Dalriada Trustees – Industry Changes

**Your Quarterly Pensions Update**

Q3 2017

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## Introduction

The purpose of this report is to provide an update for pension scheme sponsors and trustees on recent industry changes, up to mid October 2017.

For your convenience, we have summarised the key developments and highlighted the necessary actions sponsors and trustees may need to take.

We also include links to further relevant information and any deadlines you should be aware of.

We trust you will find the update useful and informative. If you require further information about how any of the topics covered might impact on your scheme specifically, please get in touch with Adrian Kennett, [adrian\_kennett@dalriadatrustees.co.uk](mailto:adrian_kennett@dalriadatrustees.co.uk) or your usual Dalriada contact.

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| NOTE |  |
| This document is aimed at providing you with generic information about recent developments in the pensions industry.  You should not take any action as a result of information included in this document without seeking specific advice in relation to the impact these matters might have on your scheme or company. Dalriada accepts no liability for actions taken or not taken as a result of this document. | |

## GDPR Compliance - Making an Assessment

**TAGS:** GOVERNANCE | DATA PROTECTION | INFORMATION SECURITY

As reported in our last quarterly update, the General Data Protection Regulations (“GDPR”) come into force on 25 May 2018. Data Controllers and Data Processors must be able to demonstrate that they are compliant with GDPR legislation, including the requirement to implement appropriate processing procedures, storage arrangements and security measures. Regular testing of the effectiveness of policies, procedures and security measures is also required where appropriate.

With just over six months until the regulations come into force, if not already addressed it is important to start work on a GDPR compliance assessment to identify and address the risks associated with your pension scheme.

**The Compliance Assessment Checklist**

The key stages are:

* Construct a data-mapping diagram for the personal data stored and processed by the Scheme.
* Review the current data privacy policies and procedures in place for the Scheme.
* Review the current information security policies and procedures applicable to the Scheme.
* Report on the risk assessment results and develop a plan to achieve GDPR compliance.
* Information gathering is a critical first step in the assessment process and so working with scheme service providers and formally documenting data processes and practices is important to get right.

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| ACTION |  |
| Trustees and employers need to ensure that they can call on a team with the appropriate knowledge, skills and experience to assess operational and information security related issues and put a plan in place for how to deliver on the project. | |

## The Pensions Regulator’s Annual Funding Statement

**TAGS:** PPF | LEVY 2018/19 | BRIDGING PENSIONS

The Pension Protection Fund (PPF) has published for consultation its draft levy determination for 2018/19, alongside the policy statement for the next three years up until 2021.

The draft levy determination indicates that the PPF plans to collect £550 million for the 2018/19 levy year - a reduction of 10% on the 2017/18 estimate of £615 million and, if confirmed, the lowest collection amount it has set in its history. This drop reflects the PPF’s view that its own funding position is strong, despite ongoing risks to PPF-eligible schemes.

The Policy Statement confirmed a number of aspects that will be used when calculating 2018/19 levies, including:

* the levy scaling factor will be set at 0.48 (down from 0.65 for 2017/18), the Scheme-based Levy Multiplier will be kept unchanged at 0.000021 and the risk-based levy cap is expected to be reduced from 0.75% to 0.5% of smoothed liabilities;
* regulated financial entities will be assessed on their credit ratings and the Standard and Poor’s credit model, replacing the current Experian assessment;
* monthly Experian scores will be retained (there had been talk of potentially moving to annual scores); and
* the process of certifying deficit reduction contributions will be simplified.

With regards levy bands, the PPF considered some changes but has decided to continue using ten levy bands and that a redesign is not merited. However, it has proposed changes to the levy rate in bands 1 to 4. Low levels of insolvency amongst employers in these bands means that the difference in insolvency probabilities between bands is smaller than implied by the current levy rates. Adjusting the probabilities in these bands will reflect more accurately the limited increase in risk.

The PPF is not proposing any changes to its approach to measuring underfunding and investment risk but does plan to work with the Regulator to review the suitability of asset classes to support better risk management.

Latest News from the Pension Protection Fund continued…

**PPF Levy Invoices for 2017/18**

Trustees reading this update will no doubt have received their scheme’s levy invoice, which will be due for payment soon – if you have not received it, contact the PPF! We would encourage trustees to review the levy calculation to ensure it is accurate. If a mistake has been made, trustees need to raise this with the PPF within 28 days of receiving the invoice.

