compliance with the charge controls (even if now rectified). Information should be provided about the breach, steps taken to reach compliance and proposals to remedy any impact on members. The Regulator will review this information to consider whether it needs to take any further action.

  The Regulator notes that breaches are required to be reported via the scheme return, but would prefer schemes to provide the above notification separately beforehand, to avoid needing to request information after the return has been submitted.

- **Governance standards**: Clarification of which schemes may be exempt, based on the wording of the applicable regulations.

- **Chair's Statement**: Further guidance on what the Chair's Statement is required to cover, based on the wording of the applicable regulations.

These FAQs only form part of the Regulator's guidance on DC schemes. The Regulator followed up this development with a consultation on a revised draft Code of Practice 13 ('Governance and administration of occupational defined contribution trust-based schemes') – see below.

Helpful Links:

- TPR FAQs

DC Code of Practice continued…

Consultation on DC Code of Practice 13

On 24 November 2015 the Pensions Regulator (TPR) published a new draft DC Code of Practice 13 for consultation, in a bid to raise standards of governance and administration.

The new draft DC code is shorter and simpler than the code currently in place and sets out the standards of conduct and practice the Regulator expects trustee boards to meet in complying with their legal duties, and to deliver better long-term outcomes for retirement savers. It will not come into force until July next year, at the earliest, so the existing code will continue to apply.

The new DC code takes into account new legislation relating to the charge cap and new flexibilities, whilst addressing standards of governance. It is divided into six sections:

- the trustee board
- scheme management skills
- administration
- investment governance
- value for members
- communicating and reporting.

The consultation closed on 29 January 2016 and can be found in the link below.

Helpful Links:
- TPR DC Code Consultation 2015

DC Code of Practice continued...

The SPP publishes DC Reporting Templates

The Society of Pension Professionals ("SPP") made available on its website two standard reporting templates to help trustees of DC schemes and independent governance committees comply with new reporting obligations introduced in April 2015. The templates have been prepared by the SPP, building on work by Hogan Lovells and Prudential, and are intended to be adapted and tailored to suit specific circumstances.

The DC annual governance template is aimed at helping trustees comply with the duty to produce an annual governance statement confirming how they are meeting the new governance standards (i.e. *Regulation 23, Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715)*). This statement must be produced within seven months of the end of each scheme year.

Helpful Links:

- SPP Templates

ACTION

Trustees should ensure they have prepared the template for their annual governance statement.
Employers should be aware of the additional compliance burden placed upon occupational DC schemes as a result of these developments.

Recoverability of VAT on Professional Fees

TAGS: VAT

In 2015 the European Court of Justice ruled that employers could recover VAT from the investment management costs of running their pension schemes. It is worth noting that many small to medium sized schemes invest via insurance policies and therefore do not pay VAT on investment management costs. However, this ruling gave HMRC a nudge to consider the reclamation of VAT on pension scheme expenses in general.

Ordinarily pension schemes do not have sales VAT so cannot reclaim VAT on expenses. However, it is common for employers to reclaim VAT on the scheme’s behalf, especially where the employer pays the expenses directly. It is anticipated that in the future an employer will have to show a direct contractual link with the service provider in order to reclaim any VAT. This revised treatment was due to apply from January 2016.

The proposed solution to this issue was for employers and trustees to enter into tripartite agreements with service providers. However, in October 2015 HMRC issued an update brief, accepting that there may be corporation tax implications with the above solution and therefore suggested two alternative approaches:

- Trustees contract with the employer for the provision of administration services, or;
- Undertake VAT grouping of a corporate trustee and the employer

The transition period has been extended to 31 December 2016, to allow for further guidance on the issue.

ACTION

Trustees should ensure there is good communication with the Employer regarding this issue.

FRS 102 and Implications for Trustees' Reports and Accounts

TAGS: ACCOUNTING

The introduction of FRS 102 – the Financial Reporting Standard applicable in the UK and Republic of Ireland – has triggered the biggest changes to pension reporting in nearly 30 years. It has required a revision of the Pensions Statement of Recommended Practice – Financial Reports of Pension Schemes ("the SORP") issued by the Pensions Research Accountants Group ("PRAG").

FRS 102 is applicable for accounting periods commencing on or after 1 January 2015 and will therefore apply to pension scheme financial statements for years ending 31 December 2015 onwards. Comparative disclosures will be required, including possible restatement of asset values for certain investments.

