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Current issues

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DWP plans to ease transfers of contracted-out rights

The Department for Work and Pensions (DWP) has put forward draft legislation that would allow bulk, non-consensual transfers of contracted-out salary-related (COSR) rights to schemes that have never been contracted-out[1]. The proposed amendments would remove an obstacle to pension-scheme restructuring that has existed since the abolition of contracting out in April 2016.

Prior to 6 April 2016, when a new single-tier State pension was introduced, members of COSR schemes could be '*contracted out*' of the State additional pension arrangements. In return, those schemes had to provide them with '*guaranteed minimum pensions*' (GMPs), in respect of service between 6 April 1978 and 5 April 1997, and '*section 9(2B) rights*' for accrual thereafter.

Currently, a transfer of guaranteed minimum pension (GMP) or '*section 9(2B) rights*' can only be made, without the member's written consent, in a '*connected employer transfer*' between former COSR schemes.[2] As it has not been possible to set up a new COSR scheme since 5 April 2016, that means that employers' options are constrained if they wish to re-organize their pension arrangements.

In broad terms, the proposals would allow transfers without consent from one salary-related scheme to another, as long as

- the schemes' employers are 'connected' (as described in footnote 2);
- the receiving scheme will mirror GMPs, both in amounts and terms of payment; and
- the transfer will not alter section 9(2B) rights so as to might make them less generous, and the transferring scheme's actuary certifies that the rights acquired are '*broadly, no less favourable*' than those transferred.

The consultation exercise lasts until 17 January 2018. The plan is for the amendments to be effective from 6 April 2016.

[1] *The draft Contracting-out (Transfer and Transfer Payment) (Amendment) Regulations 2018: Public Consultation* <www.gov.uk/government/uploads/system/uploads/attachment_data/file/669656/consultation-on-draft-contracting-out-transfer-and-transfer-payment-amendment-regulations-2018.pdf>.

[2] It is a '*connected employer transfer*' if the transferring and receiving schemes relate to the same employer, or to two employers in the same corporate group; or if the transfer is a result of a financial transaction between unrelated employers.

This is a welcome development that we have been waiting for the Government to get around to since 6 April 2016. The short consultation period suggests that the DWP anticipates few objections. Nevertheless, there may be some tweaks to the technicalities.

Some corporate sponsors have ended up sponsoring more than one defined benefit scheme, typically due to historical mergers and acquisitions. In an effort to save cost and simplify governance, companies are generally seeking to merge these schemes where they can. When doing so, it can be attractive to amalgamate all historic schemes into one new, 'clean' trust. Since 2016, it has not been possible to do so with contracted-out rights, but the draft Regulations would re-open that avenue. It will not affect the majority of schemes or sponsors, but will be important for those whose ambitions have been thwarted by the existing rules.

Auto-enrolment review & 2018/19 earnings trigger and band

The Government has published the results of its review of automatic enrolment.[3] It has also announced proposals for the earnings trigger and qualifying earnings band for the 2018/19 tax year.[4]

Increasing coverage

The highlights of the review include proposals to reduce the minimum age for auto-enrolment from 22 years to 18, and set the lower edge of the qualifying earnings band at £0 (so that once jobholders earn enough to trigger auto-enrolment, minimum benefits are based on all earnings up to the upper limit of the band). It is the Government's ambition to implement the proposed changes to the auto-enrolment framework in the mid-2020s, to give everyone plenty of time to plan for them. It intends to revisit the sufficiency of the statutory minimum level of contributions at the next review, in 2020.

Alternative quality requirements

The Government also reported on the results of scheduled statutory reviews on the alternative quality requirements for defined benefit (DB) and defined contribution (DC) schemes.

To be a qualifying scheme for auto-enrolment, a DB scheme must either satisfy the 'test scheme standard', or one of two alternative requirements. In the vast majority of cases the alternative is a cost-of-accruals test that requires a minimum contribution rate equivalent to 10 per cent of 'qualifying earnings', with variations for schemes that use different definitions of pensionable earnings and those that do not provide spouses' benefits. (There is another alternative based on the money purchase quality requirements, but the Governement thinks that it only affects one scheme.)