**PPF Compensation for Bridging Pensions**

The DWP recently consulted on draft regulations that would empower the PPF to alter compensation payable to members who are entitled to a bridging pension under their scheme rules. The consultation put forward two main approaches to this issue: 1) “Smooth”, through actuarial methods, the different levels of benefit the member is due to receive into one flat rate, or 2) “Mirror” the bridging pension that the member is entitled to in the PPF compensation plan for the scheme. The consultation closed on 1 October 2017, so we will hopefully be able to report on the outcome of this in the next quarterly update.

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| ACTION |  |
| Schemes should have already received their PPF levy invoice for the 2017/18 year and should check with their advisors if it is reasonable and accurate.  Trustees and sponsoring employers should consider the revised methods for calculating employer risk – such as the new approach for financially regulated employers – to establish whether there is any action they can take now to improve their levy for 2018/19 onwards.  Schemes with contingent assets should look out for the PPF releasing the new approach in regard to certifying those assets, so that they are in a position to re-certify for the next levy. | |

## Helping Members – Advice vs. Guidance

**TAGS:** TRUSTEESHIP | ADMINISTRATION

Employers and trustees often find themselves in the difficult position of seeking to provide the best option to individuals while simultaneously not being permitted to give advice (without the authorisation of the Financial Conduct Authority).

Of course, trustees are obliged to provide specific information to members and have a general duty to ensure that members can make informed decisions. However, there is a clear line between providing factual information to aid members’ decision-making (guidance) and an opinion based on specific expertise (advice).

Clearly, there is disparity between what trustees, employers want to do, and what they can do, given what is permissible under the FCA. Naturally, trustees want to be comfortable in providing information and empowering choice. Ideally, they would have no concerns in providing as much guidance as is practical to the member.

On 28 September 2017, the FCA and Pension Regulator published a joint guide in the form of a factsheet to give confidence to trustees and employers who want to provide support to members and employees. In essence, the factsheet clarifies the extent to which trustees and employers can assist members, without needing to be authorised by the FCA.

The factsheet does not provide an exhaustive summary of all relevant legislation but it does indicate that circumstances whereby the trustees or employer would require authorisation are unlikely to occur. The exception involves providing investment advice or if they receive a ‘commercial benefit’ for helping members.

The factsheet also outlines the type of advice a trustee or employer should avoid giving, as well as the type of general information that would be acceptable and useful to members. It addresses the extent to which trustees and employers are permitted to promote financial products.

The introduction of this factsheet is good progress in clarifying guidelines and ensuring a more uniform approach going forward.

Helping Members – Advice vs. Guidance continued…

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| ACTION |  |
| Trustees and employers should read the guide and take confidence in providing support on financial matters to members and employees. | |

# Investment Viewpoint – Achieving Value from your Investment Consultants

**TAGS:** INVESTMENT CONSULTANTS | INTEGRATED RISK MANAGEMENT

*We asked Simon Cohen, our Chief Investment Officer, to give his thoughts on a key topic in the investment markets over the last quarter. Here is what he said:*

Many pension scheme trustees are currently experiencing deteriorating scheme funding positions and so there is significant pressure on trustee boards to ensure that their investment strategies provide the right mix of stability and strong returns. The recent report from the UK’s Financial Conduct Authority – with talk of the investment consultant market being rife with opaque fees and conflicts of interest – is just another painful barb in an already thorny issue.

The co-chairman of the Association of Member Nominated Trustees recently suggested that trustee boards could achieve savings by scrutinising their investment consultants. This sounds like a promising endeavour, but what questions should trustees be asking of their investment consultants?

Here are a few openers:

* There is the obvious issue about benchmarking the consultant’s fees against the competition. As a starting point, how much does the incumbent consultant charge for a strategy review compared to the market?
* To what extent has the incumbent consultant helped negotiate down (if at all), the pension scheme’s management fees?
* Are some services actually needed? For example, is a beauty parade for manager selection a necessity for the scheme, or is it a waste of time and money? What value has the consultant added?
* How have the consultant’s proposed managers performed relative to the manager’s benchmarks?
* Given the higher manager and consultant fees associated with active management of certain asset classes, does the pension scheme really need active management in all cases?

Investment Viewpoint – Achieving Value from your Investment Consultants continued…

However, the business of asking questions comes with a caveat in the form of one further question – do you fully understand the answers that you receive?

This might be the hardest question to answer, and it is where trustee boards that are in doubt as to their ability to provide an affirmative answer may wish to shore up their expertise in pension scheme investment matters with a specialist, independent trustee appointment.

