Pensions Management Institute
Learning

Regulation of Retirement Provision, Core Unit 2 Study Manual

In Partnership with CMS Law . Tax

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Founded in 1976, the Pensions Management Institute (PMI) is the UK's largest and most recognisable professional body for employee benefit and retirement savings professionals, supporting over 6,500 members in 32 countries.

PMI's members, represented in 9 regions, are responsible for managing and advising some of the largest institutions in the world accounting for £1trillion invested in pensions. We promote excellence through a range of services for the benefit of members, the wider economy and with over six million now saving as a result of automatic enrolment, society as a whole.

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CMS Cameron McKenna Nabarro Olswang LLP

On 1 May 2017, CMS Cameron McKenna combined with Nabarro and Olswang to create the 6th largest firm worldwide by lawyer headcount. Our pensions team has been significantly enhanced as a result.

With almost 50 lawyers, including 14 partners, across London, Edinburgh, Glasgow and Sheffield, we are one of the largest and strongest pensions teams in the UK. The additional support of two full time professional knowledge lawyers also means we are always up-to date with the latest intelligence.

Weadvise trustees, employers, consultants and insurers on every aspect of pension schemes, including litigation. As well as day-to-day advice, we have particular experience of benefit redesign, scheme closures and liability reduction. We are market-leaders in longevity hedging, buy-in, asset-backed funding and corporate restructuring. Our team of pensions lawyers in Edinburgh can also advise on Scottish law and we are able to use our position as a full service international law firm to ensure the seamless provision of advice in other areas of law and jurisdictions, where required.

Chambers and Legal 500 recognise us as leaders in pensions law by ranking us in the top tier for both pensions and pensions litigation for over 8 consecutive years. Our team's technical knowledge is demonstrated by our award-winning “Pensions Law Handbook”, regarded as a definitive work across the industry. We were also awarded Pension Law Firm of the Year 2017 at the ACQ awards.

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Kate is a partner in the pensions team at CMS and specialises in advising companies and trustees on the formation, operation and winding up of pension schemes, as well as scheme mergers, complex benefit changes, incentive exercises, asset-backed funding arrangements and the pensions aspects of corporate transactions. She is also experienced in investment matters and was involved in advising in relation to a multi-billion pound longevity swap arrangement as well as various projects for other clients involving switching the index for pension increases from RPI to CPI. Kate has regularly advised on cyber security and data protection issues relating to pension schemes and recently appeared on PMITV discussing this topic. Kate has also been a trustee herself and so has an appreciation first hand of the challenges that face trustees day to day.

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Sharon has contributed to the thirteenth edition of the Pensions Law Handbook (published by Bloomsbury Professional in 2017). She is a regular speaker at various seminars and other presentations given by CMS and externally. Sharon is also a regular contributor to PMI News.

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Foreword

PMI was formed in 1976 to promote professionalism amongst those working in the field of pensions. Today, we are acknowledged as the institute for pensions professionals. We have developed study and examination facilities leading to a nationally recognised qualification – the Advanced Diploma in Retirement Provision. This embraces all aspects of law and practice relating to the management of workplace pension arrangements. The Advanced Diploma is a comprehensive and in-depth qualification for retirement benefit professionals. It is the qualification component for Associateship (APMI) of the Pensions Management Institute (PMI).

The structure of the Advanced Diploma was comprehensively revised for first examination in 2016. This revision was to ensure that the syllabuses were up to date and the qualification continues to meet the needs of users. The Advanced Diploma framework comprises five core units and seven specialist units. To complete the Advanced Diploma students will need to complete eight units as set out below.

The foundation of the qualification is formed of four core units. These compulsory units cover all aspects of retirement provision in the UK, including regulation, administration, financing and investment. There is an additional option covering international employee benefits. The core units are assessed by a two hour examination. The core units are then followed by specialist units. Students choose either, or both, of the Tier 1 specialist units - Defined Benefit Arrangements or Defined Contribution Arrangements as most appropriate for them. Depending whether both or just one of the Tier 1 specialist units are selected either one or two further specialist units can be selected from the Tier 2 specialist options including Reward, Retail Pensions or International Employee Benefits. These choices allow the students to select those areas that best fit their current work or future career aspirations. Finally the Professionalism and Governance Unit must be completed by all Students. All of the specialist units are assessed by 3 hour written examinations.

There are several Diploma level qualifications comprised of units from within the structure of the Advanced Diploma for those who do not want or need to complete the Advanced Diploma. These have also been revised as part of the changes to the Advanced Diploma.

The Diploma in Retirement Provision (DRP) includes all four UK focussed core units and either of the Tier 1 specialist units (Defined Benefit Arrangements or Defined Contribution Arrangements).The DRP would be completed by all those who proceed to complete the Advanced Diploma.

The Diploma in Employee Benefits and Retirement Savings (DEBRS) is ideal for those who need to understand pensions in the wider savings and employee benefits context, and consists of two of the core units and the Tier 2 specialist Reward unit.

The Diploma in Regulated Retirement Advice (DRRA) consists of two Tier 2 specialist units: Taxation, Retail Investment and Pensions; and Retail Advice and Regulation. It is an appropriate qualification for the FCA regulated activity “Advising on Packaged Products” which includes pensions and retirement planning and advising on pensions transfers.

The Diploma in International Employee Benefits (DipIEB) consists of the two internationally focussed units: the Foundation in International Employee Benefits core unit and the Tier 2 specialist unit - Managing International Employee Benefits. These units have been developed in partnership between PMI and the International Employee Benefits Association.

Those who wish to complete the Advanced Diploma can opt to take the units that comprise the DRP, DEBRS, DRRA and/or DipIEB on the way to becoming Associate Members of PMI. Alternatively, those who only wish to sit those Diplomas can become Diploma Members of PMI on completion.

Preface

For over a century, occupational pension schemes have formed a vital part of the UK pension system. Established by employers for the benefit of their employees, occupational pension schemes provide pension benefits (in addition to those provided by the State) for millions of individuals throughout the UK.

Under the law of England and Wales, funded occupational pension schemes must be established under trust, with trustees appointed to run them. Trust law imposes a number of duties on trustees relating to the administration of the trust. These are designed to ensure that trustees take care of the trust assets and that they administer the trust and pay benefits in accordance with the terms of the trust.

The duties imposed by trust law have been supplemented by an ever increasing raft of statutory regulation. The increase in statutory regulation is in part a response to the Maxwell scandal in 1991. More recently, a number of high profile corporate failures (which resulted in pension scheme members losing some or all of their pension benefits) led to the introduction of the Pensions Regulator (TPR) and the Pension Protection Fund (PPF). TPR has various “anti avoidance” powers which are designed to protect members’ benefits and to prevent pension liabilities transferring into the PPF. The Government has also strengthened the funding requirements for defined benefit schemes in an attempt to ensure that members receive the benefits that they have beenpromised.

Alongside this increase in regulation, in 2006 the Government introduced a new tax regime for UK pension arrangements. This regime is administered and enforced by HM Revenue & Customs and (as before) is designed to encourage pensions saving by giving tax relief on member and employer contributions (subject to certain limits) and on investment returns.

One consequence of all these changes has been an increase in the cost to employers of providing occupational pension schemes, particularly defined benefit schemes. This, along with other factors such as increasing life expectancy and poor investment performance, has led many employers to close their defined benefit schemes to new entrants (and now increasingly to future accrual) in favour of cheaper and less risky alternatives, such as personal pension schemes. It has also led to a boom in the pensions buy out market as employers look to offload the uncertainty and risks associated with running a defined benefit pension scheme. The tighter regulation has also had a significant impact on increasing the importance of pensions as never before in relation to corporate transactions and restructurings.

It is vital that trustees and others involved in the day-to-day running of occupational pension schemes understand the legal and regulatory framework within which those schemes operate to ensure that they discharge their legal duties and protect themselves from potential liability. Understanding the legal and regulatory framework also provides an insight into some of the legal constraints that apply to pension arrangements and helps to explain some of the commercial pressures that are faced by employers with occupational pension schemes. This study manual examines the regulatory requirements that apply to retirement provision, in particular:

Part 1 examines current taxation and regulation regime, including an explanation of its development in recent years. It also includes an overview of the regulation of both workplace and personal pensions and member protection. Part 2 considers trust law and the establishment of trust-based pension schemes. This Part also looks at the role of the trustees. Part 3 looks at some other relevant areas of law including data protection, human rights and financial crime. Part 4 examines the impact of pensions regulation in the context of corporate transactions. This is an area that has become increasingly regulated, a factor which has contributed to the high profile collapse of a number corporate deals over recent years. Part 5 examines the latest governance requirements in both workplace and personal pensions. Finally, Part 6 looks at some current issues, including contracting out, the pensions dashboard, BREXIT and pensions liberation.

Contents

Syllabus

Aim:

To provide an overview of the regulation of retirement provision in the UK including an appreciation of:

- l egal and taxation aspects
- compliance with regulation and where administrators need to focus on compliance issues
- the bodies responsible for defining, monitoring and oversight
- how the employee is supported by the financial services industry
- current issues.

1. **analyse** a registered pension scheme and the tax treatment conferred by registered scheme status

   outline *the Finance Act 2004 including the tax treatment of:*
   - *contributions*
   - *investment*
   - *benefits (retirement and death)*

2. **understand** the context of the principal features of the current tax regime governing registered pension schemes

   define *Benefit Crystallisation Events and the Lifetime Allowance, including protection*

   outline *the features of the Annual Allowance, including the Tapered Annual Allowance and the Money Purchase Annual Allowance*

   identify *authorised and unauthorised payments*

3. **understand** the tax treatment of unregistered schemes

   define*:*
   - *Employer Funded Retirement Benefit Schemes*
   - *Qualifying Recognised Overseas Pension Schemes*
   - *Excepted Life Schemes*

4. **understand** the implications of differences in Jurisdiction (England & Wales, Scotland and Northern Ireland) on retirement provision

   explain *the implications in the following areas:*
   - *sources of law*
   - *Income Tax*
   - *optionson divorce*

5. **understand** the roles and functions of the bodies that regulate pension schemes and provide protection to members and employers

   explain *the role and powers of:*
   - *the Pensions Regulator (TPR)*
   - *HM Revenue & Customs (HMRC)*
   - *Financial Conduct Authority (FCA)*
   - *Department for Work and Pensions(DWP)*
   - *Financial Services Compensation Scheme (FSCS)*
   - *Pension Protection Fund (PPF)*
   - *Pensions Ombudsman and Financial Services Ombudsman*

6. **demonstrate an understanding** of the principles of trust law and the role and responsibilities of pension scheme trustees and evaluate why trusts are used in a pensions context.
   identify *the main features of a trust*
   distinguish *between trust and contract-based alternatives for workplace pensions, including master trusts*
   identify *the different types of trustees*
   analyse *the appointment and removal of trustees*
   explain *the duties and powers of trustees:*
   • *investment powers*
   • *exercise ofdiscretions*
   • *delegation*
   • *meetings and minutes*
   • *trustees' liability and protection*
   • *trustee knowledge and understanding (TKU)*
   identify *notifiable events*
   describe *the Pensions Regulator's Codes of Practice and guidance notes*

7. **describe** the way in which pension schemes are established, the methods for changing trustees and employers and for amending schemes and explain the possible constraints on such amendments explain the trust deed and rules outline relevant employee communications explain how the following can be effected:
   • *changing employers*
   • *changing trustees*
   • *amending deeds*
   outline *the powers of amendment*
   identify *overriding legislation and relevant case law*
   analyse *the relevant practical considerations*
   explain *the process of consultation and notification to members*

8. **distinguish** between a share sale and a business sale and **demonstrate an understanding** of the duties of trustees in such situations and the related issues
   explain *share sales and business sales (and key differences between them)*
   analyse *sale and purchase agreements*
   evaluate *past and future service provision (including Transfer of Undertakings (Protection of Employment) Regulations (TUPE))*
   explain *the following:*
   • *section 75 debts*
   • *anti-avoidance and clearance*
   • *apportionment of liabilities*
   • *withdrawal arrangements*
   analyse scheme mergers

9. **understand** the context of the duties imposed on the 'scheme administrator' by the Finance Act 2004 outline the characteristics of effective record keeping
   describe *information requirements for:*
   • *HM Revenue & Customs*
   • *members*
   • *other scheme administrators*

10. **describe** the requirements for communication with members
    explain *the legal requirements for each of the following types of disclosure:*
    - *automatic*
    - *on request*
    - *e communications/multi media*

11. **demonstrate an understanding** of the importance of a governance structure
    explain *the features of scheme governance*
    outline *the roles of the employer, trustees, governance committees and providers*
    outline *the importance of:*
    - *risk management*
    - *member communication and engagement*
    - *investment and manager selection*

12. **outline** other laws which impact on UK pension provision
    analyse *the impact of:*
    - *data protection*
    - *divorce, civil partnership and same sex marriages*
    - *family law*
    - *human rights*
    - *equal treatment and discrimination (including age discrimination)*
    - *dismissal and redundancy*
    - *anti-money laundering and anti-bribery*
    - *information and consultation regulation*
    - *Value Added Tax(VAT)*
    - *European Union law*

13. **demonstrate an understanding** of current issues
    analyse *the impact of:*
    - *cessation of contracting out and scheme reconciliations*
    - *data protection*
    - *pensions dashboard*
    - *Guaranteed Minimum Pension (GMP) equalisation/conversion*
    - *pension scams*
    - *data quality and the scheme return*
    - *defined benefit to defined contribution transfers*
    - *pension advice allowance and provision of advice at retirement(robo advice)*
    - *Green Paper (including consultation)*
    - *TPR consultation professional trustees*
    - *possible impact of BREXIT*

14. **understand** how companies and individuals working in the pensions field are regulated by the FCA
    outline *the characteristics of*
    - *statements of principle*
    - *financial advice*
    - *best advice*
    - *treating customers fairly*
    - *advertising and promotion*
    - *regular reviews of suitability*
    - *asset management market study*
    - *Financial Advice Market Review (FAMR)*

15. **explain** how the consumer is served by the financial services industry
    describe *the role of the providers of financial products*
    explain *the relationship between product providers, advisers and consumers*
    analyse *the perception of financial services*
    identify *the main financial needs and how they are met*

PART 1

The Taxation and Regulation of Retirement Provision

OVERVIEW

In this Part, we look at the two areas of particular concern that Government authorities have always had when it comes to the oversight of private pensions.

- Her Majesty's Revenue & Customs (HMRC, formerly the Inland Revenue) is chiefly concerned with making sure that the tax advantages given to registered pension schemes are not abused and that the correct tax is paid.
- The Department for Work and Pensions (DWP), together with the bodies and regulatory authorities set up by the DWP, is primarily concerned with the protection of members' interests.

The Part consists of five Chapters.

In Chapters 1 and 2 you will learn about the tax regime under which all mainstream pension schemes operate. In Chapter 1 you will learn about the current regime, which has been in place since 6 April 2006 (A-Day) (with significant changes from 6 April 2015), while Chapter 2 gives an overview of the tax regime that applied before April 2006. This historic information is still relevant. Some aspects of the old regime are still applicable under 'transitional arrangements', and the benefit structures found in almost all private pension schemes have their roots in the pre-April 2006 regime.

The remaining Chapters cover regulation. In Chapter 3 you will learn about the roles and functions of the bodies that regulate workplace pension schemes and provide assistance or protection to members and employers. In Chapter 4 we consider the regulation of private pension schemes, including a discussion of the role of the Financial Conduct Authority (FCA, formerly the Financial Services Authority (FSA)). Finally, we summarise in Chapter 5 the legislation and regulation under which the UK financial services industry operates.

When you have completed this Part, you will have gained an understanding of the tax system that applies to pension schemes and how this has influenced – and continues to influence – much of the benefit design you are likely to come across. You will also have gained an understanding of the legal and regulatory framework that pension schemes have to comply with. Together, these two areas explain why private pensions are set up and run in the way that they are.

CHAPTER 1
The Pensions Tax Regime

INTRODUCTION

In this Chapter we set out the tax rules as they apply to private, or non-State, pensions. We cover the tax relief that is given in respect of contributions made to pension schemes, and the tax payable when the benefits are paid out or 'crystallised'. Anyone who is administering a scheme needs to have this knowledge. Those who are considering scheme design issues or are advising members on their options also need to understand how these rules apply.

1.1 CURRENT PENSIONS TAX REGIME

On 6 April 2006 (commonly referred to as 'A-Day'), a new pensions tax regime came into force. One of the changes was the introduction of 'registration'. Registered schemes are granted various tax concessions under Statute. The introduction of 'registration' meant that the discretion that HMRC had, before 6 April 2006, to decide whether or not schemes that satisfied the relevant criteria were given advantageous tax status, has gone. (You will learn more about HMRC's former discretionary powers in Chapter 2.)

The supervisory role of HMRC has therefore largely become that of policing the rules that are set out in legislation and issuing guidance as to how these rules are operated.

The criteria that a scheme needed to satisfy to become registered are not dissimilar from those that applied before April 2006 to maintain'approved' status. At the changeover date, all schemes already approved as at 5 April 2006 automatically became 'registered pension schemes'. Trustees could, in theory, elect to have their schemes treated as unregistered but, as this would mean renouncing the tax benefits, it rarely happened in practice.

1.1.1 The Advantages of Registration

The advantages of registration are:

- Employer contributions to a registered scheme generally receive relief against Corporation Tax so long as the company's tax inspector is satisfied that they are incurred wholly and exclusively for the purpose of the company's business. In most cases this is a simple test to pass.
- Member contributions usually also receive relief against Income Tax.
- The scheme's investment returns are largely free of income and Capital Gains Tax. However since UK dividend income is paid out of a company's taxed profits, to the extent that a pension scheme invests in UK equities there is no advantage to this tax exemption. This is in contrast to the position prior to the abolition of Advance Corporation Tax, in 1997, when pension schemes were able to claim tax credits on the dividends.
- Members can take a part – normally one quarter – of their benefits in the form of a tax-free cash sum. From 6 April 2015 the entire non-DB benefit can be taken as an uncrystallised funds pension lump sum (with the first 25 per cent tax free and the remainder taxed as income). Funds remaining in the scheme on the death of a member before age 75 can generally be passed on as a tax free lump sum. Where a member dies over age 75 then there will generally be a tax charge at the recipients marginal income tax rate on any lump sums paid. The payment of lump sum benefits on death are also usually free of Inheritance Tax if they are paid under discretionary trust.

1.1.2 The Regulation of Registered Schemes

Contributors to, and beneficiaries of, registered schemes benefit from these tax advantages to the extent that the relevant legislation and the rules of their scheme permit. The relevant legislation is set out in the Finance Acts, principally the Finance Act 2004 (as amended by subsequent Finance Acts and by the Taxation of Pensions Act 2014), and by secondary legislation passed under those Acts.

HMRC provides online guidance on the operation of the legislation in the Pensions Tax Manual (PTM), published at **http://www.hmrc.gov.uk/manuals/ptmanual/index.htm**. The PTM was first published in December 2015 and is frequently updated. The PTM replaced the Registered Pension Schemes Manual (RPSM) which was issued in April 2006.

1.1.3 Conditions for Registration

For a pension scheme to become registered, a person must make an application to HMRC in a prescribed form, giving certain information and declarations. To be registered, the pension scheme must be set up by one of the following:

- an employer (or group of employers);
- a person who has permission to do so in accordance with the Financial Services and Markets Act 2000 (this may include insurance companies, banks, etc.); or
- a Government Department or UK or Parliamentary body.

HMRC is required to grant registration unless:

- the application, other material provided to HMRC or accompanying declarations are false or materially inaccurate;
- the scheme administrator has failed to comply with an information notice in connection with the application, or deliberately obstructed HMRC in the course of an authorised inspection carried out in connection with the application;
- the pension scheme has not been established, or is not being maintained, wholly or mainly for the purpose of making authorised payments; or
- the scheme administrator (or any of the persons who are the scheme administrator) is not ‘fit and proper’ to be the scheme administrator.

HMRC originally intended the process of registration to be as simple as possible for new schemes and put together a standard application form to ensure consistency and efficient processing of the applications. However, following concerns about ‘pensions liberation’ (see 1.1.4 below) HMRC revised its procedures relating to the registration of schemes, moving away from a ‘process now,check later’ approach. As a result, scheme registration is no longer confirmed on successful submission of the online form. HMRC states that this will enable them to conduct detailed risk assessment activity before making a decision on whether or not to register a scheme.

1.1.4 Pension Scams (‘Pensions Liberation’)

A pension scam (or pensions liberation) is where a member is enticed into transferring their pension savings to an arrangement that will allow them to access their funds before they are entitled to receive them. This happens through early payment of pension and cash or through the payment of excessive cash.

Some arrangements set up for the purpose of pensions liberation are illegal. Even those that appear to operate within the law may result in the member facing unauthorised payment tax charges, in addition to high charges and high investment risks. This is considered in more depth in Part 6 below.

1.2 THE SCHEME ADMINISTRATOR

All registered pension schemes are required to have a 'scheme administrator'. For this purpose, 'scheme administrator' is a defined term under the Finance Act 2004. It does not necessarily mean the person or body that deals with the administration of the scheme (i.e. the collection and allocation of contributions, correspondence with members, the monthly payment of pensions etc.). For the avoidance of doubt, in the remainder of this Study Manual we refer to the statutory office holder using the term 'Scheme Administrator' in capitals (although this convention will not necessarily be followed outside this Study Manual).

A Scheme Administrator must be a 'fit and proper person' and be resident in the UK or in another EU member State (or in a handful of EEA States which are not EU member States).They must make various declarations to HMRC - in particular that the scheme meets all of the conditions to be a registered pension scheme and that the Scheme Administrator understands all of the liabilities which he or she is taking on.

More than one person may be appointed as Scheme Administrator and, in this case, each is jointly and severally liable for any tax charges or penalties for which the Scheme Administrator is liable.

A Scheme Administrator is often a trustee but may be a person or corporate body appointed by the trustees. Unless the Scheme Administrator is a corporate body, it must be a named individual or group of such persons.

The Scheme Administrator must be registered with HMRC. Application for registration as a Scheme Administrator and for the registration of the scheme itself for new schemes set up after 5 April 2006 is completed online, as is nearly all communication with HMRC. The Scheme Administrator can authorise HMRC to deal with one or more scheme practitioners.

1.2.1 Duties of the Scheme Administrator

The main statutory duties of the Scheme Administrator relate to the requirements to keep records and to convey certain information to other parties in certain circumstances.

Record-keeping requirements

The Scheme Administrator is required to preserve certain documents. The documents in question are those in their possession or under their control that relate to:

- any monies received by or owing to the scheme;
- any investments or assets held by the scheme;
- any payments made by the scheme;
- any contracts to purchase a lifetime annuity in respect of a member of the scheme; and
- the administration of the scheme.

The documents must be preserved for the tax year to which they relate and for the following six tax years. If a person has ceased acting for the scheme or providing administrative services to the scheme, they are not required to retain the documents if another person has succeeded them in their duties and the documents have been transferred to that other person.

Information requirements

Depending on the situation, the Scheme Administrator might have a statutory duty to give certain information, within prescribed timescales and sometimes in a prescribed form, to any of the following:

- HMRC;
- a scheme member (or a deceased scheme member's 'personal representative'); and
- another Scheme Administrator or an insurance company.

The main information that the Scheme Administrator needs to give HMRC automatically is that required on the quarterly tax return (unless there is no tax liability for that quarter – 'nil returns' are not required) and that set out on the annual 'Event Report'.

The Event Report relates to a number of reportable events. These fall into two principal categories:
- significant payments from the scheme (including, for example large, or unauthorised, payments madeto individuals); and
- significant changes to the rules and/or structure of the scheme (for example a scheme winding up or certain changes to its legal structure).

The information requirements relating to scheme members imposed by the Finance Acts apply principally when benefits start to be paid. At such times, the Scheme Administrator needs to tell the member how much of the Standard Lifetime Allowance (see 1.3 below) is deemed to have been used up by those benefits. There are also certain information requirements to be complied with when unauthorised payments are made to a member and when a member's pensions savings in the scheme exceed the Annual Allowance (or money purchase annual allowance where relevant) for that year. There is also a requirement from 6 April 2015 to notify a member when he first accesses a 'flexible benefit' that the money purchase annual allowance provisions will apply. See 1.4 below for more on the Annual Allowance.

Finally, the Scheme Administrator is required to supply certain information to another Scheme Administrator or an insurance company if a scheme member's rights to benefits are transferred to another scheme or are secured with an insurance company.

In the following subsections we outline some key elements of the current pensions tax regime: the Lifetime Allowance, the Annual Allowance, and Authorised Payments.

1.3 LIFETIME ALLOWANCE

One of the key elements of the tax regime is the Lifetime Allowance. Broadly speaking, this is an allowance of the total pension rights, which an individual may accrue in their life while still enjoying a tax favoured environment. The Lifetime Allowance was introduced at the level of £1.5 million and has changed each subsequent year as shown in the table below.

Tax Year	Standard Lifetime Allowance
2006/07	£ 1,500,000
2007/08	£ 1,600,000
2008/09	£ 1,650,000
2009/10	£ 1,750,000
2010/11	£ 1,800,000
2011/12	£ 1,800,000
2012/13	£ 1,500,000
2013/14	£ 1,500,000
2014/15	£ 1,250,000
2015/16	£ 1,250,000
2016/17	£ 1,000,000
2017/18	£1,000,000
2018/19	£1,030,000
2019/20	£1,055,000
2020/21	£1,073,100

Under transitional arrangements introduced in April 2006, some individuals were able to file for 'protection' against the Lifetime Allowance Charge, in which case different rules apply (see 2.2 below).

The Finance Act 2011 reduced the Lifetime Allowance in 2012/13 and subsequent years to £1.5m. Individuals could elect to continue to be subject to the higher £1.8m limit previously in place (so called 'fixed protection') but only if they ceased active membership of all registered schemes before 6 April 2012.The Finance Act 2013 reduced the Lifetime Allowance from 2014/15 and later years. Alongside this reduction, further forms of 'protection' (individual protection 2014 and fixed protection 2014) were introduced by the Finance Acts of 2013 and 2014. A further reduction to £1m from the tax year 2016/2017 was announced in the 2015 Budget, with index-linking to be introduced from April 2018. Additional protections (individual protection 2016 and fixed protection 2016) were introduced in the Finance Act 2016.

Protection	What it covers	Formalities	Future accrual?
Primary	Savings >£1.5m at 5 April 2006	Notify HMRC by 5 April 2009.	Y
Enhanced	Fully protects rights accrued as at 5 April 2006.	Notify HMRC by 5 April 2009 and no accrual from 6 April 2006.	N
Fixed	Fixes LA at £1.8m (or SLA if higher).	Apply to HMRC by 5 April 2012. Not needed for those with primary or enhanced protection.	N
Fixed 2014 (FP14)	Fixes LA at £1.5m (or SLA if higher).	Apply to HMRC by 5 April 2014. Not needed for those with primary, enhanced or fixed protection.	N
Individual 2014 (IP14)	Savings >£1.25m at 5 April 2014. Fixes LA as value of pension rights at 5 April 2014 (max £1.5m) or SLA if higher.	Apply to HMRC by 5 April 2017. Not available to those with primary protection.	Y
Fixed 2016 (FP16)	Fixes LA at £1.25m (or SLA if higher).	Apply online to HMRC. Not available to those with primary, enhanced or fixed protection or FP14.	N
Individual 2016 (IP16)	Savings >£1m at 5 April 2016. Fixes LA as value of pension rights at 5 April 2016 (max £1.25m) or SLA if higher.	Apply online to HMRC. Not available to those with primary protection or IP16.	Y

The general rule is that whenever a member takes benefits from a registered pension scheme, and on certain other occasions (Benefit Crystallisation Events – see 1.3.1 below), part of their Lifetime Allowance is used up. When there is no longer any Lifetime Allowance remaining, any further benefits put into payment will attract an additional tax called the Lifetime Allowance Charge.

The Lifetime Allowance Charge is set at a level that is intended to remove the tax advantages that the person has previously received in relation to those benefits because of their membership of a registered pension scheme. The overall effect is that benefits with a total value up to the Lifetime Allowance will enjoy the tax advantages of a registered pension scheme, but the taxation of any benefits above this level is intended to be broadly neutral.

The level of the Lifetime Allowance Charge depends on whether the benefits subject to the charge are taken in pension or lump sum form, as the following example illustrates:

Alan, a member of Colourboxx, has pension rights valued at £2.8 million in May 2011 when he retires. He has not applied for protection.

He has not previously put any benefits into payment so has not used up any Lifetime Allowance. The full Lifetime Allowance of £1.8 million applicable to 2011/12 is available.

When he retires, if Alan puts all his benefits into payment then £1 million, i.e. the excess of his pension rights over the Lifetime Allowance is liable to the Lifetime Allowance Charge.

If he elects to take the £1 million as a lump sum, then the recovery charge will be 55%, meaning that there will be a tax bill in this instance of £550,000. If he elects to draw the £1 million as a pension, then the recovery charge is only 25% but, assuming the total pension is liable to higher rate tax (40% in 2011/12), the total tax payable is calculated as:

Lifetime Allowance Charge:	25% x £1,000,000	=	£250,000
Excess amount used to provide a pension:	£1,000,000 - £250,000	=	£750,000
Gross pension provided*:			
Income tax at 40% on the pension:	£750,000 / 20	=	£37,500 p.a.
	40% x £37,500	=	£15,000 p.a.
Present value of £15,000 p.a. tax:	£15,000 x 20	=	£300,000
Equivalent total tax:	£250,000 + £300,000	=	£550,000.

*Assume for the purposes of the illustration that each £1 p.a. of pension costs £20 to buy.

The tax bill is the joint and several liability of Alan and the Scheme Administrator. What this means is that, assuming Alan opts for the lump sum and the Scheme Administrator settles £300,000 of the liability, then HMRC can pursue both Alan and the Scheme Administrator for the remaining £250,000. In practice, this means that the Scheme Administrator will normally want to ensure that any Lifetime Allowance liability has been met before the benefits are paid out.

1.3.1 Benefit Crystallisation Events (BCEs)

A BCE is an event in a registered scheme which triggers a test of the member's benefits against the Lifetime Allowance. There are 13 BCEs. These are:

BCE1	Assets being put into 'drawdown' or 'income withdrawal'
BCE2	A scheme pension coming into payment.
BCE3	An increase to a pension in payment exceeding certain permitted annual indexation levels (broadly, the greater of 5% and the increase in the RPI).
BCE4	Using the assets of a money purchase scheme to buy a 'lifetime annuity' for a member from an insurance company.
BCE5	A member of a defined benefit arrangement reaching age 75 without having put a scheme pension into payment.
BCE5A	A member of a money purchase arrangement reaching age 75 with funds still in drawdown.
BCE5B	A member of a money purchase arrangement reaching age 75 with funds that havenot been put into drawdown and which have not been used to buy an annuity / scheme pension.
BCE5C	On or after 6 April 2015, uncrystallised funds are designated for drawdown by a dependent or nominee.
BCE5D	On or after 6 April 2015, a dependent or nominee becoming entitled to an annuity purchased using uncrystallised funds.
BCE6	The payment of a Pension Commencement Lump Sum, Uncrystallised Funds Pension Lump Sum or certain other lump sums.
BCE7	Payment of most lump sum benefits on the death of a member.
BCE8	The transfer of pension rights to a Qualifying Recognised Overseas Pension Scheme.
BCE9	Miscellaneous events as set out in regulations, principally certain lump sum payments which do not fall under BCE6 for technical reasons.

Each time a test is made, part of the person's Lifetime Allowance is deemed to be used up. If there is insufficient Lifetime Allowance remaining at the time of the test, then a Lifetime Allowance charge will become payable.

1.3.2 Valuing Pension Rights

To determine whether a person's total pension rights exceed the Lifetime Allowance, they need to be valued. HMRC has laid down a set of criteria for making such a valuation when pension rights are crystallised:

- for a money purchase scheme, the value of the pension rights is taken as the fund value at the time of crystallisation.
- for a defined benefit scheme, the value is the amount of any cash sum taken plus 20 x the starting pension.

If a person is receiving a pension that was put into payment prior to 6 April 2006 (i.e. under the previous tax regime) then this is also tested. Such 'pre-commencement pensions' are tested at the time of the first post 6 April 2006 Benefit Crystallisation Event. The value of the pension is then deducted from the member's Lifetime Allowance. For this purpose, pre-commencement pensions are valued by multiplying the pension in payment at the time of the first Benefit Crystallisation Event by 25.We show this in the following example:

SupposeAlan was already receiving a pension of £10,000 p.a. on 6 April 2006 from another pension scheme. In May 2011, when he retired from the Colourboxx scheme, suppose this had increased to £11,500 p.a.

When he put his Colourboxx benefits into payment, the Lifetime Allowance that they would be tested against would be reduced by 25 x £11,500 = £287,500

Standard Lifetime Allowance:	£1,800,000
Value of pre-commencement pension:	£287,500
Reduced Lifetime Allowance:	£1,512,500
Value of benefits coming into payment	£2,800,000
Excess subject to Lifetime Allowance Charge	£1,287,500

1.4 ANNUAL ALLOWANCE

Another key element of the current regime is the Annual Allowance. The Annual Allowance is an upper threshold for the amount of new pension benefit each year that a member can accrue before being subject to a tax charge. For defined benefit schemes, the value of any pension accrued during the year is tested against this limit. For defined contribution schemes, it is the total contribution paid that is tested. If the value of the new pension benefit in any year exceeds the Annual Allowance, then the member is subject to a tax charge on the excess.

The amount that is tested against the Annual Allowance in any year is called the 'pension input amount'. The period over which the Annual Allowance is assessed is called 'the pension input period'(PIP). From 6 April 2016 all pension input periods are aligned with the tax year. Prior to that they did not necessarily have to be. Transitional provisions were put in place for in tax year 2015/16 to achieve the alignment. Essentially 2015/16 was split into two mini tax years with a single Annual Allowance charge for tax year 2015/16 as a whole arising if an individual exceeded the aggregate Annual Allowance for the mini tax years.

Since someone might be a member of more than one pension scheme or arrangement, in each tax year the total pension input amounts paid in all the pension input periods ending in that tax year are aggregated and measured against the Annual Allowance for the year.

The initial level of the Annual Allowance was £215,000, but it changes, as shown in table below:

Tax Year	Annual Allowance
2006/07	£215,000
2007/08	£225,000
2008/09	£235,000
2009/10	£245,000
2010/11	£255,000
2011/12	£50,000
2012/13	£50,000
2013/14	£50,000
2014/15	£40,000
2015/16	£40,000
2016/17	£40,000
2017/18	£40,000
2018/19	£40,000
2019/20	£40,000
2020/21	£40,000

The substantial cut in Annual allowance from 6 April 2011 was prompted by two main factors:
- the state of the public finances and the consequent need to raise revenue; and
- the fear that the 50% additional rate of Income Tax introduced in 2010/11 would prompt high earnersto put excessive amounts into pension schemes to avoid (or defer) tax.

As well as reducing the amount of the Annual Allowance, the Finance Act 2011 made various other changes including:
- The amount of the Annual Allowance Charge was originally 40%. For 2011/12 and subsequent years, the Charge is calculated by deeming the pension input amount to be part of the individual's earnings and working out the tax accordingly (so in most cases, it will be the individual's marginal rate of tax, with a more complex calculation applying where including the pension input as income would push the individual into a higher tax band).
- Before 2011/12, for any given pension arrangement, the Annual Allowance did not apply in the year in which the member starts to draw all his benefits from that arrangement. The Annual Allowance also did not apply to any member who has Enhanced Protection (see 2.2 below). For inputs applicable to 2011/12 and subsequent years, the exemption from the Annual Allowance for those who take all their benefits does not apply (except on death or in certain cases of ill health), and the exemption for members with EnhancedProtection was removed.
- Where a chargeable amount arises in any tax year, any unused relief attributable to the previous three tax years (i.e. the difference between the pension input in those years and the relevant Annual Allowance) can be carried forward and used to offset any charge. The effect of this is to limit the effect of the reduced Annual Allowance on those whose pension input is normally well below the limit but who may experience a 'spike' in their input due to a one-off event such as a promotion (particularly members of final salary schemes with long service) or an augmentation to their benefits on retirement or redundancy.

Individuals who flexibly access a money purchase arrangement will have to test their total pension input amount against the annual allowance and a 'money purchase annual allowance'. This change is intended to prevent individuals exploiting the new flexibilities by diverting their salary into a pension scheme with tax relief and then immediately accessing money purchase benefits.

The money purchase annual allowance is triggered where an individual:
- draws down funds from a flexi-access drawdown fund;
- receives an uncrystallised funds pension lump sum;
- converts a pre-April 2015 drawdown fund to a flexi-access fund and then takes drawdown;
- takes more than the permitted maximum for capped drawdown;
- receives a 'stand-alone lump sum' from a money purchase arrangement where the individual was entitled to primary protection but not to enhanced protection;
- has received a pre-6 April 2015 payment from a flexible drawdown fund; or
- has become entitled to a payment under a flexible annuity contract.

For individuals who have triggered the money purchase annual allowance broadly, depending on the amount of their money purchase inputs:
- the annual allowance can either be £40,000; or
- (where money purchase inputs in excess of £10,000 are made) a £10,000 money purchase allowance for 'money purchase inputs'; and
- the 'alternative annual allowance' for other inputs.

The 'alternative annual allowance' is found by subtracting £10,000 from the amount of the annual allowance for the tax year. For the tax year 2020/21 the alternative annual allowance is £30,000 (£40,000 less £10,000). The amount of money purchase savings over £10,000 is added to any pension input amounts that exceed the alternative annual allowance to establish a chargeable amount potentially subject to the annual allowance charge (the 'alternative chargeable amount'). Any carry forward from previous years can only be used for non-money purchase savings. There can generally be no carry forward of unused money purchase annual allowance.

If the individual does not make money purchase inputs exceeding the £10,000 money purchase annual allowance in a tax year the annual allowance for all savings (including money purchase) will continue to be £40,000. Individuals will be both assessed to a 'default chargeable amount' and the 'alternative chargeable amount'. The 'default chargeable amount' is the excess of all pension savings above £40,000.The higher of these two amounts will be the 'chargeable amount' on which tax (if any) is paid.

The money purchase annual allowance was reduced from £10,000 to £4,000 with effect from 6 April 2017. The alternative annual allowance remains at £36,000.

Since 6 April 2016, a reduced annual allowance has applied to individuals with an adjusted income in a tax year. An individual's threshold income is the taxable income after allowing for certain reliefs plus the value of certain pension-related salary sacrifice type arrangements.

Initially, this affected those with an adjusted income above £150,000 and a threshold income in the same tax year of more than £110,000.The annual allowance was reduced on a tapered basis by £1 for every £2 of income above £150,000, rounded to the nearest £1, subject to a floor of £10,000. Therefore, the annual allowance would generally be £10,000 for an individual with an income of over £210,000.An individual's adjusted income is the taxable income after allowing for certain reliefs plus the value of their pension savings in the tax year.

In the spring budget of 2020, the Chabcellor increased noth the threshold and adjusted annual allowance thresholds by £90,000. Threshold income is therefore now £200,000 and the adjusted income threshold is now £240,000. However, the minimum level for the annual allowance for those affected by the tapered annual allowance is now £4,000 rather than £10,000.

Anti-avoidance rules for the tapered annual allowance apply resulting in certain arrangements, which includes an agreement, understanding, scheme, transaction or a series of transactions whether or not legally enforceable, being disregarded from the calculation. This will arise where it is reasonable to assume that at least one of the main purposes of an arrangement is to reduce the individual's adjusted and/or threshold income for the tax year.

1.4.1 Pension input amount for Money Purchase Schemes

In a money purchase scheme, the pension input amount is the total 'relievable contribution' paid by or on behalf of the member in the pension input period, together with any employer contribution paid into his pension account.

This includes any AVCs paid by the member but does not include most transfers into the scheme from other arrangements.

1.4.2 Pension input amount for Defined Benefit or Cash Balance Schemes

The Annual Allowance operates in a different way for defined benefit schemes. In these arrangements, the value of a person's pension rights (i.e. their accrued pension) at the end of the pension input period is compared with the value of their pension rights at the beginning of the period. Subject to certain adjustments, including for inflation, the difference is the pension input amount for the period.

For inputs relating to 2011/12 and later tax years, for the purpose of valuing the pension benefits at the start and end of the pension input period, a factor of 16 is used. A factor of 10 is used for earlier tax years. We show this in the following example:

> Maxine's accrued pension in the Colourboxx Final Salary Plan immediately before the start of the input period (5 April 2011) was £20,000 p.a. She has no other pension arrangements. This amount is multiplied by 16 to give £320,000. That figure is then uplifted by the increase in CPI for the period 6 April 2011 to 5 April 2012.This was 3%, giving an 'opening value' of £329,600.
>
> At the end of the pension input period, 5 April 2012, Maxine's accrued pension had increased to £24,000 p.a. This amount is multiplied by 16 to give 'closing value' of £384,000.The opening value is deducted from the closing value to give a pension input amount of £54,400.
>
> As the total pension input amount exceeds the Annual Allowance for tax year 2011/12 of £50,000, an Annual Allowance charge is payable on the £4,400 excess.

Adjustments are made to the figures to take account of the value of any lump sum benefits, transfers in or out of the scheme during the pension input period and also of any pension debits or credits resulting from a divorce.

Deferred members with benefits that are revalued at or below the increase in CPI (or any higher rate that was written into the scheme rules as they stood on 14 October 2010) will be deemed to have no input.

1.4.3 The Annual Allowance and Tax Relief

An individual may pay an unlimited amount into a pension scheme in any tax year but will enjoy tax relief only up to 100% of UK taxable earnings (or £3,600 to a scheme operating on a 'relief at source basis' if this is higher).

Therefore, contributions in excess of the Annual Allowance will receive tax relief provided the individual has sufficient earnings. In most cases this tax relief would cancel out the Annual Allowance Charge.

If someone were to pay contributions that exceeded both their earnings and the Annual Allowance, then the top slice of their contributions would be subject to the Annual Allowance but not receive any compensatory tax relief. We show this in the following example:

> Lorraine earns £30,000 per year and uses her savings to pay £40,000 into an occupational money purchase pension scheme in August 2016. She will be granted tax relief on the first £30,000 of her contribution but will receive no tax relief on the next £10,000.
>
> Had Lorraine chosen to make a contribution of £50,000, she would, in addition, face a personal tax bill for an Annual Allowance charge on £10,000 at her marginal income tax rate. This would be collected through Lorraine's self assessment tax return or paid by the pension scheme under a 'scheme pays' arrangement.

An employer will also be allowed to pay an unlimited amount into a pension scheme on behalf of an employee but, again, any payment above the Annual Allowance figure would render the individual liable to a tax charge.

1.4.4 ' Scheme Pays'

The member is liable for any Annual Allowance Charge that may be due. However, the member has the right to require the scheme to pay the charge on their behalf, provided certain conditions are satisfied.

- The member's Annual Allowance Charge liability for the tax year must exceed £2,000.
- The pension input amount under the scheme must exceed the Annual Allowance for that year.
- The member must make the request by means of an irrevocable election made in a prescribed form. The deadline for this is 31 July after the end of the following tax year (so for example the election has to be made by 31 July 2017, for an Annual Allowance Charge relating to the tax year ending 5 April2016).

