

Leaders in Pensions

Trustee Knowledge Update

Welcome to the May 2016 edition of our Trustee Knowledge Update which summarises recent changes in the law. It is aimed at helping trustees (including trustee directors) comply with the legal requirement to have knowledge and understanding of the law relating to pensions and trusts. This edition focuses on the key legal developments over the last three months.

Automatic enrolment

Automatic Enrolment Amendment Regulations

There are a number of changes to the auto-enrolment regime, including:

Exemptions: Additional exemptions to the duty to auto-enrol are added: company directors; “genuine partners” in LLPs (not treated as employed by the LLP for income tax purposes); and workers who have received a Winding-up Lump Sum and have left and are reemployed by the employer within 12 months. In these cases the duty to auto-enrol becomes a discretion (in the latter case for the duration of the 12 month period).

Easement for formerly contracted-out schemes: Until 6 April 2016, many DB schemes satisfied the quality requirements by complying with the reference scheme test. As a result of the cessation of contracting-out, they now need to comply with another test. There are several alternatives but the Government envisages that most schemes will rely on the “cost of accruals” test. This is satisfied where the cost of providing each category of benefits is between 8% and 13% (depending on the definition of “pensionable earnings” and if death benefits are provided).

To make the cost of accruals test easier to meet in the short term, schemes which ceased to contract out on 6 April 2016 can satisfy it on a scheme wide (rather than a benefit category) basis. An actuarial report must be available before 6 April 2016 to confirm the cost of accrual. Guidance suggests that the report could be in the form of existing funding documents if “they contain the relevant information on the cost of future benefit accrual”.

This relaxation ceases to apply if benefits are amended so that the scheme would not meet the old reference scheme test. Otherwise, it can be relied upon until 5 April 2019.

Action points: Trustees of DB schemes that were contracted-out until 6 April 2016 and are still open to accrual, should check with the employer if the scheme remains a qualifying scheme for auto-enrolment.

Charges and Governance Amendment Regulations

From 6 April 2016 there are new limits on charges on members to recover payments for services supplied to members or employers. The limits apply if the scheme is an occupational pension scheme providing DC benefits that is a qualifying scheme for auto-enrolment. The prohibition applies to members (including deferreds) employed by an employer who used the scheme for auto-enrolment on or after 6 April 2016. Charges under contracts with service providers entered into on or after 6 April 2016 cannot be recovered from members.

Trustees must notify service providers that the scheme is a qualifying scheme providing DC benefits before 6 July 2016 or within 3 months of the requirement first applying to the scheme or a new service provider being appointed. The

service provider then has 1 month to comply and 2 months to confirm this to the trustees. There are provisions allowing the service provider to request additional information.

Regulations define a “service provider” as someone who “provides an administration service directly to the trustees”. Guidance says “service providers are likely to be a person or firm who provides a bundled administration service(s) to trustees..., such as an insurer or master trust provider. It will also include a person or firm who provides unbundled administration service(s) to trustees or managers, such as third-party administrators...”

Action points: Trustees of schemes used for auto-enrolment that have DC benefits need to ensure that they identify any service providers and provide them with the appropriate notifications before the July 2016 deadline.

Government

Guidance on advice requirements

The Pension Schemes Act 2015 includes a requirement for trustees to check that members have received financial advice before making a transfer of DB (and certain other) benefits to a DC or cash balance arrangement or converting them to DC benefits. This factsheet is intended to help determine which benefits are caught by this requirement and when the exception to the advice requirement for those with benefits worth £30,000 or less applies. It includes the following points:

- The advice requirement applies, in the Government's view, to benefits where there is a “guaranteed annuity rate” (GAR) or some promised level of income. A GAR will still be caught where the guaranteed rate is below the rates being offered on the open market. However, if a GAR expires at a specified point in time, the benefit will cease to be within the advice requirement when it expires.
- Any benefits where there is a GMP or reference scheme test element will be caught by the requirement. However, if benefits have been transferred to a buy-out policy, benefits over the amount needed to secure the contracted-out benefit will not be caught.
- If AVCs are caught because there is a guarantee, even though the member has a separate right to transfer DC AVCs, any DB benefits in the scheme will have to be taken into account when seeing if the AVCs are within the £30,000 threshold.

Action points: Trustees of DC schemes with GMP or reference scheme test underpins will need to consider whether their scheme has any benefits that might be caught by the advice requirement.