The Government concluded that the DB alternative requirements are still appropriate. However, it is considering amending the legislation for the cost-of-accruals test so that it excludes members who have opted for a lower benefit scale. Currently, the cost of accruals for these members has to be taken into account, which may result in a scheme failing the test.

The DC alternative quality requirements were found to continue to satisfy the statutory test that at least 90 per cent of all jobholders are expected to have the same, or better, outcomes as they would from contributions based on the standard DC quality test (eight per cent of qualifying earnings). The review found that more than 99 per cent of jobholders are likely to achieve the same, or better, outcomes.

2018/19 thresholds

Separately, the Government has also announced the auto-enrolment thresholds that it proposes to set for the 2018/19 tax year. It intends to lay an Order before Parliament that will:

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[3] <www.gov.uk/government/uploads/system/uploads/attachment_data/file/668971/automatic-enrolment-review-2017-maintaining-the-momentum.PDF>.
[4] <www.gov.uk/government/uploads/system/uploads/attachment_data/file/668521/review-of-automatic-enrolment-earnings-trigger-and-qualifying-earnings-band-2018-19-supporting-analysis.pdf>.

- keep the earnings trigger at its current level—£10,000;
- at the bottom end of the qualifying earnings band, maintain the link to the lower earnings limit for National Insurance Contributions (NICs), so that for 2018/19 the band will start at £6,032; and
- retain the link to the NICs upper earnings limit at the top end of the band, putting it at £46,350 for 2018/19.

The reduction of the auto-enrolment starting age to 18 and the lowering of the threshold for contributions will lead to more people saving more for retirement and so are very welcome. For many, the middle of the next decade is too long to wait. The Government's explanation for the delay involves a commendable desire to avoid burdening people and businesses with significant additional changes whilst they acclimatize to the phasing in of the full, eight-per-cent minimum contribution, due to be reached in April 2019.

Master-trust supervision: secondary legislation out for consultation

The Department for Work and Pensions (DWP) has revealed further details of the master-trust authorization and supervision regime set up by the *Pension Schemes Act 2017*.[5] The draft Regulations define the scope of the regime, establish the process for seeking authorization and the criteria against which applications will be assessed, and describe the system of ongoing supervisory controls and monitoring. As expected, the compliance burden will be significant, and will encompass schemes that are not commonly considered to be master trusts, such as industry-wide and other non-associated multi-employer (NAME) schemes.

The foundations of the master-trusts regulatory regime are to be found in the 2017 Act, although most of the provisions in question are not yet in force. Once they are, any scheme that meets the statutory definition of a '*master trust*' will have to obtain the Pensions Regulator's authorization; those that do not must cease operating.

Scope

The definition of a master trust scheme is, notes the DWP, '*deliberately broad*'. In summary, it embraces any multi-employer, occupational pension scheme that provides money purchase benefits, so long as there is no intention to restrict participation to employers that are connected with each other, for example as members of a corporate group. The DWP says that '*industry-wide schemes were always intended to be within the scope of authorization, as were not-for-profit schemes.*' Public service pension schemes are, however, excluded.

The draft Regulations would extend the ways in which employers are considered '*connected*', in order to prevent schemes from being labelled 'master trusts' merely as a result of transactions between employers. Notably, this would cover cases in which an employer from outside a corporate group participates in the group's pension scheme because of a joint venture with a group company or a transfer of group employees.

The DWP also proposes to exempt schemes that are primarily defined benefit arrangements, providing money purchase benefits only out of funds arising from additional voluntary contributions (AVCs) or cash equivalents transferred in from other schemes. Exception would be made, too, for some schemes for which membership is restricted to those employed by State-run industries at the time of their privatization. Other exemptions cover for example single-member schemes and '*relevant small schemes*' (small self-administered schemes).

Applications for authorization

The Regulator will be allowed to recover its costs by charging applicants a fee. The actual fees are yet to be determined; however, the DWP expects that the work involved in processing an application from an existing master trust scheme will be '*substantially higher*', and consequently the draft legislation limits the fee for an existing scheme to £67,000, whereas new master trust schemes could be charged no more than £24,000.

