UK: PENSIONS UPDATE DECEMBER 2017

Contents

1. NEW FINANCIAL REPORTING REQUIREMENTS FROM JANAURY

New financial reporting requirements under MiFID II[1] come into force on 3 January 2018, which will require financial institutions and investment managers to report on all relevant trades.

This is likely to result in an increased number of requests for clients, including pension scheme trustees, to provide "Legal Entity Identifiers" (or "**LEIs**").

What are LEIs?

An LEI is a 20-digit code that identifies legal entities and certain other structures, including trusts, that engage in financial transactions.

An LEI is already required in certain circumstances. However, from 3 January 2018, the obligation will apply more widely as a result of MiFID II.

Registration for an LEI can be made via the London Stock Exchange and the process is relatively straightforward. A registration fee (together with an annual maintenance fee going forwards) will be required.

What action should trustees take?

The LEI requirement is not a direct obligation on the underlying investor (i.e. the trustee) – it is an obligation on investment firms and others regulated by MiFID II to check that an LEI has been obtained, where required, in order to fulfil their transaction reporting obligations.

Not all investment structures will require an LEI number (for example, investments in pooled funds are unlikely to require LEIs).

We expect investment managers / consultants will have already begun to contact their affected clients, but trustees may well wish to raise the issue with their investment managers / consultants if they have not heard anything because if an LEI is needed, this should be obtained by 3 January.

2. ENHANCED SCHEME RETURN REQUIREMENTS FROM JANUARY

The Pensions Regulator will require schemes to submit additional information about the quality of their scheme data in their annual Scheme Return. For defined benefit (**DB**) schemes, this will apply to annual return notices issued from January 2018 (and for defined contribution (**DC**) schemes, from next summer).

[1] *The Markets in Financial Instruments Directive II.*

In particular, new questions concerning member data will require reporting on 'common' and 'conditional' data:

- **Common data** = basic data items used to identify scheme members which all schemes should hold e.g. name, address, National Insurance number, date of birth, etc.
- **Conditional / scheme specific data** = data specific to each scheme which have been determined by the trustees as key to running the scheme. Examples may include employment records, employee and employer contribution history, benefit specifics like GMP entitlement, etc.

Schemes will need to report on: (i) when they last measured both common and conditional / scheme specific data; and (ii) what percentage of their records is complete and accurate.

Although not a new concept (schemes should already be assessing the completeness and accuracy of their member data in line with the Regulator's record-keeping guidance, which was issued in 2010), this is the first time that schemes will be required to report on the quality of their record-keeping on their Scheme Return.

The Regulator has said it will not be taking immediate enforcement action on the basis of this information alone, but, if it has concerns, it may engage with individual schemes. It will also be monitoring the position for future years and where scores are low, will expect to see improvements.

Trustees will need to work with their scheme administrators to ensure that their common and conditional data are in a measurable form, in line with the Regulator's guidance, for inclusion on their Scheme Return.

3. MONEY LAUNDERING REGULATIONS MEAN SOME SCHEMES MAY NEED TO REGISTER BY 31 JANUARY

As reported in the September edition of UK: Pensions Update, new money laundering regulations[2] came into force on 26 June, replacing the old (2007) regulations. Updated HMRC guidance was also published in June.

The old regulations required certain categories of person to register with HMRC and to put in place policies and procedures to monitor and manage money laundering and terrorist financing risks. The new regulations revise the regime, although the core principles underpinning it remain the same.

The drafting of the new regulations is open to interpretation and there are differing views across the pensions industry as to the extent to which the new requirements will apply to pension scheme trustees, in particular with regard to:

1. a requirement to keep detailed records of information on all the trust beneficiaries; and
2. a requirement to report information about the trust to HMRC via the Trust Registration Service, including information on all the trust beneficiaries.

