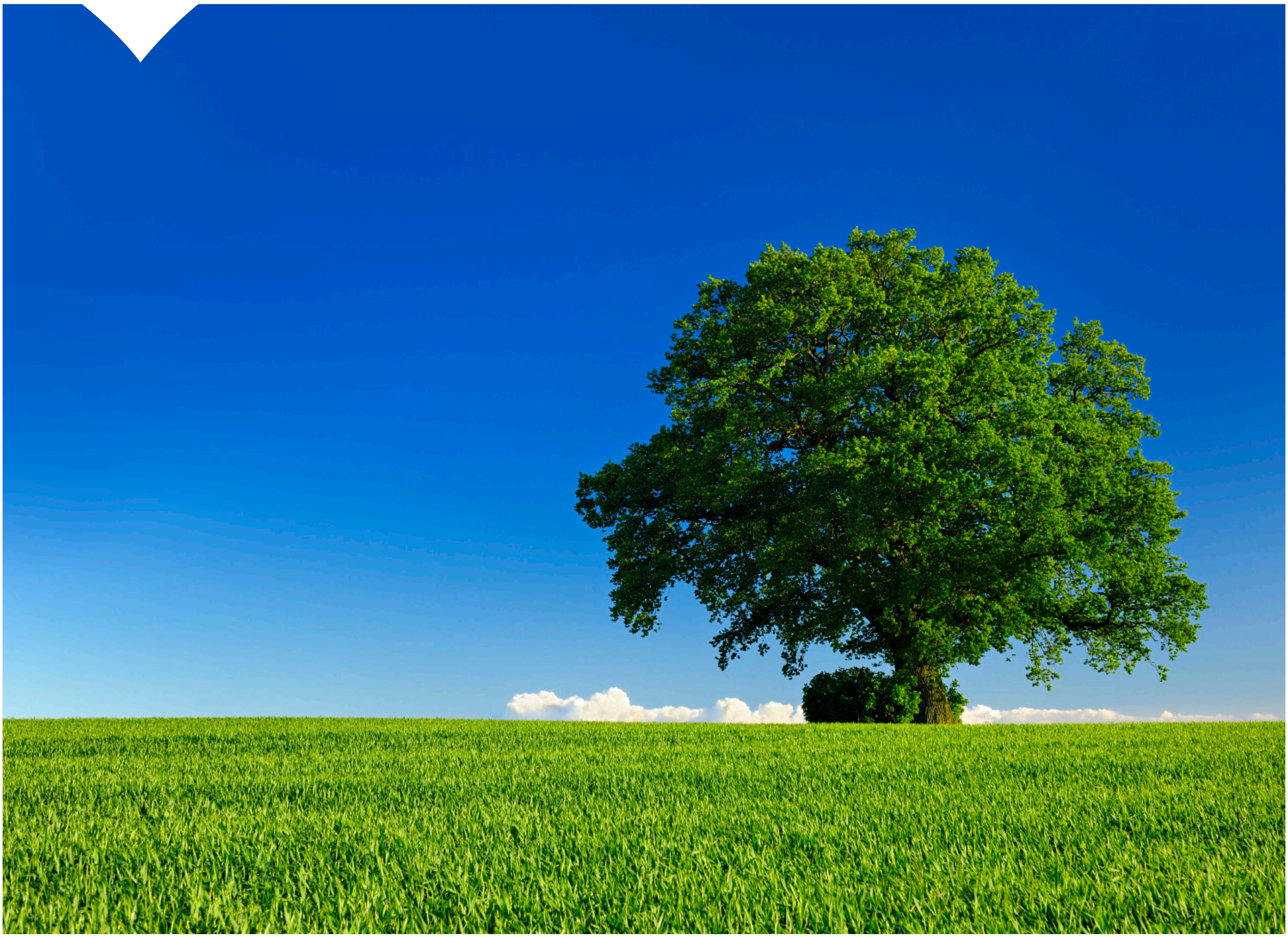
MAYER • BROWN

May 2015

Trustee Quarterly Review

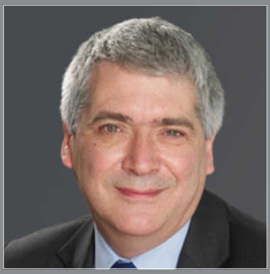
Quarterly update for pension scheme trustees