In return, the scheme will reduce the member's benefit entitlement by the amount of the Annual Allowance charge. In this case, the Scheme Administrator (normally the trustees or manager of the scheme) and the member have a joint and several liability for the charge.

Where the member has an Annual Allowance liability but one or more of the above conditions is not satisfied, the scheme can decide voluntarily to pay the member's charge on his behalf and reduce the member's benefit entitlement accordingly.

1.4.5 Disclosure Requirements

Where a member of a scheme has benefits within that scheme that exceeded the Annual Allowance, the trustees or managers are required to automatically provide a 'pension savings statement' within six months from the end of the tax year. (This statement is not to be confused with the benefit statement a scheme sends to members). No account is taken of any unused relief carried forward or of any pension input the member has in other schemes (neither of which the trustees or manager can be expected to know about).

The pensions savings statement will show the pension input amount arising in the scheme during the pension input period, together with the corresponding amounts for each of the previous three years.

Members who have not exceeded the Annual Allowance in a particular scheme can request a pensions savings statement. If they do, the pension scheme is required to provide one by the later of three months from the request and six months from the end of the tax year.

There are also disclosure requirements that apply to employers, who must provide the scheme with sufficient information to calculate the pension input amounts of its employees by 6 July following the end of the tax year.

Where a member has first accessed flexible benefits and triggered the money purchase annual allowance, the Scheme Administrator must (within 31 days of the first payment) send the individual a statement confirming this and giving details of the member's duty to report this to the Scheme Administrator of any other registered scheme under which he is accruing benefits.

1.5 AUTHORISED PAYMENTS

Prior to 6 April 2006, there were HMRC limits on the maximum benefits that occupational pension schemes could pay to members in various circumstances. On 6 April 2006, this was replaced by a system of authorised and unauthorised payments. Registered pension schemes are allowed to make unauthorised payments but, when they do, there are additional charges levied on the scheme and/or the beneficiary.

The Finance Act 2004 and supporting legislation prescribes certain payments which may be made without attracting tax charges over and above the normal Income Tax paid on pensions and similar taxes due in respect of certain other benefits. These are known as authorised payments.

Subject to certain conditions, the following are usually authorised member payments:
- pensions and pension death benefits;
- lump sums and lump sum death benefits;
- transfers to other registered pension arrangements or to a 'qualifying recognised overseas pension scheme' (QROPS);
- certain 'scheme administration' payments; and
- payments pursuant to a pension sharing order.

On 14 March 2017, the Registered Pension Schemes (Authorised Payments) (Amendment) Regulations 2017 amended the authorised payment regime to introduce a new authorised payment with effect from 6 April 2017: the pension advice allowance. A payment by a registered pension scheme not exceeding £500 will be authorised if the conditions set out in the regulations are met. The allowance, which can only be paid from money purchase or hybrid arrangements, may be taken up to three times by an individual. The request for the payment must be in writing and the member must declare that the advice is regulated financial advice provided by an FCA- authorised financial adviser, as well as declaring that no more than two pension advice allowance payments have previously been requested and made. Only one payment is allowed per tax year. The payment must be made direct from the scheme to the financialadviser.

In certain circumstances, other payments that have been made in genuine error will be regarded as authorised.

All payments that are not included in the statutory list of authorised payments are 'unauthorised' and give rise to tax charges payable by the Scheme Administrator and/or the member.

1.5.1 Tax Charges on Unauthorised Payments

The making of an unauthorised payment will generate up to four tax charges:
- the unauthorised paymentscharge – a tax charge at a rate of 40%,based on the valueof the unauthorised payment
- the unauthorised payments surcharge – where 25% or more of the value of a member's benefits is paid out in the form of an unauthorised payment an additional tax charge at a rate of 15% will be due, based on the value of the unauthorised payment.

- the scheme sanction charge – a tax charge on the Scheme Administrator. The scheme sanction charge is due on most unauthorised payments, the main exceptions being where the Scheme Administrator would not have known that the payment was unauthorised at the time it was made; the tax rate is normally 15% of the value of the payment, but this increases to 40% if HMRC have been unable to recover the unauthorised payments charge from the recipient.
- a deregistration charge (rare) – if a scheme pays out more than 25% of its assets in the form of unauthorised payments in any year then it is may have its registration withdrawn. In this case a deregistration charge will be applied equal to 40% of the value of the scheme's assets.

Where a payment is subject to an unauthorised payments charge, it will not also be subject to Income Tax.

1.6 TAX TREATMENT OF UNREGISTERED SCHEMES

We outline below the tax treatment of Employer Funded Retirement Benefit Schemes (EFRBS) and Qualifying Recognised Overseas Pension Schemes (QROPS).

1.6.1 Employer Funded Retirement Benefit Schemes (EFRBS)

Background
Because of the need to protect tax revenues, there have always been limits on the extent to which someone can benefit from a 'tax-privileged' pension scheme (i.e. a 'registered' or, prior to April 2006, 'approved' pension scheme). As a consequence, there has long been a demand for 'top-up' arrangements outside the mainstream pensions savings environment, particularly for high-earners.

BeforeApril 2006,the main top-up vehicles used were 'Funded Unapproved Retirement Benefit Schemes' (FURBS) and 'Unfunded Unapproved Retirement Benefit Schemes' (UURBS).The tax treatment of FURBS was broadly:
- no tax relief on contributions on the way in;
- no tax relief on investment returns; and
- exemption from tax on benefits paid out.

This was referred to as 'Taxed, Taxed, Exempt', or 'TTE'. There were certain tax and National Insurance advantages on contributions and investment returns, but these were progressively reduced over the years. UURBS were attractive to employers because of cash flow rather than taxation considerations. But from the employee's viewpoint, UURBS were often seen as unacceptably risky because of the absence of pre-funding. A compromise was the secured UURBS, a benefit promise that was unfunded but secured over some company asset, or backed by a bank guarantee.

Post-2006 tax regime
From April 2006, FURBS and UURBS became known as 'Employer Financed Retirement Benefit Schemes', or EFRBS. The taxation of funded EFRBS was changed from 'TTE' to 'ETT'(relief available on contributions paid in, but benefits ultimately paid out subject to tax).Therefore the main attraction of funded EFRBS became the deferral of Income Tax. However, corporation tax relief was also deferred until the benefits were paid. Because of this (and also because since April 2006 top-up benefits could be paid from within a registered scheme, albeit subject to the Lifetime Allowance charge – see 1.3 above), EFRBS became unattractive and their use after April 2006 declined sharply. However unfunded EFRBS continued to be popular, particularly where suitable security was available.

In April 2010 the top rate of Income Tax increased to 50%. At the same time, corporation tax went down, with the prospect of further reductions in the future. This made the tax deferral aspect of EFRBS attractive again. In order to prevent a revival in the popularity of these vehicles, and a resulting deferral of much-needed tax revenue, the Government took steps intended to make EFRBS no more attractive than other forms of remuneration. These took the form of 'disguised remuneration' legislation, measures that targeted all sorts of arrangements through which employment remuneration was provided via third parties, including some types of EFRBS.

'Disguised remuneration'
The disguised remuneration provisions were contained in the Finance Act 2011,which inserted a new Part 7A into the Income Tax (Earnings and Pensions) Act 2003 – ITEPA03. (The provisions therefore are sometimes known as 'Part 7A' provisions or charges.) These apply when a 'relevant third person'(meaning broadly someone other than the employer) makes provision in connection with the individual's employment.

As a result, in the case of funded EFRBS, any new contributions paid after 5 April 2011 will result in an Income Tax charge on the employee. In the case of unfunded EFRBS, any increase in security given after 5 April 2011 might result in an Income Tax charge on the employee (depending on whether or not the arrangement involves a third party).

Unfunded EFRBS, where there is no security or where there is no undertaking involving a third person, are currently unaffected by the Finance Act 2011 provisions. However, the Government has said that it will monitor changes in patterns of pension savings behaviour and act if necessary to prevent loss of tax revenue. In certain circumstances the use of an unfunded EFRBS must be reported to HMRC under the Disclosure of Tax Avoidance Schemes (DOTAS) provisions, effective from November 2013.

Where an immediate Income Tax charge is levied under the disguised remunerationprovisions,in order to avoiddouble counting it will be offset against the tax that would otherwise be due when the benefits are ultimately paid out.

Taxation outline of EFRBS
The main features of the taxation of EFRBS are as follows:
- the member might suffer a 'disguised remuneration' or 'Part 7A' charge at the time provision for future benefits is made for him through the EFRBS (see above);
- the Lifetime Allowance and Annual Allowance do not apply in relation to an EFRBS (see Part 4, Chapters 1.3, 1.4 and 1.6);
- in funded EFRBS investment income and capital gains are subject to tax, although non-UK income may be exempt where the arrangement is set up off-shore (i.e. the trustees are not UK resident);
- lump sum and pension payments are subject to Income Tax (although subject to certain conditions relating to the age at which the benefits can be paid, and the proportion that can be taken in lump sum form, NI will not be payable); this will be offset by any Part 7A charge already incurred; and
- Corporation Tax relief is available in relation to the contributions paid by the employer, but only at the point when the member become subject to an Income Tax charge; as a result, Corporation Tax relief is received earlier in cases where the disguised remuneration charge applies than in cases when it does not.

1.6.2 Qualifying Recognised Overseas Pension Schemes (QROPS)
The concept of a 'Qualifying Recognised Overseas Pension Scheme' (QROPS) was introduced by the Finance Act 2004 with effect from 6 April 2006. In order to prevent tax privileges from being abused, where a member wanted to transfer their benefit rights out of a registered pension scheme (see Part 3, Chapter 2.2 Transferring) the Act laid down rules that restrict where the transfer could be paid to. If the destination was overseas, in order to be authorised the transfer has to go to a QROPS.

The principal feature of a QROPS was that the scheme manager had to give HMRC an undertaking to inform them when the scheme made a payment out in respect of the member. This then enabled HMRC to ensure that the payment was taxed accordingly. Broadly speaking, where payments were made out of funds that had originated from a UK registered scheme then the recipient would be taxed in the same way as if they had been paid direct from the UK scheme, irrespective of whether the recipient was resident or ordinarily resident in the UK at the time. The principal exception to this was where the person concerned was resident in a country that had a double taxation agreement with the UK and where the pension was taxed in the host country.

A scheme that had been accepted as a QROPS would appear on a list that was published by HMRC (provided the scheme had given its consent to this). This enabled the administrator of a UK registered scheme to check the status of the receiving arrangement when a member had requested a transfer and thus avoid the possibility of a scheme sanction charge arising on account of the scheme making an unauthorised transfer. (For the treatment of unauthorised payments, see 1.5 above.)

There were concerns that the ability to transfer funds from a registered scheme to a QROPS was not always being used in a way that was consistent with the Government's policy objective. This objective was to allow individuals who intend to leave the UK permanently to take their pension savings with them, free of UK tax, to their new country of residence in order to continue saving to provide an income in their retirement.

In response to these concerns, new regulations came into force on 6 April 2012 which revised the conditions that a scheme had to meet to be a QROPS. The regulations also strengthened the information and reporting requirements with the aim of ensuring better operation of the regime and deterring misuse. The policy objective remains to ensure that the system continues to be used for its intended purpose of allowing individuals who intend to leave the UK permanently to take their pension savings with them, free of UK tax, to their new country of residence in order to continue saving to provide an income in their retirement. The regulations introduced:

- an acknowledgement by the individual, to be completed before a transfer was made, that tax charges may apply; and
- additional information requirements and revised time limits for registered pension schemes to report transfers to QROPS).

In addition there were some new rules introduced by FA13 concerning when a pension scheme may be excluded from being a QROPS.

Significant changes to the QROPS system were introduced in the Finance Act 2017 which received royal assent on 27 April 2017 with retrospective application. Transfers to a QROPS requested on or after 9 March 2017 will be taxed at a rate of 25 per cent (the "overseas transfer charge") unless at least one of the following conditions apply:

- both the individual and the QROPS are in the same country after the transfer;
- the QROPS is in one EEA country and the individual is resident in another EEA country after the transfer;
- the QROPS is an occupational pension scheme sponsored by the individual's employer;
- the QROPS is an overseas public service pension scheme and the individual is employed by a participating employer; and
- the QROPS is a pension scheme established by an international organisation and the individual is employed by that organisation.

The legislation allows the tax position to be revisited during the “relevant period” (five full tax years from the date of the transfer to the QROPS).The charge will still apply to a tax-free transfer if, within the relevant period, an individual becomes resident in another country so that the exemptions would not have applied. However, the charge may be reclaimed if the member made a taxable transfer but one of the exemptions starts to apply within the relevant period.

The Scheme Administrator of the registered pension scheme making the transfer is jointly and severally liable, with the member, to the tax charge and is required to deduct it before making the transfer and pay it to HMRC. If a Scheme Administrator did not deduct tax when it should have, because it thought the transfer was not taxable, it can apply to HMRC to be discharged from liability to the overseas transfer charge (although the member remains liable). However, HMRC expects Scheme Administrators to consider critically the information provided by the member and take reasonable care in establishing the correct position before making the transfer.

Managers of any scheme that was a QROPS on 8 March 2017 had to submit a revised undertaking to HMRC by 13 April 2017, confirming that they wished the scheme to remain a QROPS and operate the overseas transfer charge. If no undertaking was received, the scheme stopped being a QROPS on 14 April 2017.

1.6.3 Excepted Group Life Schemes

An Excepted Group Life Scheme (EGLS) is an arrangement which allows employers to offer tax-efficient benefits through lump sum death-in-service benefits that do not count towards the Lifetime Allowance and avoid the 55% tax charge. EGLS are not registered pension schemes. Premiums paid by the employer receive tax relief as they can be treated as business expenditure, provided that HMRC considers them wholly and exclusively for the purpose of trade as part of the remuneration of the individual.

To qualify as an EGLS, certain conditions must be met:

- lump-sum benefits can only be paid for deaths before the age of 75;
- all members must have the same benefit formula;
- if the policy is cancelled it must not have a cash value and only unused premiums may be refunded;
- benefits must be set out in the policy;
- only lump sums can be paid;
- only individuals, charities and trusts set up for individuals may receive a benefit, not other insured persons, unless they are a dependent or relative of the deceased; and
- the EGLS must not be used for the main purpose of tax avoidance.

EGLSs are particularly useful for investors with protection from the lifetime allowance.

Summary

April 2006 saw a radical overhaul of the tax legislation governing pension schemes in the UK. Schemes that are registered in accordance with the current regime enjoy tax advantages, as do those who contribute to them. Each registered scheme must have a Scheme Administrator who has certain duties in relation to record keeping and provision of information.

Two prominent features of the post 2006 regime are the Lifetime and Annual Allowances. As originally implemented, neither had any real impact on the majority of pension scheme members, being relevant principally for high earners (although a test against the Lifetime Allowance will need to be done for all members whenever a Benefit Crystallisation Event occurs). However the reduction of the Annual Allowance, and the introduction of tapering, while mitigated by the ability to carry forward unused relief, has potentially brought many more individuals 'into the net'.

Another key feature of the current tax regime is the system of authorised and unauthorised payments. Although both are allowed, unauthorised payments suffer additional tax charges, sometimes at a punitive level.

Self Test Questions

- If a pension scheme is being set up, why might one want it to be treated as a registered scheme?
- Outline HMRC's role in relation to a registered pension scheme.
- What are the duties of a Scheme Administrator?
- How might the Lifetime Allowance impact on a member who has large pension benefits?
- An individual with no pension arrangements has received a £60,000 inheritance following the death of a relative, and is considering paying it all into a personal pension. Explain any tax considerations that should be borne in mind.
- Why, in normal circumstances, should pension schemes attempt to ensure that all the payments they make to members are 'authorised'.

CHAPTER 2
The Pre A-Day Tax Regime and Transitional Arrangements

INTRODUCTION

In this Chapter we look at the tax system that applied before the current regime was put in place on 6 April 2006, or 'A-Day'. An understanding of the pre-April 2006 tax regime is important for two reasons. Firstly because under transitional arrangements, some of the old rules can be used where they are more beneficial to the member. Secondly, the old rules set out the maximum benefits and contributions that were allowed, and these 'Inland Revenue maxima' are incorporated into many scheme rules and policy provisions.

2.1 PRE APRIL 2006 TAXREGIME

Prior to April 2006, the legislation governing the tax treatment of pension schemes was consolidated in Chapter I Part XIV of Income and Corporation Taxes Act 1988 as amended by later Finance Acts and supplementary Statutory Instruments.

Pension schemes that were eligible for favourable tax treatment (broadly, relief on the investment income, contributions and certain lump sum benefits paid out) were known as schemes that were 'approved' by the Inland Revenue (now HMRC).The legislation set out the basic conditions, which entitled a pension scheme to automatic Inland Revenue approval. The legislation also supplemented this with discretionary powers to enable the Inland Revenue to approve schemes, which did not fully comply with these conditions necessary for automatic approval.

Most private sector schemes were subject to 'discretionary' approval. This contrasts with the public sector, where schemes were often set up by, and are governed by, a specific Act of Parliament (for example separate Acts govern those public sector schemes established for teachers, the police and NHS workers).

Discretionary Approval
When a scheme was subject to discretionary approval, it could provide only 'relevant benefits' within the ranges specified by the Inland Revenue.

'Relevant benefits' were defined under ICTA 88 as being any type of financial benefit given by an employer on retirement or death but excluding benefits in connection with redundancy and excluding benefits on death receivable only in the event of death by accident or disablement during service.

The Inland Revenue Guidance was primarily contained in two manuals or 'Practice Notes' aimed at pensions practitioners, one relating to occupational schemes being known as IR(12) and one for personal pensions IR(76).

If schemes failed to comply with the guidance issued under the Inland Revenue's discretionary powers, the ultimate sanction was the withdrawal of approval. This would have resulted in very severe tax consequences (a tax charge of 40% of the value of the scheme's assets) but was a very rare event.

For occupational pension schemes, the main effect of the Inland Revenue guidance was to impose limits on the maximum benefits that an approved scheme could pay its beneficiaries in various circumstances. These were known as 'Inland Revenue limits' or 'Inland Revenue Maxima'. Since 6 April 2006, these limits no longer apply. However the majority of pensions schemes in existence today were set up under the old regime and consequently their rules often reflect the old Inland Revenue limits. These limits are outlined in Appendix A.

The Inland Revenue did not limit the total benefits that could be paid out from a personal pension scheme (and retirement annuities). Instead there were limits to the amount of contributions that could be paid in. These contribution limits were removed with effect from 6 April 2006 and today have little relevance.

2.2 TRANSITIONAL ARRANGEMENTS

There are transitional arrangements to protect individuals who had already built up pension rights under the old regime that exceeded the new Lifetime Allowance.

Those whose benefits were likely to exceed the Lifetime Allowance could 'protect' rights they had under the previous tax regime, initially in three different ways: by registering for Primary Protection, Enhanced Protection or both. Individuals were given three years, i.e. until 5 April 2009, to register for any of these forms of protection, which are outlined below:

Primary Protection	Primary Protection is available only if the value of all of a person's pension rights exceeded the Standard Lifetime Allowance at A-Day (£1.5 million). Those who register for Primary Protection are given a 'Lifetime Allowance enhancement factor' (LAEF), calculated as: 1+ LAEF = Value of pension Rights at A-Day /£ 1.5 million When there is a BCE involving an individual who is relying on Primary Protection, the standard Lifetime Allowance applicable for that year is replaced by the individual's personal Lifetime Allowance, calculated as: Personal LTA = Standard LTA x (1 + LAEF) This effectively allows individuals with Primary Protection to take benefits equal in value to what they had built up at A-Day, indexed to the date of retirement in line with the increase in the Standard Lifetime Allowance.
Enhanced Protection	In contrast to Primary Protection, a person may register for Enhanced Protection regardless of the size of his pension rights at A-Day. After having registered, the value of any DC rights can grow without limit and without attracting tax charges. DB rights are permitted to increase broadly in line with salary or RPI, or at a fixed 5% p.a. However, it is a condition of Enhanced Protection that there is no 'relevant benefit accrual' after 5 April 2006. Essentially this means that no more contributions can be made to a DC arrangement and no extra DB accrual is normally allowed otherwise Enhanced Protection is lost. Enhanced and Primary A person could register for both types of protection. In this case, Enhanced Protection together Protection takes priority. Primary Protection would then only apply if Enhanced Protection were lost (typically because 'relevant benefit accrual' had occurred).

There are other measures under the transitional arrangements that protect members who were better off under the old regime in certain other ways, for example in being able to take a greater percentage of their benefits in the form of a tax-free lump sum, or in being able to retire at an earlier age.

When reductions were made to Lifetime Allowance effective from April 2012, April 2014 and again from April 2016, further transitional arrangements were introduced in order to protect benefits accrued prior to these dates. These are set out in 1.3 above.

Summary

Before April 2006 (A-Day), to obtain preferential tax treatment, schemes had to be 'approved' under the Inland Revenue's discretionary powers. Schemes that were approved at 5 April 2006 automatically became registered schemes from that date. Members who had large pension rights under approved schemes at 5 April 2006 that were (or might be) greater than would be authorised under the new regime could apply to have these rights 'protected' using the Enhanced or Primary Protection facilities. Other forms of protection were also given to those who had rights to retire below Normal Minimum Pension Age or who had built up rights to tax free retirement lump sums greater than those permitted under the new regime. Further protection was introduced when the Lifetime Allowance was reduced in 2012, 2014 and 2016.

Self Test Questions

- What were the main features of discretionary approval, as applied before A-Day.
- In what circumstances might an individual have applied for 'protection' of his pre A-Day pension rights?
- Why might an individual with large pension rights at 6 April 2006 apply for Primary Protection and how would this affect the subsequent testing of benefits against the Lifetime Allowance?
- Why might a member have both Enhanced and Primary Protection?

CHAPTER 3

Regulation and Member Protection

INTRODUCTION

In this Chapter we consider the regulation of pension schemes, and cover the roles of the Department for Work and Pensions, HMRC, the Pensions Regulator (TPR) (workplace schemes only) and touch on the regulation of personal pensions by the Financial Conduct Authority (FCA)).

We also cover the Pension Protection Fund (PPF), Financial Services Compensation Scheme (FSCS), Pensions Ombudsman (PO) and Financial Ombudsman Service (FOS).Although not directly concerned with the regulation of pension schemes, these bodies are involved in the protection of scheme members and determination of disputes.

3.1 THE DEPARTMENT FOR WORK AND PENSIONS (DWP)

The Department for Work & Pensions (DWP) is the UK's Government department responsible for welfare and pensions policy. DWP's responsibilities include:

- providing information about pensions, benefits and retirement for current and future pensioners;
- providing a decent income for people of pension age and promoting saving for retirement;
- administering the State Pension.

You can browse literature on DWP's website: https://www.gov.uk/government/organisations/department-for- work-pensions

The DWP is the sponsoring department of TPR (an executive non-departmental public body) and of the PPF (a public corporation).

3.2 THE PENSIONS REGULATOR (TPR)

TPR is the UK regulator of workplace pension schemes. A workplace pension scheme is any scheme that an employer makes available to employees. This includes all occupational schemes and any Stakeholder and personal pension schemes where employers have direct payment arrangements.

TPR has the following statutory objectives:

- to protect the benefits of members of workplace pension schemes;
- to promote and improve understanding of good administration of workplace pension schemes;
- to reduce the risk of situations arising that may lead to claims for compensation from the PPF (see 3.3 below);
- to maximise compliance with the duties relating to automatic enrolment imposed on employers and to ensure adherence to the safeguards that protect employees which are introduced by Pensions Act 2008 in connection with automatic enrolment; and
- to minimise any adverse impact on the sustainable growth of an employer (in relation to DB funding functions only).

TPR has stated that in order to meet these objectives it concentrates resources on schemes where it identifies the greatest risk to the security of members' benefits. Where possible, it will provide support and advice to trustees, administrators, employers and others where potential problems are identified.

The Pensions Acts 1995 and 2004 provide TPR with a range of powers to enable it to meet its objectives. Its stated intention is to use these powers flexibly, reasonably and appropriately, with the aim of putting things right and keeping schemes on the right track for the long term.

3.2.1 The Powers of TPR

TPR's powers are defined in statute, and described on its website, as falling into three broad categories:

- investigating schemes: how it gathers information to help identify and monitor risks;
- putting things right: what it can do where problems have been identified; and
- acting against avoidance: how it will ensure that employers do not sidestep their pension obligations.

TPR explains these in more detail:

Investigating schemes

TPR collects data through a 'scheme return'. It also expects to receive reports of significant breaches of the law from 'whistleblowers', and reports of notifiable events from trustees and employers.

Trustees or scheme managers are also responsible for notifying it promptly of changes to 'registerable' information such as the scheme's address, details of trustees, or the types of benefit provided by the scheme. It also expects to receive reports where a scheme is unable to comply fully with the scheme funding framework.

In addition, it is able to demand relevant documents (or other information) from trustees and employers, among others.

Putting things right

Where TPR decides that action must be taken to protect the security of members' benefits, it has a range of options available. The action taken will depend on the circumstances of the problem. These are some examples of the regulatory action:

- issue an 'improvement notice' to individuals or companies, or a 'third party notice', requiring specific action to be taken within a certain time;
- take action, on behalf of a scheme, to recover unpaid contributions from the employer if the due datefor payment has passed;
- where a wind-up is pending and members' interests may be at risk, it can issue a 'freezing order'; this order temporarily halts all activitywithin the scheme, so that it can investigate concerns and encourage negotiations;
- prohibition of trustees who it does not consider to be fit and proper persons for the role;
- imposition of fines where breaches have occurred; and
- prosecution of certain offences in the criminal courts.

Acting against avoidance

TPR has powers to act where it believes that an employer is deliberately attempting to avoid their pension obligations, leaving the PPF to pick up their pension liabilities. To protect the benefits of scheme members, and to reduce the PPF's exposure to claims for compensation, TPR may issue any of the following:

- **'Contribution notices'** – where there is a deliberate attempt to avoid a statutory debt,these allow it to direct that those involved must pay an amount up to the full statutory debt either to the scheme or to the Board of the PPF.

- **'Financial support directions'** – these require financial support to be put in place for an underfunded scheme where it concludes that the sponsoring employer is either a service company or is insufficiently resourced.
- **'Restoration orders**' – if a transaction involving the scheme'sassets has been undervalued (for example assets sold to some connected party at a price that is less than what would be expected from a genuinely arms length transaction), these allow it to take action to have the assets (or their equivalent value) restored to the scheme.

A 'clearance procedure' is available for an employer which wishes to confirm that it will not be subject to either a contribution notice or a financial support direction following a proposed transaction. By obtaining advance clearance from the TPR,the company receives assurance that that it can go ahead with the transaction without the risk that TPR will at some later stage use one of its anti avoidance powers in relation to that transaction.

3.2.2 TPR and Scheme Governance

TPR regards pension scheme governance as highly important. As it says in its 2009 statement to trustees, 'Good governance – keeping pensions safe':

"Good governance matters because pension scheme members entrust their savings into the hands of others. And it matters because UK occupational pension schemes hold more than an estimated £1 trillion in assets. Trustees responsible for running pension schemes need to be sure that:
- They have the right skills, and they get the right people to help them run their pension scheme; and
- They have the right processes in place to manage scheme risks".

TPR's key priorities for trustee pension scheme governance include:
- trustees' 'knowledge and understanding'(of the relevant law,of investment and, for defined benefit schemes, of funding);
- identifying and managing conflicts of interest;
- for defined benefit schemes, monitoring of the'employer covenant'(i.e. the financial ability of the employer to meet its obligations to the scheme);
- the appointment and review of advisers;
- administration processes;
- choosing investments;
- governance during wind-up;
- risk management and internal controls; and
- providing value for members.

TPR has issued guidance or codes of practice covering many of these areas.

3.3 PENSION PROTECTION FUND (PPF)

3.3.1 Eligibility

The PPF came into effect from 6 April 2005. It applies to defined benefit and hybrid schemes (defined contribution schemes are not eligible).

Where a qualifying insolvency event occurs on or after 6 April 2005 (essentially either receivership or insolvency of the sponsoring employer) and the assets of the scheme are not sufficient to provide benefits up to the level of compensation payable by the PPF, then, following an assessment period, the scheme's assets and liabilities will be transferred to the PPF. Otherwise, the scheme will have to be wound up, or may be allowed to run as a closed scheme. Schemes which started winding up before 6 April 2005 are not covered.

3.3.2 Compensation

Once the PPF takes responsibility for a scheme, its assets and liabilities will be transferred to the PPF, which will provide compensation broadly at 100% of accrued benefits for those over Normal Pension Age (NPA) or those in receipt of an ill health or survivor's pension. For others, the compensation will be 90% of accrued benefits and will be subject to an overall cap, which depends on the member's age at the date of commencement of benefits. For the year commencing 1 April 2020 the compensation cap is £ 43,081.46 p.a.(giving actual compensation of £38,773.31) for benefits commencing at 65 and £34,749.68p.a. (£31,274.71) for benefits commencing at age 60.There is also CPI indexation, capped at 2.5%, on compensation attributable to benefits earned through service after 5 April 1997, and a 50% spouse's benefit on death. Since 6 April 2017, the maximum benefits payable to those with long service (21 years or more) in a scheme that entered the PPF have been increased. For these members the cap is increased by 3% for each full year of pensionable service above 20 years, up to a maximum of double the standard cap.

On 6 September 2018, The European court of Justice (ECJ) ruled that PPF compensation levels could not be less than 50% of the originally accrued benefit. Indexation for benefits accrued before 1997 will also be required. This change is likely to affect a small number of members, with PPF liabilities increasing by about £215 million. In June 2020, a High Court Judgment ruled that the PPF's age-related compensation caps constituted a form of age discrimination. The longer-term implications of this ruling are as yet not clear.

3.3.3 Hybrid Schemes

For hybrid schemes, the PPF regulations set out the procedure for discharging money purchase benefits within schemes that are eligible for the PPF, with the defined benefit element then being subject to the PPF as described above.

3.3.4 The PPF Levy

The main funding for the PPF comes from levies collected annually from eligible schemes. The levy, which is subject to an overall ceiling each year, comprises a risk based element and a scheme based element. The scheme based element considers the amount of the liabilities for providing PPF benefits to the scheme members and the risk based element broadly takes account of the funding level of the scheme and the risk of employer insolvency. Additional levies are also payable in respect of the fraud compensation scheme and the Ombudsman, and to cover the establishment and administration of the PPF.

3.4 HM REVENUE & CUSTOMS (HMRC)

HMRC (formerly the Inland Revenue) is responsible for the collection and administration of tax and National Insurance (NI). The tax and NI liabilities of pension schemes, companies and individuals are calculated in accordance with legislation. Since the tax regime introduced by FA04, HMRC have minimal discretionary powers. However HMRC publishes comprehensive guidance on tax matters and will also answer queries on the last three Finance Acts. For pension schemes, the main body of guidance is the Pensions Tax Manual and a web page containing links to guidance on pension scheme administration. Other HMRC manuals that will sometimes be relevant include the Employment Income Manual, and the Inheritance Tax Manual. HMRC also regularly publishes newsletters and other announcements about tax matters.

3.4.1 The National Insurance Contributions and Employer Office (NIC&EO)

The National Insurance Contributions and Employment Office is part of HMRC. It is responsible for collecting and recording National Insurance contributions. This involves

- ensuring compliance with National Insurance-related legislation,
- collecting National Insurance contributions,
- administering the contracted-out system,
- maintaining accurate National Insurance accounts and the
- providing information about National Insurance

3.4.2 National Insurance Services to the Pensions Industry

The National Insurance Services to Pensions Industry (NISPI) is a directorate within NIC&EO which is part of HMRC.

NISPI deals with occupational pension schemes that were contracted-out of the state additional pension.

3.5 FINANCIAL CONDUCT AUTHORITY (FCA)

The Financial Services Authority (FSA) was established as the sole regulatory authority for financial and investment business in the UK by the Financial Services and Markets Act 2000. It took over responsibility for:

- banking supervision;
- authority for listing on the London Stock Exchange;
- investment services regulation;
- mortgage and general insurance regulation; and
- taking action to prevent market abuse.

In the wake of the financial crisis in 2010, the Financial Services Act 2012 replaced the FSA with two successor bodies, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

The PRA is a subsidiary of the Bank of England and has two statutory objectives:

- to promote the safety and soundness of institutions such as banks, building societies, insurance companies and investment firms; and
- to secure protection for policyholders.

The FCA's strategic objective is to ensure that the relevant markets function well. To support this, its operational objectives are:

- to secure an appropriate degree of protection for consumers;
- to protect and enhance the integrity of the UK financial system; and
- to promote effective competition in the interests of consumers.

The FCA is an independent financial regulator accountable to parliament through HM Treasury. It is governed by a Board, appointed by the Treasury. The FCA describes the functions of the Board as:

- managing and challenging the FCA's senior executives;
- helping to hold the FCA to account; and
- helping set the FCA direction.

All firms and individuals seeking to deal in, sell or give advice on financial products must be registered with, and are regulated by, the FCA, which has the authority to enforce its rules through fines, imprisonment and 'naming and shaming'.

3.5.1 The FCA's Principles of Good Regulation

Under the Financial Services and Markets Act 2000, as amended by the Financial Services Act 2012, the FCA must consider six principles:

- **Efficiency and economy**
  The FCA must use its resources efficiently and economically.
- **Proportionality**
  Any burden or restriction that imposed on a person or activity must be proportionate to the expected benefits, taking into account the costs to firms and consumers.

- **Consumer responsibility**
  Consumers should take responsibility for their decisions.
- **Senior management responsibility**
  A regulated firm's senior management is deemed responsible for that firm'sactivities and is held responsible for the risk management and controls within the firm.
- **Openness and disclosure**
  FCA should ensure that relevant market information about regulated persons is published, in order to reinforce market discipline and improve consumers' knowledge about their financial matters.
- **Transparency**
  The FCA should exercise its functions as transparently as possible.

3.5.2 The FCA's Standards for Guidance Guarantee Delivery Partners

The FCA is responsible for setting the standards for the Guidance Guarantee Delivery Partners (Pension Wise delivered by TPAS and the Citizens' Advice Bureau) and in November 2014, the FCA published a Policy Statement setting out these standards. The FCA is also responsible for monitoring compliance with the standards and collecting the levy which will fund the provision of the guidance.

3.5.3 Regulating Financial Advice

In relation to pensions, an individual or company must be authorised by the FCA if they wish to:
- give advice on; or
- arrange transactions of (for example, making arrangements with a view to assisting another person to complete a deal); or
- deal in (for example, buying or selling investments); or
- manage (for example, managing the assets of another person)

certain products, including the following:
- insurance policies such as group pension contracts, personal pension plans, section 32 buy outs and FSAVCs, and other long term assurance products with an investment element;
- AVCs;
- investment options in pension schemes;
- group life assurance policies (and some individual policies); and
- group permanent health insurance or income protection policies (and some individual policies).

Permission from the FCA is also required to establish, operate or wind up a personal pension scheme.

Authorisation is not required in order to advise on, arrange or provide non-financial products and or services (for example, third party administration). Authorisation is also not required to invest one's own money.

3.5.4 Best Advice

A core principle of financial advice is that where advice is being given (as opposed to a transaction or sale being made on a 'non-advised', or 'execution-only', basis – see below) the customer must be given 'best advice'.

Broadly speaking 'best advice' can be defined as 'recommending, advising on or transacting investments which are the most suitable for the client in the light of what the adviser knows of the client and of any other information which he or she ought reasonably to know'.

Before giving advice, all advisers have to inform their clients whether they provide ‘independent’ or ‘restricted’ advice. A ‘tied agent’ can only advise on the products of the company to which they are tied.A multi-tied agent is a financial adviser who is allowed to recommend the products of a limited selection of providers, rather than just one. Tied and multi-tied agents, or any other adviser who has decided to only advise on a limited range of products or providers, is said to be offering ‘restricted advice’. An ‘independent financial adviser’ (or IFA) can consider the products of all of the providers in a market (even those with tied sales forces) and the advice given must be unbiased, unrestricted, and based on a comprehensive and fair analysis of the relevantmarket.

In order to give best advice the adviser must:
- ‘know the customer’;
- take ‘all reasonable steps to be satisfied that the client understands the extent to which he or she will be exposed to risk’; and
- disclose any conflicts of interest.

‘Knowing the customer’ means that the adviser must take reasonable steps to obtain from the client such information concerning the personal and financial circumstances of that client as may be expected to be relevant. The most common method of dealing with this requirement is the completion, by the adviser and client, of a ‘Fact Find’ questionnaire.

Products can, however, be sold without ‘knowing the customer’. This is often known as ‘execution only’ business. In such cases the customer buys without taking specific advice.

If retained, an adviser must periodically review the advice given and reaffirm its appropriateness.

An adviser must keep full and accurate client records. This includes basic information on the client and also a record of the advice given and the reasons for this advice.

An IFA must make periodic returns to his or her regulator to show that he or she is not placing a disproportionate amount of business with one provider.

3.5.5 Treating Customers Fairly

A central principle is that all regulated firms must treat their customers fairly. This at the forefront of the FCA’s principles-based approach to regulation.

Compliance with this principle is expected to result in six outcomes for the consumer of financial services:
1. Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.
2. Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
3. Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
4. Where consumers receive advice, the advice is suitable and takes account of their circumstances.
5. Consumers are provided with products that perform as firms have led them to expect, and theassociated service is of an acceptable standard and as they have been led to expect.
6. Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

Firms are expected to have appropriate management information or measures in place to test whether they are treating their customers fairly and must be able to demonstrate to themselves and to FCA that they are consistently treating their customers fairly.

3.5.6 Communicating with Customers

The FCA's detailed rules on communications can be found in the Conduct of Business Sourcebook (COBS). This requires firms to ensure that information:

- includes the name of the firm – this may be a trading name or shortened version of the legal name of the firm, provided the client can identify the firm communicating the information;
- is accurate and in particular does not emphasise any potential benefits of relevant business or a relevant investment without also giving a fair and prominent indication of any relevant risks;
- is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received; and
- does not disguise, diminish or obscure important items, statements or warnings.

In deciding whether, and how, to communicate information to a particular target audience, a firm should take into account the nature of the product or business, the risks involved, the client's commitment, the likely information needs of the average recipient and the role of the information in the sales process. It should also consider whether omission of any relevant fact will result in information being insufficient, unclear, unfair or misleading.

Communications with customers, whether oral or written, should be fair, clear and not misleading and serve their purpose. COBS also applies to communications arising from existing investment business with the client, to financial promotions made and other documentation produced for client consumption. This is so that a customer can understand how and why recommendations meet his needs and objectives and why a particular promotion is being made.

3.5.7 The Asset Management Market Study

The FCA launched a market study into the UK asset management industry, which manages approximately £6.9 trillion of assets, in November 2015 to ensure that the market works well and the investment products consumers use offer value for money. In November 2016, the FCA published an interim report which presented evidence that suggested that there was weak price competition in a number of areas in the industry. Following this, it consulted on its findings and proposed remedies, including hosting round tables and one-to-one meetings with stakeholders.

The final report was published in July 2017.The FCA confirmed its interim findings that price competition is weak in a number of areas of the industry; that investors are not always clear what the objectives of funds are; and fund performance is not always reported against an appropriate benchmark. It will launch a market study into investment platforms, seek views on rejecting the undertakings given by three large pensions investment consultancies in lieu of the market investigation reference, and recommend that HM Treasury considers bringing investment consultants into the FCA's regulatory perimeter.

3.5.8 The Distance Marketing Directive

The Distance Marketing Directive ('DMD') is an EU Directive, which included among its objectives establishing a clear regulatory framework for the distance marketing of financial services in the EU and increasing consumer confidence in distance selling. In this context, 'distance' can be taken to mean dealings between individuals and financial services firms made exclusively via post, internet and telephone (i.e. no physical presence).

Like all EU Directives, it needs to be implemented within each member state, a process that necessitates the member state amending its own laws so as to give effect to the provisions set out in the Directive. In the UK the DMD was implemented mainly through the Distance Marketing Directive Instrument 2004.

The aim is to provide retail customers with a high level of protection by requiring that they are given a minimum standard of information and have the right to cancel a range (but not all types) of contracts once entered into.

The DMD prohibits 'inertia selling' i.e. processes whereby the consumer automatically enters into a contract to buy unless they take some active step to opt out. In the run up to automatic enrolment there was a concern that the DMD would prevent employers using contract-based schemes such as GPPs for automatic enrolment. However the DWP confirmed that the process of automatically enrolling and re-enrolling employees in accordance with the employer's duties under the Pensions Act 2008 falls outside the scope of the DMD.

3.5.8 Promotion of Schemes by Employers

In general, the promotion of personal pensions is 'regulated' and so can only be done by someone authorised by the FCA or using promotional material has been signed off by someone authorised by the FCA.

However employers who meet all the conditions listed below are exempt from this requirement in respect of 'financial promotions'. Here, financial promotions refer to communications including written documents, as well as promotional information given orally, such as face-to-face discussions with individual employees or group presentations.

- The employer must contribute to the scheme; the first promotion must confirm this and the employer must inform each employee in writing what the employer contribution will be before they join the scheme.
- The employer must not receive a direct financial benefit from promoting your scheme, forexample commission.
- Third parties (for example a third party pensions administrator) are permitted to promote Group Personal Pensions or Stakeholder pensions to employees provided that this is done in accordance with a written agreement between the third party and the employer and that the employer would have been permitted to promote the scheme direct to the member.
- Any written promotional material must state that the employees have the right to seek advice from someone regulated by the FCA.

There are no restrictions preventing employers from promoting occupational pension schemes to their employees. However whether the scheme is a personal pension or an occupational scheme, employers answering their employees' questions should bear in mind that they may not know the detail of an individual's financial circumstances or their expectations for the future. Because of this, employers are unlikely to be in a position to give personalised advice.

3.6 FINANCIAL SERVICES COMPENSATION SCHEME (FSCS)

The FSCS is an independent body, set up under the Financial Services and Markets Act 2000 (FSMA). It is the UK's statutory fund of last resort for customers of financial services firms and can pay compensation to consumers. Before a claim can be paid, the FSCS has to first declare that the provider or adviser is in default. Essentially this means that it firm is unable, or likely to be unable, to pay claims against it, generally because the firm has stopped trading and has insufficient assets to meet claims, or is in insolvency. The FSCS will conduct an investigation to establish this.

The FSCS protects consumers who have incurred financial loss when regulated firms are unable, or likely to be unable, to pay claims against them relating to:

- deposits
- life and general insurance policies
- investment business (on or after 28 August 1988)
- advice and arranging of mortgage business (on or after 31 October 2004)
- insurance intermediation (general insurance and pure protection contracts, for business conducted on or after 14 January 2005)

FSCS's protection is governed by the PRA and the FCA's rules. The PRA's rules cover claims in relation to deposits as well as life and general insurance policies and are set out in the Depositor Protection and Policyholder Protection parts of the PRA Rulebook. The FCA's rules cover the remaining categories of claim. These are set out in the Compensation Sourcebook (the "COMP Rules") in the FCA Handbook.

The compensation available to individual's relating to personal pensions will depend on the exact nature of the investment or product.

- Deposits: in a bank, building society or credit union are protected up to £85,000 per person per firm.
- Investments: pension funds held directly in investments (other than insurance products),are protected up to £50,000 per person per firm. This limit also applies to pension mis-selling claims.
- Retirement income: 100% of annuity income is protected.
- Pension Life Savings: 100% of the pension pot will be protected if it is managed in a life insurance contract.