In particular, there is some debate as to whether these requirements apply to all trustees. Even where trustees are considered to fall within scope, our interpretation of the regulations and further guidance published by HMRC is that:

- the requirement to maintain accurate and up-to-date records of all the beneficiaries and potential beneficiaries of the trust ((1) above) can be satisfied by keeping a record of the *description of the class of* beneficiaries and potential beneficiaries (which schemes should hold anyway).
- in relation to (2), information only needs to be reported if in a given tax year the trustees of the scheme are liable to pay any of the following UK taxes: income tax, capital gains tax, inheritance tax, stamp duty land tax, stamp duty reserve tax or land and buildings transaction tax (applicable in Scotland) in relation to the assets or income of the trust. As for (1), a proportionate approach can be taken such that providing a more generic filing (a description of the class of the scheme's beneficiaries and potential beneficiaries) should be sufficient. Where reportable, the information should be reported by 31 January after the tax year in which the trustees incurred the relevant tax, so the trustees **of any schemes which have become liable to pay any of these taxes in respect of the 2016/17 tax year should register by 31 January 2018.**

4. THE GDPR AND WHAT IT MEANS FOR PENSION SCHEME TRUSTEES

As those in the pensions industry will be well aware, the new General Data Protection Regulation (**GDPR**) will take effect in the UK and other EU Member States from 25 May next year.

[2] *The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.*

Whilst its aims do not differ from the aims of the current data protection regime (governed by the Data Protection Act 1998), the GDPR will introduce new concepts and some enhancements to the protections for individuals which will likely require pension scheme trustees to alter their existing processes.

In practice, if trustees already have robust data protection measures in place, the GDPR will not necessitate a complete overhaul of these. **However, the new requirements of the GDPR mean that action in a few key areas will need to be taken before 25 May.**

What is the essence of the new GDPR?

Like the current regime, the GDPR is concerned with the **processing** of **personal data**. Trustees are considered **data controllers** because they determine the purposes and means of processing the personal data. Those who process personal data on behalf of the trustees (e.g. scheme administrators) are **data processors**.

The aims of the GDPR do not differ from the current regime: (i) to protect individuals with regard to the processing of personal data; and (ii) to enable free movement of personal data between Member States.

The key principles of the GDPR are broadly the same as in the current regime, but there is a new focus on accountability, as well as some more detailed rules and requirements underpinning the key principles.

What should trustees be doing?

There is currently an incomplete picture as to how certain elements of the new GDPR should be interpreted in practice and further guidance from the UK Information Commissioner's Office and the European Working Party is expected in due course. However, it is unlikely that there will be any specific guidance issued for the pensions industry. Trustees should therefore ensure they understand the key principles of the new GDPR and what actions they need to take in order to be compliant from May next year.

Key actions for trustees to consider include:

- Arranging training from advisers to gain a good understanding of the new GDPR requirements and what needs to be done.
- Talking to third party service providers to gain an understanding of what personal data they hold and the arrangements in place to ensure personal data are protected.
- Reviewing existing contracts with third party service providers who process personal data on the trustees' behalf and agreeing amendments to ensure compliance with the new GDPR. (The GDPR prescribes a number of terms which all contracts between data controllers and data processors must include – existing contracts are unlikely to meet these requirements and will therefore need updating. New contracts entered into between now and May should also be on GDPR compliant terms).
- Arranging for new data privacy / fair processing notices to be prepared and sent to members.
- Revisiting ill-health information request / consent forms and updating as necessary to reflect the stricter conditions required for obtaining consent under the GDPR (necessary for processing "sensitive personal data" such as health data).
- Reviewing existing data protection policies and procedures and producing an updated data protection policy document to cover key items such as:
  - the justification for processing personal data;
  - what personal data is being retained, how long this is retained for and on and what grounds this is justified;
  - whether a Data Protection Officer needs to be appointed and whether a Data Protection Impact Assessment is necessary;
  - the process for responding to data subject access requests; and
  - processes for dealing with and reporting data breaches.