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Regulator (www.pensionsregulator.gov.uk)

DC Code of Practice and draft DC “How to” Guides

The Regulator has issued its new DC Code of Practice which is now before Parliament for approval. The Code dispenses with the existing quality features and replaces them with 6 broad subject headings. The Regulator has also issued draft supporting guides under each heading intended to support the new Code.

The Guides do not contain prescribed requirements for trustees but are intended to set out “*information on how [trustees] might meet [the Governance] standards [set out in the Code] in practice*”.

Action points: *The new DC Code and accompanying guidance is something that trustees of schemes with DC benefits (including AVCs) will need to put on the agenda for the next trustee meeting after July (when the new Code is due to come into force).*

Draft DC compliance and enforcement policy

The draft policy sets out what the Regulator will take into account when setting penalties or advising the Determinations Panel on penalties. It sets the mandatory penalty for failure to produce a chair's statement at a minimum of £500, increased by 10p for each DC member (doubled if there has been another breach in the previous 3 years) up to the statutory maximum of £2,000. Where there is a professional trustee, the penalty will usually be £2,000.

Action points: *The penalties for failing to produce a chair's statement where required are mandatory. Trustees should therefore ensure they have processes in place to produce the required statement on time.*

Updated Scorpion campaign published

The Regulator has refreshed its Scorpion guidance on pensions liberation. The substance is much the same, but there are some changes:

- The trustee guidance says that if after due diligence, trustees “*suspect that a receiving scheme may be involved in a scam*” they should “*communicate [their] suspicions to the member and record this communication.*”
- On the checklists for trustees, the check for whether the scheme is “*sponsored by an employer that doesn't employ the member*” has gone (in light of the Hughes case referred to below).

Action points: *Trustees should ensure that the updated Scorpion literature is handed out to members requesting a transfer.*

Ombudsman (www.pensions-ombudsman.org.uk)

Mather - member awarded pension for service where she had received a refund of contributions

In 1978 the member requested a refund of contributions for four years' pensionable service. The refund was paid but records did not reflect this. The member re-joined the scheme in the 1980s. From 2005 she received benefit statements including the refunded years. This was spotted when she sought to retire in 2013. The member claimed she had no recollection of having requested the refund and had made decisions based on the incorrect statements.

Teachers' Pensions (TP) argued that it was entitled to assume that the data it had was correct: it was not possible to check all members' files about service periods until an application for retirement was made. It also referred to a caveat on the benefit statements which provided that: “*The figures in this Statement are for illustration only. Every effort has been made to ensure accuracy, however this Statement confers no right to the benefits quoted*”

The Deputy Pensions Ombudsman was satisfied that the member was unaware of the mistake. Although the DPO accepted that it was not feasible for TP to verify every member's record every year, she suggested that it should not have used the phrase “*Every effort has been made to ensure accuracy*” on the benefit statements, that phrase entitled the member to expect that the data used was accurate (or, at worst, contained only trivial errors).

It would be unfair to reduce the member's benefits (save for the amount of the refund paid). TP was directed to increase her pension as if service between 1974 and 1978 was pensionable and pay arrears from her retirement date.

Action points: *This case illustrates the need for trustees to be careful about generic disclaimer wording in benefit statements and booklets.*

Lettman – two-year time limit for lump sums on death

The member died on 21 November 2008 and the London Pension Fund Authority (LPFA) received notification on 28 November 2008. However, information requested by LPFA was only provided on 9 November 2010, close to the two year limit for paying death benefits without adverse tax consequences. The employer decided to pay the lump sum to the member's mother on 23 November 2010. On 6 December the mother was told that the lump sum would be paid less a tax charge. The mother complained that she had only been informed of the two year limit on 9 November 2010, and that LPFA and the employer should have ensured that the payment was made in time.

The Ombudsman said that information about the two-year limit and the consequences of paying outside that period, was pertinent factual information and either LPFA or the employer should have volunteered it. Failure to do so amounted to maladministration.

The Ombudsman also considered whether there was any unnecessary delay after receipt of the information on 9 November 2010 (which still left 13 working days for the lump sum to be paid in time). The employer ought to have realised the urgency and even after it took the decision to pay the death benefit to the mother, there were three or four days to complete payment. The employer said it did not have relevant bank account details to make a BACS transfer. However, the Ombudsman accepted that the employer could have issued a cheque. The employer's failure to take urgent action was maladministration.

The employer was directed to pay the mother the balance of the lump sum, plus interest. The employer and LPFA were each directed to pay her £250 for distress and inconvenience.