The 3 key changes to the SORP are:

1. Accounting for annuities
2. Investments are assessed at fair value
3. Disclosure of investment risks

Further details on FRS 102 and the revised SORP can be found on the following links:

Helpful Links:

- FRS 102
- SORP

FRS 102 and Implications for Company Reporting of Pension Costs

TAGS: ACCOUNTING

The Financial Reporting Council (FRC) is replacing current UK GAAP for accounting periods beginning on or after 1 January 2015. All of the existing Financial Reporting Standards are effectively being replaced by a single standard, FRS 102.

Under the previous regime, listed Companies had to account for their pension liabilities under International Accounting Standard 19 (IAS 19). Unlisted Companies could choose to account for their pension costs under either Financial Reporting Standard 17 (FRS 17) or IAS 19. FRS 102 introduces amendments to both FRS 17 and IAS 19 which will have an effect on the profit disclosed in Company accounts, and the final balance sheet position.

FRS17 has been superseded by Section 28 of FRS 102: Employee Benefits, and the main changes are as follows;

- The pension cost charged to the P&L will tend to increase for most employers because interest is charged on the net defined benefit obligation (the difference between the fair value of the scheme's assets and the defined benefit obligation), but the expected return on assets is removed.
- There is no longer an exemption for companies participating in multi-employer schemes with non-segregated assets.
- Where a surplus exists, there is more scope for the sponsor to recognise this as a balance sheet asset.

Helpful Links:

- FRS 102 An Employers Guide

Changes to PPF levy determination for 2016/2017

TAGS: PPF LEVY

The PPF published its guidance for 2016/17 (the second year of the PPF's "triennium") on 17 December 2015.

As expected, the rules for 2016/17 are substantially the same as for 2015/16, reflecting the PPF's desire to maintain stability of methodology.

Although, even with factors such as the scheme based levy multiplier and the levy scaling factor remaining at 0.000021 and 0.65 respectively, the PPF Levy have confirmed that for the 2016/17 levy year, they expect to receive £615m from the invoices. This is £20m less than the 2015/16 levy year's estimation of £635m, reflecting improvements in the insolvency risk scores of employers and guarantors.

The main points are:

- Relaxation in the reporting requirements for re-certifying asset backed contribution arrangements ("ABCs"), and
- The possibility that charges over bank accounts can now be excluded from the insolvency risk calculation (the PPF are consulting on this).

With a lot of the factors remaining the same, combined with the expected reduction in employers' insolvency risk, we would assume that they will broadly remain the same. This could be partially offset for any schemes who "incorrectly" declared themselves as a 'Last Man Standing' scheme, as the PPF intends to re-invoice these schemes with the total amount they should have been charged in previous levy years.

Helpful Links:

- Slaughter and May PPF Consultation on 16/17 Levy

ACTION

Trustees should:

- Continue to monitor their Experian score
- Ensure the information on the TPR Exchange website is up to date
- Ensure Deficit Reduction Contribution Certificates are up submitted by 29 April

Occupational Pensions (Revaluation) Order 2015

TAGS: OPR

Members who left a final salary pension scheme after 1 January 1986 are entitled to have their pension revalued in line with inflation until they come to retire. The Occupational Pensions (Revaluation) Orders state the amount by which a preserved pension should be revalued. Since 2010, these orders have been based on the previous September's CPI Inflation. During the year to September 2015 there was actually deflation of around -0.15%. As such, the 1 year revaluation figure has been set at 0%.

Pension schemes with statutory revaluation and statutory pension increases should see a liability saving during 2016 due to this statistic. This is because an assumption is likely to have been made that pensions would increase over the year, when in reality they haven't. This will also lead to an element of an "experience gain" for pensions accounting disclosures.

Helpful Links:

- The Occupational Pensions (Revaluation) Order 2015

Pooling LGPS Assets into 6 Wealth Funds

TAGS: INVESTMENT

In early October George Osborne announced plans to combine the assets of 89 Local Authority Pension Funds into 6 "Wealth Funds", each worth in excess of £25bn, with the aim of increasing investment in major infrastructure projects. Currently around 1% of LGPS funds are invested in infrastructure projects, which include hospitals and public highways.

The increased size of the funds should provide a number of economies of scale and pave the way for investment in more diverse projects, such as infrastructure. This has the potential to both reduce the costs of operating the funds and improve their returns, thereby having a positive impact for Local Authorities and members of their pension funds alike.

There are concerns about the suitability of infrastructure investments for pension schemes, as their returns are unlikely to match pension scheme liabilities. The general cost effectiveness of these projects is also a point of debate.

Helpful Links:

- Pensions World Article on pooling of LGPS funds to six Wealth Funds

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Watch the Spence Approach video here.