Newsletter

BURGES SALMON

Pensions

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Welcome

Welcome to Pensions, our bimonthly newsletter keeping you informed of developments in pensions law.

To find out more about how we can help you with pensions issues, please email richard.knight@burges-salmon.com or call him on 0117 939 2259.

In brief

Legal

Holiday pay

A CJEU decision that holiday pay must allow for contractual commission could mean pension schemes need to change the calculation of contributions and benefits.

New definition of DC

The change in the definition of DC benefits affects AVCs as well as mainstream benefits.

Pensions Act 2014

We give an overview of the new Act.

Auto-enrolment

Members of LLPs (limited liability partnerships) are "workers" and need to be included in auto-enrolment.

Pensions Bills

The new Pensions Tax Bill reflects the Budget and the Pension Schemes Bill flows from the DWP's recent response to its consultation on defined ambition (DA) schemes.

Tax

Finance Bill 2014

We summarise the few pensions provisions in the Finance Bill 2014. Next year's crop will be bigger.

Policy

Survivor benefits

The cost of full equality for survivors in the different legal relationships would be £400m in the private sector and £2.9bn in the public, according to a DWP/Treasury review. The ball is now with the government to decide what to do.

Legal

Holiday pay and commission

Commission must be included in the calculation of holiday pay, the EU's Court of Justice (CJEU) has decided. This may mean some pension schemes need to change the way they calculate contributions and/or benefits.

It could also mean there are retrospective liabilities.

The CJEU's decision in *Lock v British Gas* is about workers who have a contractual right to commission as part of their pay.

It could be that a future decision will apply the same principle to other variable components of pay. In one example, the UK Employment Appeal Tribunal is due to hear a case in July that asks whether holiday pay must take account of overtime payments.

Hurdles

Whether an occupational scheme is affected by the decision on commission will depend on:

- whether members have a contractual right to commission,

- whether commission is included in the scheme's definition of pensionable pay for contribution and, in DB schemes, benefit purposes,
- whether the employer already allows for commission in holiday pay and
- a future decision by a UK employment tribunal in the *Lock* case about exactly how the allowance for commission must be calculated.

An employer's contributions to a personal pension scheme could also be affected.

continued overleaf

Auto-enrolment

The amount of a worker's *qualifying earnings* for auto-enrolment might change too. If extra pay means they move from one category of worker to another, that would alter their auto-enrolment rights and their employer's duties to them. It would also affect contributions.

That said, commission is already included in *qualifying earnings* so changes in amount as a result of the decision could be marginal in many cases.

Action points

In relation to commission, trustees and employers should consider now whether, in principle, their scheme will be affected.

If it will, the employment tribunal's decision in *Lock* will provide guidance on the calculation. That is the time to act.

Meanwhile, the case to watch for on overtime is *Neal v Freightliner.*

New definition of DC

The DWP has confirmed its expectation that the legislation giving effect to the new definition of DC or "money purchase" benefits will come into effect in July.

The transitional regulations will be part of the package. These mitigate many effects of the change, particularly in relation to accrued benefits. But the impact on some schemes could still be considerable.

The new definition of DC is: *"benefits the… amount of which is calculated by reference to …payments made by the member or... other person… and its …amount is calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for… its provision".*

That is, a benefit is DC only where the asset and the liability always match.

AVCs

The change in definition affects AVCs that are not DC in the new sense as well as mainstream benefits. For example, AVCs on which there is a guaranteed or minimum return.

Another example is AVCs that satisfy the new definition during the accumulation phase but cease to when the scheme itself converts them into an annuity (sometimes called *self-annuitisation*). At that point the scheme assumes a DB obligation that, subject to the transitional regulations, brings the funding and related legislation to bear.

For our briefing on the transition to the new definition, see: **http://www.burges-salmon.com/practices/pensions_and_incentives/publications/new_dc_definition_the_transition.pdf**

Pensions Act 2014

The Pensions Act 2014 has been passed by Parliament. A few important provisions come into force in mid-July but most will be brought into effect piecemeal, on dates yet to be decided.