Introduction

Welcome to the May 2015 edition of our Trustee Quarterly Review. The Review is published by the Mayer Brown Pensions Group each quarter, and looks at selected legal developments in the pensions industry over the previous quarter that we believe are of particular interest to trustees of occupational pension schemes. Each article summarises the relevant development and provides a short commentary on its likely implications for trustees. The Review also includes details of upcoming Pensions Group events at Mayer Brown, and a timeline of important dates and expected future developments.

Please speak to your usual contact in the Pensions Group if you have any questions on any of the issues in this edition of the Review



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Abolition of DB contracting-out: statutory employer amendment power

DB contracting-out is being abolished from 6 April 2016. New regulations have come into force setting out how a statutory power allowing employers to amend their pension schemes to reflect the abolition is to be exercised.

Background

Employers and members of contracted-out DB schemes currently pay a lower level of National Insurance contributions (**"NICs"**). DB contracting-out will be abolished with effect from 6 April 2016, resulting in an increase in NICs for both employers and members.

The Pensions Act 2014 introduced a power (the **"statutory override"**) that allows employers to amend their schemes without trustee consent to offset the increased employer NICs. The statutory override can be used to increase member contributions and/or reduce scheme liabilities. However, the aggregate increase in member contributions and/or decrease in scheme liabilities must not exceed the increase in employer NICs. An actuary must certify that the proposed scheme amendments comply with the relevant statutory requirements.

Content of new regulations

The new regulations came into force on 6 April 2015. Amongst other things, they:

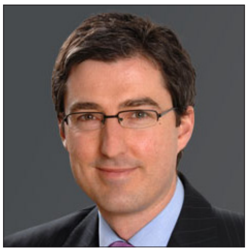
- Set out the compliance requirements for the actuary in connection with a proposed exercise of the statutory override, when calculating an increase in member contributions or a reduction in scheme liabilities, and when placing a value on the increase in employer NICs.
- Set out the requirements for appointment of the actuary, who must be appointed by the employer. The Department for Work and Pensions has warned against using the scheme actuary.
- Set out the requirements for the actuary's certificate.
- Impose an obligation on trustees to provide any information in connection with use of the statutory override that is reasonably requested by the employer.
- Set out how the statutory override will operate in relation to multi-employer schemes. It is to be exercised by the person nominated to act on behalf of the other employers in relation to statutory funding matters or, if no such nomination has been made, the person nominated to act on their behalf in relation to exercise of the statutory override.
- Provide that the statutory override cannot be exercised in relation to members who are "protected persons" – i.e. certain employees from formerly nationalised industries.

Comment

It may be that an employer will be able to amend its scheme by using the scheme's own amendment power and without relying on the statutory override. If trustee consent is required under the scheme's own amendment power, an employer may find it easier to obtain this consent as a result of the presence of the override as a fallback option.

Employers of DB contracted-out schemes will need to consider what changes, if any, they wish to make to their schemes using the statutory override. This process may take some time, so it is helpful that the new regulations have come into force well ahead of the abolition of DB contracting-out on 6 April 2016. The statutory override can be used to make changes before 6 April 2016, but the changes may not take effect before that date.

If any changes made using the statutory override are listed changes for the purposes of the statutory consultation regulations, members will have to be consulted in good time before the changes take effect.



Giles Bywater

VAT on DB investment management services: further HMRC guidance

In March 2015, HM Revenue & Customs published further guidance on the recovery by the employer of VAT charged on investment management ("**IM**") services provided to DB trust-based pension schemes.

Background

Prior to 2014, HMRC allowed employers to recover VAT paid on administration services provided to their pension schemes, but not VAT paid on IM services. However, HMRC allowed the employer to treat 30% of invoices for IM services as relating to administration and to therefore recover VAT on that 30% (unless the employer could provide evidence to HMRC that it should be entitled to recover a higher proportion). Whilst in theory the pension scheme may have been entitled to recover VAT on the other 70%, its rate of recovery was usually much lower than the employer's (and often it did not recovery any VAT at all).