[5] *Occupational Pension Schemes (Master Trusts) Regulations 2018* <www.gov.uk/government/consultations/draft-occupational-pension-schemes-master-trusts-regulations-2018>.

Authorization criteria

The draft Regulations detail the matters that the Regulator will have to consider when deciding whether the authorization criteria are met.

It will have to be satisfied about the integrity, conduct and competency of those involved in the running of the scheme—that they are '*fit and proper persons*', as the legislation puts it. To do so, it will take into account such things as bankruptcy proceedings, criminal records, adverse findings in civil proceedings, credit histories, and directorial disqualifications. Completion of the Regulator's online 'Trustee Toolkit' learning programme will go some way toward showing that a particular person is a suitable trustee; the expertise and experience of the trustee body, collectively, will be assessed.

The financial sustainability of the scheme will be judged on the basis of a long list of criteria, covering aspects of the scheme's business strategy and financial resources. A comprehensive, written business plan will have to be submitted.

Generally, under the Act, any '*scheme funder*' (an organization that is liable to provide additional funds if administration charges prove insufficient to cover scheme costs, or entitled to receive the profits if things turn out otherwise) must confine its activities to those directly related to the master trust. That could be a problem for industry-wide schemes, for which the scheme funders are likely to be participating employers that are primarily engaged in other business. The draft Regulations consequently make provision for scheme funders to apply for exemption from the need to restrict their activities. They will have to support their case by submitting details of their finances and the legally enforceable support that they will provide to the scheme.

Ongoing supervision

The Regulator will require trustees to submit supervisory returns, as means of gathering the information necessary to monitor standards after schemes obtain authorization. The draft Regulations provide for those returns to cover matters such as the maintenance of the trustees' knowledge and understanding, and development of the scheme's business plan. The Regulations also contain a list of '*significant events*' (e.g. changes affecting key personnel, material amendments to statements of investment principles and serious systems failures) that must be reported to the Regulator.

Guidance

The Pensions Regulator will produce a Code of Practice and other guidance.

Consultation arrangements

Comments about the draft legislation should be submitted by 12 January 2018. The intention is that it would come into force on 1 October 2018.

There will clearly be a need for considerable effort and expenditure from master trusts to obtain and maintain authorization. Industry-wide and other NAME schemes who may be captured by the widely cast definition should make sure that this extra burden does not catch them by surprise.

Scottish tax proposals would complicate pensions

On 14 December 2017, the Scottish Government announced its draft Budget for the 2018/19 tax year.[6] Included in it are plans to change the bands and rates of income tax for Scottish taxpayers. The proposals would complicate the operation of the pensions tax-relief system for scheme members, personal pension providers... and Her Majesty's Revenue and Customs (HMRC).

The Scottish Government intends to establish five(!) income tax rates for Scottish taxpayers.

Band	Taxable income range (£)	Tax rate (per cent)
Starter	Over 11,850 - 13,850	19
Basic	Over 13,850 - 24,000	20
Intermediate	Over 24,000 - 44,273	21
Higher	Over 44,273 - 150,000	41
Top	Over 150,000 -	46

The effects of this extra intricacy will fall mainly upon those who contribute through '*relief at source*' (RAS).[7] Generally, that means members of personal pension schemes. Occupational pension schemes typically use '*net pay arrangements*' instead of RAS, so that their members receive full, up-front tax relief on their contributions without the need for any additional action. Personal pension scheme members for whom contributions are made under their employers' salary sacrifice arrangements will also be spared from the added tax-relief convolutions.

The issue arises because of the way in which the RAS legislation was adapted to cater for the possibility of Scotland setting its own income tax rates. Under RAS, in broad terms, member contributions are paid out of taxed income, and treated as if made net of basic rate tax. The pension provider (typically an insurance company) recovers an amount equal to that assumed tax from HMRC on the member's behalf. Those who pay tax at the higher or additional rates are able to claim the balance of the tax relief due to them via the self-assessment tax process. The system is set up to cope with a '*Scottish basic rate*' (SBR) that is different from the rest of the UK's; it is *not* terribly well prepared for a structure under which the SBR remains the same, but there are extra (starter and intermediate) tax bands above and below it.