On the state pension, the Act:

- creates the single tier state pension from April 2016;
- legislates the next increase in the state pension age - to age 67 for both sexes between 2026 and 2028 and

- requires a periodic review (the first by May 2017) of state pension age in the light of rising longevity.

Provisions on occupational pension schemes include:

- the Regulator's new statutory objective in relation to funding "to minimise any adverse impact on the sustainable growth of an employer". This comes into effect on 14 July;
- the abolition of DB contracting-out and the creation of a unilateral amendment power for employers to alter future accrual and/or increase member contributions to offset the higher NIC cost;
- "pot follows member": a small DC pot transfers automatically to a member's new scheme when they leave, unless they opt out;
- 30 day vesting in DC schemes, applicable new joiners only to start with. The DWP plans this to be in force this year;
- power for the DWP to prohibit incentivised transfer exercises and
- power for the DWP to impose standards on DC schemes e.g. over charges and governance. A consultation on this closed in May.

On auto-enrolment:

- power for the DWP to exclude groups of workers from auto-enrolment. Following a consultation, groups identified include those with protected tax status, those about to retire and those who have opted out having been contractually enrolled.

continued overleaf

Auto-enrolment

As we have reported before, a member of an LLP (a limited liability partnership) will have a right to auto-enrolment, subject to the other eligibility conditions. Until a recent decision by the Supreme Court (SC) it was unclear whether such a person was a "worker" in the necessary statutory sense. The SC held that they are.

LLPs should ensure they are carrying out their auto-enrolment duties correctly.

Pensions Bills

The government has two new pensions Bills to put to Parliament. They reflect the Budget and the DWP's recent response to its consultation* at the end of last year on defined ambition (or DA) schemes.

The Pensions Tax Bill has yet to be published but will, from April 2015:

- allow members to withdraw their DC saving as they wish from age 55, subject to scheme rules and to tax at their marginal rate and
- remove any requirement that benefits be taken in the form of an annuity.

Schemes will need to decide how much of this new flexibility to allow their members.

The tax free lump sum will remain available. Members making large withdrawals will need to be aware of the threshold for higher rate tax.

The Pension Schemes Bill is now in Parliament. It:

- creates a legislative framework for DA schemes in the middle ground between DC and DB. Formally, these will be known as "shared risk schemes" and will aim make DC outcomes more certain. There will be limited prescription so that various forms of risk sharing will be possible e.g. through guarantees, insurance and gradual annuity purchase;
- creates a specific framework for collective DC (or CDC) schemes in which DC contributions would be pooled and members' pensions would depend on the performance of the pool. The pension could be paid by the scheme or by a third party. The framework includes powers for schemes to be required to give members non-binding targets for their pension;
- does not include any of the flexible DB scheme designs floated in the consultation e.g. benefits that fluctuate with funding or conversion of early leavers to DC. There was insufficient support for such ideas and the DWP observes a degree of flexibility is already available and
- as yet the Bill has no detail on the impartial guidance DC savers are to receive as they approach the time for drawing their benefits.

The Bill provides for 30 day vesting to apply to all schemes that are not salary related. The Pensions Act 2014 already provides for this in DC schemes (though the provision has yet to come into force).

The Bill allows regulations to be made prohibiting transfers to DC schemes from public sector schemes.

Whether transfer to DC from private sector DB schemes will be blocked waits on the government's response to its consultation into the extension of the Budget flexibilities to DB. It hopes to publish its response before Parliament goes into summer recess on 22 July.

As yet there is no indication of when any of the measures in the Bill (if passed) will be brought into force.

** Reshaping workplace pensions for future generations.*

Tax

Finance Bill 2014

The Finance Bill 2014 has relatively few pensions provisions: next year's crop will be bigger.