3.7 PENSIONS OMBUDSMAN (PO)

The Pensions Ombudsman is the body established to investigate complaints about pension occupational and personal pension schemes. The PO was established on 1 October 1990 and is appointed by the Secretary of State under the Pension Schemes Act 1993, s.145.Anthony Arter is the current PO and Karen Johnston is the current Deputy PO, a position that was established in 2004.

The PO's role is to investigate and decide complaints and disputes of fact or law and investigate claims of maladministration and consequential injustice. The PO acts as an independent, impartial adjudicator whose determinations are binding on the parties and enforceable in the County Court. Parties may appeal to the High Court on a point of law with the High Court's permission.

On deciding a complaint or dispute of fact or law, the PO is bound by the normal legal principles, namely limitation periods, remedies and avenues of liability, which govern the law courts of England and Wales. However, on deciding on whether behaviour has constituted maladministration, the PO can take a more liberal approach. Maladministration is not defined in legislation, but the PO describes it as including bias, neglect, inattention, delay, incompetence and arbitrariness. On such complaints, the behaviour which allegedly constitutes maladministration must lead to injustice. This is also undefined, but the PO describes it as not only including financial loss but also distress, delay or inconvenience. The general time limit for bringing a complaint to the PO is three years after the date on which the act or omission complained of occurred or three years after the date on which the complainant knew or ought to have known of its occurrence but this can be extended at the PO's discretion.

The PO website can be found at www.pensions-ombudsman.org.uk and determinations issued from 1 April 2001 are available for review.

3.8 FINANCIAL OMBUDSMAN SERVICE (FOS)

FOS is the independent body established in 2000 to investigate and decide complaints and disputes between consumers and businesses regarding financial services such as those provided by banks, building societies, insurance companies, investment firms, financial advisers and finance companies, and financial products such as pensions, savings, investments, insurance and financial advice. The FSO's decisions are based on principles of fairness and reasonableness in the particular circumstances of the complaint. Only until the consumer accepts the FSO's decision will it become binding and enforceable. If the consumer does not accept the decision, their statutory rights are unaffected and they may pursue the complaint in court. More information can be found at **www.financial-ombudsman.org.uk.**

Summary
Workplace pension schemes, including occupational pension schemes and personal pension schemes which employers contribute to, are regulated by TPR. TPR's powers are given by the Pensions Act 2004 and include the powers to investigate schemes and where he finds problems, to put things right.

When companies get into difficulties, becoming insolvent, sometimes their pension schemes will need to be wound up. In such cases, if it is a defined benefit pension scheme which is underfunded, members may be eligible for assistance from the PPF.

The Financial Conduct Authority is the authority regulating financial and investment business governed by the Financial Services and Markets Act 2000, as amended by the Financial Services Act 2012. In the pensions arena, the main areas covered are giving advice on, or transacting in, pension scheme investments and insurance policies including personal pensions, AVC contracts, group life assurance policies etc.). Firms that operate in regulated areas need to be authorised by the FCA and need to abide by the principles of Best Advice and Treating Customers Fairly. The Financial Ombudsman Service will deal with complaints relating to the sales or marketing of personal pensions.

Self Test Questions

- What is role of TPR and what are its powers?
- When might a member benefit from the PPF?
- What compensation might a member of a scheme that has gone into the PPF expect to receive and how might these differ from his benefit entitlement under the scheme rules before it entered the PPF?
- What are the objectives of the Financial Conduct Authority?
- What is the concept of Best Advice?
- When a firm abides bythe 'Treating Customers Fairly', how is this expected to impact on its customers?

CHAPTER 4
The UK Financial Services Industry

INTRODUCTION

This Chapter looks at the legislation and regulation under which UK financial services industry operates, both domestically and internationally. It is important to keep up to date with the ever changing legislation, not least to ensure that the correct processes are being followed. The regulation aspects for the UK financial services industry are considered in more depth in the "Retail Advice and Regulation" Specialism Unit.

4.1 INVESTMENTADVICE

The main areas investment advisers deal with include:

Investment Monitoring – Updating clients on the short and long term performance of their assets with in depth quarterly, bi-annual or annual investment reports.

Investment Strategy Modelling – Advising on the most appropriate asset allocations for assets, using an asset liability model. Review long term investment strategies on an annual basis and/or three year basis.

Investment Manager Research & Selection – Researching, monitoring and recommending a range of high quality investment managers within the market place across all asset classes from equities, fixed income, property and alternatives.

Asset Transition Management – Coordinating and managing the transfer of assets between asset classes and investment managers.

4.2 LEGISLATION AND REGULATION

When looking at financial services, it is important to understand the role of the bodies charged with regulating financial services. These bodies include:
- HM Treasury;
- the Financial Conduct Authority (FCA) (see 4.1 above);
- the Bank of England including the Prudential Regulation Authority (PRA);
- the Competition and Markets Authority (which took over many of the functions of the Office of Fair Trading which closed on 1 April 2014); and
- TPR (see 3.1 above).

Legislation also needs to be considered. This includes the Financial Services Act 2012 (FSA 2012), the Financial Services and Markets Act (FSMA) 2000, the Markets in Financial Instruments Directive (MiFID) and European Union (EU) regulation, and how oversight within firms operates.

The "Retail Advice and Regulation" Specialist Unit deals with legislation and regulation in much greater detail.

4.2.1 HM Treasury

The UK Government department responsible for the regulation of the financial services industry is HM Treasury, under the authority of the Chancellor of the Exchequer. Therefore each Chancellor will have his own policy agenda in this area.

HM Treasury is responsible for:
- public spending;
- financial services policy;
- strategic oversight of the UK tax system;
- the delivery of infrastructure projects; and
- ensuring the UK economy is growing sustainably.

The Financial Services Act 2012 came into force on 1 April 2013 and introduced the changes that have fundamentally changed the way financial services firms are regulated. These included:
- giving the Bank of England responsibility for oversight of the UK financial system as a whole, by establishing a new Financial Policy Committee within the Bank, with powers to ensure emerging risks and vulnerabilities across the financial system as a whole are identified, monitored and effectively addressed (the Bank of England's role is considered in more detail in 5.2.2 below);
- setting up a new regulator of safety and soundness in the financial services sector, the Prudential Regulation Authority, working under the Bank of England, to supervise all firms that manage significant risks as part of their business – banks and other deposit takers, insurance companies, and large investment banks;
- establishing a new business regulator for financial services – the Financial Conduct Authority – which will protect consumers and supervise all firms to ensure that business across financial services and markets is conducted in a way that advances the interests of all users and participants, ensuring the industry remains stable and promotes healthy competition between financial services providers; and
- clarifying the Government's responsibilities in a financial crisis by giving the Chancellor of the Exchequer powers to direct the Bank of England where public funds are at risk and there is a serious threat to financial stability – as part of the Government plan to create a stronger and safer banking system that supports the economy, consumers and small businesses, the Financial Services Banking Reform Act received Royal Assent on 18 December 2013.

4.2.2 Bank of England (including the Prudential Regulation Authority)

The Bank of England has two core purposes, to ensure monetary stability and to contribute to financial stability.

Monetary stability means stable prices and confidence in the currency. Stable prices are defined by the Government's inflation target, which the Bank seeks to meet through the decisions delegated to the Monetary Policy Committee, explaining those decisions transparently and implementing them effectively in the money markets. Setting monetary policy – i.e. deciding on the level of short-term interest rates necessary to meet the Government's inflation target – is the responsibility of the Bank and, since May 1997,the Bank has had operational independence to set monetary policy by deciding the short-term level of interest rates to meet the Government's stated inflation target.

Financial stability entails detecting and reducing threats to the financial system as a whole. This is pursued through the Bank of England's financial and other operations, including lender of last resort, oversight of key infrastructure and the surveillance and policy roles delegated to the Financial Policy Committee. Between 1997 and 2013, the Bank of England had responsibility for the stability of the financial system as a whole, while the Financial Services Authority (FSA) supervised individual banks and other financial organisations including recognised financial exchanges such as the London Stock Exchange.

In October 1997, a Memorandum of Understanding between the Bank, HM Treasury and the FSA was agreed. This formalised the allocation of responsibilities for regulation and financial stability in the UK.It made provisions for the establishment of a high level Standing Committee to provide a forum in which the three organisations could develop a common position on any problems which may emerge. An updated Memorandum was issued in March 2006.This division of responsibilities was redefined by the Financial Services Act 2012.

The Financial Services Act 2012 included two significant changes that have impacted on the role of the Bank of England in connection with financial services:

- the creation of the Prudential Regulation Authority (PRA); and
- the creation of a new macro-prudential regulator, the Financial Policy Committee (FPC).

These two changes are outlined briefly below:

- *The Prudential Regulation Authority (PRA)*
  PRA is a subsidiary of the Bank of England and has two statutory objectives:
  - to promote the safety and soundness of institutions such as banks, building societies, all credit unions, insurance companies and investment firms; and
  - to secure protection for policyholders.
- *The Financial Policy Committee (FPC)*
  FPC contributes to the achievement of the Bank's financial stability objective. It is charged with taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system. The Committee has a secondary objective to support the economic policy of the Government.

Finally, the Financial Services Act 2012 also gave the Chancellor of the Exchequer powers to direct the Bank of England if public funds are at risk and there is a serious threat to financial stability.

The PRA works alongside the Financial Conduct Authority (FCA) creating a, 'twin peaks', regulatory structure in the UK.

4.2.3 Compliance Officers

Within each investment organisation there must be a Compliance Officer whose duties are to establish the necessary systems for compliance with the rules of the FCA and to ensure that these rules are adhered to at all times. In addition, the FCA will make periodic visits to the member's premises, often with little or no notice, and will inspect client files, client accounts, the member's accounts and any other information or files which they deem pertinent to their compliance requirements. Any shortcomings are recorded in writing to the member following the inspection visit.

4.2.4 Breaches in Compliance

Serious breaches in compliance may result in temporary or permanent suspension of membership and/or fines. Every employee of the member who gives investment advice must be registered with the FCA. They will be required to demonstrate their suitability for registration either through examination or by proving an acceptable level of professional experience.

4.2.5 Financial Crime

Financial crime manifests itself in different ways including:

- Money laundering is the process by which criminals attempt to disguise the source of proceeds generated from illegal activities, such as theft, fraud, terrorist activities, dealing in drugs,illegal gambling or tax evasion.
- Bribery and fraud involve sacrificing clients' interests to greed and self-interest.

These topics are covered in more detail in the "Retail Advice and Regulation" Specialist Unit.

4.2.6 The FCA's and PRA's International Agenda

The FCA and PRA have a number of obligations internationally, which are driven by statutory obligations and objectives set by Parliament and the EU. They see their obligations in Europe as:

- influencing European policy and legislation;
- implementing elements of relevant EU legislation – increasingly European financial services regulation is implemented on a "maximum harmonising" basis, i.e. national law cannot exceed (or go below) the requirements of the European legislation, resulting in the same standards applying across the EU;
- running or participating in supervisory colleges for firms and market infrastructure providers, for whom the FCA/PRA are either the home or host supervisor; and
- being accountable through EU peer review processes.

They see their obligations globally as:

- representing the UK on a variety of international (non-European) standard setting bodies which seek, by consensus, to arrive at harmonised standards for key elements of policy and supervision;
- implementing agreed international standards;
- being accountable for implementing and complying with agreed standards to a range of international review mechanisms, most notably the International Monetary Fund's Financial Sector Assessment Program (IMF FSAP); and
- running or participating in global supervisory colleges.

This topic is covered in more detail in the "Retail Advice and Regulation" Specialist Unit.

4.3 PROVIDING FINANCIAL SERVICES

The role of a financial adviser is to provide a service to its retail customers. This includes ensuring that the consumer fully understands the obligations that the financial adviser has towards the consumer and what is included in the financial services being provided. It is also important that the adviser is able to recognise the consumer's main financial needs and is able to prioritise them. Consumers' main financial needs can be broken down into the following areas:

- managing debt;
- budgeting and borrowing, including buying a house;
- protection, e.g. life and health insurance;
- savings and investments;
- retirement; and
- estate planning and tax planning.

The adviser can meet these needs by using a combination of products including:

- mortgages and loans;
- life and health insurance; and
- savings and investments.

Regulated Activity

Under s19 of FSMA 2000, any person who carries on a regulated activity in the UK must be authorised by the FCA or exempt (i.e. an appointed representative or some other exemption). Firms need to establish whether they need authorisation to carry on regulated activities and whether this includes intermediaries selling investments and/or home finance activities and/or general insurance. For each regulated activity, firms must also identify for each activity the investment type concerned.

Any person who carries out regulated activities without being authorised may find that they have committed a criminal offence which is punishable on indictment by a maximum term of two years imprisonment and/or a fine.

The activities and specified investments are detailed inThe Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). Specified activities are defined in Part II of the RAO and comprise:

- accepting deposits;
- issuing e-money;
- effecting or carrying out contracts of insurance as principal;
- dealing in investments (as principal or agent);
- arranging deals in investments;
- arranging home finance activities;
- operating a multilateral trading facility;
- managing investments;
- assisting in the administration and performance of a contract of insurance;
- safeguarding and administering investments;
- sending dematerialised instructions;
- establishing etc. collective investment schemes;
- establishing etc. Stakeholder pension schemes;
- establishing personal pension schemes;
- providing basic advice on Stakeholder products;
- advising on investments;
- advising on home finance activities;
- Lloyd's marketactivities;
- entering into funeral plan contracts;
- entering into a home finance activity;
- administering a home finance activity; and
- agreeing to do most of the above activities.

Specified investments are defined in Part III of the RAO and comprise:

- deposits;
- electronic money;
- rights under a contract of insurance;
- shares etc.;
- instruments creating or acknowledging indebtedness;
- sukuk (shariah compliant debt instruments);
- Government and public securities;
- instruments giving entitlement to investments;
- certificates representing certain securities;
- units in a collective investment scheme;
- rights under a Stakeholder pension scheme;
- rights under personal pension scheme;
- options;
- futures;
- contracts for differences;
- Lloyd's syndicate capacity and syndicate membership;
- rights under funeral plan contracts;
- rights under regulated mortgage contracts;
- rights under a home reversion plan;
- rights under a home purchase plan; and
- rights to or interests in anything that is a specified investment listed above,excluding rights under regulated mortgage contracts, regulated home reversion plans and regulated home purchase plans.

For smaller firms, the FCA has developed several standard permission profiles containing regulated activities and investment types. If these do not match the business that the firm wants to undertake, it will need to construct its own profile. The activities and specified investment types regulated by the FCA are described in greater detail in chapter 2 of the Perimeter Guidance Manual (PERG).

It is worth noting that PERG states (in sub-section 1.1.2 of that guidance manual) that although PERG gives guidance about regulated activities and financial promotions, it does not aim to, nor can it, be exhaustive. This caveat underlines the complexity of financial regulation and why the adviser always needs to be vigilant when dealing with clients particularly when preparing suitability reports, a subject which is considered in detail in the "Retail Advice and Regulation" Specialism Unit. It also underlines the problems faced by training and compliance departments when the interpretation of the parameters used for their guidance for and supervision of advisers' work tends to have some fluidity.

Appendix 4.1 of the Training and Competence section of the High Level Standards part of the FCA Handbook lists Regulated Activities in a more digestible format juxtaposing this information against availablequalifications, including the Diploma in Regulated Retirement Advice.

Business test

Under s22 of the FSMA, for an activity to be a regulated activity, it must be carried on "by way of business". Whether or not an activity is carried on by way of business is ultimately a question of judgement that takes account of several factors (none of which is likely to be conclusive).These include the degree of continuity, the existence of a commercial element, the scale of the activity and the proportion that the activity bears to other activities carried on by the same person but which are not regulated. The nature of the particular regulated activity that is carried on will also be relevant to the factual analysis.

Exclusions

Activities that would otherwise be regulated activities can be turned into unregulated activities where an exclusion applies. If a firm can rely on an exclusion for an activity, it would not require FCA authorisation to carry it out. Such exclusions might include:

- Introducer exclusion; and
- Overseas Persons exclusion.

Summary

This Chapter has given some insight to the environment in which a UK financial services industry operates. We have looked at the legislation and regulation under which it operates, both domestically and internationally. It is important to keep up to date with the ever changing legislation, not least to ensure that the correct processes are being followed.

Self Test Questions

- What is the FSMA?
- What is a Regulated Activity?

PART 2

Trust Law, The Role of Trustees and Establishing a Trust-Based Pension Scheme

OVERVIEW

In this Part, we consider the area of trust law, in the context of pension provision.

The concept of a trust, under which one party (the trustees) holds assets for the benefit of another, was developed by the Courts during the Middle Ages (for the care of the property of knights away at the crusades). Since then, trusts have been used in a number of different contexts including charities, private wills and also as the vehicle for occupational pension schemes.

Trust law imposes a number of onerous duties on trustees, which stem from the fact that trustees are responsible for taking care of and investing the trust property on behalf of others. Pension scheme trustees are also subject to a number of statutory duties, such as those which apply in the context of scheme funding and investments. They are also required to have a sufficient level of knowledge and understanding of their scheme, the law relating to pensions and trusts and the principles relating to funding and investment. This is to ensure that they are able to run their scheme effectively.

When running their scheme, trustees need to ensure that they comply with the legislation and case law that regulates the operation of occupational pension schemes. This includes the legal requirements relating to family leave, pension sharing on divorce, data protection and equal treatment on grounds such as age, disability, sex, sexual orientation and religious beliefs. Trustees must also have regard to the various Codes of Practice and other guidance materials issued by the Pensions Regulator (TPR), which set the standards that trustees are expected to maintain.

Where trustees fail to comply with their legal duties or the legal requirements that apply to their scheme, they may be held personally liable for any loss which is suffered by the fund as a result. In the context of occupational pension schemes, which can have millions, or in some cases billions, of pounds' worth of assets, a trustee's potential liability is huge. Therefore trustees have a personal interest in ensuring that they are operating their scheme in accordance with the relevant legal requirements. It is common for a pension scheme's governing documentation to contain various protections for the trustees, including exoneration provisions, indemnities and the power to take out insurance.

The Part consists of three Chapters.

In Chapter 1 you will learn the basic principles of trust law. In Chapter 2 we consider the role and duties of trustees, and look at some of the other legal requirements with which pension scheme trustees must comply in the operation of their scheme. We also outline the potential consequences where trustees fail to comply with these requirements. Finally in Chapter 3 we look at some of the main legal and regulatory requirements that apply to the establishment of trust-based pension schemes.

When you have completed this Part, you will have gained an understanding of the nature of a trust and the key legal duties that apply to trustees. You will also be familiar with the legal and regulatory requirements within which trust-based pension schemes work.

CHAPTER 1

Trust Law

INTRODUCTION

Since the Middle Ages, when the concept of a trust was developed, trusts have been used in a variety of different contexts including wills, charities and as the vehicle for occupational pension schemes. A trust is created by a person known as the “settlor” (in the context of a pension trust this will be the employer which originally established the trust) and the trust is run by trustees who administer the trust and invest the trust property for the benefit of the beneficiaries identified in the trust deed.

In this Chapter we describe some of the basic principles of trust law, including the main features of a trust; how to create, vary and terminate a trust; and the potential liability of trustees for breach of trust.

1.1 THE MAIN FEATURES OF A TRUST

There are four main features of a trust.

- There is a separation between the legal owner of the trust property and the person or persons who have the benefit of it, i.e. the trustees are the legal owners of the trust property and the beneficiaries under the trust have the benefit of it.
- The trustees must use the trust property in accordance with the purpose for which the trust was created, according to the terms of the trust (the purpose of a pension scheme often being described as the provision of retirement benefits).
- Trust property is separate from both the trustees’ private property and the property of the person who created the trust (the “settlor”).
- A trust can be enforced only by the beneficiaries unless the settlor specifically reserves the right to enforce the trust when it is created.

These features make a trust well suited for occupational pension provision, because the trustees must hold and invest the scheme assets to provide the benefits of the members (who can enforce the trust), and those assets are separate from the assets of the sponsoring employer, which means that they are secure (and cannot be accessed by the employer’s creditors) even if the employer becomes insolvent.

Trusts also have many other modern commercial uses such as unit trusts and debentures, as well as more traditional uses, including charities and family settlements.

1.2 CLASSIFICATION OF TRUSTS

Trusts can be separated into two broad categories:

- Private trusts - trusts for the benefit of an individual or class of persons; and
- Public trusts - trusts established for some charitable purpose.

An occupational pension scheme is a private trust.

1.3 CREATION OF A PRIVATETRUST

Trusts are usually established by a written document. Once established, they cannot be revoked unless:
- there was fraud, duress or mistake present at the time of creation; or
- the terms of the trust provide for this.

The Pensions Act 2004 effectively requires all funded occupational pension schemes which are based in the UK to be established under irrevocable trusts.

1.4 THE THREE CERTAINTIES

In order for a trust to be valid, there must be present:
- certainty of intention - the settlor must show a clear intention to create a trust;
- certainty of subject matter - the trust property must be clearly identified or identifiable; and
- certainty of 'objects' - the beneficiaries of the trust and the benefits that they are to receive must be certain. If a class of persons are the beneficiaries (as in a pension scheme) the definition of the class of persons must be clear so that a Court is able to decide whether any given claimant falls within that class or not. However, it is not necessary to be able to identify all members of the class at any particular time (e.g. an unborn dependent).

1.5 THE RULE AGAINST PERPETUITIES

It is a rule of trust law that a private trust cannot last forever. In relation to trusts created on or after 6 April 2010 the law states that a trust must terminate within 125 years (regardless of any contrary provision in the trust instrument). The maximum period before that date was 80 years. Pension schemes which are registered with HM Revenue & Customs (HMRC) are generally exempt from this requirement, though the rule may apply to discretionary trusts arising on death, so pension scheme trust deeds usually specify a perpetuity period.

1.6 BREACH OF TRUST

A breach of trust is committed (broadly) when a trustee acts outside the terms of the trust instrument, exercises his powers for an improper purpose or fails to discharge his legal duties.

A trustee who has acted in breach of trust is personally liable for any loss that has been caused to the trust fund as a result of that breach and he may be sued by the beneficiaries to the full extent of his personal assets. Usually a beneficiary would claim an indemnity from the trustee requiring him to make good any loss to the trust fund. In addition, if the trustee has profited from the breach, a beneficiary can require payment of the profit into the trust fund.

A trustee may be held responsible for the acts of his co-trustees if he has not exercised due care in ensuring that they have properly discharged their duties. Where more than one trustee is liable for a breach of trust, liability is joint and several, which means that a beneficiary can claim the complete loss from any one trustee separately or from all, or several, of them jointly.

Many trusts contain provisions that seek to limit the trustees' liability for breach of trust. These provisions are described in Part 1, Chapter 2.16.

1.7 VARIATION OF A TRUST

It may be necessary or desirable to amend the provisions of a trust from time to time in order to meet changes in circumstances. There are a number of possible methods for doing this:

- exercising a power of amendment contained in the trust deed, subject to its precise terms;
- obtaining the consent of all the beneficiaries, provided they are not minors or suffering from incapacity;
- exercising a statutory power to amend the trust; or
- obtaining a Court order or other authorisation from the Court to modify the terms of the trust.

Making amendments to the trust deed and rules of a pension scheme is covered in Part 2, Chapter 3.5.

1.8 TERMINATION OF A TRUST

A trust may be terminated where the trustee has distributed its proceeds to the beneficiaries or where there are express terms under the trust deed which bring the trust to an end.

In addition, where all the actual or potential beneficiaries are in existence and have legal capacity to do so, they can require all trust property to be transferred to them, bringing the trust to an end. However, this will not be possible under a trust where the class of beneficiaries may change (as is the case with most pension schemes) or where it is contingent on a particular event occurring.

1.9 DISTINCTIONS BETWEEN A TRUST AND A CONTRACT

In order to appreciate some of the key features of a trust it is helpful to consider the main distinctions between a trust and a contract (a contract being another way in which English law can provide for someone to deal with property for the benefit of others).The main distinctions include:

- a contract is enforceable only if it is made by deed or if it is supported by consideration (i.e. something is given in return for it), whereas a beneficiary under a trust can enforce the trust even though he has given no consideration;
- as long as the Contracts (Rights of Third Parties) Act 1999 is excluded, only the parties to a contract can enforce it, whereas a trust can be enforced only by the beneficiaries (who will not be a party to the trust instrument) unless the settlor specifically reserves the right to enforce the trust when it is created;
- a trust cannot be terminated as a result of a major breach of trust, whereas a major breach of contract may lead to the termination of the contract; and
- most trusts, unlike contracts, exist for a long period of time. Consequently, a trust will usually be capable of variation. In addition, the Courts have the power to vary the provisions of a trust instrument and to advise the trustees on the proper scope of their powers.

Summary
A trust obliges the trustees to deal with the trust property for the benefit of the beneficiaries in accordance with the purpose for which the trust was created.

For a trust to be valid there must be present:
- certainty of intention;
- certainty of subject matter; and
- certainty of 'objects'.

Trusts must generally not last forever. Despite the exemption for most registered pension schemes, the rule may apply to discretionary trusts arising on death, so pension scheme trust deeds usually specify a perpetuity period.

Trustees are personally liable for any loss caused by their breach of trust. Where more than one trustee is liable, liability is joint and several.

There are a variety of ways in which a trust can be varied and/or terminated.

Self Test Questions
- Identify the key features of a trust which make it particularly suited to occupational pension provision.
- What three things must be certain in order for a trust to be validly created?
- What constitutes a breach of trust by a trustee?
- What is meant by the term 'joint and several liability'?
- Outline the main differences between a trust and a contract.

CHAPTER 2
The Role of Pension Scheme Trustees

INTRODUCTION

Trustees hold a very important position. They are responsible for looking after trust property for the benefit of the beneficiaries of the trust. As a result, the Courts have imposed a number of onerous duties on trustees in connection with the operation and management of a trust. In the context of a pensions trust these duties have been added to over the years by various statutory duties and requirements and by a raft of regulatory guidance.

This Chapter considers the different persons who may act as a pension scheme trustee and the manner in which they may be appointed and removed. It also describes the key trust law and statutory duties to which pension scheme trustees are subject, considers the potential liability of trustees who breach these duties and details a recent consultation on the definition of professional trustee.

2.1 TYPES OF TRUSTEE

A trustee may be an individual or a company. However, there are various different types of trustees who may be involved in running a pension scheme. The most common types are described below.

2.1.1 Individual Trustee

Any person aged 18 years or over may be appointed as a trustee of a pension scheme, except where that person:

- has been convicted of any offence involving dishonesty or deception (unless the conviction is legally no longer regarded as having effect);
- is an undischarged bankrupt;
- has made an arrangement with his creditors and the arrangement is still in force;
- has been disqualified from acting as a company director;
- is subject to a prohibition order from TPR barring him from being a pension scheme trustee (see Part 1, Chapter 2.4).

2.1.2 Corporate Trustee

A corporate trustee is a company which is formed to act as a trustee, with all the necessary powers in its constitutional and governing documents. An employer sometimes establishes a company with a small paid-up share capital to act as a corporate trustee of its pension scheme. One of the main reasons for doing this is because it provides the directors of the corporate trustee (who would otherwise be individual trustees) with additional protection from potential personal liability. A corporate trustee should not be confused with a trust corporation, which needs to meet certain minimum statutory requirements (see Part 2, Chapter 2.1.3).

A director's primary fiduciary duty (and any liability in respect of a breach of such duty) is owed to the corporate trustee itself rather than directly to scheme members. However, the directors of a corporate trustee ought to act in a trustee-like manner in their management of the pension scheme as if they were individual trustees of the scheme. The Trustee Knowledge and Understanding requirements contained in the Pensions Act 2004 (see 2.8 below) also apply to directors of corporate trustees.

A company is disqualified or prohibited from acting as a trustee of a pension scheme if one of its directors would be disqualified or prohibited from acting as an individual trustee for any of the reason listed above.

2.1.3 Trust Corporation

A trust corporation is a corporate trustee which is:

- formed under UK or EU law and has a place of business in the UK;
- empowered by its constitution to act as a trustee; and
- either incorporated by a special Act of Parliament or Royal Charter or is a registered company with an issued share capital of at least £250,000 of which at least £100,000 is paid up.

In addition, a company registered (in the UK or another EEA state) without limited liability which has a shareholder that is a company falling within the general definition above could also count as a trust corporation.

The main advantage of a trust corporation over a trustee company is that a trust corporation can give a valid receipt for the proceeds of a sale of land. Otherwise, at least two trustees are required to give a valid receipt. However, an employer is unlikely to establish a trust corporation to act as a trustee of its scheme because of the requirement for a paid-up share capital of at least £100,000. Banks and insurance companies often have subsidiaries which are trust corporations, to carry out trustee business services on their behalf.

2.1.4 Custodian Trustee and Committee of Management

Sometimes the trust deed for a pension scheme may specifically provide for the separation of the trustees' dual functions of holding the scheme's assets and dealing with the day-to-day administration of the scheme. In that case, a 'custodian trustee' may be appointed to hold the scheme assets and for a committee of management to be appointed, which is responsible for the administration of the scheme. However, this type of arrangement is now rare.

The Public Trustee Act 1906 lays down what type of company can act as custodian trustee. The criteria are broadly the same as for trust corporations (see 2.1.3 above).

2.1.5 Pensioneer Trustee

Prior to 6 April 2006 it was a HM Revenue & Customs (HMRC) requirement that one of the trustees of an approved Small Self-Administered Scheme (SSAS) must be a 'pensioneer trustee'.

The main function of a pensioneer trustee was to prevent as far as possible an improper winding up of the scheme in order to distribute the assets to the members. Following the introduction of the Finance Act 2004, there is no longer any need for a SSAS to have a pensioneer trustee. However, mainly for reasons of convenience, many SSAS providers have remained as one of the trustees of these schemes, although they no longer have any special functions.

2.1.6 Independent Trustee

Where, in relation to an occupational pension scheme:

- an insolvency practitioner is appointed in respect of an employer participating in the scheme; or
- the official receiver becomes:
  - the liquidator or provisional liquidator of a company which is a participating employer;
  - the interim receiver of the property of a person who is a participating employer in relation to the scheme; or
  - the receiver and the manager, or the trustee, of the estate of a bankrupt who is a participating employer in relation to a scheme,

TPR has the power, under section 23 of the Pensions Act 1995, to appoint an 'independent person' as a trustee of the relevant scheme. For the purposes of section 23, a person is independent if he:
- has no interests in the assets of the employer(s) or the scheme otherwise than as a trustee;
- is neither connected with nor an associate of:
  - any of the employer(s) of the scheme;
  - any person for the time being acting as an insolvency practitioner in relation to an employer; or
  - the official receiver acting in any of the capacities mentioned above in respect of an employer.

TPR can only appoint a person as an independent trustee of a scheme under section 23 if that person is registered on TPR's register of independent trustees.

In addition to its power under section 23,TPR also has the power to appoint a new trustee to a scheme under section 7 of the Pensions Act 1995 in various circumstances (see Part 1, Chapter 2.2.3). Where TPR has exercised this power it has almost always chosen to appoint a professional, independent trustee.

Quite apart from TPR's statutory power to appoint an independent trustee, many schemes choose to appoint at least one trustee who has no connection with the employer or with the scheme. This may be an individual or a corporate trustee. There are a number of reasons why a scheme may choose to appoint an independent trustee, including:
- wanting to ensure that an independent voice is heard in all trustee decisions (although trustees are of course
required to act independently of the employer, and of any particular constituency of members, in any event);
- wanting to add additional expertise to the trustee board; and/or
- as a means of managing conflicts of interest on the trustee board.

2.1.7 Member-nominated Trustees/Directors
The Pensions Act 2004 requires occupational pension schemes (with limited exceptions) to have arrangements in place for at least one third of the total number of trustees (or directors of a corporate trustee) to be member nominated trustees (MNTs) or member nominated directors (MNDs). Trustees must ensure that their scheme complies with this requirement.

An MNT/MND is someone who is:
- nominated in a process in which at least all the active and pensioner members, or organisations which adequately represent them, can participate; and
- selected as a result of a process which involves some or all of the scheme members.

TPR has issued a Code of Practice, which provides guidance for trustees on what they must do in order to comply with the MNT/MND requirements. The Code also outlines the timescales within which action should be taken.

The Code does not specify precisely how trustees should comply with the legislative requirements; instead it defines three principles which trustees should follow when they are deciding what arrangements they should put in place for their scheme. These principles are:
- proportionality;
- fairness;
- transparency.

The principle of proportionality means that trustees should select an approach the costs and nature of which are appropriate to the circumstances of their scheme. Trustees should also ensure that the arrangements which they use are fair (although this does not mean that all classes of member have to be treated the same) and that the process is transparent, for example, the outcomes of the nomination and selection process, and the method of selection, should be communicated to all the members involved in the process.

Under the Pensions Act 2004, the Government has given itself the power to increase the requirement for the number of MNTs/MNDs to one half instead of one third. However, at the time of writing there is no indication that this power will be exercised.

2.1.8 Professional Trustees

There is consensus from the pensions industry that a professional trustee can often help improve the decision- making and the governance of a trustee board. Currently any individual, unless legally disqualified, can act as a professional trustee. There is no formal regulation and no requirement for any recognised qualifications.

In response to TPR's "21st century trusteeship and governance" discussion paper, the pensions industry expressed concern about how "professional trustees" were defined in TPR's guidance solely on the basis of remuneration, given the growing practice of remunerating lay trustees who do not provide commercial trustee services or hold multiple scheme appointments.

On 23 March 2017, TPR issued a consultation on a new description of "professional trustee". The two are connected as penalties for professional trustees will generally be higher.

The new proposed definition for a professional trustee is any person, whether or not incorporated, who:
- acts as a trustee of the scheme in the course of the business of being a trustee; or
- is an expert, or holds themselves out as an expert, in trustee matters generally

The proposed definition requires a person to hold himself out as an expert in "trustee matters generally"; this would rule out a professional who is brought onto the board for specific expertise, such as investment. Further, there is no discussion about what TPR means by "in the course of business" and what test they intend to adopt. What is clear is the idea to move away from looking simply at remuneration. The consultation closed on 9 May 2017. In 2017,TPR established the Professional Trustee Standards Working Group (PTSWG), which was tasked with setting formal standards for professional trustees. PTSWG includes representatives from TPR, the Pensions Management Institute (PMI),Association of Professional Pension Trustees (APPT), the Association of Corporate Trustees (TACT) and the Pensions and Lifetime Savings Association (PLSA). Formal accreditation of professional trustees began in 2020 with the establishment of PMI's APTitude service. APPT also provide accreditation for professional trustees.

2.2 APPOINTMENT OF TRUSTEES

2.2.1 Appointment of a Scheme's First Trustees

When a pension scheme is established the principal employer will appoint the first trustees of the scheme in the trust deed. The trustees will normally execute the trust deed to show that they agree to their appointment.

2.2.2 Appointment of Subsequent Trustees

The trust deed and rules of a pension scheme should set out how additional or replacement trustees are to be appointed in future. It is common for the principal employer to retain the power to appoint additional or replacement trustees. Whenever a new trustee is appointed it is important that all of the requirements that are contained in the power of appointment (e.g. that the appointment should be by deed) are followed precisely; otherwise the appointment may be invalid.

2.2.3 Appointment byTPR

TPR has the power under section 7 of the Pensions Act 1995 to appoint pension scheme trustees in certain circumstances. The main purpose of these powers is to give TPR the ability to protect the interests of scheme members and to help safeguard scheme assets and the Pension Protection Fund. (Broadly speaking, the Pension Protection Fund, or PPF, was established in 2005 to pay compensation to members of defined benefit pension schemes where the employer became insolvent and there were insufficient assets to meet the liabilities.)

Under section 7,TPR can appoint a trustee to replace a trustee who it has prohibited or disqualified from being a trustee (see Part 1, Chapters 2.4 and 2.5). TPR also has a general power under section 7 to appoint one or more trustees where it believes that it is reasonable to do so in order to:

- ensure that the trustees as a whole have, or use, the expertise needed to administer the pension scheme properly;
- ensure that the number of trustees is sufficient for the proper administration of the scheme;
- ensure that the scheme's assets are used and applied appropriately; or
- protect the interests of the generality of the members of the scheme.

An application may be made by the trustees of a scheme, by a participating employer or by a member of the scheme for the appointment of a trustee by TPR for either the first or third of the grounds listed above.

2.2.4 Trustee Act 1925

In cases where the trust deed does not deal with the appointment of new trustees or if the person who had the power to appoint new trustees is unable to exercise it, section 36 of the Trustee Act 1925 gives the existing trustees power to appoint a new trustee to replace any trustee who:

- has died;
- remains outside the UK for more than 12 months;
- wishes to resign;
- refuses to act;
- is unfit or incapable of acting.

If at any time an individual who is acting as a sole trustee dies, his personal representatives will have the power to appoint a replacement trustee.

2.2.5 Appointment by the Court

If necessary, the Court may appoint a trustee in the absence of anyone else having the power to do so (section 41 of the Trustee Act 1925).

2.2.6 Limitations on the Number of Trustees

For a trust of land the maximum number of trustees is four. There is no minimum number of trustees in law (although a pension scheme's trust deed and rules may provide for a minimum number), but a sole trustee (unless it is a trust corporation) cannot give a valid receipt for the sale of land.

2.2.7 Corporate Trustees

Where a scheme has a corporate trustee, the individuals who are appointed to act as directors of the corporate trustee will need to be appointed as directors of the corporate trustee in accordance with the company's articles of association. The appointment of the directors will need to be registered at Companies House.

2.3 RETIREMENT OF TRUSTEES

The ability for a trustee of a pension scheme to retire will normally be dealt with in the trust deed. However, if that is not the case there is a statutory power contained in section 39(1) of the Trustee Act 1925.

For the directors of a corporate trustee, the ability to retire should be set out in the company's articles of association.

2.4 REMOVAL OFTRUSTEES

The trust deed should set out when and how a trustee can be removed. Typically, the principal employer will retain the power to remove trustees. However, it will be able to remove an MNT only with the consent of all of the other trustees. As with trustee appointments, it is important that all of the requirements contained in the power of removal are followed precisely in order to ensure that an existing trustee is validly removed.

In addition, TPR has the power (under section 3 of the Pensions Act 1995) to prohibit a person from acting as a trustee, if it is satisfied that he is not a fit and proper person to act as a trustee of:

- a particular trust scheme;
- a particular description of trust schemes;
- trust schemes in general.

Where a prohibition order is made this has the effect of removing the trustee. TPR is required, under section 66 of the Pensions Act 2004, to keep a register of persons who are prohibited from being a trustee. Under section 67 the register must be made available for inspection and TPR may publish a summary of the register, which it does on its website.

A corporate trustee will be automatically prohibited if any of its directors is prohibited by TPR from acting as an individual trustee.

A trustee can also be removed on the grounds set out in section 36(1) of the Trustee Act 1925 (see Part 1, Chapter 2.2.4).The Courts also have jurisdiction to remove a trustee when the proper execution of the trust is being threatened (e.g. if a trustee is in a position where his interests conflict with those of the trust or on the grounds of misconduct or mismanagement of the trust).

Where a director of a corporate trustee is being removed, this must be done in accordance with the company's articles of association and the removal must be registered at Companies House.

2.5 DISQUALIFICATION OF TRUSTEES

A person is automatically disqualified from being a trustee of a pension scheme by virtue of section 29 of the Pensions Act 1995, where he:

- has been convicted of any offence involving dishonesty or deception (unless the conviction is legally no longer regarded as having effect);
- is an undischarged bankrupt;
- has made an arrangement with their creditors and the arrangement is still in force; or
- is disqualified from acting as a company director.

A corporate trustee will be automatically disqualified if any of its directors would be disqualified from acting as an individual trustee for any of these reasons.

2.6 SUSPENSION OF TRUSTEES

Under section 4 of the Pensions Act 1995 TPR has the power to suspend a trustee of a pension scheme:

- pending consideration being given to the making of a prohibition order;
- where the trustee is a company, if a petition for the winding up of the company has been presented to the Court;
- where a bankruptcy petition has been presented to the Court;
- where proceedings have been instituted (or pending consideration being given to the institution of proceedings) for an offence involving dishonesty or deception; or
- where an application has been made to the Court for a disqualification order against him acting as a company director.

TPR also has the power to suspend a corporate trustee if it would have power to suspend any director on any of the final three grounds listed above, if he were a trustee.

2.7 TRUSTEE DUTIES

The duties of pension scheme trustees stem from:

- general trust law principles which have been developed by the Courts (and which apply to trustees ofall trusts);
- legislation; and
- the terms of the trust deed itself.

The duties of a trustee as required by trust law and by statute are summarised briefly below.

2.7.1 Trust Law Duties

Overarching duty

The overarching duty of a pension scheme trustee is often described as “a duty to act in the best interests of the members of their scheme”. However, this was recently refined by the High Court in the Merchant Navy Ratings case to be a duty to administer the pension scheme in accordance with the primary purpose for which the scheme was established (i.e. to secure the benefits)[1]. It is necessary to first decide what the purpose of the trust is and the benefits the beneficiaries are intended to receive before being in a position to decide whether a proposed course is for the benefit of beneficiaries or in their best interests.

1 Merchant Navy Ratings Pension Fund Trustees Ltd v Stena Line Ltd and others [2015] EWHC 448 (Ch).

The beneficiaries of a trust should be identifiable from the trust deed. In the context of a pension scheme established under trust, the beneficiaries will normally include:

- the active, deferred and pensioner members of the pension scheme;
- the spouses, civil partners and dependents of those members; and
- (certainly in relation to a defined benefit scheme) the scheme's sponsoring employer.

The sponsoring employer of a defined benefit pension scheme could also be regarded as a beneficiary of the scheme, on the basis that the sponsoring employer will be responsible for making up any shortfall in the scheme's funding position and because (under most schemes) the sponsoring employer would be among the list of potential recipients of any surplus on the winding-up of the scheme.

The purpose of a defined benefit occupational pension scheme has been identified as being "to provide the stated and accrued benefits to (and in respect of) the members at a cost acceptable to the employer"[2]. This reiterates the need for trustees to take account of the employer's interests and, in particular, the cost to the employer of operating the scheme as well as seeking to ensure that members' accrued benefits are paid in full.

In addition to their overarching duty, pension scheme trustees also have a number of more specific trust law duties. These are described below.

Duty to act in accordance with the trust deed
A trustee must act in accordance with the provisions of the trust deed, except insofar as those provisions are modified by the consent of all beneficiaries, overriding legislation or by the Court.

A trustee who (without the authority of the Court or the beneficiaries) departs from the letter of the trust instrument is likely to be acting in breach of trust and does so at the peril of afterwards having to satisfy the Court that the departure was necessary and beneficial.

Duty to act impartially
A trustee must be impartial in the execution of the trust and must consider the interests of all of the beneficiaries (and of the different classes of beneficiary) when making decisions in respect of the trust. However, this does not mean that trustees need to treat all beneficiaries in the same way.

The duty to act impartially was considered in the case of Edge v Pensions Ombudsman (1999).This case concerned a decision by the trustees of a pension scheme regarding the use of an actuarial surplus (of approximately £30 million) in the scheme. The trustees decided to use the surplus to reduce the employer's and active members' contributions and to grant additional benefits to members who were in employment on 1 April 1994.