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| ACTION |  |
| Trustee boards should pose themselves the questions listed above and decide whether their investment consultant arrangement is fit for purpose. | |

## ~~Conditional Data~~ “Scheme-specific Data” – It’s Time to Shape Up!

**TAGS:** DB SCHEMES | FUNDING | TPR

*(Note – Just before going to print, The Pensions Regulator (“TPR”) helpfully announced that in an effort to remove ambiguity, ‘conditional data’ will now be referred to as ‘scheme-specific data’.)*

With TPR requiring schemes to include scheme-specific data scores within their annual scheme return from January 2018, it’s time for administrators and trustees alike to take immediate action. TPR will use these scores to target schemes that are failing in their duties, so it is imperative that records are in order.

Back in December 2012 TPR set a rigid deadline for schemes to have their common data audit scores up to scratch, with very loose guidelines on scheme-specific data. Now, nearly five years later the penny has finally dropped – scheme-specific data is not a second class citizen, rather it is that most vitally important element of running a pension scheme: the ability to calculate benefits correctly.

Even so, the general stipulations regarding the auditing of scheme-specific data are still a little cloudy. In short, ‘common data’ refers to member information items that apply to all pension schemes, whereas ‘scheme-specific data’ relates to items that are dependent on scheme type, structure and design.

To get a clear view of how far the industry is behind with regards to scheme-specific data, here are a few facts taken from TPR’s 2016 survey:

* 30% of members are in schemes where scheme-specific data scores are not measured at all
* 39% of scheme administrators felt the measurement of scheme-specific data scores was not a priority
* Understanding of the term ‘conditional data’ is not universal (hence the re-brand to ‘scheme-specific data presumably!)
* Record-keeping is not always seen as a priority by trustees.

Security & Sustainability of DB Pension Schemes continued…

2. Consolidation

We believe that consolidation could lead to a dramatic reduction in expenses, with the savings redirected to paying off deficits and enhancing the security of members’ benefits.

If schemes were allowed to reform member benefits to a different, uniform structure of equal actuarial value, complex benefit structures with multiple pension tranches could be reduced to a single, simplified benefit. This would allow a vast reduction in ongoing administration costs, actuarial fees and investment advice, as a large number of schemes who reform benefits to this uniform structure could then be run on a common basis with much less need for bespoke calculations. Coupled with pooled investment vehicles, schemes could then access a wider range of investments at lower cost and focus the assets of the scheme on providing benefits.

3. Professional Trusteeship

Whilst recognising the benefit of having lay trustees who are tuned in to the needs of their membership, we expressed the view that the increased engagement of professional trustees is crucial to address some, if not the majority, of the issues raised in the Green Paper. The expansion of TPR’s engagement has merit, but to place the onus on it to monitor all schemes at a more granular level is simply unrealistic from a pure resource point of view. As such, we see the encouragement of professionalisation within the trustee community as an important step to resolving the concerns in the industry.

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| ACTION |  |
| The DWP has indicated that there will be a White Paper released later in 2017 on the future of DB schemes. So look out for this and DWP’s normal publication of responses to the Green Paper. | |

## Nice Ideas from the PLSA

**TAGS:** DB SCHEMES | ADMINISTRATION | REFORMS

The DB Taskforce of the Pensions and Lifetime Savings Association (PLSA) has issued its final report and recommendations on reforms to improve the sustainability of Defined Benefit schemes in the UK.

The Taskforce made three main recommendations:

* 1. A new Chair’s Statement for DB Schemes

In theory, requiring trustees to produce a statement explaining their views on consolidation might encourage them to actively consider the available benefits. In practice, this could well prove to be a further bit of bureaucracy that adds cost but no value to the scheme.

* 1. Easier simplification of accrued benefits

The multiple benefit tranches in schemes are a major barrier to simplified administration, streamlined actuarial valuations, common investment strategies and efficient buy-out pricing. The “Section 67” prohibition on any benefit change that disadvantages any member in any circumstance by any amount is overly restrictive and a relaxation could facilitate huge cost savings for pension schemes, while still protecting the overall value of benefits for members.

Schemes could convert their members’ benefits to a standard structure to unlock much cheaper, automated administration with increased competition between providers. We can only hope that politicians see the light and relax the rules for the greater good.

* 1. Allow sponsors to provide extra funding instead of ongoing support

The PLSA suggestion of “Superfunds” to allow employers to drop their future obligations to schemes in return for a one-off additional contribution has some merit but two fundamental problems.

Firstly, there is unlikely to be much political appetite to allow employers to hand over their responsibilities to a third party without guaranteeing full benefits and, secondly, there is no free lunch so someone has to be prepared to step in if the Superfund fails. It would seem unfair to

Nice Ideas from the PLSA Continued…

expect the Pension Protection Fund (PPF) to provide insurance backing for a new commercial enterprise.