In 2013, the Court of Justice of the European Union decided in the *PPG* case that an employer was entitled to recover the VAT charged on both administration and IM services provided to its pension scheme if there was a direct and immediate link between the services and the employer's economic activities as a whole. It was for the national court to decide whether there was a direct and immediate link.

In 2014, HMRC issued three pieces of guidance setting out its policy on employer recovery of VAT on pension scheme services in the light of *PPG*. The cumulative effect of this guidance was that HMRC would only allow the employer to recover the VAT if the services had been supplied to the employer. Exactly when services would be deemed to have been supplied to the employer was by no means clear, but a tripartite agreement between the employer, the trustees and the service provider was raised by many as a possible option.[1]

HMRC's latest guidance

HMRC's latest guidance reiterates HMRC's view from its 2014 guidance that VAT is only recoverable if the services in question have been supplied to the employer. It acknowledges that, in the DB trust-based context, there are two potential recipients of the services: the employer and the trustees. It goes on to consider the issue of tripartite agreements for the provision of IM services to DB pension schemes. (It does not consider the question on recovery of VAT charged on IM services provided to DC pension schemes as such services are now generally exempt from VAT.[2])

In HMRC's view, a tripartite agreement can be used as evidence that the employer is the recipient of the IM services under that agreement if:

- the agreement relates to a trust-based DB scheme under which the employer ultimately bears the financial risks and benefits associated with the scheme's performance;
- the IM services are supplied to the employer (although the agreement can recognise that, due to the particular regulatory context in which DB schemes operate, the fund manager is appointed by or on behalf of the trustees);
- the employer directly pays for the IM services (and receives a valid VAT invoice for the full cost of the services) – an equivalent increase in scheme contributions will not constitute payment by the employer for HMRC's purposes;
- in the event of non-payment, the fund manager will pursue the employer, and will only pursue the trustees (or the scheme) where the employer is unlikely to pay;
- in the event of a breach of contract by the fund manager, both the employer and the trustees are entitled to seek legal redress (the fund manager's liability need not be greater than if the agreement were with the trustees alone, and any payment made by the fund manager may be made to the trustees for the benefit of the scheme);
- the fund manager will provide fund performance reports on request to the employer (the trustees can stipulate that reports are withheld e.g. where there is a conflict of interest); and

1 For more details, see our February 2014 legal update and our November 2014 legal update.

2 For more information, see our November 2014 legal update.

- the employer is entitled to terminate the agreement (a condition can be included whereby the written consent of the trustees is required, and any employer termination right can be in addition to any unilateral trustee termination right).

If the employer recharges the costs of the IM services to the pension scheme, the employer must charge the scheme an equivalent amount of VAT. Again, in theory, this VAT is potentially recoverable by the pension scheme to the extent that the scheme itself is engaged in taxable business activities[3], but in practice, in many cases any VAT charged by the employer to the pension scheme (as a result of such a recharge) will not be recoverable. HMRC accepts that if adjustments are made to the scheme's schedule of contributions to reflect the fact that the employer is paying for certain costs, this will not count as a recharging of those costs to the scheme, provided that there is not a specific adjustment equal to the actual costs incurred in a given period.

The transitional period whereby, if the pension scheme is invoiced for IM services, the 70/30 split still applies, continues until 31 December 2015.

Comment

HMRC's latest guidance is a welcome clarification of what evidence HMRC will require in order to consider that services have been supplied to the employer for VAT recovery purposes, at least in the context of IM services. However, the guidance does not clarify the requirements for administration or other services, and arguably there is no reason to treat administration and IM services differently – the *PPG* case made no distinction between the two types of service.

Whether schemes should enter into tripartite agreements with fund managers and/or amend their existing agreements will depend on a number of factors, including the circumstances of both scheme and employer. There is no "one size fits all" solution, and it is imperative that trustees involve the employer's tax function in any consideration of whether to adjust the scheme's arrangements for the provision of IM services.