As a result of the trustees' decision, members who left employment before that date complained to the Pensions Ombudsman, because deferred members and pensioners, whose contributions had, at least in part, helped to create the surplus, did not receive the additional benefits. The Pensions Ombudsman upheld the complaint. However, the trustees appealed. The High Court, and subsequently the Court of Appeal, rejected the Ombudsman's decision. In his judgment in the Court of Appeal, Chadwick LJ stated that the duty to act impartially:

2 From "Trustees' duties to employers: The scope of the duty of Pension Trustees" by David Pollard, page 37 Pensions Lawyer105.

"is no more than the ordinary duty which the law imposes on a person who is entrusted with the exercise of a discretionary power: that he exercises the power for the purpose for which it is given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant. If pension fund trustees do that, they cannot be criticised if they reach a decision which appears to prefer the claims of one interest – whether that of employers, current employees or pensioners – over others. The preference will be the result of a proper exercise of the discretionary power". [Edge v The Pensions Ombudsman (1999) 4 All ER 546, [paragraph 50]

Duty to exercise reasonable skill and care
Lay trustees should use such skill and care in the management of the trust as men of ordinary prudence and vigilance would use in the management of the affairs of a third party for whom they felt morally bound to provide. This duty includes a requirement to obtain expert advice where appropriate. However, the mere fact that a trustee has acted on expert advice will not necessarily excuse him from a breach of trust.

A higher standard of skill and care is expected from professional trustees.

Duty to act without charge
A trustee, other than the public trustee or a custodian trustee, has no right to charge for his services unless the trust deed expressly allows this (which is becoming more common in the case of pension trusts). However, an independent trustee appointed under the Pensions Act 1995 is entitled to be paid for his reasonable fees and expenses out of the trust fund, regardless of whether this is permitted in the trust deed. There are also other minor exceptions to this rule.

Duty not to delegate
As a general rule a trustee must not delegate his duties or powers or the receipt of trust monies to a co-trustee or to a third party unless authorised by the trust deed or by statute. It is common for a pension scheme's governing documentation to specifically allow the trustees to delegate certain functions to a sub-committee of trustees or to certain specified third parties (e.g. fund managers). We consider delegation in more detail below in 2.10.6 and 2.12.

Duty to act jointly
In the case of a non-charitable trust (such as a pension scheme) if there is more than one trustee all must act together in the management of the trust except:
- where the trust deed or a Court otherwise directs (modern pension scheme documents usually authorise trustees to act by majority in relation to most trustee decisions, although some decisions may require unanimity);
- to receive income; or
- where there has been a valid delegation.

Duty not to profit from trust property
Trustees must not use or deal with trust property for their own private advantage or they will be personally liable to account for their profits. This rule is applied very strictly.

However, in a pensions context, section 39 of the Pensions Act 1995 disapplies this rule in respect of a trustee who is also a member of the scheme, so that the individual can benefit as a member from decisions taken by the trustees. Trustees are also permitted to charge for their services, provided (in most cases) that the rules of their scheme allow them to do so.

Duty to prepare and disclose accounts
A trustee must:
- keep clear and accurate accounts of the trust property;
- at all reasonable times, at the request of a beneficiary, disclose full and accurate information as to the amount and state of the trust property, and permit the beneficiary or his solicitor to inspect the accounts and other documents relating to the trust property.

Regulations made under the Pensions Act 1995 require pension scheme trustees to prepare audited accounts within seven months after the end of each scheme year. The audited accounts must be made available to scheme members, prospective members, beneficiaries and recognised trade unions.

2.7.2 Statutory Duties
In addition to the duties imposed on trustees by trust law, there are a number of statutory duties with which trustees must also comply. These are summarised below.

Duty of care
The Trustee Act 2000 imposes a statutory duty of care on trustees in certain circumstances. Where this statutory duty applies, a trustee must "exercise such care and skill as is reasonable in the circumstances", having regard to:
- any special knowledge or experience that the trustee has or holds himself out as having; and
- where the person acts as a trustee in the course of a business or profession, any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

Payment of tax
Under the Finance Act 2004, the 'Scheme Administrator' is responsible for accounting to HMRC for certain tax charges that are imposed under the Act (e.g. the lifetime allowance charge). In most instances, the trustees of a pension scheme will be the 'Scheme Administrator' for the purposes of the Finance Act 2004.

Disclosure
As well as the general duty of disclosure, pension scheme trustees have a duty to disclose certain documents and information to scheme members, prospective members, beneficiaries and recognised trade unions under section 41 of the Pensions Act 1995, section 113 of the Pension Schemes Act 1993 and the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013.This is considered in Part 2 Chapter 2.8.

Notifiable events
Trustees of pension schemes potentially eligible for the PPF have a duty to make a report to TPR when particular events occur in relation to their scheme (these are generally referred to as "notifiable events"). We consider this duty in more detail in 2.15 below.

Trustees who fail to notify TPR on the occurrence of a relevant scheme-related event may face civil penalties or other measures imposed by TPR.

Other statutory duties

Trustees of a pension scheme are also under a statutory duty to:

- maintain a statement of investment principles (where the scheme has 100 or more members);
- (for defined benefit schemes) prepare actuarial valuations in respect of their scheme at least once every three years (and actuarial reports for the intervening years);
- ensure that a payment schedule is prepared in the case of a defined contribution scheme or a schedule of contributions is prepared in the case of a defined benefit scheme and ensure that payments are made in accordance with that schedule;
- put in place a recovery plan where a defined benefit scheme has a deficit on a statutory funding objective basis (see Part 3);
- ensure that at least one third of the trustees are member-nominated trustees (or member-nominated directors where there is a corporate trustee);
- put in place and operate an internal dispute resolution procedure;
- operate a bank account separate from that of the employer;
- pay cash equivalent transfer values to members entitled to them; and
- report material breaches of law to TPR.

2.8 DISCLOSURE

The disclosure requirements were introduced to ensure that members are aware of their benefits, of the rights relating to those benefits and of changes that might affect their benefits directly or the scheme as a whole.

The disclosure requirements were originally introduced as part of social security legislation with effect from 1 November 1986.These requirements were considerably strengthened by the 1995 Pensions Act, the 1996 Disclosure Regulations and disclosure provisions in various other Statutory Instruments, the last one being the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (the“2013 disclosure regulations”).

The disclosure regulations specify the minimum amount of information to be provided. In practice many schemes provide more than this, for example many defined benefit schemes automatically send annual benefit statements and a short form of the scheme annual report to all active members.

The disclosure regulations detail what information is to be provided, to whom, in what circumstances and within what timescales. Some of the areas covered are:

- basic scheme information;
- the scheme’s annual report;
- member benefit statements;
- the annual Summary Funding Statement; and
- the Statement of Investment Principles (SIP), the Actuarial Valuation and the Schedule of Contributions (or Payment Schedule).

Some aspects of the regulations are, however, more explicit:

- the member must be provided with a summary of how contributions have been calculated;
- for the options provided to member at leaving, these can say that further details can be provided on request but they must state at this point if there is a charge for providing any further information;
- confirmation of tax approval has been changed to stating a scheme is tax registered; and
- electronic addresses must be provided for MaPS and the Ombudsman.

From 6 April 2015 additional disclosure requirements have been added, including the requirement for signpost members to the Pensions Wise guidance service when they make an enquiry about, or are considering accessing, ‘flexible benefits’.

2.8.1 Basic Scheme Information – the Scheme Booklet
Basic scheme information must be provided automatically to members within two months of joining the scheme (or within one month of the trustees receiving joining information where the member is being automatically enrolled) and on request to members, prospective members, their spouses/civil partners, beneficiaries and recognised trade unions.

Schemes generally produce a scheme booklet that contains all the basic scheme information. The items to be included in basic scheme information are set out in the regulations and include:
- eligibility conditions, including conditions for opting out and rejoining;
- contributions details, including how they are calculated and any arrangements for payment of Additional Voluntary Contributions (AVCs) by members;
- benefit details including the scheme's normal pension age, what scheme benefits are payable and how they are calculated;
- type of scheme, for example whether the scheme is contracted-out and the scheme`s registration details;
- lifestyling details including the strategy adopted by the scheme;
- details of the scheme's Internal Dispute Resolution Procedure;
- information about TPR, The Pensions Advisory Service and the Pensions Ombudsman;
- a statement that the scheme annual report if available on request (except for public sector schemes); and
- the address of the scheme and the contact point for enquiries.

2.8.2 Individual Benefit Statements
Although these are not compulsory for defined benefit schemes, they are very much appreciated by members and must be provided once every 12 months if requested. They are an excellent method of checking that basic data held on the records is correct. They are likely to contain details of the members' rights in certain circumstances for example:
- leaving service;
- benefits payable on normal retirement if service continues until then;
- death benefits; and
- terms and conditions attaching to any benefits quoted.

Defined contribution schemes must send annual benefit statements to all active and deferred members. The statements must contain:
- a statement of contributions paid;
- details of the accrued fund;
- the transfer value, if less than accrued fund;
- the options available at normal retirement age; and
- wording that states that a member's benefit will depend on several factors including the amount of contributions paid, investment performance and the cost of converting pension into an annuity.

Defined contribution schemes must also issue an annual 'pension forecast' to members known as a 'Statutory Money Purchase Illustration' (SMPI).This focuses on projected pensions at retirement, but expressed in today's terms.

The 2013 disclosure regulations allow some flexibility for schemes so that the SMPI can be tailored and relevant to individual circumstances.

2.8.3 Combined Pension Statements

Combined Pension Statements (CPSs) provide scheme members with details of their State and workplace pensions. If an employer or trustees choose to provide this information, the State Pension figures are issued by the DWP. It is not compulsory to provide CPSs.

CPSs allow employees to see forecasts of both their state and current private pension provision together. The DWP gives the scheme details of the State Pension members have built up at the time of the statement and a projection of their State Pension at State Pension age. This is then included in the pension statement sent out by the scheme.

There are times, for example when State Pensions are changing, when CPSs cannot be issued.

2.8.4 Trustees' Annual Report and Accounts

Trustees are required to prepare and publish an annual report. This report has to contain certain minimum information, including the scheme's audited accounts. The report must be published within seven months of the scheme's year-end. Copies of the report must be made available to members on request, but many schemes go further and issue automatically to every member a 'popular'version,which contains a summary of the information in the full report.

Information which must be in the report includes:
- the names of trustees during the year;
- details of how the trustees are appointed and removed;
- the persons/organisations appointed by the trustees to advise them, including any changes since the previous report;
- the number of members in each category (active, deferred and pensioner);
- any changes to the scheme during the year;
- details of increases in pensions and deferred benefits;
- a statement about the calculation basis used for transfer values paid;
- a copy of the audited accounts including the auditors' report;
- a copy of the latest actuarial statement (often sent with an actuarial valuation report);
- an investment report;
- the Chair's statement, if applicable; and
- an address (postal and electronic) for enquiries.

2.8.5 Statement of Investment Principles (SIP), Actuarial Valuation and Schedule of Contributions (or Payment Schedule)

Schemes must supply copies of these documents on request to members and prospective members, spouses/civil partners of members and prospective members, beneficiaries and recognised trade unions within two months of request.

The SIP must include the trustees' policy in relation to rights (including voting rights on) on investments and the extent to which social, environmental and ethical considerations are applied in choosing investments.

2.9 TRUSTEE KNOWLEDGE AND UNDERSTANDING

Since 6 April 2006,trustees of all occupational pension schemes (with a few limited exceptions) have been required to comply with the Trustee Knowledge and Understanding (TKU) requirement contained in the Pensions Act 2004.The TKU requirement means that trustees must have appropriate knowledge and understanding of:

- the law relating to pensions and trusts; and
- the principles relating to scheme funding and the investment of scheme assets.

Trustees must also be conversant with their scheme's governing documentation, including:

- the trust deed and rules;
- any statement of investment principles;
- any statement of funding principles; and
- any other documents relating to the administration of the scheme (e.g. agreements relating to scheme funding, minutes of trustee meetings, the internal dispute resolution procedure, the scheme's conflicts of interest policy, and announcements and member communications).

Conversance means that the trustees must have a "working knowledge" of those documents, such that they are able to use them effectively when required to do so in the course of carrying out their duties.

TPR has issued a Code of Practice which gives guidance on the level of knowledge that is required and the steps that trustees need to take to ensure that they comply with the TKU requirement. Trustees are not expected to be experts. However, they should be able to "understand fully any advice they are given, challenge that advice if it seems sensible to do so and enter fully into all the decision making processes". New trustees (except the chair of the trustee board and any independent trustee) have a six month 'grace period' before they are expected to comply with the TKU requirement.

In order to ensure that they comply with the TKU requirement trustees need to undertake regular training and keep a record of the training that they receive. TPR has produced an online "Trustee Toolkit" training programme which is available through TPR's website. Trustees also need to familiarise themselves with their scheme's governing documentation.

The TKU requirement also applies to directors of a corporate trustee.

2.10 GENERAL POWERS OFTRUSTEES

In order that the duties of trustees may be properly discharged, the trust deed must provide trustees with power to act. The general position under trust law is that in exercising these powers, the trustees must act unanimously unless there is provision to the contrary in the trust deed. However, section 32 of the Pensions Act 1995 reverses the position in the case of occupational pension schemes and enables trustees to act by majority, unless the scheme provides otherwise.

Some of the most important powers that you would expect to find in a pension scheme trust deed include the power to:
- amend the trust deed and rules of the scheme;
- appoint and remove trustees;
- invest the scheme assets;
- set employer and member contribution rates;
- augment members' benefits;
- insure benefits;
- buy annuities in order to secure members' benefits;
- deduct tax from payments where necessary;
- make and accept transfer payments;
- admit new employers to participate in the scheme; and
- wind up the scheme.

Some powers will be vested in the scheme's principal employer to enable it to exercise some degree of control over the operation of the scheme (e.g. the principal employer may retain the power to amend the scheme). Alternatively, a power may be vested in the trustees alone or it may be a joint power (i.e. where the consent of the trustees and the principal employer are required to exercise the power).

When establishing a pension scheme an employer should consider carefully who should exercise the various powers under the scheme. The allocation of powers between the principal employer and the trustees of a pension scheme is often referred to as a scheme's "balance of powers" and this allocation will have a significant impact on the way in which a scheme operates after it has been established. Although such balance of power can generally be shifted in favour of trustees, it may be difficult for an employer to reverse the balance of power in its own favour at a later date, because the trustees will be reluctant to relinquish their powers, given that they are required to exercise them in the best interests of the beneficiaries.

A scheme'sbalance of powersis not determined solely by the scheme'sgoverning documentation; it is also influenced by certain overriding statutory provisions. For example, for most schemes the Pensions Act 2004 now requires trustees and employers to agree upon the rate of employer contributions even where the trust deed provides otherwise.

Powers additional to those contained in a scheme's trust deed may be given to trustees by statute (e.g. power to insure trust property under the Trustee Act 2000).

2.11 INVESTMENT POWERS

2.11.1 Investment Powers

The trustees of a pension scheme are responsible for investing the scheme's assets. For most schemes, the trust deed usually contains wide investment powers which permit the trustees to invest the scheme assets as if they were the absolute beneficial owner of them. As well as granting trustees a general power to invest, it is common for a scheme's trust deed to contain a detailed list of specific types of investment which the trustees are authorised to make.

In the absence of an express power of investment in the trust deed, section 34 of the Pensions Act 1995 gives pension scheme trustees a general power of investment, subject to any restrictions that are contained in the trustdeed.

2.11.2 Investment Duty
In relation to investment, the Court held in Re Whiteley (1886) that:

'The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.'

Trustees have a legal duty not only to invest but actively to seek, within the powers they have been given, the best possible financial return compatible with:
- the degree of risk which the prudent man would regard appropriate to the trust; and
- the best financial interests of all of the beneficiaries having regard to the main purpose of the trust, even if this is contrary to the personal moral, political or social views of the trustees or beneficiaries (Cowan v Scargill (1984)).

2.11.3 Pensions Act 1995 and the Investment Regulations 2005
When exercising their investment powers pension scheme trustees must comply with the requirements contained in sections 33 to 36 of the Pensions Act 1995 and the Occupational Pension Schemes (Investment) Regulations 2005. These Regulations require the trustees of a trust scheme (and any fund manager to whom any discretion has been delegated) to exercise their discretion in accordance with the following principles:
- the scheme's assets must be invested in the best interests of the members and beneficiaries of the scheme and in the case of a potential conflict of interest in the sole interests of the members and beneficiaries;
- the power of investment must be exercised in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole;
- the scheme's assets must be invested in a manner appropriate to the nature and duration of the expected future retirement benefits payable under the scheme;
- the assets of the scheme must consist predominantly of investments admitted to trading on regulated markets, and investments which are admitted to trading on non-regulated markets must be kept to a prudent level;
- the assets of the scheme must be properly diversified to avoid over reliance on any particular asset, issuer or group of undertakings and so as to avoid accumulations of risk in the portfolio as a whole; and
- investments in derivative instruments may be made only in so far as they:
  - contribute to a reduction of risk; or
  - facilitate efficient portfolio management (including the reduction of cost or the generation of additional capital or income with an acceptable level of risk);

and any such investment must be made and managed so as to avoid excessive risk exposure to a single counterparty and to other derivative operations.

Trustees of schemes with fewer than 100 members are not required to follow these principles. However, they must still have regard to the need for diversification of investments as far as is appropriate to the circumstances of the scheme.

Section 33 of the Pensions Act 1995 prevents trustees (or any person to whom the trustee's investment functions are delegated) from excluding or restricting their liability for breach of an obligation under any rule of law to take care and exercise skill in the performance of any investment functions. However, see 2.10.6 below for trustee protections contained in the Pensions Act 1995 where trustees delegate their investment functions.

2.11.4 Statement of Investment Principles (SIP)

In accordance with section 35 of the Pensions Act 1995, trustees of an occupational pension scheme with 100 or more members are required to prepare and maintain a Statement of Investment Principles (SIP) in respect of their scheme. The SIP must be in writing and must cover the trustees' policies in respect of:

- securing compliance with the requirements of section 36 of the Pensions Act 1995 (which sets out various steps which trustees must take before choosing investments) and the principles contained in the Occupational Pension Schemes (Investment) Regulations 2005 (see Part 1, Chapter 2.10.3);
- the kinds of investments to be held by the scheme (i.e. equities, gilts, cash, property, etc.);
- the proportions in which the scheme's assets are to be invested in different types of investments;
- risk (including the ways in which risks are to be measured and managed);
- expected returns on investments;
- the realisation of investments (i.e. how easily they can be turned into cash);
- the extent (if at all) to which social, environmental or ethical considerations are to be taken into account in the selection, retention and realisation of investments;
- the exercise of the rights (including voting rights) attaching to the investments.

The SIP must be reviewed by the trustees at least every three years or without delay after any significant change in investment policy. Before preparing or revising the SIP, trustees must obtain appropriate advice and consult the scheme's employer.

2.11.5 Investment Advice

Before investing in any manner, trustees must obtain and consider proper advice on the suitability of the investment. Trustees must also seek appropriate advice before preparing or revising their scheme's SIP.

In accordance with the TKU requirement and the 'prudent man' principle, trustees are required to have sufficient knowledge of investment matters so that they are able to challenge the investment advice that they receive and satisfy themselves that any particular action is appropriate for their scheme.

2.11.6 Delegation of Investment Functions

Section 34 of the Pensions Act 1995 permits the delegation of investment decisions by the trustees where the delegation is:

a) to a fund manager who is authorised under the Financial Services and Markets Act 2000 ("FSMA");
b) to a fund manager who is not authorised under FSMA so long as any decisions made by that fund manager would not be "regulated activities" under FSMA. Regulated activities include dealing in, managing and advising on investments so this category is fairly restricted. A delegation to an unauthorised fund manager might be made, for example, in relation to direct investments in real estate;
c) to a sub-committee of two or more trustees; or
d) in accordance with section 25 of the Trustee Act 1925 – this delegation must be effected by power of attorney and can last for a maximum of 12 months.

Most pension scheme trustees delegate day-to-day investment decisions, such as which particular shares or bonds to invest in, to an authorised fund manager. If they do not, then they must themselves be authorised to take such decisions, in accordance with the requirements of FSMA. Consequently, it is very unusual for trustees not to delegate such decisions.

It is less common for trustees to delegate more strategic investment functions in respect of their scheme to an external fund manager, although fiduciary management, where trustees set the overall long term strategy but leave the investment decisions within it to a fund manager, has become more popular in recent years. Strategic decisions are often (particularly in larger schemes) delegated internally to a sub-committee of two or more trustees who have particular expertise.

Trustees cannot delegate the duty to prepare and revise the SIP to external managers or advisers (see 2.10.4 above).

Under section 34 of the Pensions Act 1995, trustees who delegate investment decisions to an authorised fund manager are not responsible for the acts or defaults of the fund manager in the exercise of those functions, provided they have taken all reasonable steps to satisfy themselves that:

- the fund manager has the appropriate level of knowledge and experience to manage the investments of the scheme; and
- the fund manager is carrying out his work competently and is complying with the requirements of section 36 of the Pensions Act 1995 and those contained in the Occupational Pension Schemes (Investment) Regulations 2005.

In contrast, all of the trustees remain responsible for the acts or defaults of a trustee investment sub-committee in the exercise of their delegated functions.

2.11.7 Restrictions on Investment for Pension Schemes

Except for pension schemes with fewer than 12 members where all members are trustees or there is a statutory independent trustee, the Pensions Act 1995 prohibits trustees from investing more than 5% of the scheme's assets in "employer-related investments"(e.g. shares issued by the employer or the employer's business premises).Loans to employers are completely prohibited.

Schemes with 50 or fewer members, where at least one member has the power to direct or influence scheme investment, are referred to in the Finance Act 2004 as "investment-regulated schemes". Any investment by these schemes in residential property or "tangible moveable property" (which includes works of art and fine wines) will be treated as an unauthorised payment and give rise to a tax charge.

2.12 EXERCISE OF DISCRETIONS

There are a number of circumstances in which pension scheme trustees may be required to make decisions which involve the exercise of discretion, such as when deciding what investment strategy to adopt or when deciding whether a member is eligible for ill health early retirement.

When exercising a discretion, trustees must:

- ask themselves the correct question, in accordance with the law and the relevant provisions of their scheme;
- consider all relevant information;
- not consider any irrelevant information;
- exercise the discretion themselves (unless there has been a valid delegation); and
- not act capriciously, in other words the trustees' decision should not be perverse or irrational (i.e. a decision which no reasonable body of trustees could havereached).

Although a beneficiary may challenge a decision that has been reached by trustees following the exercise of a discretion, the Courts and the Pensions Ombudsman are unlikely to substitute their own decision for that of the trustees. Instead, if the Court or the Ombudsman decide that the trustees have not exercised their discretion properly (e.g. because they have taken into account irrelevant factors), they are likely to refer the decision back to the trustees for them to reconsider.

2.13 DELEGATION

The basic rule is that trustees must administer the trust themselves and therefore, they may not delegate their powers and functions, except to the extent that they are permitted to do so by the trust deed or by statute. For example, the Trustee Act 2000 allows trustees of a non-charitable trust to appoint agents to carry out certain functions on their behalf, but this delegation power is restricted in the case of pension scheme trustees, for example, they may not delegate to an employer under the scheme, nor may they delegate any of their investment functions to an agent. However,section 34 of the Pensions Act 1995 allows trustees to delegate investment decisions (see 2.10.6 above).

Where trustees delegate any of their functions in accordance with a provision in their scheme's trust deed, they must be careful to comply with any procedural requirements and any restrictions on delegation that are contained in the trust deed. Otherwise the delegation will not be effective. A written record setting out the precise terms of the delegation should also be drawn up.

In addition, trustees must ensure that the persons to whom any of their functions are delegated are suitable and that they have sufficient knowledge and expertise to carry out those functions. Trustees should also monitor the performance of any person or body to whom they have delegated any of their functions.

Specific issues arise in connection with the delegation of trustees' investment functions (see 2.10.6 above).

2.14 MEETINGS

A scheme's trust deed will sometimes contain specific provisions about the conduct of trustees' meetings. These will typically cover matters such as:

- how, to whom and by when notice of the meeting should be given;
- the number of trustees required to constitute a quorum;
- how decisions are made (e.g. by majority vote); and
- how the chairman should be appointed and whether they have a casting vote.

It is vital that a trustee meeting is conducted in accordance with any requirements that are contained in the trust deed and with the general law (e.g. the Pensions Act 1995 requires minimum notice for trustee meetings at which a decision is to be made).

In the case of a corporate trustee, decisions will be made by the board of directors at a board meeting, which will need to be conducted in accordance with the company's articles of association.

There are no legislative requirements setting out precisely how often trustees should hold meetings. However, TPR's Code of Practice on Internal Controls emphasises the importance of regular trustee meetings. Therefore, subject to any specific provisions in the trust deed, it is up to trustees to decide how often they should meet, bearing in mind their duties as trustees and the needs of their scheme.

The issues that trustees will need to consider at a trustee meeting will vary according to the circumstances of their scheme. However, the sample agenda below lists the main issues that are likely to be considered at a typical trustee meeting and it also explains why they need to be covered.

The Colourboxx Pension Scheme
Agenda for the trustee meeting on xx/xx/xxxx
In attendance Apologies

1. Approval of the minutes for the last meeting - trustees should review and approve the minutes for the last trustees' meeting to show that they accurately reflect the points that were considered and any decisions that were made.
2. Matters arising - trustees should review the progress made on any matters requiring action from the minutes of the last trustees' meeting.
3. Conflicts of interest - At the outset of any trustee meeting trustees should be required to declare any conflicts of interest which they may have in respect of any of the matters to be considered. The existence of the conflict should be noted and a decision will need to be taken on how the conflict ought to be managed (ideally, consideration of how the conflict should be managed should have taken place before the meeting and the relevant trustee should have taken legal advice). See further Part 1, Chapter2.18.
4. Investment report - in accordance with their investment duties, trustees need to regularly monitor the scheme's investments and the performance of the scheme's fund managers. Therefore, it is common for fund managers to prepare an investment report (usually every quarter) for the trustees to review. Depending upon the results of the report the trustees may decide to adjust the scheme's investment strategy.
5. Administration report - trustees should review the performance of the scheme administrators to ensure that they are complying with the provisions of the scheme and with all statutory requirements and time limits (e.g. for the payment of cash equivalent transfer values). It is common for administrators to prepare a regular (e.g. quarterly) administration report to enable the trustees to monitor their performance.
6. Employer covenant - trustees are expected to monitor the strength of the financial covenant for each of their scheme's sponsoring employers (i.e. the ability of those employers to provide the necessary contributions expected to be required to support the ongoing funding of the scheme) and it is important for trustees to be able to demonstrate that they are doing this. One way of achieving this is for trustees to request a financial update from the employer(s) at every trustee meeting. Trustees should also be aware of any commercial or other developments which may affect the strength of an employer's covenant.
7. Decisions regarding discretionary benefits - typically under a scheme's trust deed the trustees will be required to decide whether or not to grant certain benefits (e.g. ill health early retirement). These decisions will usually be taken by the trustees at a trustee meeting and the outcome should be recorded in the minutes for that meeting.
8. Decisions taken by a sub-committee - trustees should receive reports of decisions that have been taken by a sub-committee of the trustees under a delegated authority.
9. Notifiable events - trustees of schemes eligible for the PPF are required to notify TPR about certain events in respect of their scheme (see Part 1, Chapter 2.15).Therefore, at every trustee meeting, trustees ought to note whether any notifiable events have occurred in respect of their scheme. Trustees are required to notify TPR as a matter of urgency. Therefore, it is important that there is also a mechanism by which notifiable events can be identified and, if necessary,reported to TPR between trustee meetings.
10. Training - as part of the TKU requirements, trustees are required to keep up to date with changes in the law. Consequently, it is becoming more common for training to be included as part of the regular trustee meetings. Trustees should also record any training that they have undertaken since the last meeting.
11. Risk register – as part of the Internal Controls requirements the trustees are required to set up and implement a process for identifying, assessing and managing risk and to maintain a risk register. The risk register should be reviewed and, if necessary, updated.
12. AOB.

In certain circumstances a meeting may not be necessary. Instead it may be possible to make a decision by written resolution signed by all the trustees, if this is allowed by the trust deed.

2.15 GIVING REASONS FOR TRUSTEE DECISIONS

Under trust law the traditional view was that trustees did not have to give reasons for their decisions (Re Londonderry's Settlement (1965)).This meant that where trustees exercised a discretion, it was very difficult to prove that they had exercised it wrongly.

However, the recent trend has seen a shift towards trustees being required to justify their decisions. For example, the case of Schmidt v Rosewood Trust Ltd (2003) suggests that pension scheme trustees may be required to justify their decisions to interested parties in some circumstances. Furthermore, the Pensions Ombudsman has decided in a number of cases that a failure by trustees to give reasons for their decisions constitutes maladministration. Therefore, trustees ought to record the main reasons for their decision either in the minutes of the relevant meeting or separately. Legal advice may need to be sought over the extent to which reasons should be recorded and, if necessary, disclosed to members, particularly if the information is confidential or of a sensitive or contentious nature.

2.16 NOTIFIABLE EVENTS

The notifiable events regime is designed to give TPR early warning of situations where the security of members' benefits could be prejudiced and/or where schemes might need to be transferred to the Pension Protection Fund (PPF).The regime applies only to schemes that are eligible for entry to the PPF (eligible schemes) and it requires employers and trustees to notify TPR if a prescribed event occurs and none of the exceptions applies.

The events which trustees of eligible schemes are required to notify TPR are:

- making a transfer payment to, or accepting a transfer payment from another scheme, or a decision by the trustees to make or accept a transfer payment, the value of which is more than the lower of:
  - 5% of the scheme's assets; and
  - £1.5 million;
- a decision by the trustees to grant benefits, or a right to benefits, to a member, or, where not trustee decision is required, the granting of the benefits or right, the cost of which is more than the lower of:
  - 5% of the scheme's assets; and
  - £1.5 million;
- any decision by the trustees to take action which will, or is intended to, result in any debt which is, or which may become, due to the scheme not being paid in full (except where the trustees compromise a debt the full amount of which is less than 0.5 per cent of the scheme's assets); and
- a decision by the trustees to grant benefits, or a right to benefits, on more favourable terms than those provided by the scheme rules, without seeking the advice of the scheme actuary or without securing additional funding where this was advised by the actuary.

However, the requirement to notify TPR about the occurrence of the events listed above does not apply (with the exception of the last event) if:

- the scheme was fully funded on a PPF basis at the most recent valuation; and
- the trustees have not had to report to TPR in the previous 12 months a failure by an employer to make payments under their scheme's schedule of contributions.

Where trustees are required to notify TPR, they must do so in writing "as soon as reasonably practicable" after the person giving notice becomes aware of the notifiable event. What is reasonably practicable depends on the circumstances. However, in its Code of Practice on notifiable events TPR states that in all cases it implies urgency. "For example, where a trustee is made aware of a notifiable event on a Sunday, the Regulator should be notified on Monday".

Under the Occupational Pension Schemes (Employer Debt) Regulations 2005, trustees are also required to notify TPR of any decision by them to take action which will, or is intended to, result in:

- entering into a scheme apportionment arrangement on or after the applicable times; or
- a flexible apportionment arrangement taking effect.

Notice of any such decision must be given in writing as soon as reasonably practicable after the making of the decision.

2.17 TRUSTEE LIABILITY

2.17.1 General

Being a trustee is an onerous responsibility. A trustee can be held personally liable to the full extent of his personal assets for:

- his own acts or omissions if he has failed to act with reasonable care and prudence or if he has not acted in good faith;
- losses to the trust fund which result from an act or omission which constitutes a breach of trust;
- the acts of his co-trustees if he has not exercised due care in ensuring that they have properly discharged their duties.

A trustee is liable for acts or omissions which occur during his term of office and he remains liable for acts or omissions which occur during that period even after he has been removed from office or resigns. Where more than one trustee is liable for a breach of trust, liability is joint and several, which means that a beneficiary can claim the complete loss from any one trustee separately or all or several of them jointly.

In addition, TPR has the power to issue a fine under section 10 of the Pensions Act 1995 and section 168 of the Pension Schemes Act 1993 of up to £5,000 on individual trustees (up to £50,000 on corporate trustees) where they fail to comply with certain statutory requirements, such as the requirement to prepare and maintain a statement of investment principles, the duty to appoint one-third member-nominated trustees or directors and the requirement to report notifiable events.

2.17.2 Trustee Protection

Given the extent of a trustee's potential liability it is common for pension scheme trustees to be given certain protection against liability. The most common forms of protection are described below.

Exoneration

An exoneration clause seeks to exclude the trustees from liability. Many trust deeds contain provisions to absolve trustees from responsibility for breach of trust, unless they have acted fraudulently or dishonestly. Following a number of judgments in cases concerning exoneration clauses, it is now clear that such clauses are not contrary to public policy and that trustees may be expressly protected in their scheme's trust deed against all acts or omissions except fraud or dishonesty and subject to the restrictions of section 33 of the Pensions Act 1995 with regard to investments (see 2.10.6 above).

Indemnity
An indemnity allows the trustees to recover any loss which they suffer as a result of a successful claim against them or in respect of costs incurred in defending a claim from a third party (typically the principal employer and/or the scheme). On the face of it an indemnity may look as if it will provide excellent protection. However, it must be remembered that:

- an indemnity from a company is only as good as that company's ability to pay;
- an indemnity from the scheme itself will be of no use once the scheme has wound up;
- a Court may refuse to uphold an indemnity in relation to an act which has been shown to be a deliberate breach of trust;
- a trustee cannot be indemnified from the fund for fines imposed by way of a penalty for an offence of which he is convicted or a penalty which he is required to pay under or by virtue of section 10 of the Pensions Act 1995 or section 168(4) of the Pensions Schemes Act 1993 (civil penalties); and
- a trustee may not be able to rely upon an indemnity in respect of liability flowing from breach of an investment duty, as a result of the restrictions contained in section 33 of the Pensions Act 1995 (see 2.10.6 above).

There are also restrictions in the Companies Act 2006 on the extent to which company directors can be exonerated or indemnified in relation to negligence, default, breach of duty or breach of trust in relation to the company. This will be of particular relevance to trustees who are also directors of the sponsoring employer.

There is a provision (section 235 of the Companies Act 2006) which allows a director of a corporate trustee of a pension scheme to be indemnified by an associated company (usually the sponsoring employer) in relation to liabilities incurred by the trustee, other than for criminal fines and costs and for regulatory penalties.

Insurance
Protecting the trustees against personal liability
Insurance has the advantagethat it offers trustees the most certain form of protection against liability for breach of trust, particularly in situations where the employer is insolvent or the scheme is being wound up. However, before taking out insurance, trustees should consider whether it may prove to be an unnecessary expense which does not provide any greater protection than that already offered by an exoneration clause and/or an indemnity. Furthermore, trustees need to consider carefully the terms of the policy and what liability it covers (e.g. it would be important to check whether a claim could be made under a policy if trustees also have the protection of an indemnity from the employer).

Trustees also need to check whether their scheme's trust deed specifically permits them to take out insurance and to pay for the insurance premiums directly from the fund. The Court has made clear in the decision in Kemble v Hicks (No. 2) that trustees may do this only if there is specific authority in the trust deed; they cannot rely on more general powers, for example, a power enabling them to pay for the expenses of administration out of the scheme. If the trust deed does not permit the premiums to be paid for out of the scheme's assets, they will need to be paid by the employer (or the scheme amended to allow for it).

Protecting the scheme assets
Insurance provides an indemnity from a source outside the scheme. Since a loss to the scheme is likely to be borne ultimately by the employer it can be in the employer's interest to insure against any loss resulting from a breach of trust.

The employer will have to weigh up whether it is considered more economical to insure the risk or to bear any loss which may arise. A common risk is an administrative error, such as paying a wrong benefit or paying a benefit to the wrong beneficiary. Such losses may often be trivial in amount but there is the possibility of larger amounts being at risk if, for example, the breach affects the benefits of a large number of members.

Policy limitations
It should be noted that some policies include a right of subrogation so that the insurer is entitled to exercise any rights that the trustees may have to be indemnified out of the scheme assets. The policy may also exclude losses arising from breaches of trust for which the trustees would be excused liability under an exoneration clause in the trust deed or under section 61 of the Trustee Act 1925.

The policy will not normally cover a trustee against liability arising from fraud, dishonesty or deliberate breach of trust (on the part of the trustee), and cannot normally cover fines or penalties imposed under section 10 of the Pensions Act 1995 or section 168 of the Pensions Schemes Act 1993.

Section 61 of the Trustee Act 1925
Section 61 of the Trustee Act 1925 gives the Court discretion to relieve a trustee of liability for a breach of trust if it believes the trustee acted honestly and reasonably and, in the circumstances, ought fairly to be excused. However, in practice, trustees would not want to rely on this as their first line of defence.

Corporate trustees
Alongside the other forms of protection listed above, it is becoming increasingly common for corporate trustees to be established to run occupational pension schemes (including where schemes have historically been run by individual trustees).One of the main reasons behind this is because it is very difficult (except in cases involving fraud) for the liability of the trustee company to be passed on to its directors. This means that the individual directors of a corporate trustee are to a large extent shielded from liability for the actions and decisions of the corporate trustee.

2.18 CODES OF PRACTICE

TPR is required to issue Codes of Practice on certain statutory requirements. TPR also has the power to issue Codes on other matters if it wishes to do so. TPR's Codes contain practical guidance on what trustees should do in order to comply with the relevant statutory requirements and they also set out the standards that TPR expects trustees to maintain. To date, TPR has issued fourteen Codes on issues such as scheme funding, TKU, notifiable events and reporting breaches of the law. The Codes are available on TPR's website (www.thepensionsregulator.gov.uk). A list of all Codes that have been issued to date is contained in AppendixB.

A Code of Practice is not a statement of law and there is no direct sanction for breach of a Code. However, a Court or Tribunal will take any relevant Codes of Practice into account when considering whether trustees have fulfilled their legal obligations.

2.19 CONFLICTS OF INTEREST

Pension scheme trustees need to be alert to the potential for conflicts of interest to arise in the exercise of their functions. Circumstances which commonly give rise to conflicts include negotiations over scheme funding, corporate transactions involving a scheme's sponsoring employer, making changes to a scheme's benefit structure, the exercise of discretions as to early/late retirement and scheme mergers.

Where a trustee takes part in a decision in relation to which he/she has a potential or actual conflict of interest, the existence of the conflict may cause others to call into question the legitimacy of the decision. The conflict could also adversely influence the decision and prevent the conflicted trustee from properly discharging his duties to the beneficiaries of the scheme.

The starting point for the Courts when they are thinking about trustee conflicts of interest is the fact that a trustee is a fiduciary. A fiduciary is “someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence” [3]. Loyalty lies at the heart of the obligations which have been imposed on fiduciaries by the Courts.

The Courts have considered the situation where a fiduciary acts for more than one principal and in those circumstances they have held that the fiduciary *“must take care not to find himself in the position where there is an actual conflict of duty so that he cannot fulfil his obligations to one principal without failing in his obligations to the other”[4].*

Judging from these strict principles you might wonder how a director or a member could ever act as a pension scheme trustee. However, over the years the Courts have shown a willingness to act flexibly and pragmatically when faced with situations involving conflicts of interest.

In October 2008,TPR issued guidance for trustees on conflicts of interest. The guidance says that “conflicts of interest are a serious concern for the Regulator” on the basis that if they are not “managed effectively, decisions may be taken that put the interests of the beneficiaries at risk, or subsequently prove to be invalid”.

TPR’s main concern is that potential and actual conflicts should be identified, recorded, evaluated and appropriately managed. In connection with this TPR recommends that all schemes put in place a written conflicts policy, setting out how they intend to deal with conflicts of interest that arise. Schemes should also keep a register of potential and actual conflicts which may arise, or which exist, in respect of the trustees of their scheme and record how these are being managed.

The guidance sets out a number of different ways in which conflicts can be managed. However, it also recognises that the way in which conflicts should be managed will be scheme specific and that it is dependent on the particular circumstances in each case. There is no one-size-fits-all answer to this question and the way in which a conflict should be managed will depend upon the particular circumstances in each case. However, there are a number of solutions which should be considered. These include:

(i) seeking independent legal advice;
(ii) the conflicted trustee not taking part in the decision-making process;
(iii) delegating decisions to a sub-committee;
(iv) the appointment of an independent trustee; this is becoming increasingly common and it is an option which is favoured by TPR;
(v) the trustees making an application to court to seek directions on a particular decision; this is an expensive option but it may be appropriate where there is a conflict which affects the whole or a vast majority of the trustee board and where the decision is likely to have significant consequences for the scheme;
(vi) the use of confidentiality agreements – confidentiality agreements can be used to encourage a sponsoring employer to disclose confidential information to the trustees (this may solve the problem for a director who feels unable to disclose confidential information about the company to his fellow trustees);
(vii) resignation of the conflicted trustee – in TPR’s guidance this is seen as a last resort but it may be appropriate, particularly in circumstances where there is a conflict of an “acute or pervasive” nature which would be better avoided than managed; and
(viii) amending the scheme rules to reflect the trustees’ procedures for conflict management – although there is still some doubt over the effectiveness of an amendment which would allow trustees to take part in decisions even where there is a conflict or which would take advantage of an existing provision purporting to authorise conflicts.

3 Bristol &West Building Society v Mothew[1998] 4 Bristol &West Building Society v Mothew [1998]

Summary
A trustee may be an individual or a company.

Trustees of all occupational pension schemes are required to ensure that at least one third of the trustees of their scheme are member nominated trustees (or member nominated directors where there is a corporate trustee).

There are a number of ways in which trustees can be appointed and removed. Normally, the principal employer will retain the power to appoint and remove trustees under the trust deed. TPR also has the power to appoint and remove pension scheme trustees in certain circumstances.
Trustees have a number of trust law duties, including a duty to act in accordance with the trust deed and a duty to exercise reasonableskill and care. Variousstatutory duties also apply to pension scheme trustees.

A scheme's trust deed will set out the powers of the trustees and the powers of the principal employer. The distribution of powers between the trustees and the principal employer of a scheme are referred to as the scheme's "balance of powers".
The trustees of a pension scheme are responsible for investing the scheme's assets.

Trustees may be held personally liable for breach of trust or for failing to discharge their legal duties with reasonable care and prudence. Where more than one trustee is liable, liability is joint and several, which means that a beneficiary can claim the complete loss from one trustee separately or from all, or several, of them jointly. Common forms of protection for trustees against potential liability include an exoneration clause, an indemnity, insurance and the use of corporate trustee.
TPR has so far issued fourteen Codes of Practice which cover various requirements contained in the Pensions Act 2004 and one under the Public Service Pensions Act 2013.

Conflicts of interest should be identified, recorded, evaluated and appropriately managed.

Self Test Questions
- What are the circumstances in which an independent trustee may be appointed and by whom?
- Explain what trustees must do in order to comply with the MNT requirements.
- Outline trustees' key trust law and statutory duties.
- List the main powers you would expect to see in a pension scheme trust deed.
- Explain what is meant by the term "balance of powers".
- Outline what trustees must do/not do when exercising a discretion.
- What are the requirements that apply to the investment of scheme assets by pension scheme trustees?
- What are the most common ways in which a trustee can be protected from liability for breach of trust?
- Outline the circumstances in which the trustees of an occupational pension scheme are required to notify TPR about a notifiable event.
- Give an example of a situation where a conflict of interest might arise at a trustee meeting and suggest two possible ways of managing it.