Action points: *Trustees should make every effort to ensure that death benefits are distributed within the two year time limit and that all parties are aware of the importance of the time limit. Administrators should send out reminders where appropriate well before the deadline is reached.*

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Cases

Hughes v The Royal London Mutual Insurance Society Ltd (High Court)

Ms Hughes requested a transfer from her personal pension plan to a small self-administered scheme. The plan rules gave the provider absolute discretion whether to agree a transfer, and the provider refused to do so because of suspicions over pension liberation. The member argued that she had an overriding statutory right to transfer.

The Ombudsman had held that Ms Hughes had no right to a statutory transfer. The statutory right requires the transfer value to be used to secure "transfer credits". Transfer credits are defined as "rights allowed to an earner under the rules of an occupational pension scheme". Ms Hughes had no relevant earnings with an employer in the receiving scheme so the transfer was not a statutory transfer.

The High Court disagreed with this approach and held that Ms Hughes was entitled to a statutory transfer. In order to meet the "transfer credits" requirement, it was sufficient that she had earnings from any source: they did not have to be from an employer in the receiving scheme.

The Ombudsman issued a press release on the decision, noting: *"It seems likely that most transferring members will meet this requirement so, beyond verification of earnings and the provision of risk warnings, trustees... will be conscious that under current legislation they cannot refuse such a transfer – even if they have significant concerns that it may be for the purposes of pension liberation."*

Action points: *Where a member requests a transfer, trustees must undertake appropriate due diligence, taking into account legal duties, regulatory guidance and good practice. If, having done so, they believe there is a right to a transfer, their duty is to make payment. If trustees have previously refused a transfer on the "transfer credits" ground alone, they should review their decision.*

British Gas Trading Limited v Lock and Secretary of State for Business, Innovation and Skills (UKEAT)

Mr Lock was employed by British Gas with a remuneration package including basic salary plus commission (the latter accounting for some 60% of his earnings). However, he received only basic pay when he took annual leave. In 2014 the European Court held that holiday pay calculations should include commission, if it was "intrinsically linked" to their contract of employment. In February the Employment Appeal Tribunal confirmed that UK legislation could be interpreted in a manner consistent with this judgment.

This means that UK law requires commission to be included in holiday pay. However, further hearings will be required to determine how commission should be valued for these purposes. The case raises potential issues for pension schemes where scheme rules define pensionable earnings by reference to elements of variable pay, or provide that all pay is pensionable. In these cases incorrect figures may have been used to calculate contributions and benefits.

Action points: *This is primarily an issue for employers – they will need to let trustees know if incorrect salary information has been supplied in the past. However, until there is greater clarification on how notional commission should be valued, employers are unlikely to take any definitive action.*

Legislation (www.legislation.gov.uk)

Persons with significant control

Legislation requires UK companies to maintain a register of persons with significant control (PSCs) from 6 April 2016. "Control" includes having direct or indirect control of more than 25% of the voting rights in the company or having the right to appoint or remove a majority of the board.

Many trustee companies are wholly-owned subsidiaries of the principal employer or another group company. In such cases, the immediate parent company will usually be the only person with direct control. If that parent company is a UK company, the trustee company will enter that company in its PSC register. If the parent is an overseas company, the trustees will need to investigate who controls it.

Where a trustee company is owned by its directors, if any of them holds more than 25% of the shares or voting rights they will need to be entered in the PSC register. If the principal employer has a right to appoint and remove over half of the trustee directors, it will be a PSC even if it does not hold any shares in the trustee company.

Annual details of PSCs will need to be provided to Companies House from 30 June 2016.

Action points: *Where corporate trustees are in place, the trustee should consider who its parent company is and how it intends to comply with this duty.*

Modification of Schemes Regulations

These Regulations introduce a power for trustees to modify their scheme by resolution to enable "them to provide for fixed rate revaluation for... GMP... from when pensionable service ends rather than when contracted-out service ends." The resolution must be passed before 6 April 2017 and can be retrospective (to 6 April 2016 but not before). There is no requirement for trustees to consult the employer and consultation with members is not needed.

Action points: *This change is intended to allow trustees of schemes that were contracted-out on 6 April 2016 to comply with the statutory requirement to revalue GMPs using revaluation orders without having to provide a fixed rate revaluation underpin because of the way their scheme rules work.*

Miscellaneous Amendments Regulations

The Regulations make a variety of amendments to deal with the introduction of DC flexibility. The key one for trustees to be aware of relates to risk warnings and advice.

Amendments introduce a new obligation on trustees to provide generic retirement risk warnings to members at the point that they give them application forms or other methods of access to flexible benefits. The risk warnings must be issued before members access their benefits but do not need to be tailored to individual circumstances.