5. VAT ON PENSION SCHEME MANAGEMENT COSTS – IS ACTION REQUIRED?

As reported previously, HMRC published guidance in 2014 and 2015 for DB schemes making clear that the existing treatment for VAT recovery on pension scheme management costs (as outlined in VAT Notice 700/17) was no longer appropriate as a result of HMRC's interpretation of developing European case law in the area.

Various alternative options for the treatment of VAT on services to DB pension schemes were being considered by HMRC and while the details were being worked out, a transitional period was declared; allowing the VAT treatment outlined in Notice 700/17 to continue to be applied until 31 December 2017 (originally extended from 31 December 2015 and then again from 31 December 2016).

With the 31 December 2017 fast approaching, is action required?

No. While HMRC is yet to publish a formal Brief extending the transitional period beyond 31 December 2017, it did update the pages of its VAT manual at the beginning of this month.

According to HMRC's updated VAT Input Tax Manual, [3] in consideration of some of the difficulties associated with the alternative options for VAT recovery previously tabled, the existing rules for input tax deduction will continue to be available to taxpayers going forward, meaning that the existing 70/30 rule (where a single invoice is issued by a third party covering both administration costs and investment costs, the employer can apportion 30% to administration services (and recover VAT on this) and 70% to investment services (which would generally not be VAT recoverable)) can continue to be used.

As expected, the updated VAT guidance does cover some alternative options for VAT recovery (tripartite contracts, back to back supply of services and VAT grouping) which may be used. However, the guidance dealing with the various alternative options is somewhat muddled and the problems previously identified with these alternative routes do not appear to have been resolved.

6. AUTUMN BUDGET

The Chancellor delivered the second Budget of the year on 22 November – the Autumn Budget (in line with the previously announced switch to an Autumn Budget and a Spring Statement).

To the relief of many in the pensions industry, there were no significant announcements on pensions in the Budget.

Key points on pensions

- Plans to encourage and facilitate pension funds to invest in long-term investments (e.g. infrastructure), with guidance from the Pensions Regulator to come.
- From April 2019, tax relief for employer premiums paid into life assurance products or certain overseas pension schemes to be "modernised" to cover policies when an employee nominates an individual or registered charity to be their beneficiary.
- Confirmation that the State Pension will increase in line with the triple lock from April 2018.
- Confirmation that the Lifetime Allowance will increase in line with CPI, rising to £1,030,000, from 2018/19.

There had previously been suggestions the Government might unveil plans to cut higher-rate tax relief or re-model pensions tax-relief on an age-related basis to promote intergenerational fairness (as well as rumours that the Annual Allowance might be slashed and/or that the way DB pensions are calculated for Lifetime Allowance purposes may be changed), but the Budget was silent on all of these points.

7. DWP CONSULTS ON MASTER TRUST REGULATIONS

The Department for Work and Pensions (**DWP**) has published for consultation the *Occupational Pension Schemes (Master Trusts) Regulations 2018*, which will supplement the Pension Schemes Act 2017 and implement the new regime for master trust authorisation due to come into force from 1 October 2018.

From 1 October 2018, a master trust will be prohibited from operating unless it has been authorised.

To be authorised, the trustees will need to apply to the Pensions Regulator, who will then decide whether it is satisfied that the scheme meets the authorisation criteria. The draft regulations set out what information (additional to that required by the Pension Schemes Act 2017) the Regulator will require to determine whether the application has met the authorisation criteria.

In addition, the draft regulations indicate that a fee will be required to obtain authorisation – with master trusts in existence before 1 October 2018 to pay no more than £67,000 and new master trusts established after this paying no more than £24,000. This reflects the Regulator's expectation that the work involved in processing an existing master trust application will be substantially higher than processing a new application.

The consultation closes on 12 January 2018. The Pensions Regulator is due to publish a corresponding Code of Practice, which will be subject to a separate consultation and will also publish operational guidance.