CHAPTER 3

Establishing a Pension Scheme

INTRODUCTION

Establishing a pension scheme is a complex process. Before a scheme is established some important decisions need to be made, such as what type of pension arrangement and what sort of benefits is the employer going to provide?

Pension arrangements come in a variety of forms and sizes, ranging from large occupational pension schemes set up under trust to contract-based personal pension arrangements taken out by an individual with an insurance company.

The choice of benefit structure is very important because it determines the amount of benefits that a member might expect to receive in retirement, the cost to the employer of providing the arrangement and also who is going to bear the risk of factors such as poor investment return and increasing life expectancy. The most common benefit structures for pension arrangements continue to be either defined benefit (under which a member's pension is usually calculated by reference to a multiple of his salary) or defined contribution (under which a member's pension is based on the contributions paid into the arrangement plus investment return). However, other benefit structures can be used to suit particular circumstances.

Once these questions have been answered, the arrangement then needs to be created. Occupational pension schemes seeking to register with HM Revenue & Customs (HMRC) will be set up by the creation of a trust, usually using a Definitive Trust Deed and Rules. However, not all pension arrangements involve trusts: for example, personal pension schemes and unfunded schemes are typically contractual arrangements, whilst statutory schemes are set up by legislation. Regardless of the constitution of the arrangement, documentation must be drawn up to evidence the arrangement and explain its benefit structure to the scheme membership.

Once a scheme is in existence it will be necessary to amend the express terms of the scheme from time to time, to reflect changes in the commercial and business context within which the scheme operates and to reflect changes to the legal framework that applies to the scheme. It has also become increasingly common for employers to close defined benefit schemes to new members, and to future accrual, because of the costs and risks associated with continuing to operate such a scheme.

There are a number of formalities which need to be complied with in order to establish a pension scheme. In this Chapter we consider:

- the documentation that is required to establish a conventional occupational pension scheme;
- the documentation used to establish some more unusual types of pension arrangement;
- the registration process;
- additional documentation required where some or all of the benefits under the pension scheme are insured; and
- the statutory requirement to prepare employee communications.

3.1 DEFINITIVE TRUST DEED AND RULES

Until A-Day (6 April 2006), in order to qualify for the generous tax relief enjoyed by pension schemes, an occupational pension scheme had to be approved by HMRC (which was then known as the Inland Revenue). HMRC would not "approve" a funded occupational pension scheme unless it had been established under an irrevocable trust. The current tax regime, under which schemes are "registered" rather than "approved", has replaced this system. However, section 252 of the Pensions Act 2004 still requires all funded occupational pension schemes that are based in the UK to be established under trust.

An occupational pension scheme may originally have been established by a short document known as an Interim Trust Deed. This was designed as a 'stopgap' measure to allow time for a larger document to be prepared, known as a Definitive Trust Deed. Interim Trust Deeds are now rarely used in practice and most modern schemes will be established (and governed) by a Definitive Trust Deed. It is very common for a Definitive Trust Deed to have a separate section attached called the "Rules". The Definitive Trust Deed and the Rules contain the provisions which govern the terms of the scheme.

The Definitive Trust Deed will generally include the trustees' powers and duties and other provisions dealing with the terms of the scheme. The Rules will normally set out the conditions of membership, the contributions payable, the benefit promises, benefit options and any payment conditions attaching to those benefits. It is largely a question of style for the draftsman of the particular scheme as to which provisions go in the Definitive Trust Deed and which go into the Rules.

Whilst not all Definitive Trust Deeds and Rules contain the same provisions, a summary of the most commonly included provisions, and where they are often included, is set out below.

Definitive Trust Deed: general
- effective date for the adoption of the trust provisions and rules
- parties to the deed
- appointment of the first trustees of the scheme
- definitions used in the deed and in the rules
- a statement that the scheme assets are held upon irrevocable trusts
- power of amendment
- provision for participation of new employers and withdrawal of existing employers
- special and general powers to augment a member's benefits, including the provision for the payment of special contributions by employers where augmentation is envisaged
- provision for change of principal employer
- provision setting out the circumstances in which the scheme will be wound up.

Definitive Trust Deed: trustees' powers and duties
- power of appointment and removal of trustees
- duty to administer and manage the scheme
- conduct of trustee meetings (including notice periods, quorum, etc.) and decision making (e.g. by majority vote, written resolution, etc.)
- power to invest the scheme assets
- funding of the scheme, including provision for regular actuarial valuations and the disposal of any surplus
- duty to prepare audited scheme accounts
- power to operate scheme bank accounts
- power to insure scheme assets

- power to raise and borrow money
- payment of scheme expenses, including trustees' remuneration
- power to appoint advisers (including actuary, auditor, fund manager and legal advisers)
- trustees' indemnities, exoneration provisions and power to take out trustee liability insurance
- power to delegate certain duties
- power to buy out members' benefits and to purchase annuities from insurance companies.

Definitive Trust Deed or Rules: administration of scheme
- provisions relating to periods of absence (including temporary absence, maternity leave, paternity leave, adoption leave and parental leave)
- giving notices to beneficiaries
- mechanics of payment of benefits (e.g. timing, what to do if the recipient is a minor/mentally ill)
- requirement for members to provide trustees with information regarding age/health/marital status, etc.
- what happens to unclaimed benefits
- incapacity of beneficiary
- employer's lien or set off (i.e. ability for employer to recover moneys owed to it by a member of the scheme (usually) due to the member's criminal, negligent or fraudulent act)
- prohibition on the assignment of benefits.

Rules: membership
- eligibility conditions (reflecting the automatic enrolment requirements, where the employer has reached its staging date)
- opting out and rejoining (again, reflecting the automatic enrolment requirements where appropriate)
- transfers in from other arrangements
- power for employer and/or trustees to waive eligibility conditions.

Rules: contributions
- power to set employers' contributions
- members' contributions (including voluntary contributions and transfers in from other arrangements)
- power to reduce or suspend employer contributions.

Rules: benefits on retirement
- benefits payable at normal retirement age
- benefits payable on early retirement (i.e. before normal retirement age), including ill heath early retirement
- benefits payable on late retirement (i.e. after normal retirement age)
- lump sum benefits (e.g. pension commencement lump sum)
- provisions relating to flexible retirement (i.e. drawing some or all pension while continuing to work).

Rules: benefits on death
- lump sum payable on death of a member whilst still in service
- benefits payable on death of a pensioner
- benefits payable on death of a deferred pensioner (i.e. someone who has left service and who is entitled to deferred benefits under the scheme)
- spouses' and dependents' pensions.

Rules: leaving service and the preservation of benefits
- short service benefits: entitlement, calculation, revaluation and right to cash equivalent transfer value
- refunds of contributions
- cash transfer sums
- transfers to other arrangements (including bulk transfers).

Rules: tax issues
- right to recover tax from members' benefits
- HMRC maximum benefit limits. Pre-A-Day HMRC prescribed a comprehensive and complex set of benefit limits which could not be exceeded if HMRC approval was to be maintained. Most schemes tended to incorporate HMRC's own published model rules into their own rules to ensure that these limits were incorporated. Many schemes in existence on A-Day, when these limits were replaced with new allowances, chose to retain at least some of these limits; see Part 2, Chapter 1.3.1 or at the very least have a rule which prevents them making unauthorised payments without express consent.

Rules: contracting out
- Specific provisions are needed if the scheme in question was contracted out of the State Second Pension (contracting out ceased from 6 April 2016 – see Part 6, Chapter 1).

Rules: pension sharing on divorce
- Explanation of the provisions and restrictions with which the scheme must comply where a Pension Sharing Order has been issued on the divorce of a scheme member (or dissolution of a civil partnership).

3.2 REGISTRATION AND OTHER FORMALITIES

In order to benefit from favourable tax treatment a pension scheme must be registered with HMRC.The main features of the registration process are as follows:
- the 'Scheme Administrator' (usually the trustees or an agent for the trustees) must register with HMRC as a user of its Pension Schemes Online Service at http://www.hmrc.gov.uk/pensionschemes/register.htm
- once this registration process is complete the Scheme Administrator applies online to register the scheme, giving details about the scheme and who set it up and making a declaration that:
  - the scheme meets the Finance Act 2004 criteria for a pension scheme (e.g. it provides benefits on retirement, death, reaching a particular age or incapacity)
  - the information on the form is correct
  - the scheme documents do not entitle any person to unauthorised payments
  - the Scheme Administrator is a fit and proper person.

All schemes (except those which voluntarily opted out) which were approved under the pre-A-Day tax regime automatically became registered schemes with effect from A-Day, without any need to go through the registration process.

3.3 INSURED BENEFITS

3.3.1 Introduction
Some schemes may choose to insure some or all of the benefits that are provided by the scheme.Where this is done the employer or, more usually, the trustees will enter into an insurance contract with an insurance company. The contract will consist of:
- the proposal form completed by the trustees or employer;
- the acceptance document issued by the insurance company; and
- the terms referred to in the proposal form and acceptance document.

The insurance policy is usually a standard document provided by the insurance company and this evidences the contract. However, depending on the circumstances, there may be some scope to negotiate changes to the standard terms. The trustees (or the employer) will enter into a group pension policy where the policy is to provide the pension benefits and a group life policy where the policy is to provide any lump sum death benefits that become payable under the scheme. Where the arrangement is for an individual member, an individual policy rather than group policy will be issued.

The terms of the policy govern any dispute arising between the trustees (or employer) and the insurance company but do not directly affect the members' rights under the scheme, which continue to be determined by reference to the terms of the trust deed and rules of the scheme. It follows, therefore, that the terms of the policy should reflect the terms of the scheme's trust deed, except to the extent that the scheme holds other assets in respect of such benefits.

3.3.2 The Terms of the Insurance Policy

The policy should specify:

- to whom the benefits are payable;
- the circumstances in which they are payable and any conditions to which payment is subject; and
- the amounts payable.

In addition, a group policy should include:

- the rates of premium to apply and the terms on which the insurance company can revise them;
- the terms on which the insurance company will include further members;
- the terms on which the insurance company will grant further increases in benefits;
- provisions dealing with payments of benefits other than at normal retirement date (i.e. on early or late retirement);
- details of pension (or cash) options; and
- where the policy participates in profits, details of bonus distributions.

As modern practice is to try to keep policy documents as short as possible, many of the items listed above, particularly those relating to benefits and their payment conditions are often dealt with by reference to the trust deed and rules rather than being set out in detail in the policy itself. This has the added advantage of ensuring consistency between these two documents.

3.3.3 Amending Insurance Contracts

It is often necessary to amend the terms of the insurance policy. Amendments may be required for a number of reasons, for example:

- to reflect changes in the terms and conditions offered by the insurance company;
- to reflect amendments made to the rules which affect the benefits that are insured; or
- to comply with legislative changes.

Amendments to the benefits to be provided by an insurance policy or the terms and conditions of the policy are noted or 'endorsed' on the policy document. The endorsement will be prepared by the insurance company and adopted by the trustees (or employer, where the policy has been issued in its name).

As the policy forms all or part of the assets of the trust, where a change is made to the benefits to be provided by the policy, then to the extent that the revised terms of the policy conflict with the terms of the trust deed and rules, the terms of the trust deed and rules will also need to be amended to reflect the change in benefit. As there may be restrictions on the power of amendment, it is important to ensure, before the policy is endorsed, that the proposed amendment will not contravene any of those restrictions.

3.4 EMPLOYEE COMMUNICATIONS

3.4.1 Informing Employees

An employer that intends to set up a pension scheme will obviously not do so without informing the employees of its intentions. Indeed, if the proposed scheme is to be contracted out of the State Second Pension the employer is required to consult them and any recognised trade unions involved.

When establishing a pension scheme an employer will usually want to advise its employees as quickly as possible of this new employee benefit. For this reason an employer often does this by means of an announcement rather than an employee booklet. The announcement will summarise the main features of the new pension scheme leaving the booklet to explain the provisions in greater detail once the scheme has been established.

Although the precise contents of the initial announcement are largely a matter of style, varying from scheme to scheme, it will always:

- state that a scheme is to be set up;
- advise from what date it will commence;
- state who will be eligible;
- briefly outline the contributions required and benefits that are payable under the scheme;
- give the information which the automatic enrolment legislation requires to be given or, if the employer has not yet reached its staging date, include an application form for individuals to join the scheme and (in either case) to authorise deduction of any contributions from a member's salary (or make reference to where an application form can be obtained).

The announcement is also likely to state that a booklet describing the scheme will be issued to members in due course. Sometimes a benefit statement giving an employee an idea of the benefits he may be likely to receive (based on current salary) may be supplied at the same time.

The information may be disseminated by post, at staff meetings, by e-mail, via staff notice boards, etc., subject to any requirements under the automatic enrolment legislation to provide certain information to individuals.

3.4.2 Booklets

The main purpose of a scheme booklet is to communicate the principal provisions of the pension scheme to scheme members. The form of scheme booklets varies greatly but they must be sufficiently detailed to enable members (and prospective members) to understand the benefits to which they, and their dependents, will be entitled on retirement and death, and how much it will cost them to participate in the scheme.

3.4.3 Disclosure of Information Requirement

The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 require certain basic information about a scheme to be given to prospective members or, where it has not been practical to do so, it must be given to new members:

- where the employer is subject to the automatic enrolment requirements, within one month of the scheme receiving "jobholder information" from the employer in relation to the member; or
- where no jobholder information has been received, to the employee within two months of his becoming a member of the scheme.

The same information is also to be given to recognised trade unions, and spouses or civil partners of members or prospective members, if they so request.

As the employee booklet is the scheme's main communication tool, the basic information that needs to be disclosed is usually included within the booklet. This information may also be included on a pension scheme website. Electronic disclosure is now permitted by law but members have a right to opt out and receive information by post if they wish.

Additional information on automatic enrolment must be provided where the requirements apply. The basic information that needs to be provided under the disclosure regulations includes:

- eligibility criteria;
- details regarding opting out and re-joining the scheme;
- details of member and employer contributions (including arrangements for the payment of additional voluntary contributions);
- contracting-out information;
- scheme benefits for members and survivors (including any conditions attaching to the payment of such benefits (e.g. employer or trustee consent));
- the age at which members have the right to take their benefits under the scheme;
- right to cash equivalents transfer values;
- details of the scheme's internal dispute procedures, TPAS, the Pensions Ombudsman and TPR;
- an address for scheme enquiries.

3.4.4 Establishing Benefit Expectations

Pension scheme booklets are circulated to all members to help them understand the benefits provided by their employer's scheme. Therefore, it is vital that a scheme booklet accurately reflects the benefits payable under the scheme's rules. However, it is also very important that it is clear from the booklet that it is only a guide to the main provisions of the scheme, and it should be expressly stated that the booklet is subject to the rules of the scheme as amended from time to time and that the rules take precedence in the case of any inconsistency between the two.

Where the booklet has been issued by the employer, rather than the trustees, this may (depending on how a Court or Tribunal would construe the employment contract) mean that it has become part of the employees' contractual rights. Furthermore, the Pensions Ombudsman will look at all the information which has been given to a member and may in certain circumstances determine the member's expectations on the basis of that information, rather than on the scheme rules, even though the scheme rules may technically override that information.

3.4.5 Encouraging Employees to Join the Scheme/not Inducing Opt-out

An employer who wishes to encourage widespread scheme membership will want to use the booklet to 'sell' the scheme, and the benefits it provides, as compared with other alternatives available to the employees, such as personal pensions. However, the employer and trustees must be careful not to be seen to be giving employees financial advice. If they do this, they will be acting unlawfully.

Under the automatic enrolment legislation an employer must not induce employees to opt out of the scheme, and TPR may impose penalties on employers who do.

3.4.6 Expression of Wish Form

Under most pension schemes, lump sum death benefits are payable under discretionary trusts, thus generally avoiding a liability to inheritance tax which may arise where the payment is made to the member's estate (or as of right to a named person).This means that the trustees have discretion over which of the member's relatives or dependents should receive the benefit payable and in what proportions. The class of people who can be considered will be defined in the Definitive Trust Deed or Rules. However, it commonly contains the following categories:

- spouse;
- civil partners;
- children (including adopted children);
- other relatives;
- persons dependent on the member;
- anybody named in the member's estate; and
- charities or other associations.

In exercising their discretion, it is helpful to the trustees if they have an indication as to the person(s) to whom the member would have liked the benefit to be paid. Members are therefore invited to let the trustees know their wishes by completing an Expression of Wish form, sometimes called a Nomination of Beneficiary form.

The Expression of Wish form gives a member an opportunity to nominate one or more beneficiaries for this purpose, and to indicate the proportions in which he would like the amount to be divided. It is important that the form makes it clear that whilst the trustees will take full account of the member's wishes, ultimately they are not bound by them and they do have the power to depart from them should they see fit. If this were not the case the trustees would not have a genuine discretion and the inheritance tax advantage would be lost.

Although the form is not binding on the trustees, who will do their own research into the member's personal circumstances at the time the benefit becomes payable, they should take the member's wishes into account. Enquiries made by trustees at the time the benefit becomes payable will be particularly relevant if the Expression of Wish form is quite old, particularly if the member's personal circumstances have changed in the intervening period. For this reason members are recommended to complete new forms whenever there is a change in their personal circumstances.

3.5 AMENDMENTS AND SECTION 67

3.5.1 Express Power of Amendment

It is essential when establishing a scheme to include in the Definitive Trust Deed (or other document declaring the trusts) a power of amendment that will be wide enough for the scheme's purposes in years to come. In the absence of a specific power to amend, neither the trustees nor the employer can amend the trust or benefit provisions of the scheme without recourse to either TPR or the Court. Any restrictions contained in a power of amendment cannot properly be removed at a later date.

The power of amendment in the Definitive Trust Deed will state:

- who has the power to amend the trust deed (e.g. the employer alone, the trustees alone or, more commonly, the employer with the consent of the trustees or the trustees with the consent of the employer);
- how an amendment can be made (e.g. by resolution of the trustees or the board of directors of the employer or by deed); it may also give the trustees the power to operate the scheme on the basis of announcements made to members until such time as they are incorporated into the scheme's trust deed by formal amendment;
- whether a requirement exists to consult with or take professional advice from a third party (e.g. the scheme actuary) before exercising the power; and
- the extent to which the amendments may have retrospective effect.

It is a common misconception that it is possible to amend the provisions of a scheme on the basis of announcements to members only. It cannot be stressed strongly enough that, without an express power to make changes by member announcement, amendments made by that means will be ineffective.

Deeds

The majority of schemes require amendments to be made by deed. One advantage of a deed is that it is a formal means by which to make amendments and is likely to be kept together with the other trust deeds relating to the scheme; the need to keep resolutions with the deeds should not be, but sometimes is, overlooked.

Resolutions
Where amendments can be made by means of a resolution, the power of amendment will state whether the resolution is to be made by the employer or the trustees. If the power of amendment is vested solely in the employer, the board of directors of the employer will usually make the resolution. However, it is more usual for the power of amendment to require such resolution to be made by the trustees (and generally, then, with employerconsent).

Note that, even if the employer alone has the power to amend under a particular scheme's provisions, for certain amendments the trustees' consent will still be required under section 67 of the Pensions Act 1995 (see Part 2 Chapter 3.5.3 below).

Decisions recorded in the resolution will be made either unanimously or by majority, as specified in the trust deed.

Whilst a resolution has the advantage of being quicker and less costly to prepare than a deed, it is often seen as a less formal scheme document than a deed of amendment. Changes made in this way should therefore be kept together with the original trust deed and notified to interested parties (such as the scheme's actuary, administrators and lawyers) to ensure that they will not be lost or forgotten.

The power to amend a scheme is one of the most important provisions within a scheme's trust deed and rules and ensuring it is exercised properly is absolutely critical. Therefore, employers, trustees and other interested parties will want to obtain legal advice before exercising their scheme's amendment power. In particular, they will need to consider the impact of any express restrictions on the amendment power and the restrictions contained in sections 67 to 67I of the Pensions Act 1995.

3.5.2 Express Restrictions on the Power of Amendment
It is important that the power of amendment is drawn up in such a way that amendments are not inadvertently prohibited or unnecessarily restricted, because, as already noted, those restrictions cannot subsequently be removed. A simple and useful power of amendment would be in the following terms:

"The Principal Employer has power with the consent of the Trustees by deed to amend all or any ofthe provisions of the Trust Deed or the Rules; and any amendment may have effect from the date of the deed or such other time, whether before or after the date of the deed, as may be specified in it."

In older trust deeds it is quite common to find one or more of the following restrictions on the power to amend - usually in the form of a proviso within the amendment power itself:
- "No amendment shall be made which alters the main purpose of the scheme, namely the provision of pensions and other relevant benefits for members"
- "No amendment shall be made which permits the payment of any monies to the employer"
- "No amendment shall be made which shall prejudice the accrued rights and interests of any person who is a member at the date of the amendment".

The effect of these restrictions is considered below.

The Main Purpose of the Scheme
It is important to be clear what the ambit of this restriction is as the precise wording will vary from scheme to scheme.

Where the main purpose of a scheme is identified as being the provision of benefits for the employees of a particular employer or group of employers, there are several changes which could be deemed to alter the main purpose of a scheme, including, an amendment to the trust provisions which would enable the admission of an associated or subsidiary companies, the substitution of the principal employer or the merger of the scheme with another. This is because the result of all these amendments could be to open up the scheme to new members of a different employer.

In the case of Courage Group's Pension Schemes (1986) there was an attempt to substitute a new principal employer for commercial reasons. The judge held that it could not be done. In reaching his decision one of the points he considered was the scope of the amendment power, which prohibited a change in the main purpose of the scheme, namely to provide retirement benefits for the employees of a specific employer. More recently in British Airways Case5, the High Court confirmed that the power to amend could only be used for the proper purposes for which it was conferred. Here, "the power to amend was used in order to amend the rules of the scheme and was not used for some other purpose which was collateral or ulterior. "When considering whether, and how, to exercise the power to amend, the trustees must have regard to all relevant considerations and to no irrelevant considerations and must not act perversely or irrationally.

Payment of Monies to the Employer
This restriction, which seeks to protect fund monies for beneficiaries, prevents any changes being made to the trust or benefit provisions if their adoption would result in the repayment of any scheme monies to the employers. In the 1980s and 1990s when it was common for defined benefit schemes to be in surplus this restriction often caused the trustees problems as, under the old HMRC tax regime in place until 5 April 2006, legislation required a surplus to be reduced in the event that the scheme was ongoing but funded in excess of 105% (on the very conservative basis set out in the Income and Corporation Taxes Act 1988). For this reason many such restrictions included in trust deeds have been adjusted to permit the repayment of assets to employers to the extent required by legislation.

The restriction could also present a difficulty where a scheme has a large surplus on wind-up. In these circumstances the trustees will usually first augment members' benefits but may also deem it appropriate to refund some of the surplus to the employers.

Note that if schemes wish to preserve an existing power for a surplus to be refunded to the employer, a special trustee resolution (under section 251 of the Pensions Act 2004) must have been passed before 6 April 2016. British Airways plc v Airways Pension Scheme Trustee Limited [2017] EWHC 1191 (Ch)

Changes to Accrued Rights
This restriction, which seeks to protect the benefits which members have accrued prior to the date of the amendment, is often found within the power of amendment. Whether mentioned expressly within the trust deed or not, a similar provision is now implied automatically into occupational pension schemes by section 67 of the Pensions Act 1995 (see below).

Particular wording in the trust deed may still, however, be relevant. For example terms which are used one way in section 67 may have a different meaning in the context of the trust deed.

3.5.3 Sections 67 to 67I of the Pensions Act 1995

As well as considering any express restrictions on the exercise of a scheme's power of amendment, it is also necessary to consider the restrictions contained in sections 67 to 67I of the Pensions Act 1995. Collectively sections 67 to 67I are referred to as the "subsisting rights" provisions of the Pensions Act 1995 (or just "section 67").They comprise some ten pages of very detailed legislation which add complexity to scheme amendments.

TPR has issued a Code of Practice entitled "Modification of subsisting rights" which is designed to help employers and trustees understand the impact of section 67.

In a nutshell "section 67" provides as follows:

- It is not possible to make a "regulated modification" (meaning either a "protected modification" or a "detrimental modification") unless various conditions are met.
- A "protected modification" is one which "would or might" result either in a member's "subsisting rights" (broadly his accrued rights (or entitlements) and those of any survivor claiming through him) being replaced with money purchase benefits or in the reduction in the rate of any pension in payment. Such a modification cannot be made without the properly informed written consent of every affected member (which may be difficult to obtain, especially in the case of large schemes).
- A "detrimental modification" is one which "would or might" result in a member's "subsisting rights" being adversely affected in any other way. Such a modification cannot be made without either (i) properly informed, written member consent, or (ii) the member being informed in advance of the proposed change (and given the opportunity to comment), the trustees taking all such steps as they can to protect the actuarial value of his benefits, and the scheme actuary giving a certificate which confirms that from an actuarial perspective the value of the benefits being taken away is no lower than the value of replacement benefits being granted.
- Furthermore, neither kind of "regulated modification" can be made unless the trustees have given their consent to it, which in turn they can only do if they are satisfied that member consent or (if permitted) an actuarial certificate has been forthcoming.
- TPR can impose civil penalties (a fine of up to £5,000 for individuals or £50,000 for companies) upon either trustees or a scheme employer for a breach of section 67.

Definitions for the purposes of section 67 are as set out below.

- A "member" includes any active member, deferred member, pensioner, postponed pensioner and pension credit member and, if any such person has died, the person to whom a pension is to be paid in respect of the deceased (usually the widow, widower or civil partner).
- "Subsisting rights" are, broadly, those which a member has earned through service up to the date of the proposed amendment. In the case of an active member, his subsisting rights are determined as if he had opted immediately before the date of the change to leave pensionable service; thus death-in-service benefits, for example, do not form part of his accrued rights.

3.5.4 Changes to future service benefits

Where it is proposed to make changes to future service benefits only (i.e. there are no Section 67 issues) the employer may be required to consult with employees on the proposal. The Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 require an employer of (broadly) more than 50 employees (note it is the number of employees, not the number of scheme members) to give specified written information to all affected members or their representatives at least 60 days before the proposed effective date of a "listed change". Examples are changing benefits from defined benefit to defined contribution; closing an occupational scheme to new members or to future accrual; and (broadly) reducing employer contributions or increasing member contributions.

TPR can impose a civil penalty on a person who has failed, without reasonable excuse, to comply with the requirements to consult.

Some schemes may have a restriction in the amendment power which prevents a change to future benefit accrual. In the Lloyds Bank Pension Trust Corporation Limited v Lloyds Bank plc [1996] PLR 263 a restriction in the amendment power prohibited changes "...decreasing the pecuniary benefits secured..." to or in respect of active members of scheme. It was held that this prevented not only the amendment of benefits relating to past service, but also the amendment in relation to future accrual.

3.5.5 Court Orders

Where it would not otherwise be possible to amend the provisions of a scheme's trust deed and rules, a court order to vary the terms of the trust deed and rules may be sought in the following circumstances:

- Where the trustees do not have the necessary investment or administrative powers to deal in some particular way with the trust property, they may make an application to vary the trust under section 57 of the Trustee Act 1925. Before issuing the order, the court must be convinced that the proposed transaction is necessary.
- Where the beneficiaries want the court to approve an amendment on their behalf, they could apply to the court under the terms of the Variation of Trusts Act 1958, although this is not normally used in relation to pension schemes.
- Where the trustees, employer or beneficiaries want the court to exercise its inherent power to vary trusts. Generally the court will only issue an order using this power where some other matter concerning the scheme has in any event come before the court.

3.5.6 Overriding Legislation

'Overriding legislation' means the application of statutory requirements to pension schemes by means of provisions which directly override scheme rules. Amendments to scheme documents are not necessary to reflect overriding legislation as the provisions within the legislation apply directly to members. However, it is often considered good practice to update a scheme's trust deed and rules to take account of major pieces of new overriding legislation.

Scheme provisions have effectively been overridden by overriding legislation in several respects in recent years including:

- the requirement to treat male and female members equally;
- age discrimination;
- pension sharing on divorce; and
- scheme funding.

3.5.7 Statutory Powers to Amend

In addition to any other powers they may have, trustees also have the statutory power to amend scheme provisions by resolution in certain circumstances under section 68 of the Pensions Act 1995.

Section 24 of the Pensions Act 2014 gives an employer the power to amend a formerly contracted-out scheme in order to offset the additional cost of national insurance following the abolition of contracting-out on 6 April 2016.

3.5.8 TPR's Power to Amend

Section 69 of the Pensions Act 1995 gives TPR power in certain circumstances to modify a scheme which is being wound up for the purpose of enabling assets remaining after the liabilities of the scheme have been fully discharged to be distributed to the employer.

3.6 CHANGES TO PARTICIPATINGEMPLOYERS

Where employees of a new employer are to become members of the scheme, it will usually be necessary for the principal employer, the trustees and the new employer to enter into an agreement whereby the new employer agrees to participate in the scheme as an employer and to be bound by the terms of the trust deed and rules of the scheme. This situation can arise where, for example:

- a new company has been acquired and it has been agreed that its employees are to join the scheme, or
- a new employer is to be created because of a corporate restructuring.

Example
During its period of expansion Colourboxx Holdings Limited acquired a number of companies. In order to provide pension benefits under the Colourboxx Pension Scheme for employees of a newly acquired company, a deed of participation would need to be adopted extending either or both of the final salary and money purchase sections of the scheme to the new company.

The power to admit new employers is usually included in the Definitive Trust Deed. Where this is not the case, the Definitive Trust Deed will first need to be amended to include such a power.

Usually, in the deed of participation (also known as a deed of adherence – the new employer agrees to adhere to the provisions of the scheme), the new employer will authorise the principal employer to do things and make decisions on its behalf in relation to the scheme. This authorisation will commonly cover the followingpoints:

- decisions regarding member-nominated trustees;
- funding agreements; and
- consultation on the statement of investment principles.

Many scheme rules require the new employer to be associated in business with the principal employer (for example, a parent or subsidiary company). Since A-Day there has been no overriding requirement for rules to contain this restriction.

Where a participating employer ceases to participate in a pension scheme a deed of cessation may be adopted, but this is usually not required under the Definitive Trust Deed, which generally provides that participation ceases on the happening of certain triggering events without the need for a formal deed of this nature. From an administrative perspective, it is useful to have a record of the date from which an employer has ceased to participate.

3.7 CHANGE OF PRINCIPAL EMPLOYER

Sometimes there is a desire to replace the existing principal employer with a new principal employer. For example, this may happen where there is a group reorganisation or corporate transaction resulting in the old principal employer ceasing to participate in the scheme. The principal employer is generally (but not always) also a participating employer under the scheme (meaning, broadly, that it employs active members).

Where there is to be a substitution of the principal employer, the trustees, the new principal employer and the old principal employer (where it still exists) will enter into an agreement whereby the new principal employer takes on the powers, duties and discretions of the old principal employer from a specified date. In addition, the new principal employer may be indemnified in respect of any actions taken by the old principal employer prior to the date of substitution. This agreement is known as a Deed of Substitution.

The power to substitute the principal employer is usually included in the Definitive Trust Deed. Where this is not the case, the deed substituting the principal employer will first need to amend the provisions of the trust deed to include such a power.

Example
In 1997 Colourboxx Holdings Limited acquired a cosmetics-manufacturing subsidiary and made the decision to retain the existing final salary scheme - The Colourboxx Cosmetics Retirement Benefits Scheme. If Colourboxx Holdings wished to take over the role of principal employer in order to attain a degree of control in the running and costs of the scheme then it would need to enter into a Deed of Substitution with the existing principal employer and the trustees of the scheme.

3.8 OTHER TYPES OF PENSION ARRANGEMENT

An informal method which is sometimes used to establish a pension arrangement is exchange of letters. Arrangements established by an exchange of letters are typically set up for directors and senior executives.

The arrangement is established, usually by contract, when the employer writes a formal letter to the individual concerned setting out the pension benefits that will be payable to (and in respect of) him. Such arrangements can prove extremely costly, so great care should be taken when drafting the formal letter.

The employer will usually formally adopt the arrangement by means of a board resolution.

Summary
In order to benefit from favourable tax treatment a pension scheme must be registered with HMRC. Funded occupational pension schemes which are based in the UK must still be established under trust.

A scheme's trust deed and rules should set out, in full, the manner in which the scheme is to be administered and the benefits to be provided.

The scheme booklet will summarise the provisions of the scheme, and is a means of establishing a member's expectation of his entitlement to benefit. It is vital that the booklet accurately reflects the terms of the trust deed and rules and that it contains an express statement which makes it clear that it is subject to the trust deed and rules of the scheme.

Where all or part of the scheme benefits are insured, the trustees must enter into an insurance contract with an insurance company.

Self Test Questions
- Identify the documents which can govern an occupational pension scheme established under trust.
- Identify the principal provisionsthat are commonly contained in a Definitive Trust Deed and Rules.
- Outline the application process for registration of an occupational pension scheme.
- Outline the basic information which the trustees of a pension scheme need to give to members to satisfy the disclosure regulations.
- Identify who would complete an Expression of Wish Form, and explain why.

PART 3

Other Relevant Areas of Law

OVERVIEW

In this Part, you will learn about other areas of law and jurisdiction which impact on occupational pension schemes.

The Part consists of two Chapters. In Chapter 1, we consider other areas of law, for example employment and discrimination law, which impact on retirement provision, particularly on occupational pension schemes. In Chapter 2 we provide an overview of the implications of Jurisdiction (England and Wales, Scotland and Northern Ireland) on retirement provision.

When you have completed this Part you will have gained an understanding of how pension schemes are affected by non-pension areas of law and jurisdiction.

CHAPTER 1

Other Relevant Areas of Law

INTRODUCTION

In this Chapter, we consider other areas of law which impact on retirement provision, in particular occupational pension schemes. These include:
- data protection;
- divorce and civil partnerships;
- human rights; and
- employment law.

1.1 DATA PROTECTION

1.1.1 Introduction
Until 25 May 2018, the processing of personal data was covered by the provisions of the Data Protection Act 1998, which was enacted in response to the 1995 European Directive (95/46/EC). However, after four years of negotiations, the General Data Protection (GDPR) was negotiated with a view to harmonising existing data protection legislation throughout the European Union. In the United Kingdom, GDPR was enforced through the Data Protection Act (DPA) 2018, which was enacted on 23 May 2018.

The DPAlays down the requirements for 'data controllers'. In most cases the trustees will be the 'data controllers' for the pension scheme, since they determine why and how personal data is held and processed. 'Personal data' is data from which an individual can be identified and 'processing' covers almost every activity from obtaining data to deleting data. The DPA refers to the individuals on whom the data is held as 'data subjects'.

The DPA gives data subjects a number of rights, including the right to demand a copy of their personal files and to correct or remove any inaccuracies. Computerised data records are covered, as are paper records if they are part of a 'relevant filing system' where information relating to a particular individual can be accessed. Data subjects also have a right to be told whether, and for what purposes, personal information relating to them is being processed, the nature of the data and the people to whom the information may be disclosed.

Under the provisions of the DPA, data controllers are now required to obtain the explicit consent of data subjects to process their data. They must explain the legal basis for processing data and remind data subjects that they have the right to withdraw their consent

1.1.2 Notification
Data controllers who process personal data must submit an annual notification to the Information Commissioner's Office (ICO) (see Part 1, Chapter 1.1.5 below), unless they are recognised as being exempt from this duty. Failure to notify is a criminal offence. The ICO uses the details notified by the data controller to make an entry describing the processing in the register of data controllers that is available to the public for inspection.

The information which data controllers must notify to the ICO includes:
- a description of the personal data that is being processed;
- a description of the category or categories of data subject in respect of whom personal data is being processed;
- the purposes for which the data is being processed; and
- any person to whom the data needs to be disclosed.

1.1.3 Data Protection Principles

The DPA sets out eight principles that apply to the processing, storage and use of personal data. The eight principles are (broadly) that:
- personal data shall processed lawfully, fairly and in a transparent manner in relation to individuals;
- personal data shall be collected for specified, explicit and legitimate purposes and not further processed in a manner that is incompatible with those purposes;
- personal data shall be adequate, relevant and limited to what is necessary in relation to the purposes for which they are processed
- personal data shall be accurate and, where necessary, kept up to date;
- personal data shall be kept in a form which permits identification of data subjects for no longer than is necessary for the purposes for which the personal data are processed;
- personal data shall be processed in a manner that ensures appropriate security of the personal data, including protection against unauthorised or unlawful processing and against accidental loss, destruction or damage, using appropriate technical or organisational measures;

Additionally, the data controller ‘shall be responsible for, and be able to demonstrate compliance with’ the six principle set out above.

These principles apply for so long as any data is retained.

1.1.4 Disclosure

Confidentiality is very important. The information normally found within pension scheme records is extensive and should not, under any circumstances, be disclosed to any individual or body that does not have the right to access it. Disclosure of personal data can occur in a number of ways:
- by word of mouth;
- by printed matter; or
- by visual display (e.g. computer terminal screen).

The data controller must take adequate steps to ensure that data is kept securely and that it is only disclosed to appropriate persons for the purpose that was notified to the Information Commissioner.

Failure to ensure the confidentiality of data carries a penalty. The Information Commissioner can impose a penalty of up to the greater of 4% of annual worldwide turnover or €20 million on a data controller where one or more of the data protection principles have been seriously contravened provided that the contravention is likely to cause substantial damage or distress. The penalty may only be imposed where the breach is deliberate or where the data controller must or might have known that there was a risk of contravention but failed to take reasonable steps to prevent it. If unlawful disclosure occurs, and the data controller cannot demonstrate that reasonable security measures have been taken, the data controller may lose its registration.

Particular care needs to be taken with sensitive personal information (such as medical records or reports), which should not be disclosed to anybody without the relevant individual’s express consent.

1.1.5 The Information Commissioner’s Office (ICO)

The ICO is the UK’s independent public body set up to protect personal information by promoting good practice, ruling on eligible complaints, providing information to individuals and organisations, and taking appropriate action when the law is broken.

The ICO is responsible for maintaining a register of those who process personal information. It is also responsible for enforcing the registration requirement and the eight data protection principles. In connection with this the ICO has a number of powers which it can use to enforce the data protection requirements, including the power to:

- conduct assessments or audits to check organisations are complying with the DPA;
- serve information notices requiring organisations to provide it with specified information within a certain time period;
- serve enforcement notices and 'stop now' orders where there has been a breach of the DPA, requiring organisations to take (or refrain from taking) specified steps in order to ensure they comply with the law;
- issue penalty notices for serious breaches;
- prosecute those who commit criminal offences under the DPA; and
- report to Parliament on data protection issues of concern.

Appealsfromnoticesareheard by the First-tier Tribunal(Information Rights),an independentbody set up specifically to hear cases concerning enforcement notices or decision notices issued by the Information Commissioner.

1.1.6 Implications for Pension Scheme Trustees

The trustees of most occupational pension schemes will be data controllers of personal data. Therefore, they must register with the Information Commissioner and they must ensure that all personal data is stored and processed in accordance with the data protection principles described above.

Data processors (who process personal data on behalf of a data controller) are not subject to these notification requirements. Therefore a scheme administrator who merely processes data on behalf of the trustees is not responsible for notifying the Information Commissioner; if, however, it processes any personal data in its own right as data controller, it will need to notify in respect of that data.

The members, as data subjects, are entitled to access any of their own personal data controlled by the trustees. As noted, they may also withdraw consent for their data to be processed.

The trustees must enter into a contract with anybody that processes data on their behalf (including the employer) under which the processor agrees only to act on the instructions of the trustees and to put in place sufficient technical and organisational measures to keep the data secure.

Sensitive personal data (such as medical reports) relating to scheme members should not be processed or disclosed to anybody unless the relevant member has expressly given their consent.

For more information about the data protection requirements visit www.ico.org.uk.

1.2 DIVORCE AND DISSOLUTION OF CIVIL PARTNERSHIPS

1.2.1 Attachment Orders/Earmarking

The Courts have been able to make attachment orders (also known as earmarking orders) in respect of an individual's pension benefits, in respect of divorce proceedings started on or after 1 July 1996.Attachment orders can be issued by the Courts under petitions for divorce, judicial separations and even annulment. An attachment order enables the Courts to earmark some or all of an individual's pension benefits to provide maintenance or a capital sum to an ex-spouse. The money is paid by the scheme, on the member's behalf, directly to the ex-spouse. However, the benefit will only become payable when the member's entitlement to benefits arises under the scheme. These provisions apply equally to divorce and dissolution in relation to same sex marriages.

There are several deficiencies with attachment orders. In particular, they do not achieve a clean break, as the pension remains in the control of the scheme member. For example, payments to the former spouse can only be made when the member's pension comes into payment and the spouse's rights must match the form of the member's benefits. Therefore, it will not usually be known at the time of the divorce how much the former spouse will receive or when it will be paid. In addition, payment of an earmarked pension stops if the former spouse remarries. There are also administrative difficulties as the former spouse needs to maintain some form of contact with the scheme provider or the trustees.

Given these deficiencies, the use of attachment orders has been limited in practice, particularly since the introduction of pension sharing orders.

1.2.2 Pension Sharing Orders

Pension sharing orders have been available in respect of divorces (or annulments) on or after 1 December 2000. The effect of a pension sharing order is that the capital value of the pension is divided between the parties, with the rights of the member being reduced by way of a 'pension debit' and the ex-spouse being granted a 'pension credit' of the same amount. The precise split will be decided by the Court.

The main advantage of a pension sharing order over an attachment order is that pension sharing offers the opportunity for a clean break, on the basis that the ex-spouse obtains a right, independent of the member, to receive benefits from the scheme or to transfer to another pension arrangement. What happens in practice depends on the rules of the particular scheme.

1.2.3 Civil Partnerships

Pension sharing orders and earmarking orders are also available on the dissolution of a civil partnership.

1.3 HUMAN RIGHTS

The Human Rights Act 1998, which came into force on 2 October 2000, gives effect in UK law to some of the basic rights and freedoms which are contained in the European Convention of Human Rights and Fundamental Freedoms. However, the Act only applies to public bodies, so it includes public sector pension arrangements but (generally) does not include private sector pension arrangements. This means that members of public sector schemes may be able to bring direct claims against the scheme's trustees and/or sponsoring employers to enforce their human rights, whereas members of private sector schemes (generally) will not.

The Act also applies to Court proceedings, the actions of the Pensions Regulator (TPR), investigations by the Pensions Ombudsman and to UK legislation, which must be read in a way that is compatible with the Human Rights Act 1998.

1.4 EMPLOYMENT LAW

1.4.1 Introduction

Although an occupational pension scheme is established under trust (which means that it is separate from the establishing employer) and run by trustees, it is important to remember that it is set up by an employer. It forms part of the overall remuneration and benefits package that the employer has decided to offer to its employees.

Therefore, occupational pension schemes have to be seen in the context of the employment relationship that exists between the employer and employee. This is vital in order to fully understand the legal framework within which occupational pension schemes operate. The right to be a member of an occupational pension scheme and to receive benefits from it may form part of an employee's contract of employment (where the employer offers such a scheme).Where this is the case, the employer's ability to change the scheme may be restricted. However, except in the case of some highly paid senior executives, an employment contract is likely to provide for little more than the right to join the pension scheme subject to its rules from time to time.

The fact that occupational pensions are provided in an employment context also means that trustees of such schemes are subject to the legislative requirements relating to equal treatment and non-discrimination.