The Bill legislates for:

- the interim flexibilities announced in the Budget (many of which are already in force);
- wider powers for HMRC to combat pension liberation and
- individual protection 2014, a transitional protection available to those affected by the reduction in the lifetime allowance to £1.25m from the start of the 2014/15 tax year.

The interim flexibilities include:

- capped drawdown: the annual withdrawal cap rises from 120% to 150% of a comparable annuity for drawdown years starting on or after 27 March 2014;

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- flexible withdrawal: the minimum income requirement for those who apply for flexible drawdown on or after 27 March 2014 reduces from £20,000 to £12,000;
- trivial commutation: the ceiling, across all a member's schemes, increases from £18,000 to £30,000. This applies to commutation periods starting on or after 27 March 2014;
- small lump sum commutation: the limit for the scheme by scheme lump sum increases from £2,000 to £10,000 for commutation periods starting on or after 27 March 2014 and
- the window for taking commutation on retirement (a pension commencement lump sum) is extended, with some retrospective effect, to give more people access to the greater flexibilities that will be available next year. HMRC has published some guidance: **http://www.hmrc.gov.uk/pensionschemes/pensionflexibility.htm**

Policy

Survivor benefits

The cost of full equality for survivors in the different legal relationships would be £400m in the private sector and £2.9bn in the public, according to a DWP/Treasury review.

It is now up to the government to decide what, if anything, to do about equalising.

These figures are the price of removing all differences of treatment in survivor benefits between opposite sex surviving spouses, same sex surviving spouses and surviving civil partners. Administration costs would be extra.

The bulk of the cost - 75% in the private sector and more in the public - lies in equalising survivor benefits in opposite sex marriage.

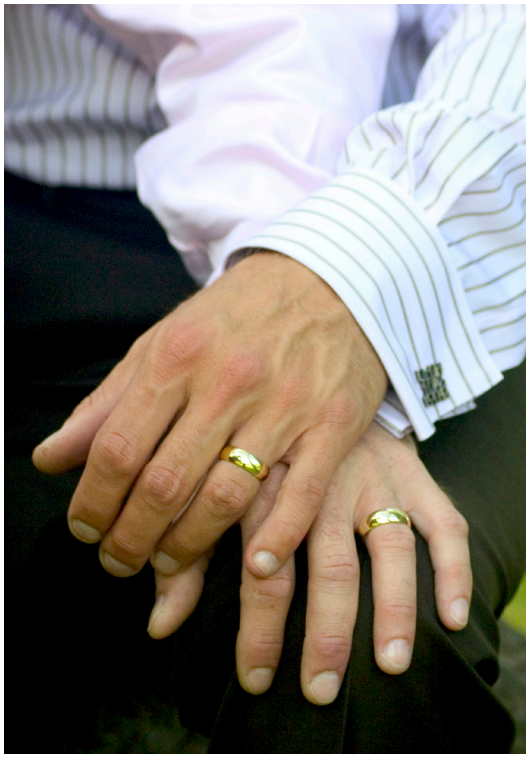
The recently published review was required by the same sex marriage legislation.

It points out a snag with steps to reduce inequality without eradicating it: they would create new differences of treatment.

Next step

The government's stated position is that same sex couples who are married or civil partners should be treated equally with opposite sex married couples. But the figures show that is less than half the story.

Meanwhile an appeal in *Innospec v Walker* is due to be heard in the autumn. The case asks whether it is



lawful for UK legislation to allow a surviving civil partner's pension to be restricted to post 2005 service while an opposite sex spouse would receive a pension based on all the member's service.

The government may want to wait for the outcome of this case before responding to the review.

Visit our website at www.burges-salmon.com

One Glass Wharf
Bristol BS2 0ZX
Tel: +44 (0) 117 939 2000
Fax: +44 (0) 117 902 4400

6 New Street Square
London EC4A 3BF
Tel: +44 (0)20 7685 1200
Fax: +44 (0)20 7980 4966

www.burges-salmon.com

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