8. PPF CONSULTS ON NEW LEVY RULES AND CONTINGENT ASSET FORMS

At the end of September, the Pension Protection Fund (**PPF**) published for consultation its draft 2018/19 levy determination and rules for the next triennium. The consultation closed on 1 November and a response is

[3] https://www.gov.uk/hmrc-internal-manuals/vat-input-tax/vit44600

currently awaited (the final rules are expected later this month).

Draft rules

The PPF plans to implement the proposals it consulted on in March (please see the May edition of UK: Pensions Update for more details), with only limited changes. Key points include:

- **Employer scorecards**: changes to the scorecard system to improve predictability of insolvency and to use a company's credit ratings, where available, to generate insolvency risk scores.
- **Certification of deficit reduction contributions**: proposals to use two simplified options for certifying deficit reduction contributions.
- **Certification of Type A contingent assets**: requiring a guarantor strength report to be obtained by trustees in advance of certifying high value Type A contingent assets (group company guarantees). The proposal is for the requirement to apply from the 2018/19 year where the levy benefit of a contingent asset is £100,000 or more.
- **Levy discount to reflect good governance**: the PPF has concluded that it will not take forward proposals to offer a levy discount for well governed schemes, but this will remain subject to review.

Contingent asset forms

In March, the PPF said it would undertake a full review of the wording of the PPF's standard-form agreements for all contingent assets, with the intention that all newly certified contingent assets for the 2018/19 levy year must be in the new standard form and for existing contingent assets to be amended or re-executed on the new terms.

The proposal that existing contingent assets would need to be re-executed was not welcomed by respondents to the consultation.

The PPF has since issued a separate consultation on the draft Type A and Type B contingent asset standard form agreements (which closed on 21 November). The consultation proposes some significant changes to these forms.

However, the PPF has said that any contingent assets entered into before these forms are published in final form (expected to be in early January) can be executed on the existing standard forms. Existing contingent assets will not need to be re-executed on the new forms for 2018/19, but may need to be for 2019/20 onwards.

9. AUTO-ENROLMENT CONTRIBUTION RATES RISE FROM APRIL 2018

The statutory minimum contribution rates required for DC schemes to meet auto-enrolment requirements will increase from 6 April 2018.

The minimum rates[4]

Date	Employer contribution	Employee contribution (including tax relief)	Total contribution
Up to 5 April 2018	1%	1%	2%
From 6 April 2018 to 5 April 2019	**2%**	**3%**	**5%**
From 6 April 2019 onwards	3%	5%	8%

Different rates apply where an employer self-certifies on the basis of one of the three tiers under the alternative quality requirement (most typically used where contributions are calculated as a percentage of basic salary rather than a percentage of qualifying earnings). These rates will also rise from 6 April 2018.

What should employers be thinking about in the run up to April?

Employers will need to check whether their current contribution structure will continue to meet the statutory minimum required from 6 April. If not, contribution rates will need to be increased in time to take effect from that date. This may require an amendment to the scheme rules and employers will also need to consider whether consultation with affected members is required, if employee contributions are to be increased. Payroll systems will also need to be updated.

Even if contribution rates are already at sufficient levels to meet the increased statutory minimum from April 2018, employers should think about whether any other action is needed in advance of April. For example, it may be useful to communicate with employees to explain that the minimum contribution rates required by auto-enrolment legislation are going up from April, but that the scheme

[4] As a percentage of qualifying earnings.

already complies with the increased limits and so nothing is changing. Although not technically required, the Pensions Regulator's guidance says that employers may wish to communicate with staff about increases to help minimise queries. Employers who currently certify compliance on the basis of the alternative quality requirements will also need to check the scope of their certification and may need to re-certify compliance.

10. DWP CONSULTS ON NEW COST DISCLOSURE REGULATIONS

The DWP has launched a consultation on regulations[5] which would impose new requirements on trustees regarding the disclosure of costs and charges to scheme members. The new regulations are intended to come into force on 6 April 2018.