The industry continues to make representations to HMRC on the issue of VAT recovery, particularly in relation to administration and other services, and it seems unlikely that we have heard the last from HMRC on this topic.

James Hill

3 Some pension schemes do engage in taxable business activities (e.g. those owning commercial property), but many of those activities are exempt from VAT, limiting the level of recovery that schemes can expect to make. Schemes would also need to be VAT-registered in order to recover VAT.

Pensions liberation: what checks should trustees make?

The Pensions Ombudsman has rejected a complaint from a member whose benefits were transferred, at his request, to a suspected pensions liberation vehicle that the trustees of the transferring schemes had failed to carry out appropriate checks on the receiving scheme.

In addition, the Pensions Liberation Industry Group has published a Code of Good Practice (the "**Code**") for combating pension scams.

Ombudsman determination

Mr W requested transfers from two personal pension schemes (held by two different providers) to an occupational pension scheme which was registered with HM Revenue & Customs. The transfers were completed in November 2012. At the time of the complaints (March 2014), Mr W was unable to contact the receiving scheme, and complained that insufficient checks had been carried out by the transferring schemes in relation to the receiving scheme. In particular, the risk of pensions liberation had not been brought to his attention.

The Ombudsman said that in considering whether there was maladministration he had to consider (a) the legal obligations owed to Mr W by the providers, and (b) whether the transferring schemes acted consistently with good industry practice.

Having noted that the transfer application seemed to comply with the requirements for a statutory right to transfer, the Ombudsman commented that the Pensions Regulator did not issue guidance to providers about pensions liberation until February 2013. He said that "*that could be regarded as a point of change in what might be regarded as good industry practice*", but he could not apply current levels of knowledge and understanding of pensions liberation/scams or present standards of practice to a past situation. The Ombudsman therefore rejected the complaints, noting that to the extent that the transferring schemes had a duty of care to Mr W, this would have been overridden by the statutory obligation to make the transfer in accordance with his wishes.

Code of Good Practice

The Code, published on 16 March 2015, seeks to develop an industry standard due diligence process for schemes to follow when considering a transfer request. It is aimed at trustees, administrators and pension providers, and operates under three key principles:

- raising members' awareness of pension scams;
- having robust and proportionate processes for assessing a receiving scheme; and
- having general awareness of the known current strategies of scam perpetrators.

There are detailed due diligence procedures in the Code, which include suggested questions to be asked of members and additional informational requests that can be made. The Code also includes example letters to members at various stages of the process, example discharge wording, and template decision recording sheets.

The Code is voluntary, but on a practical level, we expect that it will prove useful to administrators, and recommend that trustees ask their administrators to update their procedures to take account of the suggested due diligence procedures.

Comment

Given that the Ombudsman placed weight in his decision on the fact that the transfers pre-dated the Regulator's 2013 guidance on pensions liberation, it is possible that the Ombudsman might reach a different conclusion in relation to a transfer which took place after February 2013.

While the Code is also not legally binding, the Ombudsman may well take it into account too when deciding if a scheme has followed "good industry practice" for transfers taking place after it was published: the Ombudsman's power to address cases of "maladministration" covers poor practice even when a breach of the law is not involved.

Olivia Caird

Employer debt: Government seeks industry's views

In March 2015, the Department for Work and Pensions issued a call for evidence asking for views on the employer debt regime as it applies to non-associated multi-employer ("**NAME**") DB pension schemes.

Most pension schemes cover either a single employer or a group of connected employers. By contrast, NAME schemes are "industry-wide" arrangements, under which the employers are unconnected and may even be competitors.

All aboard the employer debt refresher train

As readers will know, an employer in a multi-employer DB pension scheme is required to pay a "s75 debt", equal to its share of the scheme's buy-out deficit, if:

- the employer becomes insolvent;
- the scheme winds up; or
- the employer ceases to employ active members, but at least one other employer continues to employ active members. (This is known as an employment-cessation event.)

