Dalriada Trustees – Industry Changes

Your Quarterly Pensions Update

Q4 2017

Dalriada. A better way

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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 December 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 or your usual Dalriada contact.

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 Trustees Limited accepts no liability for actions taken or not taken as a result of this document.

Anti-Money Laundering Regulations: Trust Registration Service

TAGS: ANTI-MONEY LAUNDERING REGULATIONS | TAX | TRUSTEESHIP

Background

The new Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, which came into force last year, contains new reporting and registration requirements for trustees to HMRC.

Does your scheme need to submit information?

Most UK occupational pension schemes will not need to register with HMRC. However, schemes should do so in cases where the trustees are liable to pay any of the "relevant UK taxes". These consist of income tax, capital gains tax, inheritance tax, stamp duty land tax, stamp duty reserve tax, land and building transaction tax (Scotland).

Having said this, the guidance confirms that in cases where a registered pension scheme has to pay UK income tax solely for certain reasons it will not need to register. This includes cases where the tax liability relates to:

PAYE on payments of pension or lump sum benefits to members and beneficiaries;

certain charges under the Finance Act 2004 such an unauthorised payment charge, lifetime allowance charge or "scheme pays" annual allowance charge.

Trustees will need to satisfy themselves of these conditions each tax year, with the first tax year to be considered being 2016/17. The responsibility for registration lies with the trustees, although they can appoint an agent to register the trust on their behalf.

How does the scheme provide information if required?

The trustees must first register with HMRC through the Trusts Registration Service (TRS). This is a new service that will provide a single online route for trusts and complex estates to comply with their registration obligations and to obtain their Self-Assessment (SA) Unique Taxpayer Reference (UTR).

Anti-Money Laundering Regulations Continued…

Deadlines for this tax year

If a scheme is not registered for SA and has incurred an income tax or capital gains tax liability in the 2016/17 tax year, registration should have been completed by 5 January 2018 and relevant information needs to be submitted by 31 January 2018.

In all other circumstances, if a scheme has incurred a relevant UK tax liability in the 2016/17 tax year, registration must be completed and information provided no later than 5 March 2018 (HMRC recently pushed back the deadline from the original 31 January 2018 date).

If a pension scheme has not incurred one of the relevant UK taxes in the 2016/17 tax year, there is no requirement to register with the TRS or submit any information. We expect this to be the case for the majority of schemes, but it is imperative that trustees check with their advisers whether any of the above mentioned taxes were paid by the scheme in the 2016/17 tax year (and in subsequent tax years going forward).

Helpful Links:

- HMRC TRS Guidance FAQs - 22 November 2017
- The Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017
- Trust Registration Service (TRS)

ACTION

Trustees should check if their pension schemes need to register and take appropriate action immediately. Contacting scheme investment managers who were in place in the 2016/17 tax year should provide trustees with the quickest avenue to confirm whether a relevant UK tax liability was incurred by their scheme.

VAT on Defined Benefit Pensions Scheme Management Costs – Welcome Update from HMRC

TAGS: VAT | DB PENSION SCHEME | MANAGING SUPPLIERS | HMRC

HMRC quietly issued some further guidance regarding VAT on defined benefit pension scheme expenses during Q4 of 2017. Transitional arrangements had been due to expire on 31 December 2017. However, the revised position is that the existing rules regarding input tax deduction and when an employer can recover VAT on services provided to its DB scheme will now continue to be available, together with newer options.

The guidance confirms that a VAT registered employer can treat VAT incurred on the day-to-day administration of the scheme as its input tax even where the trustee is responsible for the general management of the scheme and contracts and pays for the services supplied. Where all parties agree, trustees can arrange for invoices to be made out by the supplier to the employer to facilitate VAT recovery.

The existing option to apply the "70/30 split" for combined investment and administration services remains available. Helpfully HMRC has provided further clarification and a categorisation of activities between administration and investment, which may allow a more accurate split and potentially higher VAT recovery.

The continuation of the current rules does not rule out other arrangements. Some of the proposed arrangements may indeed be attractive to a particular employer or group and the scheme trustees, for example VAT grouping and onward supply of services by the trustees to the employer. The tripartite contract between trustee, employer and supplier had been proposed as a possible solution, but it has proven very difficult in practice to construct a contract that satisfies all the competing legal and regulatory demands.

In conclusion, the recoverability of VAT will continue to depend on the nature of the service rather than who contracted for it and received it. The distinction between costs relating to administration (VAT recoverable by the employer) and those to do with investment (VAT not recoverable by the employer) remains pivotal.

VAT on Defined Benefit Pensions Scheme Management Costs – Welcome Update from HMRC Continued…

Helpful Links:

HMRC Internal Manual - VAT Input Tax

ACTION

No immediate action required.