Schemes must also send members a statement highlighting the importance of reading the risk warnings and accessing pension guidance or independent advice. Trustees who provide more personalised risk warnings do not need to send generic retirement risk warnings as well.

Action points: *Trustees need to ensure administrators are aware of this new requirement and are providing DC members with the appropriate risk warnings.*

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Tax (www.hmrc.gov.uk/pensionschemes/index.htm)

Newsletter 76

This newsletter considers those members affected by the reduction of the lifetime allowance to £1 million in April 2016 and who want to take their benefits before the new forms of protection can be applied for. There is a pro-forma letter for members to apply for interim protection.

Where a member does not have time to apply for interim protection, HMRC suggests that there are 3 options, members can:

- postpone taking benefits until they get a temporary reference number from HMRC;
- take benefits up to £1 million and defer taking the rest until they have received a temporary reference number from HMRC; or
- take all benefits, pay the tax charge and once a temporary reference number is obtained, claim a repayment.

Action points: *Members retiring now should have had time to apply for interim protection. However, if they have not, and they may be eligible for the 2016 protections, trustees may wish to highlight the various options available to them.*

Newsletter 77

The appendices to this newsletter provide wording explaining Individual and Fixed Protection 2016 to members and sample letters for members to apply for them using the interim process. There are also some useful "member messages" explaining how the new tapered annual allowance will work.

Action points: *The Appendices to this newsletter provide a useful source of information for members and trustees may wish to consider using them.*

Miscellaneous

New European data protection rules

The new rules are in the form of a regulation that is directly applicable in all member states. It is very long and complex but some of the key implications for trustees are:

- Changes to the consent requirements for processing personal information. Consent must be freely given, specific, informed and unambiguous. It cannot be implied where a member simply fails to do something and can be withdrawn at any time. Separate consents will be required for different activities.
- The information that must be provided to individuals whose data is being processed has been expanded.
- Breaches of the data protection requirements must be notified to the relevant authority within 72 hours (except where they are insignificant). Some breaches must also be notified to affected data subjects;
- A new "accountability" data protection principle is introduced. Trustees will need to build certain measures into their data processing to ensure they can demonstrate compliance with the Regulation.
- Data processors may face direct fines for breach of the data protection requirements.

The new rules will apply from May 2018 and trustees should start to consider the impact on their scheme over the coming year and what changes they made need to make.

Pensions Administration Standards Association: Guidance on GMP reconciliation

All schemes that ceased to contract-out on 6 April 2016 will be undergoing a GMP reconciliation exercise. This document provides some practical guidance in relation to issues which might arise during such an exercise:

- Where there is a discrepancy in the amount of the GMP and the reason cannot be identified, it is assumed that trustees will typically pay the figure provided by HMRC (reflecting HMRC's stated policy).
- Appropriate tolerance levels will depend on factors such as the member and benefit profile of the scheme and the cost/benefit analysis of different approaches.
- Schemes which ceased to contract out on 6 April 2016 will not receive data in relation to members who are active at that date until HMRC has conducted its closure scan of all remaining contracted-out schemes. This is due to take place in December 2016 and data will be provided to schemes by December 2018.

Dates for diaries: Trustee training remains one of the most important ways of ensuring that trustees have the knowledge and understanding required to perform their duties. We will be holding trustee training courses on 14 June and 11 October 2016. If you have any enquiries about any of these courses or would like to reserve a place, please contact **Karen Mumgaard** – E: karen.mumgaard@cms-cmck.com.

If you are interested in any additional trustee or employer training, please contact **Karen Mumgaard** who can provide you with a list of our current training topics or discuss any particular training needs you might have.

General: For further information on our pension services, please contact **Mark Grant** – E: mark.grant@cms-cmck.com, T: +44 (0)20 7367 2325 or your usual pension partner. Please also visit our website at www.cms-cmck.com.

The Pensions team is part of the CMS Human Capital group and advises employers and trustees of schemes varying in size, from a few million pounds to several billion pounds. Additionally, we act for some of the largest firms of administrators, actuaries, consultants, brokers and professional trustees. We provide a full range of services in connection with occupational pension schemes, including all aspects of employment and EU law. The team also works closely with our corporate lawyers, providing support on mergers and acquisitions, insolvency lawyers supporting us on employer covenant issues, and the financial services team which specialises in regulatory and fund management matters.

The information in this publication is for general purposes and guidance only and does not purport to constitute legal or professional advice. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The Update is intended to simplify and summarise the issues which it covers. It represents the law as at 6 May 2016.

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