Over the years, various easements have been added to the legislation, designed to help employers manage their potential s75 liabilities. However, the DWP acknowledges that only a few of these are likely to be available when there is an employment-cessation event in a NAME scheme, bearing in mind that the participating employers will be unconnected and it is highly unlikely that one employer will accept responsibility for another employer's payment. The existing easements that are most likely to be relevant in a NAME scheme are:

- withdrawal arrangements and approved withdrawal arrangements (where the immediate liability of a departing employer is reduced provided that a guarantee is given to the trustees); and
- periods of grace (where, in some circumstances, an employer which temporarily ceases to employ active members can avoid a s75 debt altogether).

The DWP recognises that many employers consider the employer debt regime to be overly onerous for NAME schemes. At the same time, the DWP is mindful that an employer under a NAME scheme needs to pay its fair share, so as to protect members and to ensure that other (unconnected) employers do not end up having to foot the bill.

All change?

The call for evidence considers whether the employer debt regime needs to be modified for NAME schemes. It asks for views on the effectiveness of the current easements in practice and for views on three additional ideas for easements:

- *Allowing trustees to agree a debt repayment plan with the departing employer to permit the debt to be paid over a longer period of time (possibly with the Regulator's approval).*

  This would lessen the immediate burden on the employer. However, it could result in the full debt not being recovered.

- *Amending the legislation so that an employment-cessation event does not trigger an employer debt at all, and the employer remains liable to the scheme under the normal statutory funding regime instead. (An employer insolvency or scheme wind-up still would trigger a debt.)*

  This would apply where the departing employer remained in existence after the employment-cessation event and could therefore continue to settle any liability towards members. If the trustees were concerned that the employer would not pay the employer debt or that the employer covenant had weakened, they could trigger the debt.

- *Changing the way the employer debt is calculated following an employment-cessation event. (On an employer insolvency or scheme wind-up, the debt would still be calculated on a buy-out basis.)*

  Legislation might provide for or allow the debt on an employment-cessation event to be calculated on (for example) a technical provisions basis rather than a buy-out basis. This might be conditional upon the trustees being satisfied as to the strength of the employer's covenant. An employer which paid a reduced debt on departure would, it seems, remain liable for the balance of its buy-out liability. The trustees might be given power to call in that liability in prescribed circumstances.

The end of the line?

The call for evidence runs until 22 May 2015 and we will have to wait to see whether the DWP decides to propose any changes to the employer debt regime. The DWP has made it clear that it is only seeking views to assist in its policy development at the moment and is not proposing any reforms. It considers that the employer debt regime is imperative in preserving scheme stability and therefore any changes will need to be considered carefully.

Comment

It remains to be seen what, if any, changes will be made to the employer debt regime, but NAME schemes will appreciate that the DWP has acknowledged that the current regime is onerous on them and is seeking views on how to improve the situation.

Beth Brown

In other news...

Last man standing schemes – 2015/16 PPF levy

Don't forget that "last man standing" (**"LMS"**) schemes with more than one statutory employer need to confirm to the PPF that they have received legal advice as their LMS status by **29 May 2015**. The Regulator will email all schemes which have listed themselves as LMS on Exchange asking for confirmation that the trustees have received the necessary legal advice. The email will contain a link to an online form that will ask the trustees to confirm that they:

- have received legal advice that the scheme's structure is LMS;
- have received legal advice that the scheme's structure is not LMS; or
- have not received legal advice in relation to the scheme's structure.

The scheme's 2015/16 levy will be calculated on the basis of the option chosen.

The online form is also available on the PPF's website. All LMS schemes should ensure that they submit the confirmation, even if they do not receive an email from the Regulator. For more information, please see our guidance note on the 2015/16 PPF levy.

Schemes with overseas employers – PPF eligibility

The Supreme Court has upheld the Court of Appeal's 2013 decision that a Greek company did not have sufficient "non-transitory economic activities" for the purposes of EU insolvency law to have an "establishment" in the UK. As a result, the company (which was the sponsoring employer of its UK pension scheme) had not suffered a qualifying insolvency event for PPF entry purposes, rendering the scheme ineligible for PPF entry. For more information, please see our client alert.