An employee may also have contractual rights in relation to the right to join and the level of contribution in a workplace personal pension schemes (where the employer makes arrangements for the payment of contributions) but as the employer will not be a party to the scheme itself, many of the issues considered below would not generally apply. Further, much of the law derived from the European Union relating to equal treatment and non-discrimination applies only to occupational pension schemes.

1.4.2 The Meaning of Discrimination

Discrimination may be direct or indirect. It may also take the form of harassment or victimisation.

Direct discrimination is where one person is treated less favourably (on the basis of their sex, race, age, etc.) than another person who is in a comparable situation (e.g. where men and women are paid different amounts for doing the same work simply because of their sex or where an occupational pension scheme provides a death- in-service lump sum for a spouse but not for a civil partner).

Indirect discrimination is where an apparently neutral provision, criterion or practice exists which puts persons of one group (based on their sex, race, age, etc.) at a particular disadvantage compared with persons of a different sex, race, age, etc. and the claimant suffers that disadvantage. An example would be an employer requiring employees to work full-time in order to qualify for certain benefits. Although this might apply equally to all employees, it is likely to have a disproportionate impact on women, as women generally bear a greater part of the childcare responsibilities than men and are more likely to request to work part-time.

Indirect discrimination (and also direct discrimination where it relates to age) which would otherwise be unlawful, will be permitted if it can be objectively justified by the employer, i.e. it can be shown to be "a proportionate means of achieving a legitimate aim".

It is unlawful for an employer to discriminate on grounds of sex, race, age, religion or belief, sexual orientation or disability in the following circumstances:

- in relation to job applications and selection processes;
- terms of employment (including pay and benefits);
- access to opportunities for promotion, transfer, training, benefits or services; or
- dismissal.

The right to equal treatment and non-discrimination, deriving from European Union law, also applies to the operation of occupational pension schemes. We will now look at some examples of how the right to equal treatment and the non-discrimination legislation applies in this context.

1.4.3 Equal Pay for Equal Work

Prior to the 1990s it was common in the UK for men and women to be given different pension provision. However, the principle of 'equal pay for equal work' for men and women, which is enshrined in EU law, has forced this to change, affecting:

- access for men and women into UK occupational pension schemes; and
- the benefits provided by such schemes to male and female members.

Access

In Bilka-Kaufhaus GmbH v Weber von Harz (1986) (which related to a female part-time employee's access to a pension scheme) the European Court of Justice (ECJ) held that the principle that men and women should receive equal pay for equal work applies to access to pension benefits. This meant that men and women who were doing the same type of work should have the same access to pension benefits.

The ECJ also held that it was indirect discrimination to exclude part-timers (without justification) from occupational pension schemes on the basis that this policy affected more women than men. As a result, employers were required to grant male and female part-timers backdated membership of their scheme unless their exclusion could be objectively justified on grounds relating to the needs of the business (backdated membership was also subject to the individual paying any past contributions that were required by the employer).

Benefits

The cases of Barber v Guardian Royal Exchange Assurance Company (1990) and Coloroll Pension Trustees v Russell (1995) established beyond doubt that benefits under a private occupational pension scheme constitute "pay" for the purposes of EU law, except where those benefits are derived from voluntary contributions.

Following the decision in Barber, the normal pension ages for men and women under an occupational pension scheme have had to be equalised with effect from the date of the judgment in Barber (i.e. 17 May 1990), unless legal proceedings had been instituted before that date. For most schemes this meant that the rules of the scheme needed to be amended. Many schemes had normal pension ages of 60 for women and 65 for men (in line with state pension ages), meaning that a woman retiring at 60 would be entitled to the full amount of pension she had accrued, whereas a man retiring at 60 would usually be treated as retiring early and therefore have an actuarial reduction applied to his pension. In this context the ECJ referred to women as the advantaged sex.

During the period from 17 May 1990 until the scheme rules were amended, normal pension ages for men and women had to be equalised to those of the advantaged sex (typically age 60); this period is often referred to as the "Barber window". However, once a scheme's rules had been amended, benefits for the period of service after the amendment could be paid by reference to the "equalised" age (typically age 65) provided that it was the same for both sexes. Unfortunately, a large number of schemes attempted to make amendments in order to equalise benefits, following the decision in Barber, but they failed to make the amendments correctly (e.g. because the scheme's power of amendment required amendments to be made by deed but no deed was executed).This means that the Barber window was not brought to an end, significantly increasing the liabilities of affected schemes.

The principle of equal treatment

The principle of equal treatment for men and women was incorporated into UK law by the Pensions Act 1995 and is now reflected in the Equality Act 2010 (see below).

Equalisation of GMPs
The Government has stated its view that guaranteed minimum provision (GMPs) have to be equalised for men and women. GMPs must be provided by most defined benefit occupational prevision schemes that were contracted out prior to 6 April 1997 in place of certain state pension benefits. State Pension ages are in the process of gradually being equalised as between men and women but this process had not begun when schemes provided GMPs: State Pension ages were 60/65, so the value of GMPs to a male and female scheme member of identical age, pensionable service and pensionable salary is unequal. The Government believes that EU law requires schemes to equalise GMPs. For further details, see Part 2, Chapter 5.6.

1.4.4 Age Discrimination
Age discrimination has been prohibited since 1 October 2006 in respect of employers and 1 December 2006 in respect of occupational pension schemes (benefits accrued in respect of pensionable service on or after 1 December 2006). The relevant provisions were originally contained in the Employment Equality (Age) Regulations 2006 but are now to be found in the Equality Act 2010 (see below) and the related Equality Act (Age Exceptions for Pension Schemes) Order 2010.

Discrimination, victimisation and harassment by employers on grounds of age are prohibited, unless such treatment can be objectively justified. A non-discrimination rule is also implied into the rules of all occupational pension schemes, i.e. the scheme rules are deemed to include a rule prohibiting discrimination, victimisation and harassment.

Pensions are inevitably age-related. Consequently, many age-related provisions which are commonly found in pension scheme rules are specifically excluded from the application of age discrimination legislation. Some of these exemptions include:
- minimum and maximum ages for admission to a scheme;
- a minimum level of pensionable pay for admission (provided not above lower earnings limit);
- use of age-related criteria in actuarial calculations;
- a minimum age for entitlement to benefits;
- specified ages for drawing benefits early without reduction or late with an enhancement;
- ill health pensions based on prospective service; and
- age-related contributions to occupational defined contribution schemes where the aim is to equalise benefits or make them more nearly equal.

However, the exemptions do not cover all aspects of occupational pension schemes and trustees are required to disapply any provisions which are not excluded and which discriminate on grounds of age unless those provisions can be objectively justified.

Certain limited exemptions also apply to workplace personal pension schemes including age-related contributions where the aim is to equalise benefits or make them more nearly equal, differences in contributions due to differences in pay and a minimum age for the commencement of contributions.

Under the age discrimination legislation, discrimination on grounds of age may be objectively justified if it can be shown that it is “a proportionate means of achieving a legitimate aim”. Unlike sex and race discrimination, objective justification is a defence to both direct and indirect discrimination.

1.4.5 The Equality Act 2010

The Equality Act 2010 was designed to consolidate, simplify and (to an extent) expand existing UK discrimination legislation. Most of its provisions came into force on 1 October 2010.

The Act provides that each occupational pension scheme must have read into it a non-discrimination rule and a sex equality rule. In addition, where trustees do not have the power to amend their scheme to remove discriminatory rules or practices, or where use of the amendment power would be overly complex or protracted, trustees are given the power to make the necessary amendments unilaterally by resolution.

1.4.6 Pension Rights on Dismissal

When an employee is made redundant or asked to leave employment they may be entitled to compensation. Their rights will depend on the circumstances and their employment contract.

In summary, if the employee is successful in a claim for wrongful dismissal in breach of his contractual rights then he will be entitled to be put back into the position he would have been in had his employment contract been properly complied with. If the employee is above the minimum retirement age this may mean retiring on pension.

If the employee is a member of a personal pension or defined contribution scheme he may be entitled to compensation for lost pension contributions during any period of notice. This loss will be reduced to reflect the fact that the contributions will be received as a single lump sum rather than over a period of time.

If the employee is a member of a defined benefit scheme the position is more complicated. To calculate pension loss, a comparison is made between pension rights at the date of leaving and the pension rights that would have accrued at the end of their notice period. The difference is the pension loss. An actuary will have to calculate the value of this difference, unless the employee is offered an additional period of service in the pension scheme to cover the notice period. Several factors will be taken into account including:

- any pay rises the employee might have been entitled to during the notice period;
- the fact that the employee is being paid the money before he would have been entitled to it;
- any new job the employee may obtain, as this is likely to offer some form of pension thus mitigating the loss; and
- any contributions that the employee would have had to make during the notice period.

1.4.7 Adoption, Maternity, Paternity or Parental Leave and the Impact on Pension Rights

During paid leave, whether for maternity, paternity or parental leave (together referred to as family leave), employee pension contributions will be based upon the pay actually received when on leave.

If the employee is a member of a defined benefit scheme, paid leave is treated as normal pensionable service and employee should not suffer any reduction in pensionable service as a result of taking paid leave.

If the employee is a member of a defined contribution arrangement the employer is required to contribute based on the normal salary i.e. as if not on family leave. This is the statutory minimum, some employers may make additional contributions to compensate for the reduction in total contributions.

Death in service cover must continue during paid family leave.

Periods of unpaid family leave do not constitute pensionable service and employee pension contributions cease. Some pension schemes offer employees the option to make additional contributions on their return to work to cover any period of unpaid family leave and make pensionable service continuous should they wish to do so.

1.5 INFORMATION AND CONSULTATION REGULATIONS

1.5.1 Information and Consultation of Employees: ICE

The Information and Consultation of Employees Regulations (often abbreviated to the ICE Regs) were introduced on 6 April 2005 and apply to businesses with 50 or more employees. The regulations give employees the right, subject to certain conditions, to request that their employer sets up or changes arrangements to inform and consult them about issues in the organisation.

The requirement to inform and consult employees does not operate automatically. It can occur either by a formal request from employees for an agreement, or by employers choosing to start the process. If a company already has a pre-existing agreement in place to inform and consult it may not be necessary to make any changes. To be valid the pre-existing agreement must:

- be in writing;
- cover all the employees in the undertaking;
- set out how the employer will inform & consult employees or representatives; and
- be approved by employees.

1.5.2 Duty to Consult on Changes That Affect a Pension Scheme

The employer duty to consult on changes that affect a pension scheme is set out in:

- sections 259-261 of the Pensions Act 2004;
- the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 (the main regulations); and
- the Occupational Pension Schemes (Consultation by Employers) (Modification for Multi-employer Schemes) Regulations 2006.

Unless otherwise excluded, the duty to consult applies to an employer with at least 50 employees in Great Britain in relation to listed changes (ones which affect future pension arrangements) as defined in the main regulations. The main regulations also list exempt changes such as those made for the purposes of complying with a statutory provision.

Unlike the ICE Regs, where the requirement to inform and consult does not operate automatically, under the main regulations there is an automatic requirement for the employer to consult with affected members or their representatives. Affected members are defined in legislation as the active or prospective members of the scheme to whom the proposed change relates.

If any of the requirements in connection with the duty to consult have not been met, any persons who believe that they are or may be affected members (or their representatives) may make a complaint to TPR. TPR has two discretionary enforcement powers:

- to issue an improvement notice under section 13 of the Pensions Act 2004 to the person who has contravened the regulations, directing them to take whatever steps are necessary to remedy the contravention; and
- imposition of a penalty not exceeding £5,000 in the case of an individual or £50,000 in any other case, where a person fails without reasonable excuse to comply with the duty to consult.

It should be noted that under the legislation, the validity of any decision made in respect of a listed change is not affected by any failure to comply with the consultation requirements. TPR has no power to alter any listed change that has been made.

1.6 MONEY LAUNDERING

Money laundering obligations will be familiar to anyone in the pensions industry who is undertaking 'regulated sector' activities as defined in the Proceeds of Crime Act (POCA). It is a criminal offence to fail to disclose knowledge or suspicion of money laundering activity (i.e. handling the proceeds of crime) by another person, or where there are reasonable grounds to know or suspect this.

However, independent of these obligations, it is important for all those working in the pensions sector to be aware of the wider money laundering offences in POCA. These impose personal criminal liability on anyone dealing with any funds or other property where they know or suspect these may be or connected to the proceeds of crime. Two important features of these offences mean great care should be taken by those responsible for handling pensions assets or facilitating transfers:
- the offences involve some dealing in "criminal property". But criminal property is broadly defined to include any funds that constitute a person's benefit from criminal conduct or represent, even indirectly, such a benefit; and
- there is no requirement for actual knowledge of another's wrongdoing. Suspicion is enough; this means believing that it is possible the funds or property may be tainted by criminal conduct.

There are then three main offences under POCA to keep in mind:
- It is an offence to conceal, disguise, convert or transfer criminal property.
- It is an offence to enter into or become concerned in an arrangement if you know or suspect this facilitates, by whatever means, the acquisition, retention, use or control of criminal property by or on behalf of another person. Arguably this may present the most risk for those in the pensions industry.
- It can be an offence to acquire, use or simply possess tainted funds.
  If trustees or pension providers suspect money laundering, they can make a suspicious activity report (SAR) to the National Crime Agency (NCA).

It is also possible to seek consent to continue with a transaction even if there are suspicions about it. This is known as making an authorised disclosure. NCA has discretion about whether or not to grant consent within certain timescales. This authorised disclosure and consent process protects reporting individuals and companies from ongoing criminal money laundering liabilities they might otherwise have.

1.7 THE BRIBERY ACT 2010

The Bribery Act 2010 (the Act) created four criminal offences, three of which are potentially relevant for trustees of pension schemes. Essentially these offences are: giving a bribe; taking a bribe; and the failure of a corporate organisation to prevent bribery by someone associated with it. The first two apply to individuals; the final offence is a corporate offence.

A bribe is very widely defined as 'a financial or other advantage', so it can include such matters as corporate hospitality or gifts.

The corporate offence is only relevant to corporate trustees and requires commercial activity. The associated person has to be performing a service for the corporate entity or on behalf of the corporate entity with an intention to obtain a business advantage for it.

The penalties for breaching the Act are:
- for an individual on conviction, up to 10 years imprisonment or an unlimited fine or both; or
- for a company, unlimited fines which can be imposed on both the company and its individual directors.

The Ministry of Justice confirmed that it was not the intention to stop ordinary proportionate hospitality from taking place. It recognised that there is a need to build relationships in the business world and that principally remains acceptable. What needs to be shown, if there is to be an offence under the Act, is an intention to influence to gain or retain a business advantage.

Trustees should take a proportionate look at, and assessment of, their likely risks and formulate a bribery policy accordingly. This policy should be reviewed on a regular basis and it is expected such a policy would confirm zero tolerance of any attempts to bribe an individual or acceptance of a bribe.

As with conflicts of interests, if trustees can establish a regular reporting structure and forum for highlighting and discussing the issue of bribery, they should be able to satisfy themselves that in all but very extreme cases they are adequately dealing with this issue and taking it seriously. Trustees should never ignore the issue, and must ensure that their response is proportionate to the risks.

1.8 RECOVERY OF VALUE ADDED TAX (VAT)

A pension scheme that bears its own administration costs (actuarial and legal fees among others) will not be able to obtain tax relief on the costs as its income is generally not taxable. However, VATincurred by the trustees is a pension scheme expense and therefore may be recoverable by the employer in certain circumstances on the basis that this has a direct and immediate link on the employer's business activities. The position is different for DC and DB schemes.

DC Schemes

A Court of Justice of the EU (CJEU) judgement in 2014 confirmed that fund management and administration fees will be exempt from VAT where the services are supplied to a Special Investment Fund (SIF) under Article 135 of the EU VAT Directive 2006/112/EC. The test is satisfied where a fund is solely funded by contributions made by or on behalf of the members, the member bears the investment risk, the fund contains pooled contributions of several members and the risk is spread over a range of securities. This description will include many DC pension schemes. HMRC has clarified that this may also extend to the DC element of hybrid schemes and, where a SIF has a number of funds some of which are non-compliant, VAT treatment can be split accordingly.

DB Schemes

The previous position was that, where an invoice was addressed to the employer, the VAT cost on administration expenses (but not fund management costs) was recoverable by the employer. HMRC applied a notional 70/30 split where administration and fund management costs respectively were issued on the same VAT invoice. Following a separate CJEU 2014 judgment, HMRC announced that it would no longer apply the split, other than on a transitional basis until 31 December 2015, and instead require evidence that the services were provided to the employer and that the employer was a party to the relevant contract. As pension scheme trustees are required to appoint fund managers, administrators and other professional advisers in writing on their terms agreed by them under s. 47, Pensions Act 1995, HMRC revisited the issue. It confirmed the unique nature of DB schemes and accepted that tripartite contracts (between employers, trustees and fund managers) would allow for VAT on fund management services to be recoverable provided the contract met specific conditions.

This did not resolve the issue. Some trustees were reluctant to adopt tripartite contracts because of section 47 issues. Another option is for a corporate trustee to be placed in the same VAT group as the employer, but this could have VAT consequences for the group as a whole and potentially place the trustee at risk of liability for group VAT obligations. Despite HMRC providing further guidance and extending the transitional arrangements of the 70/30 split to the end of December 2016, then again to 31 December 2017, the relevant VAT treatment is still unsettled not least due to complications surrounding the employers' ability to deduct corporation tax from the relevant supplies.

In 2016, HMRC accepted that parties who had made structural and contractual arrangements to comply with the 2014 judgment may revert back to their original position during the ongoing transitional period. HMRC has stated that it will issue further guidance on the treatment of administration fees and fund management fees.

Summary

Occupational pension scheme trustees will almost certainly be 'data controllers' for the purposes of the Data Protection Act 1998. Therefore, they must be registered with the Information Commissioner's Officer (ICO) and they must notify the ICO of the purposes for which they process personal data. Trustees must also ensure that all personal data is stored and processed in accordance with the eight data protection principles.

The Information Commissioner is responsible for maintaining a register of data controllers and for enforcing the requirements of the Data Protection Act 1998.

Members' personal data must be stored securely and kept confidential. Particular care needs to be taken with sensitive personal information, such as medical reports.

On divorce, the Courts may issue pension sharing orders or attachment orders (earmarking orders) to provide for a member's ex-spouse. These are also available on the dissolution of civil partnerships.

The main impact of human rights law on private pension schemes is likely to be in relation to the operation of the Courts, the Pensions Ombudsman and TPR and in relation to the interpretation of pensions and other legislation.

Occupational pension schemes must be seen in the context of the employment relationship between employer and employee.

Pension schemes are subject to legislative requirements relating to equal treatment and non-discrimination on grounds of age, disability, sex, sexual orientation, religion or belief and race.

Self Test Questions

- Outline the eight principles of data protection.
- What is the role of the Information Commissioner's Office?
- Explain what powers the Information Commissioner's Office has to ensure that data controllers comply with the Data Protection Act 1998.
- What are the Orders that the Courts can make on divorce and identify the main differences between them?
- Summaries the age discrimination provisions relating to pension schemes.
- Explain the impact of the judgement in Barber v Guardian Royal Exchange Assurance Company on occupational pension schemes in the UK.

CHAPTER 2

Implications of Jurisdiction (England & Wales, Scotland and Northern Ireland)

INTRODUCTION

In this Chapter we outline the implications of jurisdiction on retirement provision.

2.1 INCOME TAX

Following the Scottish independence referendum in September 2014, Lord Smith of Kelvin chaired a Commission to consider new powers for Scotland, which would form the basis of legislation to be adopted by the UK Government after the May 2015 General Election.

One of the Smith Commission recommendations was that the Scottish Parliament should be able to set its own Income Tax rates. Prior to this the same rates of Income Tax applied to England and Wales, Scotland and Northern Ireland.

The Scottish Parliament will have the power to set its own Income Tax rate from 2016 which may be lower than those applicable to the rest of the UK.

The introduction of the Scottish rate of Income Tax means that pension scheme members will receive tax relief on their contributions based on their residency tax status. From January 2018, HMRC will be telling scheme administrators operating relief at source the tax residency status of individual members. HMRC will use the data submitted on the previous year's annual return to inform scheme administrators of the correct relief at source rates. As part of this process a new electronic submission service, the Secure Data Exchange Service (SDES) will be introduced from April 2018.The first residency tax status notifications will be issued by HMRC in January 2018 so that the correct relief at source rates can be applied in tax year 2018-2020.There will also be a real time residency tax status look up service for scheme administrators to check the status of new joiners.

2.2 OPTIONS ON DIVORCE

In general, Scottish law places a considerable emphasis on the concept of matrimonial property. This means that pre-martial, post-separation, gifted or inherited assets are likely to be out of the pot for sharing in Scotland.

Matters such as housing and income needs are not nearly as important in Scotland as they are in England. Whilst both Scottish law and English law share the clean-break principle; they have a very different interpretation of how to apply it, with Scotland applying it much more assiduously than England.

Typically a spouse with substantial pre-marriage assets or assets that have been gifted or inherited will do better under Scottish law. Typically, a spouse seeking maintenance or housing will do better under English law. The financial advantage to be gained by being divorced in one country as opposed to another will vary from case to case, but in high value cases the advantage to be gained by being divorced in either Scotland or England can be considerable – millions of pounds in the really big cases.

The law relating to pensions and divorce has evolved in recent years. We cover some of the main changes below.

2.2.1 The Matrimonial Causes Act 1973
This Act gave the courts of England and Wales the power to resolve matrimonial assets and financial matters, including the value of retirement benefits of any pension arrangement. Courts could take pensions into account but they didn't have to, there was no provision for pension benefits to be passed from one party to another. Northern Ireland introduced a similar Act a few years later, in 1978.

2.2.2 The Family Law (Scotland) Act 1985
Either party to the marriage can apply to the court for an order to split the matrimonial property. The value of the pension benefits had to be offset as part of the financial settlement, although the ex-spouse had no direct access to the pension.

There was no such provision in English law.

2.2.3 The Pensions Act 1995
This Act gave the courts in England, Wales, Scotland and Northern Ireland the power to make an "earmarking order", which meant that a percentage of the member's benefits could be earmarked for the spouse to receive in the future.

This can be used for divorces petitioned (i.e. started) on or after 1 July 1996 (England and Wales), 19 August 1996 (Scotland) or 10 August 1996 (Northern Ireland.)

The Act also made it compulsory for courts to take pension rights into account when determining the value of the matrimonial estate, effectively bringing England and Wales into line with Scotland.

2.2.4 The Welfare Reform and Pensions Act 1999
Pension funds can be the largest asset after the family home but previous Acts did not give the parties concerned a "clean break", so the Welfare Reform and Pensions Act 1999 introduced the option of pension sharing. It became effective for divorces occurring after 1 December 2000.

For the first time pension rights had to be treated as any other asset and could be transferred from one spouse to another on settlement. Both the husband and wife have separate, independent pensions.

2.2.5 The Civil Partnership Act 2004
With effect from December 2005, this Act allows same sex couples to enter into a civil partnership, with rights and responsibilities similar to the legal status of married couples. The Act introduced discretionary powers for a court on dissolution of a civil partnership, which include powers to make pension sharing and earmarking orders.

2.2.6 Marriage (Same Sex Couples) Act 2013
This Act was introduced for England and Wales on 17 July 2013 so that same sex couple have the same rights in law as other couples from March 2014.

2.2.7 Dealing with Pension Benefits on Divorce
There are three main ways of dealing with pension benefits on divorce:
- Offsetting;
- Pension Attachment Order/Earmarking; and
- Pension Sharing.

Offsetting is the simplest way to deal with the benefits, the total value of the pension benefits is offset against other assets such as a share in the family home. The use of this method does not vary between UK jurisdictions. It is however important to note that there are differences between English (applies to England and Wales) and Northern Ireland and Scottish law if either of the other two ways of dealing pension benefits on divorce are used – see below. Affected members should seek advice from an independent financial advisor and a solicitor.

Attachment/Earmarking Order
In this case, a part of the member's benefits are set aside for the spouse as directed by the Court.The amount is specified at the time of divorce and an Attachment/Earmarking Order is made against the member's benefits which takes effect when they come into payment.

Both pensions and lump sums (including death lump sums) can be earmarked and an Attachment Order made in England, Wales and Northern Ireland. In Scotland only lump sums can be earmarked and an Earmarking Order made.

Pension Sharing
This option applies to divorce proceedings from 1 December 2000 only and the member may not have a choice, as the court can order pension sharing to take place. The Pension Sharing Order (PSO) is sent to the scheme administrator who must implement it as directed, the administrator must also have a copy of the decree absolute.

Pension sharing separates the member's pension entitlement so there is a clean break and it offers greater flexibility than earmarking/ offsetting.

It applies to all pension assets belonging to the couple however, if the member is divorcing under Scottish law then there are some differences, for example the assets are only those built up during the period of marriage/ civil partnership.

Orders and agreements in Scotland will normally be ineffective unless the person responsible for the pension arrangement receives copies of the relevant matrimonial documents within two months of the 'decree of divorce' or 'declarator of nullity.'

Summary
This brief Chapter has provided an overview of some of the implications of the differences in jurisdiction within the United Kingdom and their impact on pension related matters. It is likely that the differences will become more pronounced and consequently it is an area of growing importance.

Self Test Questions
- Does the State pension age differ in the UK?
- What implications might there be of differences in Income Tax rates across the UK?
- Does Earmarking differ between Scotland and England?

PART 4

Corporate Transactions

OVERVIEW

n this Part, we build on the previous Parts of this Study Manual and look at how the pensions regulatory and legal framework applies in the context of corporate transactions.

The Part consists of a single Chapter. You will learn about how the pensions regulatory framework applies in the context of corporate transactions. We then examine the key legal issues that need to be considered in connection with share sales and business sales. Finally we set out some of the practical and commercial considerations that need to be taken into account on any corporate transaction. You will discover that this is an area of crucial importance for trustees and employers alike. It provides a practical illustration of how the increasingly tight regulation of occupational pension schemes has impacted on corporate activity.

When you have completed this Part, you will have gained an understanding of corporate transactions – purchases, sales and mergers – and how they interact with occupational pension schemes.

CHAPTER 1

Corporate Transactions: Purchases, Sales and Mergers

INTRODUCTION

Over recent years the importance of pensions matters in the context of corporate transactions and restructuring has increased significantly. There are three factors in particular that have led to this increased significance.

1. The increased regulation of pension schemes and, in particular, the introduction of a more stringent funding regime (which has increased the power oftrustees).
2. The introduction of onerous employer debt legislation supported by the Pensions Regulator's moral hazard powers.
3. The fact that the value of the pension liabilities concerned can be very substantial and, in some cases, may exceed the value of the company or business which is being acquired.

Corporate transactions can be structured as either a share sale or a business (i.e. asset) sale. The structure of a transaction will have a significant impact on the nature of the pensions issues which will then arise as a result of the transaction. The structure will also affect the liabilities that transfer to the buyer as a result of the transaction and on the buyer's future pension obligations in respect of transferring employees.

The parties involved in any corporate transaction that involves a defined benefit occupational pension scheme will also need to consider the impact of section 75 of the Pensions Act 1995 (as amended by the Pensions Act 2004) (the employer debt legislation). In particular they need to decide whether to obtain clearance from the Pensions Regulator (TPR). Clearance is a voluntary procedure which provides assurance to the parties involved that TPR will not issue either a contribution notice or a financial support direction in respect of the transaction.

1.1 THE DIFFERENCE BETWEEN A SHARE SALE AND A BUSINESS SALE

Corporate transactions can be structured as either a share sale (i.e. the sale and purchase of a company by share transfer) or a business sale (i.e. the sale and purchase of some or all of the assets of a company). Business sales are also referred to as asset sales.

A share sale is where:

- a seller sells, and a buyer buys, shares in a company (the 'Target');
- the sale and purchase agreement is made between the buyer and the owner(s) of the Target's shares but the business activity is still owned by the Target – and so therefore;
- there is no change in the direct ownership of the Target's business; and
- the buyer may be an individual or another company.

A business (or asset) sale is where:

- a buyer acquires the assets that make up the business (the 'Target'), for example plant and machinery, customer lists or particular product lines;
- the sale and purchase agreement is made between the buyer and the owner of the Target business, who may be an individual or a company; and
- as a result of the sale, some or all of the employees employed in the Target transfer their employments to the buyer.

1.2 THE STAGES OF ATRANSACTION

Most transactions, regardless of whether they are a share sale or a business sale, go through the following key stages:
- due diligence;
- negotiation;
- signing; and
- completion.

1.2.1 Due Diligence

Due diligence is the term used to describe the buyer's investigations of the Target company or business before it decides whether or not to proceed with the transaction. A buyer would normally instruct solicitors, accountants and other professional advisers to investigate and report on all aspects of the Target, including its financial position, any properties which the Target owns or uses and any disputes which may affect the company or business. The Buyer would also want to gain a full understanding of the Target's pension arrangements, including:
- whether the pension arrangements are defined benefit (DB) or defined contribution (DC) arrangements;
- the rate of contributions which the Target pays into those arrangements;
- (for defined benefit arrangements) how the liabilities under the arrangement have been calculated, whether there is a deficit under the arrangement and, if so, how large it is;
- whether the pension arrangements have been run properly and in accordance with the relevant legal requirements and whether there are any outstanding disputes connected with any of the arrangement;
- whether the Target has made any unfunded pension promises to any of its employees.

Information about the Target would normally be provided by the seller. Depending on the size and complexity of the transaction and the Target and on the availability of information, the due diligence process may be long and very involved.

1.2.2 Negotiation, Signing and Completion

Once the due diligence exercise is complete, the parties will negotiate the final terms on which the transaction will take place. Whether the terms end up being favourable to the buyer or the seller will depend on the parties' relative bargaining positions. When the terms have been agreed they will be documented in a sale and purchase agreement ('SPA').

There will also be a disclosure letter. This details the information provided by the seller to the buyer as part of the due diligence exercise. The disclosure letter may also qualify the effect of the warranties in the SPA (and as a result it may be more difficult for the buyer to claim breach of warranty) (see 1.3.1 below).

When they have agreed the SPA, the various parties will sign it. The sale, however, does not take effect until completion. It may be that signing and completion occur simultaneously. However, it is common for there to be a gap between signing and completion, to allow time for any pre-conditions to completion (such as listing or consultation requirements) to take place.

1.3 SALE AND PURCHASE AGREEMENTS

The SPA will set out the terms upon which the purchase of the Target company or business has been agreed. As far as the pensions aspects of the deal are concerned, you would normally expect an SPA to include:
- warranties from the seller regarding the Target's pension arrangements;
- indemnities from either the buyer or the seller, which will address specific issues of particular concern to one party or the other;
- where the transaction involves a transfer of assets and liabilities from the Target's pension scheme into the buyer's pension scheme, a pension schedule setting out the terms upon which the transfer will take place (such schedules tend to be relatively rare these days)

We set out below the typical pensions warranties and indemnities which you would expect to be included in an SPA.

1.3.1 Warranties
A warranty is a binding statement of fact given by the seller about a particular aspect of the Target company or business. Warranties serve two main purposes.
- They provide the buyer with a remedy (a claim for breach of warranty) if a statement made about the Target proves to be incorrect. Warranties, in effect, provide a form of retrospective price adjustment. However, claims for breach of warranty will normally be subject to limitations which will be included in the SPA (such as maximum and minimum values on the claim and a time limit on when claims can be made) and to the legal duty for the buyer to 'mitigate' its losses. This means that the buyer, once aware of the breach, should try to limit its losses.

- They encourage the seller to disclose known problems to the buyer. This is done in the disclosure letter. The seller's liability under the warranties would normally be limited to the extent that proper disclosure is made against them. The effect of the warranties, therefore, should be to flush out potential problems.

1.3.2 Indemnities
An indemnity is an undertaking by a party to meet a specific potential legal liability which another party may incur as a result of a specific event. In the context of a corporate transaction, indemnities are usually most appropriate to cover specific risks which are of particular concern to the buyer. For example, it is common on a share sale involving a defined benefit pension scheme for the seller to indemnify the buyer against any potential liability which the buyer may incur under section 75 of the Pensions Act 1995 as a result of the transaction.

One of the primary advantages of an indemnity over a warranty is that (generally speaking) it will be easier for a buyer to make a claim under an indemnity. This is because to bring a successful claim for breach of a warranty, a buyer would need to show that the warranty has been breached, that the seller did not disclose the existence of the breach and that the buyer has suffered a loss as a result of the breach. Whereas under an indemnity, the buyer only needs to show that the liability covered by the indemnity has arisen and the seller is then required to reimburse the buyer in respect of that liability.

It is commonly thought that the party with the benefit of an indemnity does not need to mitigate its losses. However, the law is not clear on this point.

1.3.3 Typical Pensions Warranties and Indemnities

The warranties and indemnities that a buyer would normally request under an SPA will depend upon:

- the structure of the transaction (i.e. whether it is a share sale or a business sale);
- the nature of the Target's pension arrangements and whether the buyer will be assuming any liability for those arrangements as a result of the transaction;
- the results of the buyer's due diligence; and
- the respective bargaining position of the parties.

However, a typical set of pension warranties will normally include confirmation that:

- all pension and life insurance schemes in respect of which the Target has a liability to contribute (now or in the past) have been fully disclosed to the buyer;
- all contributions due to such arrangements have been paid, and paid on time;
- there are no disputes in relation to the Target's pension arrangements;
- the trustees of those arrangements (if any) and the Target have at all times complied with thegoverning documentation of those arrangements and all applicable laws and requirements;
- the arrangements (as appropriate) are registered with HMRC;
- all documentation governing the arrangement and member communications and data has been disclosed.

In addition, if the Target has any liability under a defined benefit occupational pension scheme, the buyer would also commonly want warranties that:

- there are no employer debts under section 75 of the Pensions Act 1995 ('section 75 debts' or 'employer debts') due from the Target to the scheme (or any other scheme) and that none will arise as a result of the transaction;
- the seller is not aware of anything that could result in the Target having a contribution notice or financial support direction imposed upon it (see 1.8 below);
- the Target has not been party to an application for clearance (see 1.8 below);
- the Target has not done anything which could prejudice the scheme's eligibility to enter the Pension Protection Fund (PPF) (such as compromise a section 75 debt).

If the Target only operates a group personal pension scheme, the seller will usually be expected to give fewer warranties. This is because these arrangements are usually run by an insurance company, and the Target's primary obligation in respect of it is to ensure that the correct contributions are paid to the scheme on time.

The matters commonly covered by indemnities (as an alternative to a warranty) are that:

- the seller will indemnify the buyer for any section 75 debt which the Target may have to pay to the scheme (see 1.8 below);
- the seller will indemnify the buyer for any pensions liability which the Target may have as a result of any previous transfer of employees to the Target under TUPE, including under the principles in the Beckmann and Martin cases (see Part 5, Chapter 1.5 below); and/or
- the seller will indemnify the buyer for any pensions liability which the Target may have as a result of TPR imposing a contribution notice or financial support direction in respect of the scheme on it or the Target.

These (and any other appropriate) indemnities would commonly only be sought where there is at least a material risk that the relevant liability may arise.

1.4 SHARE SALES

On a share sale, ownership and control of the Target company transfers from the seller to the buyer. This means that the Target's business will continue as before. In particular, the Target will continue to employ the same employees, be subject to any contracts that it has entered into with customers, and suppliers will be subject to the same pension liabilities as before the transaction (unless, as part of the transaction, it has agreed with its scheme's trustees and any other participating employers that this should change).

1.4.1 Effect on Target's Pension Scheme

The pensions issues that will arise on a share sale and the impact that the sale will have on the Target's pension scheme will very much depend on the particular circumstances. We consider below some common scenarios.

- *The Target is the sole employer of an occupational pension scheme*
  Here the pension scheme is likely to remain with the Target. The Target will become part of the buyer's corporate group on completion and the Target would remain liable to fund the scheme in the same way as before the transaction. The buyer would be "associated" with the Target and therefore, if the Target operates a defined benefit occupational pension scheme, the buyer (and the other companies within the buyer's group) could be issued with a contribution notice or financial support direction by TPR in respect of the scheme, should the relevant statutory conditions be met.

Example
If Colourboxx Cosmetics is purchased as part of a share sale, the Colourboxx Cosmetics Retirement Benefits Scheme would remain with Colourboxx Cosmetics after the sale. This means that Colourboxx Cosmetics will remain as the principal employer and the trustees will remain in office. The buyer will want to know as much as possible about the scheme (in particular about its funding position) before it acquires Colourboxx Cosmetics, because the scheme will become a liability of the buyer's group following the transaction. When the transaction has completed, the buyer may wish to appoint different trustees, amend the scheme rules or merge it with its existing pension arrangements.

- *The Target is the principal employer of a multi-employer occupational pension scheme.*
  In this case, the general rule is that the scheme will remain with the principal employer (in this case the Target) and it will remain liable to fund the scheme. This means that the scheme will become part of the buyer's group and, therefore, where the scheme is a defined benefit scheme, the buyer (and the other companies within the buyer's group) could potentially be on the hook for contribution notices and financial support directions. Where the buyer is not acquiring all of the other participating employers along with the Target a mechanism will need to be agreed for those other employers to leave the scheme and discharge their liabilities towards the scheme (see 1.8 below). Where it is a defined benefits scheme, the parties will need to carefully consider whether the transaction will trigger the payment of a section 75 debt (see 1.8 below), whether it is appropriate to seek clearance in respect of the transaction (see 1.8 below) and at what stage to discuss the proposed transaction with the trustees (and, if so, what their reaction may be).

- *The Target is a participating employer in a multi-employer occupational pension scheme.*
  In this situation, the general rule is that the scheme will remain with the principal employer. Assuming the buyer is not also purchasing the principal employer as well as part of the transaction, the scheme will remain behind with the seller's group and the Target will need to leave the scheme on completion. Whilst it is possible for the parties to agree that the Target can continue to participate in the scheme after the sale, such periods of temporary participation are now rare. When the Target leaves the scheme it will need to ensure that it discharges its liabilities towards the scheme, including, any section 75 debt (see 1.8 below).

Where it is a defined benefits scheme, the parties will need to carefully consider whether the transaction will trigger the payment of a section 75 debt (see 1.8 below), whether it is appropriate to seek clearance in respect of the transaction (see 1.8 below) and at what stage to discuss the proposed transaction with the trustees (and, if so, what their reaction may be).

- *The Target contributes to a group personal pension plan.*
  Here the obligation to contribute to the group personal pension plan (GPP) will remain with the Target after the sale. This is the case regardless of whether the transaction is a share sale or a business sale. If the seller's group operated the scheme the Target may need to set up a new scheme for its employees to join immediately after the transaction.

1.5 BUSINESS SALES

When a company sells a business, broadly speaking all liabilities of the seller in respect of its employees (except for certain occupational pension scheme rights - see 1.5.3 below) pass under The Transfer of Undertakings (Protection and Employment) Regulations 2006 (TUPE) to the buyer.

Where a business sale occurs, it is very unlikely that the employees of the Target business will be able to remain in the seller's pension arrangement after completion of the transaction on an ongoing basis. Therefore, on completion the transferring employees will become deferred members in the seller's pension arrangement. It will be up to the buyer to put in place arrangements for future service pension provision which complies with the various legal requirements.

1.5.1 Future Service Pension Provision for the Target Business' Employees

Where the transferring employees were members of a defined benefit occupational pension scheme or a defined contribution occupational pension scheme to which the seller is required to contribute or has contributed prior to the transaction taking place, the buyer has to provide a certain minimum level of future service pension benefits for transferring employees. The Pensions Act 2004 requires the buyer to put in place either:

- an occupational defined benefit pension scheme which meets certain minimum criteria (i.e. the contracting out reference scheme test, benefits worth at least 6% of pensionable pay per year or matched contributions up to 6% of pensionable pay); or
- a defined contribution arrangement (which can be an occupational pension scheme or a group personal pension scheme to which the seller is required to contribute or is not required to contribute but has in fact paid contributions) under which the buyer can choose either to match employee contributions up to 6% of pensionable pay or, if less, pay contributions at the same rate that the seller was required to contribute immediately before the transfer.

Where the seller only provided access to a group personal pension scheme (GPP) to the transferring employees, the Pensions Act 2004 protection does not apply. However, if the transferring employees' had a contractual right to participate in such a scheme, this contractual right would pass from the seller to the buyer and would be enforceable against the buyer under TUPE. Consequently, the buyer would be required as a minimum to put in place an equally generous arrangement.

In addition, once the buyer's staging date for automatic enrolment has passed, the buyer must ensure that the automatic enrolment requirements are satisfied in relation to the transferring employees.

1.5.2 Implications for Employees' Past Service Benefits in the Seller's Scheme – Introduction
If the buyer has its own scheme, there is no legal requirement for transferring employees' past service benefits to be transferred from the seller's pension scheme into the buyer's scheme. However, the buyer and the seller may agree to a bulk transfer from the seller's scheme to the buyer'sscheme in respect of the transferring employees 'past service benefits. This tends be unusual these days. If no bulk transfer is agreed, employees can request an individual transfer. However, the buyer's scheme would not be obliged to accept such a transfer. It is important to note that bulk transfers generally only occur where both the buyer and the seller have occupational pension schemes.

The terms of any bulk transfer will be contained in a pensions schedule in the SPA. This schedule will describe precisely how the assets and liabilities relating to the transferring employees are to be valued and dealt with. The buyer will wish to ensure that its scheme will receive sufficient funds to fund the liabilities that it will accept in respect of the transferring employees.

From a transferring employee's perspective, he or she will wish to receive at least broadly the same value benefits as they were entitled to in the seller's scheme. This requires continuous service with the equivalent number of years service (i.e. adjusted to take account of different accrual rates) being credited to them in the buyer's scheme, as they had in the seller's scheme. This may not however be achieved if the seller's scheme is underfunded and the transfer payment cannot fully reflect the value of the benefits promised under it. In addition, it may be that the assumptions used in the buyer's scheme are such that the funds being transferred will not be sufficient to buy equivalent value benefits. If either of these things happen, the seller would commonly be required to pay an amount equal to the shortfall so that the equivalent benefits can be provided.

Transfers can be difficult to achieve if the seller's scheme is, or has been, contracted out but the buyer's scheme is not.

If the seller's scheme provides defined benefit pensions and the buyer's scheme provides pensions on a defined contribution basis, there will be a difficult choice to be made by members who may prefer to leave their defined benefit entitlement as deferred benefits in the seller's scheme, rather than convert their rights into DC benefits by transferring their accrued benefits into the buyer's scheme. It will not be possible to make a transfer in these circumstances without the consent of members.

If both schemes provide benefits on a defined contribution basis, a transfer may be easily achieved since the liabilities will equal the aggregate value of the accounts held for each member. There will usually be little dispute as to the amount to be transferred on a business sale, although the ongoing contribution levels under the seller's and the buyer's schemes may be different.

1.5.3 Implications for Employees' Past Service Benefits in the Seller's Scheme: the Beckmann and Martin Cases
Rights under occupational pension schemes which relate to "old age, invalidity or survivors benefits" do not pass under TUPE on a business sale. However, the meaning of 'old age' benefits for this purpose has been the subject of two important cases in the European Court of Justice (ECJ), Beckmann v Dynamco Whicheloe Macfarlane (2002) and Martin v South Bank University (2003), and more recently in the High Court, Proctor & Gamble v Svenska (2012).