The consultation precedes new FCA rules coming into force on 3 January, which place new disclosure obligations on "firms" (broadly, FCA authorised persons) who hold information (most likely, asset managers) needed for the calculation of transaction costs or administration charges in the course of providing services in connection with a relevant pension scheme.

Key points

The draft regulations would apply to trustees and managers of occupational pension schemes which provide money purchase benefits (other than just additional voluntary contributions, and subject to some limited exceptions).

The regulations would impose a number of new requirements:

- Extension of the scope of the Chair's annual statement so that it must include: (i) information about the level of charges and transaction costs applicable to **each** default arrangement and **each** fund that members are able to select (rather, than just information on the **range** of costs and charges, as is currently required); and (ii) an illustrative example of the cumulative effect over time of the application of charges and transaction costs on the value of a member's money purchase benefits.
- A requirement to publish on a website those parts of the Chair's statement concerning information in relation to the default arrangement and information in relation to the level of charges and transaction costs.
- A requirement to prepare and disclose on request a statement concerning pooled funds.

Draft statutory guidance to support schemes has been published alongside the draft regulations. The consultation closes on 7 December 2017.

Some of the new requirements could cause difficulties in practice, if the regulations are implemented as drafted. In particular, the requirement in (2) above is likely to be difficult for schemes without a public website (or access to one via e.g. the sponsoring employer) to comply with. (The consultation paper refers to using 'cloud services or online tools', but it is not clear how this would work in practice).

11. DWP CONSULTS ON BULK DC TO DC TRANSFERS

The DWP has launched a consultation on draft regulations[6] which would amend the requirement to obtain an actuarial certificate for bulk transfers of occupational DC to DC pension schemes without member consent, and replace it with an alternative test and new member protections.

Under the draft regulations, trustees would need to assess the suitability of the receiving scheme and a bulk transfer would be permitted if either: (i) the receiving scheme is an authorised master trust (though trustees would still need to consider whether it is appropriate); or (ii) the receiving scheme is not an authorised master trust, but the trustees have obtained and considered the advice of a suitability qualified independent professional as to the suitability of the receiving scheme. The regulations would also extend charge cap protections for those transferred.

The changes would not apply to DB schemes or DC schemes which include guarantees.

Designed to encourage scheme consolidation, the new measures are likely to be welcomed. However, further clarification regarding exactly how the member protections will operate would be helpful (in particular, guidance around who would count as a suitability qualified independent professional). There are also a number of related issues which seem to have been parked for now – in particular, the issue of how members' protected rights regarding tax-free lump sums greater than 25%, protected pension ages and protected Lifetime Allowances would be treated. The consultation paper refers to these issues having been flagged to HMRC for

[5] The draft *Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018.*

[6] The draft *Occupational Pension Schemes (Preservation of Benefits) (Amendment) Regulations 2018.*

further consideration, but comments that HMRC is not thought to be revisiting the relevant legislation imminently.

The consultation on the draft regulations closed on 30 November 2017 and the intention is for the regulations, once finalised, to come into force from 6 April 2018.

12. AMENDMENTS TO INDEPENDENT ADVICE REGULATIONS

Over the Summer two new sets of regulations were laid before Parliament, which are due to come into force on 6 April 2018 (subject to Parliamentary approval) and make various amendments to the regulations governing the requirement for members to seek appropriate independent advice on DB to DC transfers worth more than £30,000.

The Pension Schemes Act (Transitional Provisions and Appropriate Independent Advice) (Amendment) Regulations 2017

These regulations will require trustees to provide specific risk warnings to members who have "safeguarded-flexible" benefits when a member is looking to transfer, convert or take a lump sum from such benefits.

"**Safeguarded-flexible benefits**" are defined as benefits that are calculated by reference to a member's individual pot, but which include some form of guarantee in relation to a secure income in retirement. The example most commonly cited is a DC benefit with an attaching guaranteed annuity rate (most commonly found in personal pension schemes), though schemes may wish to seek advice as to whether the benefits they provide could be considered "safeguarded-flexible" benefits if they have unusual DC benefit structures in place.