The scheme in question will in fact be eligible for PPF entry nonetheless thanks to regulations passed last year (see our August 2014 edition). However, these regulations are unlikely to assist other schemes in similar circumstances.

Budget 2015

The main pensions-related announcements in the 2015 Budget included the following:

- The lifetime allowance will be reduced to £1m from 6 April 2016 (fixed and individual protection regimes will be available).
- The lifetime allowance will be indexed to increase annually by CPI from 6 April 2018.
- From April 2015, beneficiaries of individuals who die under age 75 with a joint life or guaranteed term annuity will be able to receive future payments from that policy tax-free if no payments have been made to the beneficiary before 6 April 2015. Where the individual dies over age 75, payments from the policy will be taxed at the beneficiary's marginal rate. In addition, tax legislation will be changed so that joint life annuities can be paid to any beneficiary.
- From April 2016, people who have already bought an annuity will be able to sell the income from that annuity to a third provider (subject to the consent of the annuity provider), with the sale proceeds being able to be taken as a lump sum or via drawdown – HM Treasury and the DWP have published a joint call for evidence on this announcement.

General Election

The Conservatives won sufficient seats in the General Election to form a majority government. Their election manifesto promised that the state pension triple lock would be retained, and that tax relief on pension contributions would be reduced for individuals earning over £150,000.

The Pensions Minister, Steve Webb, lost his seat and will be replaced as Pensions Minister by Ros Altmann (who will become a member of the House of Lords).

April 2015 reforms

Just a reminder that you can access guidance notes on the April 2015 reforms on our website. The notes cover the following topics and have been updated to reflect the finalised legislation:

- the new DC flexibilities
- transfers
- DC governance and charging
- other changes

Katherine Dixon

Upcoming Pensions Group events at Mayer Brown

If you are interested in attending any of our events, please contact Katherine Dixon (kdixon@mayerbrown.com) or your usual Mayer Brown contact. All events take place at our offices at 201 Bishopsgate, London EC2M 3AF.

- **Trustee Foundation Course**

  15 September 2015
  1 December 2015

  Our Foundation Course aims to take trustees through the pensions landscape and the key legal principles relating to DB funding and investment matters, as well as some of the specific issues relating to DC schemes, in a practical and interactive way.

- **Trustee Building Blocks Classes**

  16 June 2015 – DB funding and investment
  17 November 2015 – topic to be confirmed

  Our Building Blocks Classes look in more detail at some of the key areas of pension scheme management.

Dates and deadlines

1 October 2015
Abolition of short service refunds from DC occupational schemes comes into force

5 April 2016
Revised deadline for making resolution under s251, Pensions Act 2004 to retain scheme rules allowing surplus payments to employer

6 April 2016
- Introduction of single-tier state pension and abolition of DB contracting-out
- Ban on active member discounts, consultancy charging and commission in DC occupational qualifying schemes comes into force
- Lifetime allowance reduces to £1m

5 April 2017
Lifetime allowance deadline for members to apply for individual protection

30 September 2017
Automatic enrolment – end of transitional period for DB schemes

1 October 2017
Automatic enrolment - 2% employer contributions required for DC schemes

5 April 2018
Deadline for making resolution under s68, Pensions Act 1995 to remove protected rights provisions from scheme rules

6 April 2018
CPI indexation of lifetime allowance to be introduced

21 May 2018
Deadline for implementation of Portability Directive into UK law

1 October 2018
Automatic enrolment - 3% employer contributions required for DC schemes

5 April 2021
Deadline for employers to exercise statutory power to amend their schemes to reflect increase in employer NICs resulting from abolition of contracting-out

Key:

Important dates to note

For information

About Mayer Brown

Mayer Brown is a global legal services provider advising clients across the Americas, Asia and Europe. Our geographic strength means we can offer local market knowledge combined with global reach. We are noted for our commitment to client service and our ability to assist clients with their most complex and demanding legal and business challenges worldwide. We serve many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest banks. We provide legal services in areas such as banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

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