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| ACTION |  |
| Trustees and employers should watch this space, but don’t hold your breath waiting for any helpful changes. | |

## State Pension Age Increase Brought Forward and Longevity Slowdown

**TAGS:** STATE PENSION AGE | MORTALITY | LONGEVITY

The Government recently announced that the State Pension Age will increase to 68 in 2037 – seven years earlier then planned. The first State Pension in the UK was introduced in 1908 and paid the 25% of people who reached age 70 for an average of 9 years. The Basic State Pension came in from 1948 and allowed people to retire at 65, with a life expectancy of 12 years. However, by 2014 this life expectancy had risen to 21 years (for men).

The Office of Budget Responsibility (OBR) projects that the state pension will grow from 5% of GDP to 7.1% of GDP over the next 45 years. That is an extra £40bn to find every year, when other age-related spending on healthcare and so on will already be adding an extra £100bn a year. We can either agree to all pay a lot more tax (there are not enough high earners to cover it on their own), or we can make some hard decisions on cutting back the benefits.

There is a good argument that the improvements in longevity have slowed down recently but the general trend is still upwards. Life expectancy for men went up from 70 in 1981 to 79 in 2011, slightly narrowing the gap to female life expectancy, which increased at a slightly slower rate to 83.

The rapid improvements from 2000-2010 largely reflected a massive reduction in smoking rates (and other lifestyle factors) which cannot be repeated, since you can only give up smoking once. Recent data might be just a blip with a bad winter last year leading to 140,000 deaths of people over 65 – an 11% increase on the previous year. There was also a similar mortality spike in 2015 after a flu epidemic.

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| ACTION |  |
| Trustees and Employers need to consider whether the approach taken by their pension schemes to deal with mortality uncertainty is appropriate. | |

The key thing for the Government is to make decisions based on evidence, good advice and thoughtful consideration.

**VAT – Taxing times for Pension Schemes**

**TAGS:** VAT | GOVERNANCE | ADVISORS

On 5 September 2016, HMRC extended to 31 December 2017 the transitional period dealing with the issue of how VAT is applied (and reclaimed) in respect of pension scheme services. It was anticipated that the extension would produce some guidance from HMRC on how DB schemes should react.

Well, no such guidance has emerged from HMRC in the following 12 months, meaning the transitional period is to end when the bells of Big Ben (would normally) chime on 31 December 2017.

It has been suggested that there may be a further extension of the deadline, but in the absence of further clarification from HMRC, sponsoring employers should liaise with their tax advisers and prepare their strategy on how to deal with the new VAT arrangements.

Whilst the initial guidance (published back in September 2016) is only in draft, it does provide an insight into HMRC’s thinking and provides some clarity on when VAT will be charged on pension management services, and in what circumstances this VAT can be recovered.

The key points are as follows:

* HMRC will no longer allow sponsoring employers to recover VAT on pension scheme costs as a matter of course.
* Employers must have implemented one of HMRC’s approved structures by 1 January 2018 (or later date if extended) in order to recover VAT on pension scheme costs.
* Employers are urged to act now to secure VAT recovery going forward.

For the vast majority of employers, failure to implement a HMRC-approved structure before the end of HMRC’s transitional period will result in the employer no longer being able to recover VAT on pension scheme costs. Employers who fail to act risk being targeted by HMRC, and may incur penalties.

VAT Taxing times for Pension Schemes Continued…

To recap, whilst the guidance could be amended, there remain three potentially viable arrangements, which will allow for an increased level of VAT recovery for pension scheme costs, from 1 January 2017.

* 1. Trustee VAT Registration
  2. Group VAT Registration
  3. Restructuring contracts from third party service providers

There is no ‘one size fits all’ solution – what is best for a particular employer/trustee group will depend on their particular circumstances.

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| ACTION |  |
| We would recommend that trustees and employers commence discussions now, taking appropriate VAT and legal advice, in order to ensure sufficient time to go through all the necessary steps. | |

## Scottish Rate of Income Tax (“SRIT”) – ‘Wha’s like us? Damn few and they’re a’paying less tax.’

**TAGS:** TAX | ADMINISTRATION | GOVERNANCE

From 6 April 2016, Scotland has had its own rate of income tax, “SRIT”. People resident in Scotland (identified by HMRC with an “S” at the start of their PAYE tax code) pay 10% less income tax to the UK than other UK residents, but in addition to this reduced rate of UK income tax Scottish residents pay SRIT, the rate of which is set by the Scottish Government. For 2016/17 and 2017/18 the rate of SRIT has been 10% meaning that Scottish residents pay the same overall rate of income tax as other UK residents.