Employers should continue to engage with their VAT Advisors to ensure appropriate and optimal treatment of VAT on invoices of all suppliers in compliance with HMRC guidelines. This may result in employers or trustees engaging with suppliers to ensure that supply of services is clearly defined to ensure compliance with HMRC definitions and guidelines.

A change to your VAT arrangements in response to HMRC guidance on VAT for pension scheme costs may no longer be necessary. We recommend that you review the activity list contained in the latest guidance, and continue to ensure, with the advice of your Tax Advisor as necessary, that your ongoing treatment of VAT is compliant with HMRC guidance.

21st Century Trusteeship

TAGS: TRUSTEESHIP | ADMINISTRATION

In 2016, the Pensions Regulator published a discussion paper on 21st Century Trusteeship and Governance, designed to stimulate a dialogue about how government, regulatory bodies and the pensions industry can raise standards of trustee competence. It was subsequently felt that many pension schemes aren't meeting the governance standards expected. As a result, a programme was created outlining areas that must be enforced in order to support trustees of all pension schemes in good decision-making.

Pension scheme members have the right to expect that their retirement savings are being looked after properly by the trustees. Poor trustee stewardship will have a direct impact to the funding costs of schemes and as such this means that poor governance is bad for members and employers. To improve the standards of governance, the programme focuses on three key areas:

- Good governance
- Clear roles and responsibilities
- Clear purpose and strategy

The Pensions Regulator has stressed that it is not creating new or high standards of governance but, instead, is making clear what it thinks good governance looks like and the actions it will take if these standards are not being met.

Helpful Links:

- The Pensions Regulator - Raising the Standards of Governance
- 21st Century Trusteeship - Discussion Paper and Consultation Response

ACTION

Trustees and employers should review the Regulator's 21st Century Trusteeship programme and consider whether their approach towards governance and trusteeship is of a high enough standard and what improvements, if any, could be made.

Bank of England Interest Rate Rise

TAGS: INTEREST RATES | BANK OF ENGLAND

After a decade of nothing but maintaining (or reducing) interest rates, in October 2017 a majority of the Monetary Policy Committee of the Bank of England voted to increase interest rates, from 0.25% to 0.50%.

Faced with above-target inflation and increasing employment figures, it was widely expected that the Bank of England would take this action and that one of the consequences would be a rise in long term bond yields. Pension schemes would have been forgiven for expecting a resultant reduction in the value of their liabilities.

However, the market's reaction was not entirely as expected, with long term bond yields actually falling (admittedly very slightly), pushing up liability values. What appears to have happened is that the market had already priced in this initial interest rate rise, and the Bank of England's published expectation that there may only be two further increases in the coming three years had more of an impact on the market.

These "gradual and limited" increases will be welcome news to savers, but pension scheme trustees and sponsoring employers, with hopes of seeing deficits fall in the coming three years will not have been so welcoming. An interest rate rise is no doubt good news for some, but pension scheme funding levels won't be jumping for joy just yet.

Schemes may in the future see a reduction in the demand for transfer value quotations from members, if the higher interest rates are reflected in long-dated gilt yields, pushing down the value of those quotations. Yet, with the uncertainty still in the market – Brexit being a primary driver of that anxiety – the future trend for interest rates and long term gilt yields is still unpredictable. Schemes should continue to monitor their asset portfolios and assess risk, without making any knee-jerk reactions to this rise in interest rates.

ACTION

Trustees should continue to monitor their investments and assess their scheme's vulnerability to interest rate changes. Consider implementing a trigger strategy to take advantage of market fluctuations.

Autumn 2017 Budget: Key Pensions Announcements

TAGS: BUDGET | LIFETIME ALLOWANCE | STATE PENSION

The Chancellor of the Exchequer, Philip Hammond, delivered his Autumn Budget on 22 November 2017 with no real surprises from a pensions perspective.

Hammond firstly confirmed the previous decision that the Lifetime Allowance will increase in line with the Consumer Price Index (CPI) from April 2018. This will mean that the allowance for the 2018/19 tax year will be £1,030,000.

State pensions will be increased by the "triple lock" (3%) in April 2018. This will lead to a rise in the basic state pension of £3.65 a week, with the full new state pension increasing by £4.80.

The government will legislate in the Finance Bill 2018 to introduce a power for HMRC to register and de-register unauthorised master trust schemes and schemes with a dormant company as a sponsoring employer. As per a previous consultation, this will be effective from April 2018.

From April 2019, the government will "modernise" tax relief for employer premiums paid into life assurance products or some overseas pension schemes. In essence, relief will now cover policies where an employee nominates an individual or registered charity to be their beneficiary.