In Beckmann, the ECJ decided that pensions payable below normal pension age were not "old age" benefits, and accordingly would transfer under TUPE. In particular, the ECJ held that enhanced pension rights on redundancy were not "old age" benefits and, therefore, they would pass under TUPE. It also held that early retirement benefits would also pass under TUPE.

In Martin, the ECJ agreed with Beckmann, and held in addition that rights contingent on either dismissal or early retirement by agreement with the employer also do not fall within the TUPE exclusion and so would transfer on a business sale.

The Beckmann and Martin decisions related to the (statutory) NHS Pension Scheme. There has been some uncertainty about how these cases apply to UK private sector occupational pension schemes but, in practice, it has generally been accepted that the decisions also applied to such schemes. Therefore buyers have proceeded on the basis that they may be bound to provide transferring employees with enhanced early retirement and/or redundancy benefits to which they were entitled under the seller's occupational pension scheme. As a result, buyers commonly seek an indemnity from the seller in respect of any such rights that are provided under the seller's scheme or which the seller is bound to provide by virtue of a previous business sale involving the seller.

In *Proctor & Gamble v. Svenska* (2012) the High Court decided that:

- where the seller's scheme allows early retirement with the employer's consent, the right of the member to be considered for early retirement benefits in good faith transfers to the buyer; and
- the buyer is responsible for the enhancements to an early retirement pension following a TUPE transfer (and not necessarily the full amount of an early retirement pension).

1.5.4 Public Sector Transfers: Local Authority

The Secretary of State can issue directions to (broadly speaking) best value authorities under the Local Government Act 2003 describing the terms upon which a local authority's staff must be employed following the outsourcing of services to private sector contractors. In relation to pensions, a direction was made in 2007 to require transferring staff to be provided with an appropriate good quality pension arrangement by the receiving employer.

The direction requires that when a best value authority enters into a contract with a person for the provision of services and those services are, immediately before the contract was entered into, provided by the authority and carried out by employees of the authority:

- the contract between the authority and the contractor must require that the contractor provides pension rights for each transferring employee that are broadly comparable to, or better than, those he or she had (or had the right to acquire) as an employee of the authority;
- the contract must provide that the transferring employee has the ability to enforce the right to broadly comparable benefits directly against the contractor; and
- the contract between the authority and the contractor must require that broadly comparable pension rights are provided, if and when a contract is retendered.

A contractor can comply with these requirements by obtaining "admitted body status", which allows it to participate in the relevant fund of the Local Government Pension Scheme (LGPS) or by providing the employees with access to its own "broadly comparable" pension scheme.

Transfers of employment for members of other public sector schemes (including the NHS Pension Scheme, the Civil Service Pension Schemes and the Teachers' Pension Scheme) are subject to the Fair Deal policy. This was originally set out in guidance in 1999 and required the private sector contractor to provide a pension scheme for transferring staff which was "broadly comparable" to the relevant public sector scheme. New Fair Deal guidance issued in October 2013 now requires contractors, other than in exceptional circumstances, to arrange for transferring staff to remain active members of the public sector scheme. Each scheme has put in place slightly different arrangements to achieve this but they all require the contracting employer to contribute to the public sector scheme.

1.6 TRANSITIONAL ARRANGEMENTS

As commented above, the buyer in both share and business sales will need to have pension arrangements in place on completion. However, it may not be possible to achieve this in the time available. The buyer in such circumstances may be able to participate in the seller's scheme for a transitional period. A deed of adherence or participation needs to be executed for the anticipated period.

Where the seller's scheme is contracted out, the National Insurance Services to the Pensions Industry will invariably allow the transferring employees to be covered under the seller's contracting-out certificate until the period of temporary participation comes to an end. Thereafter, the company will be removed from the seller's certificate and the normal election procedures will then be made by the buyer in order for its new pension arrangement to become contracted out. However, temporary participation by a buyer in the seller's scheme is becoming much less popular in the case of defined benefit schemes because when the buyer ceases to participate in the seller's scheme it will be liable to pay its share of the scheme's buyout deficit, which could be considerable. The buyer could also be putting itself within the scope of the Pension Regulator's anti-avoidance powers (see 1.8.2 below).

1.7 COMMERCIAL CONSIDERATIONS

A corporate transaction will give rise both to current and future pension liabilities for the buyer. If both the buyer and the seller have defined benefit schemes, it is likely that these will have been funded using different actuarial assumptions and methods and will have different contribution rates and solvency levels. The price paid for a business or company, however, will depend upon its past profit record and its future prospects in the new merged environment.

In calculating profits, the pension costs of the acquired business or company may well have been assessed on a basis different from that used by the buyer. The buyer therefore needs to satisfy itself, for example, that when acquiring a company, adequate reserves already exist in that company's scheme for any past service liabilities which the buyer is being asked to maintain. If there is a promise in the agreement about future service benefits the buyer needs to ensure that, to date, an adequate allowance for the cost of these has been made in the Target company's accounts.

1.8 ANTI-AVOIDANCE AND CLEARANCE

Currently many defined benefit occupational pension schemes are in deficit, typically on a number of different bases including the buy-out basis (which relates to the cost of securing the scheme's liabilities with an insurance company). Section 75 of the Pensions Act 1995 requires that where an employer ceases to have active members in a defined benefit occupational pension scheme (where at least one other employer continues to have active members in it), a debt (known as a "section 75 debt") may be payable by the departing employer calculated on a buy-out basis. However, the legislation providesvariousmethodsfor reducing the amount of the section 75 debt payable by the departing employer.

In addition, in April 2005 the Government introduced an anti-avoidance and clearance regime which was designed to address concerns that some employers were trying to structure corporate transactions in order to minimise or avoid any section 75 debt which was, or may have become, due in respect of their scheme. This anti-avoidance and clearance regime is regulated by TPR.

The introduction of the anti-avoidance and clearance regime, combined with the size of some section 75 debts, has brought pensions issues to the forefront of transactions involving a defined benefit occupational pension scheme. Therefore, from a practical point of view, extra time and resources need to be built into the planning for a corporate transaction where clearance is to be sought or where an arrangement is to be put in place designed to reduce the section 75 debt that is payable by a departing employer.

A change of ownership of a participating employer (by sale of shares from the seller to the buyer) is usually a notifiable event and must be reported to TPR except in limited circumstances.

1.8.1 Section 75 Debts

Where an employer operates a defined benefit occupational pension scheme, section 75 of the Pensions Act 1995 provides for a debt to be payable by the employer to the trustees of the scheme where (broadly):

- the employer becomes insolvent;
- the pension scheme is wound up; or
- (in relation to a multi-employer scheme) an employer ceases to employ any active members in the scheme at a time when at least one other employer continues to do so (an “employment-cessation event”).

A section 75 debt may be triggered on either a share sale or a business sale. In relation to a share sale the debt may be triggered where the Target company withdraws from the seller’s multi-employer defined benefit occupational pension scheme on completion of the sale, or following a temporary period of continued participation. Subject to the terms of the SPA (i.e. whether the seller must indemnify the buyer against a section 75 debt) the buyer would be responsible for paying the section 75 debt, if any. A section 75 debt may be triggered on an asset sale where the seller withdraws from a multi-employer defined benefit occupational pension scheme by virtue of all its employees who are active members of the scheme being transferred to the purchaser as a result of the sale. The seller would normally be responsible for paying the section 75 debt triggered as a result of a business sale because the company that employed the transferring employees (and to whom the section 75 debt relates) would still be part of the seller’s group.

The default position is for a departing employer’s section 75 debt to be calculated by reference to its share of the scheme’s deficit calculated on a buy-out basis (this is known as its “liability share”) unless an alternative arrangement is put in place.

The employer can prevent an employment-cessation event from being treated as having occurred by serving notice on the trustees (within two months of the employment-cessation event) confirming that it intends to employ an active member of the scheme within a “period of grace”. This is a period of up to 12 months from the date of the employment-cessation event (which can in certain circumstances be extended to up to 36 months).

Alternative arrangements

In respect of section 75 debts which are triggered on or after 6 April 2008, the amount of the debt that is payable by a departing employer can be reduced by entering into:

- a withdrawal arrangement
- an approved withdrawal arrangement
- a scheme apportionment arrangement
- a flexible apportionment arrangement
- a regulated apportionment arrangement

In certain circumstances, the departing employer may also be able to benefit from a “relevant transfer deduction” (i.e. the amount of the bulk transfer out of the seller’s scheme, if any).

The key features of these different arrangements are described below. Which of these arrangements would be the most suitable will depend upon the particular circumstances. Other easements are available (in limited circumstances) on corporate restructurings and reorganisations.

Withdrawal arrangements
A withdrawal arrangement is an arrangement which is entered into between a scheme's trustees, the departing employer and a guarantor under which part of the departing employer's debt is guaranteed by a guarantor and which:

- specifies the amount the departing employer must pay and when (the amount payable must be at least the employer's share of the scheme's deficit calculated on a statutory funding objective basis (as opposed to a buy-out basis), which may still be a material cost)
- specifies the amount that the guarantor(s) are liable for
- specifies who will meet the expenses in connection with the arrangement

The trustees can only enter into a withdrawal arrangement where they are satisfied that the remaining employers are reasonably likely to be able to fund the scheme to meet its statutory funding objective. The trustees must also be satisfied that, at the date of the agreement, the guarantors have sufficient financial resources to be likely to be able to pay the guaranteed amount.

Regulatory approval is not needed for a withdrawal arrangement. However, consideration should be given as to whether clearance should be sought.

Approved withdrawal arrangements
An approved withdrawal arrangement is similar to a withdrawal arrangement but it requires regulatory approval. Significantly, under an approved withdrawal arrangement the departing employer agrees to pay less than its share of the scheme's deficit calculated on a statutory funding objective basis.

TPR cannot approve the approved withdrawal arrangement unless:

- the amount that the departing employer agrees to pay under the arrangement is less than its share of the scheme's deficit calculated on a statutory funding objective basis (if it was equal to or higher than this amount the parties could simply enter into a withdrawal arrangement)
- the trustees have notified TPR that they are satisfied that the remaining employers are reasonably likely to be able to fund the scheme to meet its statutory funding objective
- TPR is satisfied that it is reasonable to approve the arrangement taking into account such matters as it considers relevant

TPR can impose any conditions in relation to the arrangement as it thinks fit. It also has the power to issue a variety of directions to the parties.

Scheme apportionment arrangements
A scheme apportionment arrangement is an arrangement under a scheme's rules that provides for the departing employer to pay an amount other than its "liability share". Where the departing employer pays less than the "liability share" then the shortfall is apportioned amongst one or more of the remaining participating employers. The trustees, the departing employer and the remaining employer(s) must consent.

The scheme's trustees can only agree to a scheme apportionment arrangement if they are satisfied that:

- the remaining employers will be reasonably likely to be able to fund the scheme to meet its statutory funding objective
- there is no adverse affect on the security of members' benefits

Entering a scheme apportionment arrangement may be a "notifiable event", but it does not require regulatory approval (although consideration should be given as to whether clearance should be sought).

Flexible apportionment arrangements
A flexible apportionment arrangement (introduced from January 2012) is similar to a scheme apportionment arrangement. The key feature of a flexible apportionment arrangement is that the departing employer's "liabilities" are transferred to one or more of the remaining employers and no debt is treated as due from the departing employer. The trustees, the departing employer and the employers taking on responsibility for the liabilities must consent to the arrangement in writing. The trustees must also be satisfied that:

- the remaining employers will be reasonably likely to be able to fund the scheme to meet its statutory funding objective
- there is no adverse effect on the security of members' benefits

A flexible apportionment arrangement is only available where the scheme is not being wound up or in a PPF assessment period and the trustees are satisfied that a PPF assessment period is unlikely to begin in the next 12 months.

Entering this arrangement does not require regulatory approval (although consideration should be given to whether clearance should be sought).

Regulated apportionment arrangements
A regulated apportionment arrangement is similar to a scheme apportionment arrangement. However, it can only be put in place where trustees think that there is a reasonable likelihood of their scheme going into a PPF assessment period within the next 12 months or where an assessment period has already commenced but not ended. Where an assessment period has not commenced, the trustees and the affected employer(s) must consent to the arrangement. The arrangement and any amendments made to it must have regulator and PPF approval.

Relevant transfer deductions
Where, as part of a corporate transaction, there is going to be a bulk transfer of the assets and liabilities that are attributable to a departing employer from the departing employer's former scheme into a new scheme, the departing employer may be able to obtain the benefit of a "relevant transfer deduction". Essentially, a relevant transfer deduction has the effect of reducing the amount of the debt that is payable by the departing employer. Where all of the assets and liabilities that are attributable to the departing employer are transferred into a new scheme, the debt will usually be reduced to nil.

In order to benefit from a relevant transfer deduction the transfer must take place within 12 months after the effective date used to calculate the section 75 debt or, in the case of an approved withdrawal arrangement, such longer period as TPR permits.

Summary of alternative arrangements
The table below summarises the key features of the alternative arrangements.

Amount of debt		Trustee and employer agreement	Regulator approval	PPF approval	Guarantor needed
Default position	Share of scheme's buy out deficit ("liability share")	✘	✘	✘	✘
Withdrawal arrangement	Share of scheme's SFO1+ (or PPF*) deficit OR such higher amount as the parties decide	✔	✘	✘	✔
Approved withdrawal arrangement	An amount which is less than the cessation employer's share of scheme's SFO+ (or PPF*) deficit	✔	✔	✘	✔
Scheme apportionment arrangement	Amount agreed by the parties	✔	✘	✘	✘
Flexible apportionment arrangement	No debt	✔	✘	✘	✘
Regulated apportionment arrangement	Amount agreed by the parties	✔	✔	✔	✘

Key for table: ✔- yes ✘- no
+ SFO means the "statutory funding objective".
* The PPF basis is only used where the trustees have not yet received the first statutory fundingobjective valuation for the scheme.
‡ A scheme apportionment arrangement is a notifiable event, and notifiable to the Regulator if it is entered into after the occurrence of an employment-cessation event.

This table is intended to be used for guidance only.

1.8.2 The Anti-avoidance Regime
There are three main aspects to the anti-avoidance regime:
- TPR's power to issue contribution notices
- TPR's power to issue financial support directions
- TPR's power to grant clearance

Contribution notices
Under the Pensions Act 2004, TPR has power to issue a contribution notice against a person (this can be a sponsoring employer and companies or individuals who are "connected or associated" with a sponsoring employer) who within the previous 6 years has been party to an act or deliberate failure to act (or a series of acts or failures to act):
- (which occurred on or after 27 April 2004) the main purpose, or one of the main purposes of which, was (broadly) to avoid or reduce the amount of a section 75 debt which was, or which may have become, due to a defined benefit occupational pension scheme, or

- (which occurred on or after 14 April 2008), where TPR considers that the act or failure to act has "detrimentally affected in a material way the likelihood of accrued scheme benefits being received" from a defined benefit occupational pension scheme.

TPR has issued a Code of Practice which outlines the circumstances in which it expects to use the "material detriment" test. The circumstances identified are:

i) the transfer of a scheme out of the UK
ii) the transfer of a sponsoring employer out of the UK or the replacement of a sponsoring employer with an entity that does not fall within the UK
iii) sponsor support being removed, substantially reduced or becoming nominal
iv) the transfer of the liabilities of a scheme to another pension scheme or arrangement which leads to a significant reduction of:
   - sponsor support in respect of those liabilities; or
   - funding to cover those liabilities
v) A business model or the operation of a scheme which creates from a scheme, or which is designed to do so, a financial benefit for:
   - the employer; or
   - some other person,

where proper account has not been taken of the interests of the members of the scheme, including where risks to members are increased

A contribution notice may only be issued where TPR considers it is reasonable to do so.

In the context of a corporate transaction, this means that before any transaction involving a defined benefit pension scheme takes place, the parties need to consider the impact of the transaction on the scheme. If the pension scheme will suffer a material detriment (for example, because the transaction will materially weaken the financial strength of the scheme's sponsoring employer(s)) the parties should consider requesting clearance from TPR and the need to mitigate the detrimental impact on the scheme. Examples of mitigation include the payment of additional monies into the scheme or granting the scheme some form of additional security.

Potential recipients of a contribution notice can also seek clearance from TPR in the usual way before proceeding with a transaction. There is also a statutory defence against a contribution notice being issued under the 'material detriment' power. This will be available (broadly) where the potential recipient can demonstrate that they considered the impact of their actions on the pension scheme before proceeding and they took all reasonable steps to mitigate any detrimental impact.

Where a contribution notice is issued by TPR it will require the recipient to pay a contribution to the relevant scheme, which may (depending on the circumstances) be up to the full amount of the scheme's buy-out deficit.

Financial Support Directions

TPR has the power to issue a financial support direction to an entity (not usually an individual) connected or associated with a sponsoring employer that is either a "service company" or "insufficiently resourced" and which participates in an underfunded defined benefit occupational pension scheme. TPR may only issue such a direction where it is reasonable to do so.

A "service company" is (broadly) a company which has as its only function the provision of staff to other companies within its group.

An employer is "insufficiently resourced" if its assets are less than 50% of its share of the estimated section 75 deficit in the scheme and the assets of one or more companies within the same corporate group would be 50% or more of that deficit, when added to the insufficiently resourced employer's resources.

A financial support direction compels the recipient to put in place financial support (such as a company guarantee or regular payments) in respect of the sponsoring employer's obligations towards a scheme. The financial support must remain in place until the scheme winds up.

A company that leaves a corporate group (following a share sale) is still potentially liable to receive a financial support direction in respect of its former corporate group's pension arrangements for up to two years following the sale. This potential liability would normally be dealt with by way of an indemnity in the SPA.

Where a person fails to comply with a financial support direction, TPR has the power (in certain circumstances) to issue a contribution notice against the non-compliant party.

Clearance

The clearance procedure is run by TPR and its operation is set out in TPR's clearance guidance (March 2010). The clearance guidance sets out the circumstances when it will be appropriate for companies to consider seeking clearance from TPR. Seeking clearance is optional. However, a clearance statement from TPR will give companies assurance that the activities in relation to which clearance is granted will not give rise to either a contribution notice or a financial support direction (provided that the information given to TPR is accurate and that there are no material omissions).

TPR's guidance states that clearance should be sought in relation to events which are "materially detrimental to the scheme's ability to meet its pension liabilities" (these are known as "Type A events"). All Type A events will do one or more of the following either immediately or in the future:

- prevent recovery of the whole or part of a section 75 debt
- prevent a section 75 debt from becoming due or compromising the section 75 debt
- reduce the amount of the debt which would otherwise become due
- weaken the strength of the employer's financial covenant in respect of the scheme

TypeA events are divided into two categories; employer-related events and scheme-related events. An employer- related event will only be a Type A event if the scheme has a deficit on the highest of the following bases:

- FRS17/IAS 19 (this is the method used to calculate the amount of a company's pension liabilities which needs to be reported in its company accounts)
- section 179 (this is the method used to calculate a scheme's PPF risk-based levy
- the statutory funding objective

Examples of employer-related events include:

- a change in a group's structure
- business sales from an employer or widergroup.

A scheme-related event may be a Type A event, whether or not the scheme has a deficit on the bases listed above. A scheme-related event may have a direct impact on the employer's legal obligations to the scheme. However, detriment resulting from a scheme-related event cannot usually be assessed solely by reference to the impact on the employer's covenant.

Examples of scheme-related events include:
- agreements to compromise a section 75 debt
- non-payment of all or any part of a section 75 debt for an unreasonable period (for example more than 12 months)
- an arrangement which has resulted in preventing a section 75 debt from being triggered

The method for assessing whether a scheme-related event is a Type A event will vary depending on the specific event. Employers and trustees should consider an event in terms of its immediate impact on the scheme and the security of members' benefits and the possible impact of the event into the future.

For both employer and scheme-related events, where the employer and the trustees have identified a possible Type A event, they should consider and agree the most appropriate mitigation (i.e. a way to reduce the impact of the event on the scheme and, in particular, on the security of members' benefits). The level and type of mitigation will vary depending on the nature, circumstances and impact of the event and the scheme's level of funding. Appropriate professional advice should be sought.

Examples of mitigation include:
- additional contributions to the scheme
- a parent company guarantee
- a letter of credit to cover employer contributions or the scheme's deficit

Trustees should be involved in any clearance application as soon as practicable. As part of the clearance process, they should be asked to comment on whether or not they support the application and, if so, why. For the application to proceed efficiently, TPR will expect trustees to:
- have had the opportunity to assess the impact of the event
- consider appropriate mitigation
- negotiate where necessary, taking appropriate professional advice.

Trustee support of a clearance application does not mean that clearance will be granted. Lack of trustee support equally does not mean that clearance will be refused.

Where trustees are aware of a Type A event for which the employer is not seeking clearance, they should raise their concerns with the employer and, where any mitigation is either lacking or inadequate, consider contacting TPR.

1.9 SCHEME MERGERS

Following on from a corporate transaction a buyer may be left with multiple pension arrangements. Therefore, in order to reduce the administrative burden and cost associated with running multiple schemes, the buyer may decide to merge them into a single scheme.

1.9.1 How are Mergers Achieved?

A merger can be achieved by either setting up a completely new scheme and transferring the assets and liabilities of the existing schemes into the new scheme, or by transferring the assets and liabilities of one or more schemes into another of the existing schemes and then winding up the "shell" of the transferring scheme(s). A bulk transfer of the assets and liabilities of a scheme into another scheme can be achieved in two ways:

Transfers with members' consent
In this case each member is provided with full details of the benefits which they will be promised in the receiving scheme for both past and, where there is ongoing accrual, future service. The member is then offered the choice of transferring their accrued rights into the receiving scheme or retaining deferred benefits within the transferring scheme (these deferred benefits would then be bought out on the subsequent winding up of the transferring scheme).Alternatively, the member may opt to transfer their benefits into a separate arrangement of their choice. In practice, obtaining members' consent to a transfer in connection with a scheme merger is uncommon.

Transfers without members' consent
Trustees can agree the terms of a transfer with the trustees of the receiving scheme without the consent of each member concerned provided that:
- the trust deed and rules permit such a transfer without the members' consent;
- either the schemes apply to employment with the same employer, the transfer results from a financial transaction between the employers or the employers are (broadly) in the same corporate group;
- the actuary to the seller's scheme has issued a certificate under Schedule 3 of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 to the effect that the benefits to be attributed to the transferring members in the receiving scheme are broadly no less favourable than those given up under the transferring scheme; and
- the trustees of the transferring scheme consider that the bulk transfer would not adversely affect the security of the members' accrued rights.

In considering whether benefits are no less favourable, the actuary must take into account the years of pensionable service that will be credited to the members in the receiving scheme, the level of benefits and the security of those benefits, i.e. the solvency position of each scheme.

Although in these circumstances consent is not required, the members must be given full information of the transfer at least one month before the transfer takes place.

1.9.2 Issues to be Considered
The trustees of the transferring and receiving schemes will need to agree to the merger before it can take place and there are a number of issues that the trustees will need to consider before they can give their consent. The main issues that would need to be addressed are considered below in the context of a merger of two defined benefit occupational pension schemes.

Rules of transferring and receiving schemes
It is crucial that each set of trustees considers whether they have power in their trust deed and rules to make and receive the transfer of members' benefits and the associated assets. If they do not, they will have to consider whether or not they can amend the scheme's rules to address this.

The trustees of the transferring scheme should also consider the balance of powers in their own scheme with those of the receiving scheme. If the receiving scheme'sbalance of powers is overall less favourable to the trustees (and so the beneficiaries), the transferring trustees should question whether or not to make the transfer unless the unfavourable shift in the balance of power is compensated for by other factors, for example better benefits or significantly better funding. Should this not be the case, the transferring trustees should consider negotiating some kind of safeguard for the transferring beneficiaries from the employer of the receiving scheme.

Funding considerations
It is important for transferring scheme trustees to seek advice on the funding position of both the transferring and receiving schemes. If the transferring scheme is significantly better funded than the receiving scheme, the trustees of the transferring scheme should consider whether or not they can make a transfer into a scheme which would put their members in a worse position than they are already. Generally, transferring trustees should seek additional contributions from the employer to minimise or remove any funding disparity before they agree to the transfer. Receiving scheme trustees will have similar considerations where the receiving scheme is better funded than the transferring scheme. Alternatively, separate sections could be created within the receiving scheme so that the assets and liabilities of the transferring and the receiving scheme could remain separate for funding purposes.

Benefits for transferring members in receiving scheme
The most common arrangement is for the transferring employees to be granted, in the merged scheme, benefits for their past service in accordance with the rules of the old scheme. Benefits for future service (if any) will be determined by reference to the new rules of the merged scheme (which may or may not provide that future service benefits for the transferring members continue on the same basis as before the scheme merger). If the employers are prepared to meet the extra cost, or if there were surpluses in the old scheme, the members might be offered enhanced benefits in the new scheme for both past and future service.

Contracting out issues
Contracted out benefits may only be transferred into contracted out arrangements unless the relevant safeguards relating to transfers between defined contribution and defined benefit schemes are satisfied (the safeguards are introduced as a result of the abolition of protected rights from April 2012). Therefore, it is important to make sure that the relevant requirements are fulfilled.

1.9.3 Documentation
The merger will be documented in a transfer agreement which is executed by the trustees of both the transferring and receiving schemes as well as the employer(s) involved. In addition, where a scheme amendment needs to be made to one or both schemes to enable the transfer to take place, this will need to be documented either as part of the transfer agreement or as a separate deed of amendment. It is important that any such amendment is effected before the transfer takes place. Where there is going to be a transfer without consent, the scheme actuary will need to provide the relevant certificate. Appropriate announcements will also need to be issued to the affected members.

1.9.4 Tax and Transfer Payment
The transfer will not be subject to tax provided that it takes place between registered pension schemes. Transfers have to be reported to HMRC in the annual Scheme Return and are also an event that needs to be notified to TPR.

1.10 ACCOUNTING TREATMENT

FRS102, which applies to accounting periods from 1 January 2015, requires that scheme assets are measured using their fair value, and liabilities will be calculated using an unbiased actuarial rate and a discount rate based on high quality corporate bond yields. The resulting surplus or deficit must be recognised on the balance sheet.

These requirements have a significant impact on the calculation of corporate profits and this needs to be considered carefully by a buyer before they take on any liabilities in respect of a defined benefit pension scheme.

FRS17, the predecessor accounting standard, was adopted by TPR as the measure of funding below which it will consider imposing contribution notices and financial support directions. The guidance has yet to be formally updated to include references to FRS102.

The charge for defined contribution schemes is the cash contribution that is payable by the employer towards the scheme.

From 1 January 2005, all companies listed (quoted) and based in the European Union have had to comply with International Accounting Standards (IAS). FRS17 has to be consistent with IAS19.

Summary
A share sale is where a seller sells, and a buyer buys, shares in a company (the 'Target').

A business (or asset) sale is where a buyer acquires the assets that make up a business, for example plant and machinery, customer lists or particular product lines.

The commercial agreement between the seller and buyer will usually lay down how pensions will be dealt with (particularly if the seller has a defined benefit occupational pension scheme).

On a share sale, the effect on the Target's pension scheme very much depends on the particular circumstances. The type of pension arrangement and whether or not it will transfer to the buyer as a result of the sale will also impact on the warranties and indemnities that the buyer will seek in the SPA.

In the case of a business sale, the employees will almost always have to leave the seller's pension scheme for future service benefits. In addition, to their statutory right to take a cash equivalent transfer value, they may be offered the opportunity to transfer their accrued rights into the buyer's scheme. Alternatively, a bulk transfer may be made without the members' consent, subject to certain safeguards.

On a business sale, rights under an occupational pension scheme that relate to "old age, invalidity or survivors benefits" will not transfer to the buyer. The scope of this exception was addressed in the ECJ decisions in the Beckmann and Martin cases and by the High Court in Proctor & Gamble v. Svenska.

In addition, where the seller operates an occupational pension scheme, the buyer will need to provide a minimum level of pension provision or pension contribution to the transferring employers following completion of a business sale.

One of the key issues that needs to be considered on a corporate transaction involving a defined benefit pension scheme is whether a debt will become payable to the scheme in accordance with section 75 of the Pensions Act 1995.

Related to this is the decision of the commercial parties whether to seek clearance from TPR in relation to the proposed transaction.

Self Test Questions
- Explain what matters a buyer should take into account when taking a transfer of employees under a business sale where the seller provides a defined benefit occupational pension scheme.
- Outline the issues that would commonly be addressed through warranties and indemnities on a share sale.
- Explain what is meant by a "section 75 debt" and outline the circumstances in which a section 75 debt may become payable.
- Describe how a departing employer may be able to reduce the amount of any section 75 debt which it is liable to pay as a result of leaving a defined benefit occupational pensionscheme.
- Outline the circumstances in which TPR may issue:
- a contribution notice;
- a financial support direction.
- What is the benefit of obtaining clearance from TPR for a company involved in a corporate transaction?
- outline the methods by which the merger of two or more pension schemes can be achieved.
- outline the various factors which the trustees of the transferring and the receiving schemes need to consider before they agree to a scheme merger.

PART 5

GOVERNANCE

OVERVIEW

In this Part, we look at various aspects of governance.

Traditionally, scheme governance has been the preserve of defined benefit (DB) pension schemes. However, the number of individuals who are members of defined contribution (DC) schemes is increasing dramatically due to the automatic enrolment requirements. The Pensions Regulator (TPR) is taking an increased interest in ensuring that DC schemes are governed appropriately.

The Part consists of a single Chapter in which you will learn about the general principles for scheme governance, firstly from the perspective of scheme trustees and then from the perspective of employers and scheme providers. You will also learn about risk management and the importance of good member communications.

When you have completed this Part, you will have gained an understanding of the increased importance of good governance of a scheme from an operational, investment and risk perspective.

CHAPTER 1
Governance Requirements

INTRODUCTION

In this Chapter we explain about the importance of effective governance, and note the increased focus of TPR on DC scheme governance.

Having an effective governance programme in place can help ensure the smooth operation of a scheme whilst at the same time greatly reducing its vulnerability to risk. For trust-based schemes the responsibility for implementing and monitoring the operation of a governance framework predominantly lays with the trustees, in the case of contract-based schemes the employer and the provider both have an important role to play.

When you have completed this Chapter, you should be able to demonstrate an understanding of the importance of high level scheme governance. You will also understand the role the employer can play and how an effective communication programme can enhance the operation of a scheme.

1.1 SCHEME GOVERNANCE

Trustees/managers are expected to implement an effective governance programme to minimise the risks that members' benefits may be exposed to. As part of this, they would be expected to identify and deal with a number of potential risks.

1.1.1 Internal Controls

Trustees have a duty to act in the best interest of a scheme's beneficiaries, as set out in the principles of trust law. Therefore, it is vitally important that the trustees have a framework of internal controls – the processes and procedures to be followed for the effective administration and management of the scheme. Having such a framework helps them to identify, evaluate, control and monitor the risks to their scheme. The types of risk to a scheme could either be operational, financial, funding or regulatory and compliance.

The trustees should use a risk register to document the risk and show the controls in place to manage it. They should update the risk register on a regular basis at each trustee meeting and use it to identify any weaknesses in the scheme's internal controls.

1.1.2 Conflicts of Interest

A conflict of interest can arise where an individual, in this case the trustee, has multiple interests, one of which could potentially influence the decision making in the other. For example, where an employer-nominated trustee is also the Finance Director of the sponsoring employer. In this situation, there may be occasions where that particular trustee is conflicted between their responsibility to act in the best interest of the scheme's beneficiaries and their desire to keep employer costs down in their role as Finance Director as well as their company law duties as a director to promote the success of the company.

It is important that trustees have a process in place to identify potential conflicts of interest and a workable policy to deal with them as and when they arise. It may be that when the trustees are discussing a particular issue and it is recognised that a conflict of interest exists for one of the trustees, then that trustee may be required to remove himself from the discussion.

The relationships between the parties to a contract-based arrangement are different compared to trust-based arrangements. An employer governance committee for a contract-based arrangement can operate a similar oversight role to the trustees of a trust-based scheme; however, the sorts of conflicts described in the above paragraphs may not arise.

1.1.3 Record Keeping

The need to have good records is necessary for all financial products. However, the length of time pension scheme records need to be kept and the number of transactions that need to be noted on a DC member's record or salaries for DB members, mean that accurate data is of vital importance to a successfully functioning scheme. TPR has stated its view that the fundamental requirement of good administration is that members can be told the correct value of their pension rights. However, the ability to do this very much depends on maintaining accurate scheme records. Poor record keeping can lead to significant additional costs to a scheme in areas such as administration, error correction and claims from members. We cover this in more detail in section 1.7.1.

1.1.4 Knowledge and Understanding

The Pensions Act 2004 requires trustees to have a good knowledge and understanding of the law relating to pensions, and to be conversant with their own scheme's governing documents. The legislation requires trustees both to obtain the appropriate level of knowledge and understanding, and to ensure this level of knowledge is maintained and to help trustees comply with this requirement, TPR has published a Code of Practice. The Code is designed to guide trustees as they ensure they have adequate knowledge levels to effectively fulfil their obligations.

The online 'Trustee Toolkit' contains a number of modules designed to help prepare trustees for some of the issues they may come across in their role. It is regularly updated, and provides a good foundation and reference point for trustees. A number of firms also offer trustee training programmes and some also incorporate the PMI's Awards in Pension Trusteeship qualification for trustees. TPR also has relevant regulatory guidance on its website, giving an overview of the issues which trustees may be required to address in the course of their duties.

Trustees should consider maintaining their own log of the training they have undertaken to update their knowledge and understanding. Alternatively, a trustee board may wish to maintain a central register of relevant training for all their trustees.

Similarly, for a contract-based scheme, a risk to members' benefits would arise if the managers lacked knowledge and understanding of their scheme. Whilst they are not required under the statutory duty to possess the same knowledge and understanding as trustees of trust-based schemes, the providers of contract- based schemes are subject to regulatory oversight by the Financial Conduct Authority (FCA). Providers are required to be authorised by the FCA before they can engage in the establishment and operation of a regulated pension product.

1.1.5 Monitoring Investments

The nature of risks and internal controls associated with investment strategies for DC and DB schemes may vary considerably. Whilst this may be the case, there will be a number of areas of investment governance where there are similarities and where objectives will be the same.

In order to achieve better returns for members and meet scheme funding obligations it's important that consideration is given to the appropriateness of a fund's strategic asset allocation. Poor investment decision making and controls can have significant consequences in terms of both funding and investment performance. From an employer's point of view, one of the advantages of DC schemes is that the investment risk within the scheme lies with the member. However, it is in the interests of all parties to ensure that the member is able to make the most appropriate investment choices to increase the probability of achieving their retirement goals. Therefore, it is vitally important that those in charge of the investment choices within a DC scheme consider the most appropriate investment options for their members, monitor these regularly and communicate effectively with the members about the options available and their risks.

Neither the trustees nor the sponsoring employer can provide the member with investment advice or be held responsible for the day-to-day decisions taken by the investment manager. However, the trustees are responsible for monitoring investment performance, querying decisions taken by the investment manager and taking further action if required. Although in a contract-based workplace scheme the contract is between the member and the provider, it is the employer that selects the provider and it is in the employer's interests to ensure the members have access to an appropriate fund range. It may want to monitor the funds to some degree in a similar way to a trustee.

An employer governance committee can help select investments, such as a default strategy and a core fund range, and then monitor these on a regular basis, adding and replacing where applicable,with the use of professional advisers.

Consequently, trustees/managers/employer governance committees should undertake regular reviews of the funds offered and their performance, whilst having clear procedures in place for the selection and removal of investment managers and for any alteration to the range of investments/funds and ensure these are applied consistently.

Since 6 April 2015 specific new requirements set out in the Occupational Pension Schemes (Charges and Governance) Regulations 2015 have applied in relation to DC governance and the charges levied on default arrangements. The key governance requirements in the regulations for trustees are:

- core financial transactions must be processed promptly and accurately;
- the value of costs and charges borne by members must be assessed;
- a statement of investment principles governing decisions about investments for the purposes of the default arrangement must be prepared;
- default arrangements must be designed in the members' interests and kept under regular review;
- the scheme deed and rules must not restrict the choice of administrators, fund managers or advisers to the scheme; and
- a chair of trustees (the Chair) must be appointed with responsibility for signing off an annual statement describing how the governance requirements have been met.

Core financial transactions are defined as including, but not being limited to:

- investment of contributions to the scheme;
- transfers of assets into and out of the scheme;
- transfers between different investments within the scheme; and
- payments from the scheme to or in respect of members.

Some of the new governance requirements apply only to "default arrangements". Broadly these are investment arrangements where the member does not have to express a choice in order for his contributions to be allocated to that fund. In addition, the arrangement must be used by the employer in relation to at least one worker as a qualifying scheme in order to discharge its automatic enrolment obligations. So a fund could be considered a default arrangement even if it is not being used to meet automatic enrolment duties in relation to all members. The new charge cap will only apply to default arrangements, details of this are in 1.4.2 below.

The Chair can be an individual trustee, a director of a corporate trustee or a professional trustee body which is a trustee of the scheme (e.g. a professional independent trustee). The first Chair had to be appointed by 5 July 2015. Schemes which already have a Chair in place will not have to appoint a new one.

Each scheme must produce an annual statement signed by the Chair which must be published within seven months from the end of the scheme year to which it relates. Further guidance is expected from the DWP on the content of the Chair's statement but it must include:
- latest statement of default investment strategy;
- details of any review of the default strategy and resulting changes (or if no review, date the last review took place);
- description of how the requirements in relation to core scheme financial transactions have been met;
- report on charge levels in default funds and the range of charges in other funds and whether they deliver value to members;
- report on transaction costs, or an explanation of why they have not been able to obtain them and an assessment of the value they represent; and
- assessment of how the combined knowledge and understanding of the trustees, together withadvice available, enables them properly to exercise their functions.

The FCA has issued parallel rules which apply to contract-based schemes, including requirements for Independent Governance Committees (IGCs) (see below).

1.2 DC GOVERNANCE

1.2.1 Member Outcomes

There is an increasing focus on improving member outcomes as part of good governance.

Minimum governance requirements and expectations should be met (including, of course, any legal requirements). Good member outcomes can be influenced by assessing/obtaining value for money, acting in members' best interests, transparent and well communicated costs/charges, mitigating risk, financial protection, and investment governance.

In deciding where and how to focus attention, activities should be aligned with scheme objectives (which may themselves include objectives to help deliver good member outcomes) and available resources, time and budget.

Providers and advisers also have an important part to play (and should work in a joined-up way with employers) to help deliver good member outcomes.

1.2.2 Value For Money(VFM)

The term 'value for members' ('VFM') is relatively new in the area of DC trust-based workplace pension schemes, replacing the term 'value for money' which is still used for contract-based schemes.

Poor value is considered a key risk for DC workplace pensions and, as a result, such schemes are under increasing scrutiny to provide VFM – Part 5 Chapter 1 refers to schemes' duty to assess and report on costs and charges. Although there is no absolute definition of what represents VFM, such is the diversity between DC workplace pension schemes, both TPR and the FCA have set out their expectations in this regard.

Essentially, VFM relates to the value of benefits or services to members in return for the costs they bear.

1.2.3 VFM in DC Trust-based Pension Schemes (Including Master Trusts)

TPR describes VFM in the DC Code as: "...where the combination of costs [to which members' funds are subject] and what is provided for the costs is appropriate for the scheme membership as a whole, and when compared to other options available in the market". VFM does not necessarily mean low cost, provided higher costs can be justified by improved benefits.

TPR encourages trustees to consider which areas members place most value on, which includes taking into account scheme demographics and, where possible, the membership's salary profile. The areas that constitute VFM and the weightings of importance will, of course, vary from scheme to scheme (and may even vary for different tranches of members within the same scheme).TPR notes that there is no uniform approach to assessing VFM, but expects trustee boards to consider four key areas, as a minimum, when they are assessing VFM:

- scheme management and governance
- administration
- investment governance
- communications

Where trustees find that changes to the scheme need to be made as a result of a VFM assessment, but the changes are under the remit of the employer, the trustee should act as a demanding consumer. In this regard, trustees should, to the extent they can under their own powers, try to ensure their schemes remain fit for purpose and competitive.

TPR sets out a model process for a VFM assessment:

- Step 1 – Collect information on what the scheme provides for members and at what cost
- Step 2 – Assess the scope of the service provided and the quality
- Step 3 – Evaluate the scope and quality of the service provided against costs
- Step 4 – Report on the findings and, if necessary, take action to address poor value

As mentioned in Part 5, Chapter 1.1, the law requires most DC trust-based workplace pension schemes to explain their VFM assessment and set out their different levels of charges and costs in the annual Chair's statement. When assessing VFM, TPR expects trustees' boards to focus on those elements of scheme provision for which members bear the cost. Where costs are shared between members and employers, the basis of this should be set out clearly in the Chair's statement as part of the explanation about the VFM assessment.

TPR sets out the key factors that might influence the overall value offered by a scheme, as opposed to the prescribed VFM assessment. These include the scheme's governance framework, security of assets, employer contributions and the value over the longer term (and gives examples).TPR suggests that trustees may wish to refer to these additional factors in the Chair's statement to provide context for the report on the VFM assessment – although this additional information is not required by law.

Even if trustees report good value, TPR suggests that it is best practice to have arrangements in place to continue to monitor and evaluate services (and indeed, as mentioned above, there is a requirement to undertake a VFM assessment at least annually). It sets out developments that could affect good value, such as changes in legislation, new technology and a switch between products or investment platforms. Trustees should also review their assessment approach each year to ensure it is fit for purpose, considering whether examples of good practice have emerged in the industry that could be adopted.

More information on VFM can be found in the "VFM" section of the DC Code and supporting "How to" guide on TPR's website:
http://www.thepensionsregulator.gov.uk/trustees/managing-your-dc- scheme.aspx

1.2.4 VFM in Contract-based Workplace Pension Schemes
The FCA is keen to keep the assessment of "value" consistent across contract-based and trust-based workplace pension schemes. As mentioned in Part 5, Chapter 1.4 below, value for money features as a main focus within an IGC's terms of reference.

Initsguidancetoemployersentitled'Monitoring yourpension scheme' from July2013,TPRsuggestsvaluefor money as an item on which the employer governance committee could focus. The link for this paper is found at: **http://www.thepensionsregulator.gov.uk/docs/employer-management-committees.pdf**

Under value for money, considerations should include:
- That the costs and charges taken from a member's savings should be competitive when compared against the benefits and services offered
- What members are getting for their money should be transparent
- A scheme's effectiveness – is it still fit for purpose, taking into account the profile of membership and other schemes' services and costs?

Does the scheme's provider offer information about the scheme's charges in accordance with the Joint Industry Code of Conduct (as set out by the former NAPF (which is now called the Pensions and Lifetime Savings Association) – see **http://www.napf.co.uk/PolicyandResearch/~/media/Policy/Documents/0273_ Pensions_charges_made_ clear_code_of_Conduct.ashx)**

The Financial Conduct Authority (FCA) published new rules for IGCs in April 2015 (PS15/3).These make it clear that the primary purpose of an IGC is to act in the interests of scheme members in assessing and raising concerns about the VFM of the provider's workplace personal pension schemes. The FCA requires that the minimum terms of reference for an IGC include a requirement to assess whether default investment strategies are designed in the interests of members. IGCs are also encouraged to recommend to the provider that the IGC should review all investment strategies, in the interests of relevant scheme members, and, if the provider refuses to support this, may escalate that refusal to the FCA. There is no mandatory framework for how VFM should be assessed.