From 6 April 2017 the Scottish Government have also had control of the income tax bands for Scottish residents and chose not to increase the higher rate of income tax threshold of £43,000 whereas the threshold increased to £45,000 for other UK residents, meaning that Scottish residents earning over £43,000 pa now pay more income tax than similarly remunerated people in the rest of the UK.

**What does this mean for pension schemes?**

The obvious implication is, for any pensioners who are resident in Scotland, payroll providers should be aware of the potential different tax treatment.

For members actively contributing to standard trust based pension schemes where tax relief is applied using the net pay method, contributions are deducted from gross pay prior to income tax being charged so SRIT has no special impact on pension contributions.

Where contributions are paid direct to personal pension schemes, or to some master trusts, tax relief is applied using the relief at source method. Contributions net of basic rate tax are paid to the pension provider who then collects basic rate tax relief at the appropriate rate from HMRC. Payroll and pension providers have to be able identify contributors who are Scottish residents as the rate of relief could potentially be different. Higher and additional rate tax payers can reclaim additional tax relief separately using their self-assessment tax return, whether you fall into this category now depends on where you live.

*Scottish Rate of Income Tax (“SRIT”) – ‘Wha’s like us? Damn few and they’re a’paying less tax’ continued…*

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| ACTION |  |
| All payroll providers have to be aware of SRIT and register with HMRC’s Secure Electronic Transfer (“SET”) system, which is to be replaced by their Secure Data Exchange Service (“SDES”) from January 2018, to allow them to identify Scottish residents.  Where tax relief is applied via the relief at source method, extra care is needed and contributors should be aware of the different tax rate bands and how relief on non-basic rate tax can be reclaimed.  There may be an opportunity for some Scottish resident individuals earning slightly over £43,000 to reduce their taxable income by paying more pension contributions and as a result pay no more income tax than were they resident elsewhere in the UK. | |

## Coming Up Next… Again

In our last Quarterly Update, we highlighted some major topics that were due to appear in the last three months. Unfortunately, the Government, ECJ and HMRC have all disappointed us, with expected updates not materialising. So this coming up Next may feel repetitive in parts, but we are forever optimists, so have updated those items from last time, to go with new developments:

* As mentioned earlier, the PPF released its policy statement for the calculation of levies over the next three years. As part of that announcement, the PPF confirmed that they will be producing documentation to amend the process for **certifying contingent assets** in time for the next levy cycle. Schemes with these assets should keep an eye out for this in the coming months.
* The Chancellor will be delivering his first **Autumn Budget on 22 November 2017**. As always, it is a guessing game as to whether pensions will see many reforms, but some rumours have been circulating that Mr Hammond may look to amend the tax relief rates (perhaps setting a flat rate) and/or introduce auto-enrolment for self-employed individuals via the self-assessment system.
* On 4 December 2017, a potentially significant case will be heard by the High Court, with BT seeking a ruling to allow an alteration in the **indexation measure for the BT Pension Scheme** from RPI to CPI. It has been suggested that this could be to the detriment of 80,000 members, so given the discussions around this “hot topic” in the industry; it will be interesting to hear the arguments made and final decision.
* **White Paper on the reform of the DB Sector** – In mid-July the DWP said they would release their “proposed next steps on what reform is needed to support the sector, including the powers of the regulator”. We thought we would have this for this Quarterly Update, but perhaps we will hear more in the last quarter of 2017, if the Government is not too preoccupied with all things Brexit!
* On 26 June 2017, the Government published new regulations transposing the 4th **Anti Money Laundering** Directive into UK law. The HMRC are yet to produce guidance that clarifies the impact on pension schemes, but we hope this will be released for our final update of 2017.
* In our last two Quarterly Updates we said we were expecting to see the Government’s response to the recent **Pension Cold-Calling** consultation. The Government’s response is still not here. However, in the House of Lords in October a cross-party amendment calling for a ban on cold calling in the Financial Guidance and Claims Bill was successful, representing a

Coming Up Next… Again continued…

significant defeat for the Government. Again, perhaps in our final Update of 2017 we will have more clarity!

Trustees and sponsoring employers alike should also be aware of the following key dates coming up:

* **November 2017** – TPR to publish a ‘Quick Guide to Measuring Data’, to assist in calculating data scores for the next scheme return submissions.
* **Autumn 2017** – DWP to issue consultation on regulations to be drafted for the supervision of master trusts.
* **Later in 2017** – TPR to launch their 21st Century Trusteeship initiative

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