The Budget also reflects the government's support for long-term investment. Indeed, as part of a package of measures, the Pensions Regulator will "clarify guidance" on how trustees can invest in illiquid assets such as venture capital and infrastructure as part of a diverse portfolio. The aim is to remove barriers to entry, finance growth in innovative firms, and provide an opportunity for DB and DC schemes to achieve greater diversification and a higher level of expected returns.

ACTION

Administration processes should be reviewed to take account of the 2018/19 statistics. Trustees should monitor changes to the investment markets and consider opportunities to improve their risk/return profile as new products become available.

Changes to Regulations of Investment Firms

TAGS: MIFID II | REGULATION

The Markets in Financial Instruments Directive (MiFID) is a piece of EU legislation regulating investment firms. The first MiFID regulations (created in 2007) are now being revised to improve financial markets and strengthen investor protection in light of the 2008 financial crisis.

The new rules, set out in MiFID II, are effective from January 2018. The main changes are:

- Asset managers will have to pay for investment research which is currently provided "free of charge" by brokers and investment banks (who receive payment for their services indirectly via commission). This may lead to smaller commissions which should benefit the client as they will not be subsidising the cost of research. However, some managers may seek to pass on the cost of third party research to clients, which in turn could lead to an increase in fees.
- More transparency and additional reporting on securities trading. Trades will have a unique code which will identify the parties involved in the transaction. New systems will have to be installed at investment firms, increasing the costs of regulation and reducing profits.
- Investment firms will need to disclose to clients all costs and charges they incur both in % and £, and provide a breakdown of these costs if requested. This is excellent news for investors as they will easily be able to compare fund managers costs which over time should help drive management fees down.

MiFID II will increase costs and reduce margins at investment firms; however, the increased costs are unlikely to be passed onto investors in full due to competitive pressures. This could lead to more mergers of asset managers in the future to benefit from economies of scale.

Given the increased costs, it will be harder for new firms to enter the investment market. This could lead to a decrease in the competition and potentially poorer fund choices available to investors. Despite this, MiFID II should be positive news for investors - although the regulations may not stop another financial crisis, they are a step in the right direction.

Helpful Links:

Financial Conduct Authority - MIFID II

ACTION

Keep an eye on fees - check if fund managers pass on the research fee to clients.

Latest News from the Pension Protection Fund

TAGS: PPF | LEVY 2018/19

Last quarter, we reported here that the Pension Protection Fund (PPF) had published for consultation its draft levy determination for 2018/19. The consultation closed on 1 November 2017 and the PPF has since confirmed its levy rules for the 2018/19 levy year, which starts on 1 April 2018. The Policy Statement and Levy Rules for 2018/19, published on 19 December 2017, sets out the way in which levies will be calculated and is largely in line with the consultation paper. As such, it includes a number of changes to the current rules.

The determination confirms 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 the lowest collection amount it has set in its history. This drop is an indication that, despite ongoing risks to PPF-eligible schemes, the PPF is comfortable with the strength of its own funding position.

The Policy Statement confirmed a number of other proposals that will be of significance when calculating 2018/19 levies, including:

- the levy scaling factor will be set at 0.48 (reduced from 0.65);
- the risk-based levy cap will be reduced from 0.75% to 0.50% of smoothed liabilities to reflect the fact that the proportion of schemes protected by the cap has fallen in recent years; and
- the process of certifying deficit reduction contributions will be simplified so that all expenses associated with investment can be disregarded.

The PPF received few responses in relation to the existing levy band structure. Therefore, as expected, it has confirmed that the existing approach of using ten levy bands will continue, although there are some changes to the Experian scorecard model.

The PPF’s proposal to narrow the levy rates between bands 1 to 4 elicited a mixed response, however. Although it considered alternatives to have merit, the PPF will go ahead with its original proposal. The PPF feels that narrowing the difference between these bands will more accurately reflect the risk profile. As a result, the levy rates for Bands 1 to 3 will be increased accordingly.

Latest News from the Pension Protection Fund Continued…

In addition to the above, there is a revised approach to contingent assets. Many schemes will now not be required to re-execute their existing PPF-compliant contingent assets, whereas some schemes (around 20% of those affected) will now need to obtain a 'guarantor strength report' in order to benefit from these in the levy calculation. Standard forms should be available in mid-January 2018, as well as further guidance on the requirements of guarantor strength reports.

For further information on the changes expected, see the link below to the Policy Statement.

Helpful Links:

2018/19 Levy Rules and Policy Statement

ACTION

Trustees and sponsoring employers should consider the implications of the revised levy rules and whether there is any action they can take now to improve their levy for 2018/19 onwards.

Schemes with contingent assets should get to grips with the new approach to certifying those assets, so that they are in a position to re-certify for the next levy. In particular, schemes with Type A contingent assets should consider whether they need a guarantor strength report to be prepared.