The risk warnings must include:

- A statement that the member's benefits under the scheme include a potentially valuable guarantee which will be lost if they proceed with the transaction.
- An explanation of the key features of the guarantee.
- Two pension illustrations comparing a projection of the income the guarantee might provide against the income a pension pot of the same size would purchase on the open market.

The DWP has also recently published some guidance on the topic which provides more detail on what these risk warnings should cover.

The Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) (Amendment No.2) Regulations 2017

These regulations amend the existing regulations so that for the purposes of calculating whether a member's benefits are worth more than £30,000, the value should be calculated based on the cash equivalent transfer value. This will make it simpler for personal pension schemes which reportedly struggled to calculate the value based on the old method (which used the cash equivalent method for salary-related DB benefits in occupational schemes).

13. UPDATE ON PROPOSED ACCOUNTING CHANGES

As reported in the September edition of UK: Pensions Update, the International Accounting Standards Board (**IASB**) has recently been consulting on proposed changes to IFRIC14 (which prescribes when it is possible for an employer to recognise a balance sheet asset for a pension scheme that is in surplus on the IAS19 basis).

If implemented, the proposed changes would mean that an employer may no longer be able to account for a surplus assuming the gradual settlement of liabilities over time if the pension scheme trustees have a unilateral power to buy-out benefits in member names in a single event (regardless of whether or not the scheme's funding position would make this practically impossible).

The impact could be that an employer would only be able to recognise an asset if there is a surplus in the pension scheme calculated on a buy-out basis (rather than an IAS19 surplus). The employer would also have to recognise an additional liability if they are making past service deficit contributions.

However, since September, notes from a meeting of the IASB indicate that the IASB has decided not to finalise the proposed amendments at this stage. Instead of issuing detailed rules at this stage, the IASB is to consider whether a principles-based approach governing when there is an unconditional right to surplus would be more appropriate.

Employers may still wish to amend scheme rules if they contain a unilateral trustee buy-out power, but the position is likely to need revisiting once the IASB finalises its proposals in this area.

14. OTHER NEWS IN BRIEF

- **Finance (No.2) Bill 2017 receives Royal Assent**

The Finance (No.2) Act 2017 received Royal Assent on 16 November 2017, introducing two key pensions changes which take effect retrospectively from 6 April 2017: (i) a reduction in the money purchase annual allowance from £10,000 to £4,000; (see the September edition of UK: Pensions Update for more details); and (ii) an increase in the tax exemption for employer-arranged pensions financial advice to £500.

- **PPF consults on draft regulations to address bridging pensions**

  The PPF is consulting on draft regulations[7] which would enable the PPF to take account of bridging pensions when calculating PPF compensation. The current legislation means that members who are entitled to a bridging pension at the date of PPF assessment have their compensation fixed at the higher rate for life, rather than reducing when the bridging pension would have ceased to be payable under the scheme rules.

- **Not long left to make use of Scheme Reconciliation Service**

  HMRC's November contracting-out countdown bulletin[8] proved a useful reminder that the deadline for submitting queries via the Scheme Reconciliation Service remains 31 October 2018, with HMRC confirming its intention to respond to most queries by December 2018. (The service is available to contracted-out DB schemes for checking their contracted-out data against HMRC's records).

  The bulletin confirms that HMRC will issue a final report of membership records held by HMRC to schemes in March 2019. Following this date, schemes should continue to maintain scheme records, but HMRC will not be maintaining its own records. The bulletin also states that HMRC has now decided not to issue statements to individuals with details of their contracted-out history after December 2018, as previously planned.

[7] The draft *Pension Protection Fund (Compensation) (Amendment) Regulations 2018.*
[8] https://www.gov.uk/government/publications/countdown-bulletin-30-november-2017/countdown-bulletin-30november-2017

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