On the basis of the legislation as it stands at present, it seems as though personal pension providers could claim relief at 20 per cent on behalf of Scottish taxpayers who paid 19 per cent (starter-rate) tax on the relevant earnings. And whereas currently it is only higher- and additional-rate taxpayers who must complete a self-assessment tax return in order to obtain full tax relief on their contributions, in future those on the 21 per cent Scottish 'intermediate' rate may also need to do so.

We will need to wait and see how the Scottish Government's plans—which do not mention contributions tax relief, as far as we can see—develop between now and 6 April 2018. It seems unlikely that it intends to donate an extra one-per-cent relief to those paying tax at the starter rate, but only time will tell. On the other side of the coin, if the intermediate-rate taxpayers who would be drawn into the self-assessment regime do not think that the hassle of submitting a tax return is worthwhile for the one-per-cent relief that they would otherwise forgo, the Government will receive a windfall. The amounts involved may appear trifling, annually; but they could make a significant difference to a person's money purchase pensions pot after a lifetime of contributions.

[6] <https://beta.gov.scot/publications/scottish-budget-draft-budget-2018-19/>.

[7] Our focus is primarily on the implications for contributions tax relief. It goes without saying that if the Scottish Government changes the income tax rates payable by Scottish taxpayers, it will have direct effects upon household incomes. We are sure that there will be no shortage of analyses of the broader tax implications of the SNP's plans.

Purple Book

The Pensions Protection Fund (PPF) has published the twelfth edition of their 'Purple Book', which looks at the risks faced by defined benefit (DB) schemes (predominately in the private sector) in the year ending March 2017.[8] This edition is based primarily on the information provided by the scheme returns submitted by 5,588 schemes using the Pension Regulator's online Exchange system.

The data reveal that, over the year to March 2017:

- the number of schemes open to new members is down one per cent (to 12 per cent);
- the number of schemes closed to future accrual has increased to 39 per cent (from 35 per cent);
- the aggregate funding of DB schemes on a section 179 valuation basis improved, with the aggregate deficit falling from £221.7 billion as at 31 March 2016 to £161.8 billion as at 31 March 2017; and
- the proportion of scheme assets invested in equities falling from 30.3 per cent to 29 per cent, while the proportion invested in bonds increased from 51.3 per cent to 55.7 per cent.

HMRC Newsletters

Her Majesty's Revenue and Customs (HMRC) has published Pension Schemes Newsletter 94.[9]

It includes:

- information on relief at source for Scottish Income Tax following the changes proposed in the Scottish Budget (see our article '*Scottish tax proposals would complicate pensions*' above);
- a reminder that members should be informed that it is important that if they have exceeded the annual allowance for 2016/17 to declare it on their self-assessment tax return; and
- a request for help from trustees to help HRMC simplify the pension language used in its legislation and guidance.

The latest edition of HMRC's *Countdown Bulletin* is also available.[10]

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8 <www.pensionprotectionfund.org.uk/About-Us/TheBoard/Documents/WEB_170407%20-%20PPF_Purple_Book_2017.pdf>.
9 <www.gov.uk/government/publications/pension-schemes-newsletter-94-december-2017/pension-schemes-newsletter-94-december-2017>.
10 <www.gov.uk/government/publications/countdown-bulletin-31-january-2018>.

And Finally…

The 2017 award for the least-imaginatively named pensions scammers goes to… [drumroll] Pension Services. *AF*'s initial thought when the FCA outed them was that they had cunningly chosen a hum-drum name in an attempt to harmonize with general attitudes to the subject (readers will be shocked—shocked—to find that The Man On The Clapham Omnibus sometimes finds it hard to get excited about pensions). Some of their Web sites, however—www.cashinpensionexperts.co.uk and www.pension-release.co.uk, for example—couldn't scream 'SCAM!' any louder without totally giving the game away. We were also struck by the profundity of the following koan, which we found on www.pension-services.com:

> '*There are many ways in which you can withdraw money from your pension, some methods are legal and some are not illegal…*'

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