The majority of information need to calculate the PPF levy needs to be submitted by schemes no later than 31 March 2018 (Note, this is Easter Saturday).

Transfer Value Redress

TAGS: DEFINED BENEFIT | PENSION REDRESS

The Financial Conduct Authority has published its final guidance on how to calculate redress for unsuitable pension transfers from a defined benefit pension scheme to a personal pension.

The guidance follows a consultation that ended in June 2017 and replaces the previous guidance in force, introduced as part of the Pensions Review.

The new regime applies to any cases not settled on a full and final basis prior to 3 August 2016.

The assumptions used in the calculations have been updated to better reflect an individual's circumstances, such as term to retirement and expected retirement age. They have also been updated to reflect the fact that individuals are likely to take a cash lump sum on retirement, and to reflect gender neutral mortality rates. Overall, the revised guidance is expected to result in higher redress payments on average, all other things being equal.

Disappointingly, the assumptions still largely mirror those that would be used by insurers in pricing annuity contracts, despite individuals no longer having to purchase an annuity in retirement. As we commented in our response to the consultation, this approach places a higher value on the redress and is not reflective of the cost of providing the benefit in the DB arrangement.

On a practical note, the assumptions will no longer be produced quarterly by PricewaterhouseCoopers and instead should be produced by the firms carrying out the redress calculations.

Helpful Links:

- Financial Conduct Authority - Final Guidance

ACTION

For trustees and employers involved in any redress exercises, any redress cases previously on hold can now be processed under the new guidance.

Guaranteed Minimum Pension (GMP) to be included on the 'Pensions Dashboard'

TAGS: GMP | CONTRACTING-OUT | PENSIONS DASHBOARD

It was 6th April 2016 when the Government abolished contracting-out for defined benefit schemes, as a result of its decision to bring about the flat-rate single-tier state pension. We are now over half way through the three year transitional period announced at the time to deal with the practical issues of contracting-out cessation.

As part of this transition, HMRC initially planned for a mass mailing to pension scheme members to communicate their GMP amounts – a not insignificant task, to say the least. Well, perhaps seeing the light, HMRC have now backtracked on that huge mail out.

The new plan is that individuals will be able to check their GMPs via HMRC's online 'Pensions Dashboard'. This ambitious initiative – with a target release date in 2019 – would be a natural place to hold records of GMP amounts, given it is also due to house details of an individual's State Pension, DC pensions and DB pensions. Considering the Dashboard is already aiming to bring together the estimated 64 million different pension pots in the UK, integrating GMP data that is already on HMRC systems seems like a sensible and achievable target.

The timing for the release of the Dashboard ties in with the March 2019 HMRC membership scans due to be sent to schemes following the completion of the Scheme Reconciliation Service (SRS) project. The SRS project, which is still ongoing, allows trustees to ensure that they have the correct contracted-out liabilities recorded for their scheme members.

ACTION

Review any past communications which may have mentioned HMRC's previous plans for communication of GMPs and consider an updated member communication.

Review any action to confirm data with HMRC with the following deadlines in mind:

- 29th June 2018 — Final Date to request SRS re-scans to check currently held contracted-out liabilities
- 31st October 2018 — Final Date to submit SRS queries to HMRC

Coming Up Next...

In each Quarterly Update we like to finish by highlighting some of the major topics that we expect to hit the headlines in the next quarter. With the Government focusing on Brexit negotiations, we've seen a lot of pensions developments go past their expected timescales, but fingers crossed that we see some movement in the below over the coming months:

- **White Paper on the reform of the DB Sector** – In mid-July 2017 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". Rumours are that the DWP will launch the White Paper in February/March 2018, so hopefully we'll be able to provide you with an update in our next Quarterly Update.
- The consultation on the draft **Occupational Pension Schemes (Master Trusts) Regulations 2018** closed to responses on 12 January 2018, so we expect to see proposals on the authorisation and supervision regime for master trusts later in 2018.
- In our last three Quarterly Updates we said we were expecting to see the Government's response to the recent **Pension Cold-Calling** consultation. Perhaps in our first update of 2018 we'll receive a call to say the draft legislation is available!

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

- **31 January 2018 & 5 March 2018** – Schemes to provide information to HMRC via the Trust Registration Service (see earlier article 'Anti-Money Laundering Regulations: Trust Registration Service').
- **1 February 2018** – Final auto-enrolment staging date for employers to enrol workers in a workplace pension.
- **8 February 2018** – The Monetary Policy Committee of the Bank of England to decide on the base interest rate.
- **13 March 2018** – The Chancellor, Phillip Hammond to deliver the Spring Statement.
- **1 April 2018** – Deadline for local government pension schemes to pool their assets
- **25 May 2018** – The General Data Protection Regulation (GDPR) comes into force.

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Dalriada. A better way

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