1.2.5 The Structure of Bundled and Unbundled Arrangements
DC arrangements can be structured as 'bundled' or 'unbundled' arrangements. The features and differences between these approaches are considered below.

Bundled arrangements
Bundled arrangements can be used for trust-based or contract-based workplace pension schemes. A bundled arrangement is one where the services provided to a workplace pension scheme, such as administration, investment advice and scheme communications are all provided by a single provider. Commonly, all provider charges are borne by members (usually through the annual management charge (AMC) that applies to members' investments).

Advantages of a bundled arrangement:
- There is one point of contact for the employer to manage.
- Cross-team relationships already exist, for example between administration, investment and communication teams.
- With one provider, online access is made easier for members who have only one system/website to refer to.
- Easier to facilitate a negotiation of terms.
- Use of the provider's standard communications to members.
- The costs of the service can be met by members through the AMC, which is an advantage to theemployer.
- Toassist with the governance structure, providers can produce management information reports on a quarterly/annual basis.

Disadvantages of a bundled arrangement:
- It may be more expensive to members in the longer term than unbundling – the AMC is higher for the use of more services.
- A bundled arrangement may require compromise, as the provider may be best-of-breed in one area and not in another (for example, a provider may show strength in administration, but may not have a strong communications capability).
- There can be limitations on tailoring the scheme (i.e. communication materials).

Unbundled arrangements

When trust-based workplace pension schemes are unbundled, this means that the trustees may choose to outsource some or all of their duties (such as administration, investment and communication) to different service providers and pick 'best-of-breed' providers in each area. It should be noted that contract-based workplace pension schemes generally do not have the ability to be operated on an unbundled basis and are invariably operated on a bundled basis through pension providers.

Unbundled arrangements tend to be better suited to larger trust-based DC workplace pension schemes. It is common for the costs of operation under unbundled arrangements to be split between members and the trustees/employer, with often the investment costs being borne by members through an AMC and the administration and communications costs being met by the trustees/employer. In some (less common) cases with unbundled arrangements, all costs of operation are met by the trustees/employer or, occasionally, the members.

Advantages of an unbundled arrangement:
- Employer can choose 'best-of-breed' for fund managers and provider services.
- Wider range of investment funds tends to be available to members.
- Easier to use bespoke communications for members.
- More flexibility to leave an area of service/provider when it is no longer suitable.
- In-depth administration reports can be produced.

Disadvantages of an unbundled arrangement:
- There is a higher governance responsibility for monitoring the administrator and investment managers.
- There is a need to coordinate services from different providers.
- Responsibility for designing communications is on the trustees.
- It tends to be more expensive for the employer.

1.2.6 Appointing and Managing Advisers and Service Providers

As part of the governance structure, the trustees/employer should have processes in place for scheme advisers and service providers, in terms of:
The selection process and appointment of services (whether required by law or otherwise) Management of the services, including monitoring and reviewing

TPR expects trustee boards to be able to demonstrate their ability to manage commercial relationships effectively. Its expectations include:

- Ensuring as far as possible that the terms and conditions of any contracts with advisers and service providers enable the trustee board to obtain all the information and advice they need to make key decisions
- Communicating regularly with representatives from service providers who carry out key elements of the day to day running of the scheme and, where appropriate, inviting them to attend trustee board meetings.
- Where performance is not satisfactory, considering whether it is in members' interests to replace the adviser/service provider

To meet these expectations, trustees should operate adequate internal controls, and appoint auditors and fund managers, to ensure the scheme is run in accordance with both the law and the scheme rules.

Further information can be found in the "Scheme management" section of the DC Code and supporting guidance on TPR's website:
http://www.thepensionsregulator.gov.uk/trustees/managing-your-dc-scheme.aspx

For contract-based workplace pension schemes, there are no explicit regulatory requirements in identifying and appointing scheme advisers or service providers. However, like trustees, the employer will wish to ensure that it is appropriately supported in terms of operating a successful workplace pension scheme and delivering good member outcomes. As a result, employers will often look to use advisers and service providers in the same way as for trust-based workplace pension schemes.

1.2.7 Selection and Appointment

It is vital that trustees/employers evaluate the suitability of all advisers and service providers prior to their appointment to ensure they will satisfy the needs of the workplace pension scheme.
A professional adviser should be asked to provide a scope of services, remuneration basis and to demonstrate how they provide good service, innovative ideas, tailored solutions etc..

A trustee or employer may also use a professional adviser to assist them in selecting a service provider. In such a process the trustees/employer could be asked, for example, to identify areas of importance from a list of criteria (including investment, business and communication areas), which would then be matched to the strengths of different providers (particularly bundled providers) to help it construct a shortlist of potentially suitable candidates.

There should be a clear and comprehensive contract in place setting out terms for appointment of advisers or service providers, which can include items such as:

- scope of the work required;
- standard of care to be adhered to and service level agreements;
- extent of trustees'/employer access to key personnel and dedicated teams;
- data protection and security arrangements in place;
- limitations of liability;
- fees:
  - agreed fees
  - basis for calculating fees
  - additional charges

- agreement on delegating functions; and
- agreement on terminating the appointment (including if a notice period is required and the basis for any exit fees).

1.2.8 Management of the Services

Trustees/employers will need to have adequate controls in place to ensure their relationship with advisers and service providers remains robust and professional.

Trustees should ensure that:
- information or advice given to them is fully understood and acknowledged;
- they understand what information the adviser needs to fulfil their role;
- any fee basis is appropriate and that it is documented;
- members are receiving value for money for services available;
- advisers are aware of their accountability to trustees for advice given; and
- they understand the complaints procedures for advisers and service providers.

1.2.9 Monitoring and Reviewing Services

Trustees/employers should continually monitor the performance of their professional advisers/providers. Trustees will usually have a rolling programme of review, for example, over three or five years, and each professional adviser/provider will be reviewed during that period. The review can take the form of a meeting between some or all of the trustees/managers and the professional adviser/provider, or a formal questionnaire or presentation. If problems are identified, trustees/managers may give the professional adviser/provider a set period of time to rectify the situation, but if the trustees/managers are not satisfied with a service they may choose to consider appointing a replacement professional adviser/provider, often through a tender process.

Regardless of who the trustees of a trust-based workplace scheme appoint to assist them with managing a scheme, the trustees remain responsible for the management and administration of the scheme. The employer will work closely with any provider and adviser to establish an effective governance framework.

To be able to monitor professional advisers/providers, trustees or employers need to understand how they make their decisions. All decisions need to be made following an appropriate procedure. For example, trustees/employers need to ensure that all professional advisers/providers have a conflicts of interest policy in place, so that any actual, perceived or potential conflict can be adequately addressed and does not have an adverse effect on the workplace pension scheme. Trustees/employers may also want to monitor and assess professional advisers/providers against any agreed service levels (for example, an agreement that the adviser/provider will respond to instructions from the trustees/employers within 5 working days).

1.3 ROLE OF THE EMPLOYER

The employer has an important role to play in helping scheme members achieve good outcomes from their pension savings. In response to both the recent economic downturn and the workplace pension reforms, TPR has recently focussed on the responsibility employers have for ensuring their employees are suitably informed about pension provision.

The aim is to improve employer engagement with minimal additional burden on the employer and to encourage a greater level of appreciation by employers of the value of their workplace pension arrangement and the importance of retirement planning. It is important that trustees, employers, providers and advisers ensure they have clearly defined responsibilities for the governance and management of their pension arrangements. In trust- based schemes, the trustees have the lead responsibility for governance activities. However, in contract-based workplace arrangements, employers should take the lead role and work closely with their provider and adviser to establish an effective governance framework.

The employer's governance role for contract-based schemes is aided by the introduction of provider IGCs from April 2015. An employer should still provide oversight of their scheme to some degree as the IGCs remit is to monitor the provider's whole book of business and not the individual arrangement at a scheme level.

An important part of an effective governance framework is to have a clear communication and education programme in place. This ensures that both members and potential members understand the need to plan for their retirement. The employer can play an important role in the communication process and this is covered in further detail below.

1.4 ROLE OF THEPROVIDER

With the introduction of automatic enrolment, the number of people contributing to DC pension schemes is increasing dramatically, and of those a significant portion will be contributing to contract-based schemes.

The importance of providers offering a well managed product with appropriate investment options, well run administration and adequate internal controls, has increased with the introduction of the automatic enrolment requirements. This is particularly important for small employers who do not have the resources to spend time on developing an appropriate pension scheme. Insurance companies wanting to provide an alternative to NEST for these types of employers, have to ensure that their contract-based schemes are an attractive alternative.

Within contract-based workplace pension schemes, in the absence of any trustee to monitor the scheme, the importance of the oversight of the provider has received more attention. This has resulted in the requirement for providers to operate IGCs from April 2015.

Provider IGC role
The role of the IGC within the governance structure of a contract-based pension scheme will be to monitor, and report on, whether the members of these schemes are receiving value for money. In this regard, its main areas of focus are on default investment strategies, fund performance and core financial transactions.

Another role of the IGC is to challenge the provider – hence the need to be "independent". An IGC needs to be proactive and can escalate any concerns to the FCA about concerns with the provider.

1.5 PENSION CHARGES

All DC schemes have a charging mechanism in place to cover the cost of administering and investing members' funds. The amount and method by which charges are collected varies depending on the type of scheme and between providers. It is important for members to be aware of the charges that apply to their pension to make sure they are getting value for money, an important part of scheme governance.

1.5.1 Types of Charges

Examples of charges that might apply in a DC scheme include:

- *Annual management charge (AMC)*
  Here, an amount is charged each year (often a proportion of a member's fund). The AMC that applies in NEST is 0.3% per annum (with an additional 1.8% contribution charge).

- *Fund switches and bid/offer spread*
  If a member wants to move their fund from one investment to another, there may be a fee for doing this. The fee would be either a fixed amount or a proportion of the member's fund. However, the trustees/ provider may allow members a certain number of free switches a year.

The bid/offer spread is an investment charge which usually applies when switching investments and reflects the difference between the buying and selling price of a unit in a unit linked investment. A unit linked investment is a fund split into smaller parts called units and contributions into the fund buy further units. The value of the units fluctuates in line with the underlying investments. A typical bid/offer spread is 5%. The buying and selling price is related to the value of assets in the fund.

- *Policy fees*
  These cover the cost of administration and are usually included within the AMC (but may be separate for legacy policies).

- *Allocation rates*
  Under the terms of some pension policies (typically legacy ones), the provider may use less than 100% of a member's fund to buy investment units and keep the rest. The proportion that is invested is called the Allocation Rate. Older policies tended to have a low allocation rate but, due to pressure to offer fairer terms, most providers have increased the amount they allocate to be closer to 100%.

- *Initial and accumulation units*
  Charges may be taken through using different types of units. Typically, in the first few years of a pension policy, contributions are invested in capital units, which have higher charges. Then, as per the terms and conditions of the policy, additional contributions are invested in accumulation units which have lower charges. At the end of a year, a provider may allocate additional accumulation units rather than pay a bonus reflecting the investment performance.

- *Transferring a pension fund*
  There may be charges involved in transferring a pension fund between schemes/providers and the charges in the new scheme may be higher or lower than those in the existing scheme.

1.5.2 Charge Cap
Since April 2015, a charge cap of (broadly) 0.75% has been imposed on default arrangements in DC schemes used by the employer in relation to at least one worker as a qualifying scheme in order to discharge its automatic enrolment obligations. The charge cap encompasses all member-borne deductions paid to the pension provider or another third party, excluding transaction costs. It applies to:
- members who contribute to a default arrangement from 6 April 2015; and
- all those members' funds within the default arrangement, regardless of whether the contributions were made before or after 6 April 2015.

1.5.3 Charges Code of Conduct
The Joint Industry Code of Conduct on DC pension charges was launched in April 2013. It sets out an industry standard for providing clear and accurate information to employers about costs and charges when they are selecting a pension scheme for their employees. The Code applies to all parties providing services to employers in setting up and administering pension schemes. This is crucial as employers need to be able to make an informed choice about which scheme to use to satisfy their automatic enrolment duties. The key elements are:
- all charges should be clearly stated in writing to the employer via a Summary of Charges document which has certain key features;
- a standard template should be used to summarise the services to be provided to the scheme;
- clear examples should be given of the effect of charges on employees' pension pots directly or via a web tool.

1.5.4 Retail Distribution Review

New regulatory rules came into force on 31 December 2012 following the Retail Distribution Review (RDR). The RDR was in response to concerns about the selling of commission-based products and a lack of understanding in general by consumers about financial services and financial decision-making. The key objectives of the RDR are to:

- improve the clarity with which firms describe their services to consumers;
- address the potential for adviser remuneration to distort consumer outcomes; and
- increase the professional standards of advisers.

The new rules require financial advisers to move away from charging commission, where an amount is indirectly taken from the product bought, to charging a fee for the whole advice process that is agreed upfront with the customer. This applies in respect of all Retail Investment Products as defined by the FCA including stakeholder and personal pension schemes.

With commission removed from the market, and all advice being paid for on a fee basis, the FCA were concerned that this would leave a gap in the market. In particular, small employers might not take advice on the most suitable workplace scheme for their employees if they have to pay upfront fees. The FCA thought that the solution was to introduce consultancy charging. The employer agreed a charge with the adviser. This was to be deducted from member funds, and was to be clearly identifiable for members. However, the Government became increasingly concerned that the additional costs to members could undermine the success of automatic enrolment and that the impact on member funds would be even more significant for employees who moved jobs frequently. Therefore in September 2013, the Government published regulations banning consultancy charging for DC automatic enrolment schemes, affecting all contracts taken out after 10 May 2013 (when the Government first announced the ban).The ban was extended to all contracts from April 2015.

1.6 RISK MANAGEMENT

Robust risk management and controlled processes are required to administer schemes correctly.

TPR highlights administration, in particular poor record keeping, member awareness and investment as key areas of concern. Those responsible for running schemes need to understand the key risks and to have a clear strategy to manage them. It is very easy to overlook or not recognise risks associated with administration; however, it is very difficult and time consuming to correct the situation if it goes wrong. Some of the risks a scheme might face include:

- internal controls not operating effectively;
- fraud;
- inappropriate investment strategies;
- a deterioration in the employer covenant (DBschemes);
- failure to comply with legislation or scheme rules;
- maladministration;
- computer system and database failures;
- ineffective scheme management; and
- risk of poor value for money (DC schemes).

Implementing an effective risk management strategy at an early stage, together with regular and effective monitoring, will allow risks to be identified before they escalate. Areas that would normally be covered within a risk management framework include ensuring that:
- the internal controls and monitoring process are robust and timely;
- the financial systems are adequate to minimise and extinguish the risks of fraud or misappropriation of scheme assets;
- investment strategies are monitored and reviewed;
- administrators have the requisite skills to deliver a good quality service evidenced by regular stewardship reporting, monitoring of service level agreements, performance appraisals and strict authorisation procedures;
- scheme advisers are regularly reviewed and having in place a conflicts of interest policy;
- the IT platform has the capabilities to meet administrative needs which could include online member access;
- the scheme is managed effectively with a clear communications programme; and
- the scheme delivers value for money and good outcomes for members.

It is important to monitor the controls to these risks on an ongoing basis. This is to ensure that the relevant information is provided to the trustees/managers, and that it is understood, reviewed and, if necessary, challenged. If something fails the internal controls, the trustees/managers need to take corrective action to remedy the error and reduce the risk of it happening again. Managing a pension scheme is very similar to running a business; attention to detail is critical.

1.7 MEMBER COMMUNICATION AND ENGAGEMENT

The points below are good practice guidelines for member communications. They do not consider the legal requirements concerning what information should be provided to a member and when (as set out in the Disclosure of Information Regulations 2013).

With DC schemes, both trust-based and contract-based, the onus is very much on the member to make the important decisions; decisions which can greatly affect the level of benefits they then go on to receive. If members have a lack of understanding of their pension arrangements they may well make poor decisions or take no action at all.

1.7.1 The Importance of Effective Member Communications

If members do not understand their pension scheme, then they may not appreciate its value or realise how it can help them to save for their retirement. Trustees/managers and employers have a shared interest in seeing that:
- members are engaged and motivated to plan for their eventual retirement;
- the scheme is effective in attracting, motivating and retaining employees;
- time and resources are not taken up by ineffective communications exercises; and
- legislation is complied with.

1.7.2 What Makes Member Communications Effective?

TPR has stated its belief that effective communications should have the following qualities:
- impact – to get the members’ attention;
- clarity – so the members are able to understand it; and
- accuracy – so members receive full and reliable information.

It is important that the right balance is struck between these qualities.

1.7.3 Good Practice When Communicating with Members

When looking to produce a communication aimed at pension scheme members, the trustees/ managers and employers should consider the following:

- having a clear communication plan;
- identifying the best way to communicate;
- tailoring communications to the audience;
- remembering the needs of all different categories of members;
- being open and honest;
- avoiding jargon; and
- choosing the correct time to engage.

1.8 SUPPORT FROM THE PENSIONS REGULATOR

TPR supports workplace pension schemes and provides information, and guidance to support their good governance. The strategic aim is to deliver good outcomes for members.

1.8.1 Guidance on Record Keeping

Poor record keeping in schemes can result in significant costs in areas such as administration, buy-outs and wind- ups, including error correction and claims from members (not to mention reputational damage). To address this issue, TPR published detailed regulatory guidance in 2010 aimed at trustees, providers and administrators on the testing and measurement of member data. The guidance categorises the data into three types:

- **Common Data** – this is data that is necessary and applicable to all members of all schemes. Its absence is likely to mean that the member cannot be identified or traced, or their benefits calculated with any degree of certainty (for example name, date of birth, sex, address, membership status).
- **Conditional Data** – the nature of this data is will vary from scheme to scheme and will depend on many factors including scheme type and design, a member's status in the scheme, system design and events that have occurred during their membership of the scheme.
- **Numerical Data** – numerical information regarding members' records that will help put the results of other measures into perspective.

Trustees/managers should ensure that a data review exercise is carried out at least once a year, including an assessment of the accuracy and completeness of the above types of data. They are required to put in place a data improvement plan to address poor quality data. Such a plan should have a defined end date within a reasonable timeframe.

1.8.2 The DC Code

TPR's Code of Practice on 'governance and administration of occupational trust-based schemes providing money purchase benefits' (the 'Code') came into force on 28 July 2016, replacing the previous Code.

The Code concentrates on TPR's expectations of trustees in complying with their legal obligations. It is supported by six sets of guidance on specific areas of good practice. The Code applies to trustees of any occupational pension scheme holding money purchase benefits (other than certain very small schemes). This includes AVC sections of DB schemes and money purchase benefits with a DB underpin, to the extent that the legislation applies to those sections or schemes.

The first section of the Code sets out the requirements and expectations for the appointment and fitness of trustees and the chair of trustees. It also includes reminders on the member nominated trustees and knowledge and understanding requirements. It also includes requirements for trustee selection and independence for master trusts and other relevant multi-employer schemes.

The Code focuses on the requirement to process core financial transactions promptly and accurately. This should include the handling of all employer and member contributions and assets relating to those contributions. There is no clear definition of 'promptness'. TPR accepts that trustees will not always have control over all the processes but where they do they should regularly review them to see if they can be done more quickly. Electronic processes should be used wherever possible. Trustee board sign-off should not delay a transaction. Statutory longstop dates should be considered by trustees as the absolute maximum. As to accuracy, trustees are expected to carry out a data reconciliation exercise at least annually and that contributions and investments are reconciled at least monthly. On investment, under the Code trustees are expected to engage with members about how and when they intend taking their benefits and then to use this information to help determine investment options and strategies. When considering value for members, TPR expects trustees to make efforts to understand the characteristics of their members, their preferences and their financial needs. This may include demographic characteristics and salary profile.

The requirements for communicating with members are largely set out in regulations. However, in the, TPR expects trustees to consider what additional information members might need in order to make informed decisions. This might include reminders about the right to transfer out or about flexible benefit options not offered by the scheme.

The six guides provide more detail and best practice in the following areas:
- trustee board;
- management skills;
- scheme administration;
- investment governance;
- value for members;
- communicating and reporting.

1.8.3 Clarifying the Role of DC Trustees
TPR published a statement for trustees to clarify the differences between DB and DC schemes, and the behaviour trustees of DC schemes should demonstrate.

1.8.4 Supporting Trustees and Employers
TPR has published material to help various parties in their goal to deliver good outcomes to retirement savers from workplace pension schemes.

For trustees, there is guidance to help them understand their role, help in how they such manage their scheme and advice on the role trustees should play alongside the employer's automatic enrolment duties.

For employers there are tools to help employers check whether their existing scheme meets the minimum criteria for an automatic enrolment scheme as set out in legislation. There is information to help employers begin planning and then implementing automatic enrolment. There is also guidance and resources to help employers understand their role in running a good quality pension scheme.

1.9 SUPPORT FOR MASTERTRUSTS

In May 2014, TPR and the Institute of Chartered Accountants in England and Wales (ICAEW) developed a voluntary assurance framework that will enable trustees of master trusts to demonstrate to employers that their scheme is governed and managed to a sufficiently high standard.

It sets out how trustees should report against a series of 'control objectives' relating to governance and administration, which are aligned with TPR's DC quality features. It acts as a check against schemes being set up by those who lack the competence or financial resources to take care of pension savings properly.

Although the assurance framework is voluntary, TPR expects master trusts to obtain this independent assurance report and to report for the first time for reporting periods ending in 2014/15. TPR will also establish and maintain a publicly available list of master trusts that have obtained independent assurance, to which employers and advisers can refer when selecting a scheme for automatic enrolment.

The ICAEW's guidance on applying the assurance framework to occupational DC master trusts is called 'Assurance Reporting on Master Trusts (Master Trusts Supplement to ICAEW AAF 02/07)'. AAF 02/07 is the guidance for practitioners who provide assurance services on operations or arrangements agreed between two or more organisation (third party operations).

The Occupational Pension Schemes (Charges and Governance) Regulations 2015 contain specific requirements in relation to master trusts. Additional requirements will apply to master trusts and other occupational schemes with non-associated employers (other than statutory schemes, which will not be subject to the new requirements until April 2016).These schemes must have at least three trustees, the majority of whom must be appointed under an open and transparent appointment process for a period of not more than five years and who must not be affiliated with any service provider in relation to the scheme. The Chair's statement in relation to such schemes must (as well as the information outlined in 1.1.5 above) include details of the recruitment process for trustees and a description of how members have been encouraged to make their views known.

The Pension Schemes Act 2017 provides for the authorisation and closer supervision of master trusts. The new provisions (which will be supported by detailed regulations) are expected to come into force in October 2018, although some transitional provisions apply to existing master trusts from 27 April 2017.

1.10 INDEPENDENT ASSURANCE REPORTING FOR RELEVANTTRUSTEES

Since 2005,TPR was required, by regulations, to maintain a register of independent trustees (known as Relevant Trustees) who satisfied certain legislative conditions. This register was known as the Trustee Register. To be on the Trustee Register, the trustee had to:
- have sufficient experience of occupational schemes;
- be a fit and proper person to act as a trustee;
- operate sound administrative and accounting procedures; and
- have adequate indemnity insurance cover.

TPR used this list to appoint a trustee to a pension scheme, usually on protective grounds, to ensure that the scheme was properly administered and members protected when its employer was insolvent.

TPR assessed the third condition above by requiring independent trustees to prepare an annual report on their administrative and accounting procedures and obtain an independent annual assurance report from an accountant on this before they could be accepted (and kept) on the Register. TPR also promoted the assurance report as best practice for independent trustees even if they did not wish to be on the Register.

The details are contained within AAF 04/13, the relevant Trustee Supplement to AAF02/07. This contains a number of principles and control objectives that the independent trustee's control procedures should be evaluated against, where relevant, and guidance for accountants.

However the Pension Schemes Act 2015 includes a provision removing the statutory requirement TPR to maintain a register of independent trustees. This provision is not yet in force.

Summary

Two important parts of running a successful scheme are to have in place:

- an effective scheme governance programme; and
- a co-ordinated and targeted approach to communicating with members.

In devising a programme of governance, the trustees of a scheme should consider its internal controls and procedures to manage scheme risk, manage conflicts of interest effectively, ensure their data and records are of a high standard, keep their knowledge and understanding up to date and monitor investments of the scheme. For a contract-based scheme, the issues are relatively similar and it would be the employer's responsibility with the manager for dealing with them rather than a trustee body.

It is vital to have a targeted member communication programme in place, particularly for a DC scheme as members are responsible for making their investment choices. If members have a lack of understanding of their pension arrangements they may well make poor decisions or take no action at all. DC members' understanding of their pension arrangements must also extend to the charges that are being applied on their funds and to this end, it is important for employers to understand the charges too.

TPR has produced a range of materials in support of its recent focus on good governance and administration standards.

Self Test Questions

- What are the types of risk a scheme could encounter?
- Identify the resources TPR provides to support good governance.
- Why is it important for trustees to have a policy in place to deal with conflicts of interest?
- What role should the employer play in relation to the governance of a DC scheme?
- Why is it important for schemes to have an effective communication programme in place?

PART 6

CURRENT ISSUES

OVERVIEW

In this Part, we look at current issues relating to the retirement provision. The Part consists of three Chapters.

In Chapter 1 you will learn about the impact of the cessation of contracting out on pension schemes. Chapter 2 covers pension liberation and Chapter 3 considers the possible impact on pensions of the UK leaving the European Union. Chapter 4 considers miscellaneous current issues.

When you have completed this Part, you will have gained an understanding of these issues and their impact on retirement provision.

CHAPTER 1
Cessation of Contracting Out

INTRODUCTION

In this Chapter, we explain briefly what contracting out was, and the impact of its cessation, which will happen in 2016 with the abolition of the State Second Pension and consider GMP equalisation.

When a pension arrangement is contracted out, both the members and the sponsoring employer pay National Insurance contributions (NICs) at a reduced rate. In return, the contracted out pension scheme agrees to provide a minimum level of pension benefits, or the investment proceeds of a minimum level of contributions, in lieu of the State Second Pension (S2P) (and the State Earnings Related Pension Scheme prior to 6 April 2002).

Prior to 6 April 2012, there were a number of ways in which a pension arrangement might be contracted out:
- Contracted out Salary Related (COSR) Scheme;
- Contracted -out Money Purchase (COMP) Scheme;
- Contracted out Mixed Benefit (COMB) Scheme; and
- Appropriate Personal Pension (APP) / Stakeholder.

From 6 April 2012 contracting out on a money purchase basis was abolished. Funds built up from the NIC rebates in these schemes (protected rights) are now treated as any other defined contribution benefits. From that date, the only contracted out schemes have been COSRs.

Contracting out on a defined benefit basis (COSRs) ceased when the State Second Pension (S2P) was abolished in April 2016 to make way for the single tier State pension.

1.1 IMPACT OF CESSATION OF CONTRACTING OUT ON DEFINED BENEFIT SCHEMES

The State Pension was reformed from April 2016 into a single-tier pension – the 'new State Pension' – for future pensioners. The introduction of the new State Pension means that there will no longer be an additional State Pension from which to contract out. Consequently, contracting out and the NIC rebate came to an end on 6 April 2016. Employers and employees participating in contracted out defined benefit (DB) occupational pension schemes at that date will then pay the standard rate of NICs after April 2016.The increase in NICs for employers and scheme members is 3.4% and 1.4% of NI band earnings respectively.

1.2 ISSUES TO CONSIDER

1.2.1 Recouping the Increase in NICs

Some employers have provisions in their scheme rules to enable them to amend their schemes to recover this additional cost but others will be prevented from making such changes by their scheme rules or the requirement for trustee consent for such changes, or both of these.

Section 24(2) of the Pensions Act 2014 gives employers sponsoring contracted out salary-related occupational pension schemes a power to amend the scheme rules in order to adjust for the increased NIC liability – this is known as the "statutory override". Changes may be made either to increase employee contributions or reduce the future accrual of benefits in respect of the scheme members. The extent to which an employer can amend the scheme rules using the statutory override is limited to that estimated as matching the amount of increase in the employer's NICs.

On 8 May 2014 the Department for Work and Pensions published a consultation on draft Regulations and an Impact Assessment. The Regulations were:

a. The Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-out) Regulations.
b. The Occupational Pension Schemes (Schemes that were Contracted-out) Regulations

The Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-out) Regulations 2015 were laid before Parliament on 4 March 2015 and came into effect on 6 April 2015. Any amendments may not have effect before 6 April 2016.The Occupational Pension Schemes (Schemes that were Contracted-out) Regulations were laid before Parliament on 16 September 2012 and came into force (for the most part) on 6 April 2016.

The statutory override applies regardless of scheme rules and does not require trustee consent for its exercise (although the trustees must be consulted on the effective date of any change). It will be valid for five years from its commencement date.

The scope of the new power is strictly limited, giving employers the ability to:

- increase the employee contributions of affected members; and/or
- reduce their future benefit accrual,

but by no more than the increase in the employer's NICs in respect of them. The employer will have to obtain actuarial certification to confirm this last point.

The likelihood is that many employers will seek to offset the extra cost, or otherwise use the end of contracting out as the trigger for wider scheme changes. Obvious options would be to increase member contributions, reduce future accrual rates or maybe exit DB provision altogether.

1.2.2 Issues Arising from Benefits Structure

Many schemes, DB and DC, integrate with the State Pension system in ways other than contracting out. Examples include bridging pensions and offsets to benefits or pensionable salaries. If, say, a bridging pension is expressed in terms of the Basic State Pension, then it is not at all clear how that provision will operate, if it operates at all, when the Basic State Pension ceases to exist.

The scheme rule wordings that give effect to such integration designs can be extremely diverse, so outcomes may be unpredictable. Trustees and employers should review their scheme rules' integration provisions, to try to determine how they might be affected – and maybe start to consider amendments. (For example, where scheme rules currently refer to "Basic State Pension", could "lower earnings limit" be substituted as a reasonable proxy?)

However, those trying to tackle these issues will face the usual obstacles relating to amendment powers and protection of subsisting rights.

1.2.3 Automatic Enrolment

Some employers use their scheme's contracted out status as a means of fulfilling their automatic enrolment obligations. These employers will therefore need to consider whether from 6 April 2016 the scheme still meets the automatic enrolment requirements on one of the alternative bases available. If not, then changes will be needed if the employer wishes to continue using that scheme as its automatic enrolment vehicle.

1.2.4 Early Cessation of Contracting out
If a scheme which has GMP liabilities ceases to be contracted out before 6 April 2016 there is a danger that "anti-franking" laws will apply. In essence this means that means that GMP revaluation would need to be provided in addition to accrued benefits rather than providing an underpin.

1.2.5 Guidance on Conversion
While the new measures will simplify future provision, legacy contracted out benefits will continue to exist for many decades to come. Conversion of guaranteed minimum pensions (GMPs) to other scheme benefits of equal value is an existing facility that might offer some way round the issue. However, the option has so far had negligible take up – partly because of legal uncertainties and partly because the costs have hitherto outweighed the benefits.

The looming issue of GMP equalisation (see 1.2.7 below) may prompt the Government to issue statutory guidance on conversion.

1.2.6 Government Assistance

Technical support
HMRC are providing technical support to employers and scheme providers, for example through publicising the new procedures being put in place in preparation for ending contracting out. The first in a series of "Countdown Bulletins" was published in March 2014 to give pension scheme administrators and providers information about changes to processes.

HMRC are also collecting Scheme Contracted out Numbers (also known as "SCONs") from employers from April 2014 to enable the automatic closure of all contracted out scheme memberships from December 2016. This means there will be no need for schemes to return their contracted out certificates to HMRC.

Scheme reconciliation service (SRS)
Working with pension schemes, HMRC has developed a reconciliation service to ensure individual contracted out records are correct. Employers and pension providers will be able to use a self-serve portal to obtain information about accrued GMPs (the rights arising from contracting out between 1978-1997).

The SRS allows pension scheme administrators to reconcile their membership and GMP data against the records held by HM Revenue and Customs (HMRC). Registration for this service is the first step in a process to support the ending of contracting out in April 2016 and must have been done before 5 April 2016.

SRS gives a list of contracted out periods and GMP data for members who have left contracted out employment. This includes early leavers, pensioners, widows, widowers and surviving civil partners. SRS is available to all defined benefit schemes that have contracted out rights preserved within the scheme.

1.2.7 GMP Equalisation

GMPs
GMPs are a minimum level of pension benefits in lieu of the S2P (and the State Earnings Related Pension Scheme prior to 6 April 2002) for service up to April 1997. GMPs were abolished from 6 April 1997, but accrued benefits remain. GMPs are payable from age 65 for men and age 60 for women. This means that GMP accrues differently for men and women and leads to inequality in the resulting benefit. The inequalities are exacerbated by the fact that revaluation and indexation requirements which apply to GMPs are different to those most schemes use for non GMP benefits. Pension schemes are required by EU law to provide the same retirement ages for men and women for benefits accrued since 17 May 1990.

The vast majority of schemes have not taken steps to carry out GMP equalisation. However, over the past few years successive Governments have stated that they consider there to be an obligation under existing law to equalise the effects of GMPs (although this is not the view of some pensions lawyers).

The Government's 2012 consultation
In its January 2012 consultation the Government assumed schemes were legally obliged (under EU law) to equalise GMPs accrued in defined benefit schemes between 17 May 1990 and 5 April 1997. The consultation included a description of a possible method to equalise for the effects of GMPs. It made it clear that in doing so, it was not prescribing this method, or making it a legal requirement. However it stated that "schemes would know it had been considered by a wide range of pension professionals".

The Government's proposed method required that an additional calculation was made to compare what a member would get under the scheme rules and the relevant legislation taking into account GMP - if they were treated as being a person of the opposite sex. This method ensures that members receive the best benefit that either a man or a woman with their level of benefits in the scheme would receive at any point in time. However, this means that a comparison would need to be undertaken each time the amount of pension in payment is calculated (which would be at least annually).

Interim Government response to consultation (published in April 2013)
In this consultation response the Government reaffirmed their stance that EU law requires GMP equalisation and advised that it was going to legislate to, in effect, require GMP equalisation, but not yet. This was to allow further time to consider the conversion of GMPs to ordinary scheme benefits and maybe give guidance on GMP equalisation. The Government stated that it wanted to work with the pensions industry on developing guidance.

Current Government position
In November 2016 the Government issued a consultation paper which includes an update on the work of the working group on GMP equalisation (this was set up following the withdrawal of the 2012 draft GMP equalisation regulations in 2013).A new proposal is suggested (the 'ten-stage process') for a one-off calculation and actuarial comparison of benefits between a man and a woman with the greater of the two then being converted into a main scheme benefit. The proposals include a number of suggested amendments to the legislation allowing the conversion of GMPs into main scheme benefits.

The consultation document states:

> *'The Governmentisnotplacinganyobligationonschemes to usethismethodnordoes it comprise legal advice to schemes on how to equalise: it should not be treated as a definitive statement of how equalisation should be effected. It simply describes one way of equalising for the effect of the GMP legislation which the Government believes meets the equalisation obligation derivedfrom EUlaw. The Government does not assert this is the only way that equalisation can be achieved.'*

It goes on to say that: 'where trustees are content that they are providing equal benefits, they need take no further action'.

Schemes entering the Pension Protection Fund (PPF)
The Pensions Act 2004 requires PPF compensation to be paid on a basis that is no more or less favourable to a woman (or man) than it would be to a comparable man (or woman), in respect of pensionable service on or after 17 May 1990.To meet this requirement, the calculation of compensation payments must take into account any differences in scheme benefits that have arisen due to differences in the calculation of GMPs for men andwomen.

The PPF has developed methodology that it requires schemestoundertakeinordertoequalisescheme benefits for the effect of GMPs. Trustee sandadvisersofschemesthattransfertothe PPFfrom1 June2013 are expected to implement the PPF methodology set out in the Technical Statement that can be found on the PPF website at **http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/GMP_Statement_Dec 12.pdf.**

Implementation issues

Whichever approach is settled on there may be a number of issues to be addressed in relation to implementation including:

- *Missing members*
  Many members who are affected by this have already died, retired, transferred out, divorced or been bought out. As a minimum that means going back over records for many years. In some cases it means tracking down members with whom they have lost contact.
- *Unknown GMPs*
  Many schemes do not know the exact GMPs they have. Before schemes can equalise benefits they need accurate records.
- *Cost*
  Regardless of the exact method, adviser fees will arise at a time when many schemes are trying to reduce fees.
- *Communication*
  Explaining the issue and any amendments to scheme benefits will require.

Summary

In the past it has been possible to contract out of S2P, either on a scheme basis or, by using a personal pension (or Free Standing Additional Voluntary Contribution (FSAVC)), on an individual basis. From April 2012, only DB schemes have been able to contract out. From the State's point of view, contracting out reduces the liability of future generations of workers to pay income to pensioners out of general taxation. From the point of view of the scheme or individual, it offers the possibility of providing a similar benefit at a lower cost through a COSR or, historically, the possibility of a higher benefit through a COMPS or APP if investment returns arefavourable.

However, whether or not contracting out makes financial sense depends on the level of the NI rebate available compared to the cost of providing the alternative benefit, which in turn depends on the age of the individual. Making this decision has become increasingly difficult, and as a result contracting out on a money purchase basis has been abolished.

Contracting out on a defined benefit basis will cease when S2P is abolished in 2016 to make way for the single tier State pension.

In 1997 contracting out changed for COSRs which no longer had to provide GMPs for servicefrom that time but instead had to satisfy the Reference Scheme Test. Benefits accrued in a COSR post 1997 are known as Section 9(2B) rights.

Self Test Questions

- How did contracting out change with effect from 6 April 1997 for a defined benefit scheme?

CHAPTER 2
ISSUES

INTRODUCTION

Pensions liberation scams generally encourage members of registered pension schemes to access their pension fund before normal minimum pension age, they may also promise high investment returns on any remaining assets. Action Fraud (the UK's national reporting centre for fraud and internet crime) received 750 reports of pension liberation fraud in 2015 and the Pensions Regulator (TPR) warned in mid-2014 that £495 million had been paid into pension scams.

The difficulty for trustees (and personal pension scheme managers) is balancing the individual member's statutory right to a transfer payment (Part 4ZA of the Pension Schemes Act 1993 (PSA 1993)) with concerns they may have that the member is the potential victim of a pension liberation scam. TPR has issued guidance suggesting trustees should warn members about the risks of pensions liberation and that they should undertake appropriate due diligence before a transfer is made (**http://www.thepensionsregulator.gov.uk/trustees/pension-scams- trustees.aspx**). In March 2015 a voluntary industry code of practice was issued by the Pensions Liberation Industry Group (**http://www.combatingpensionscams.org.uk**) setting out standards of due diligence.

HMRC has introduced tighter checks on applications to register pension schemes. Where it appears that the scheme is not genuine, or the scheme administrator is not a fit and proper person to take on the role, it will not register the scheme. HMRC will continue to monitor schemes, and may deregister schemes for instance where the scheme has not complied with its tax obligations.

Ultimately, as recent Pensions Ombudsman determinations and High Court judgments have confirmed, if the member does have a right to transfer (either under statute or under the scheme rules) then the transfer cannot be refused, hence the importance of making members aware of the risks of transferring and of proper due diligence.

2.1 WHAT IS PENSIONS LIBERATION?

Members are often targeted by unsolicited text messages and cold calling. They are offered pension reviews, higher returns on investments, pension loans and upfront cash to lure them into transferring. Members may also pressured by liberators to push through the transfer and sign the paperwork quickly.

Generally, scams see members being offered the opportunity to obtain pension monies before their normal minimum pension age (age 55). However, with the new pension flexibilities from 6 April 2015, members over the age of 55 are now being targeted too.

A payment to a member under the age of 55 is an unauthorised payment under the Finance Act 2004 and is subject to a tax penalty at a rate of 55%.Additionally, commission fees of around 20-30% are often charged and the balance of the fund may be transferred by the liberator overseas and never seen by the member again. Therefore, the member is left with substantially reduced benefits for retirement.

Some key risk indicators for trustees and members to spot a scam include:
- newly established schemes with little or no formal documentation;
- cold calling or unsolicited text or emails;
- pressure to force through the transfer quickly;
- encouragement to take cash and reinvest it;
- claims to allow access to pension before age 55; and
- transfers of money into an overseas investment.

2.2 STATUTORY RIGHT TOTRANSFER

Section 94 of PSA 1993 provides a right for a member of an occupational scheme who has ended his pensionable service (subject to certain conditions as to age and length of service) to take a cash equivalent transfer value (CETV). Section 95 provides that the transfer payment may only be made to an occupational scheme, personal pension schemes or annuity contract. Additionally, under section 169 of the Finance Act 2004 a transfer will only be an authorised payment if it is transferred to another registered pension scheme or a qualifying recognised overseas pension scheme (a 'recognised transfer').

As long as a member satisfies the relevant statutory requirements then he has a right to take his CETV within the statutory timescale (broadly within 6 months of him making a valid application).TPR can extend this time period in certain limited circumstances, including where the trustees have not been provided with such information as they reasonably require properly to carry out what the member requires (section 99(4) PSA 1993 and Regulation 13 of the Occupational Pension Schemes (Transfer Values) Regulations 1996).

From 6 April 2015, trustees or providers cannot make a transfer payment relating to DB benefits of £30,000 or more to a DC arrangement unless the member has first taken independent financial advice (section 48, Pension Schemes Act 2015).

2.3 DUE DILIGENCE

The voluntary code of practice on combating pension scams has three principles:
1. Trustees should make members and beneficiaries aware of pension liberation scams;
2. If a member requests a transfer, trustees should also have a robust but proportionate process forassessing potential liberation scams; and
3. Trustees should be aware of the methods used by liberators to ensure an appropriate course of due diligence.

Trustees should conduct due diligence to obtain information on the legal status of a receiving scheme, its registered status, details of the administrators, location, the employment link between the member and the new scheme, scheme documentation and the marketing methods used.

If there is a material risk, trustees should consider whether the member has a right to transfer; if the member does have this right, the transfer should be made within six months of the application (unless there are grounds for a time extension). If the trustees conclude that there is no legal right to transfer then they should inform the member of this (and the reasons) and consider reporting the matter to Action Fraud and TPR.

2.4 PENSIONS OMBUDSMAN DETERMINATIONS

There have been a number of Pensions Ombudsman determinations on liberation.

In Jerrard (PO-3809), Stobie (PO-3105) and Kenyon (PO-1837), the members had requested a transfer from a personal pension scheme to an occupational pension scheme, but the transferring schemes had refused to make any payment because they suspected that the transfer would result in pension liberation. Their suspicions arose for a variety of reasons, including:

- the receiving scheme had only been recently registered;
- a pattern of recent transfer requests for connected schemes;
- research into the receiving scheme and the employer to which it was linked; and
- the employment status of the member.

While the detailed facts of each case are different, the conclusions the Ombudsman drew were broadly similar (and his findings are equally relevant to trustees of occupational pension schemes as to personal pension scheme providers). Even if trustees suspect that the receiving scheme is for pension liberation purposes, if the member has the right to a transfer, they cannot refuse to make the transfer. It is up to the trustees to be satisfied that a right to transfer does not exist, rather than for the member to prove that it does. If the trustees refuse to make a transfer, they should provide a full explanation to the member concerned as to why the right to transfer does not exist in the circumstances.

Therefore, the primary question should be whether or not a member has a right to a transfer, whether under statute or the scheme rules. This must be considered on a case by case basis, and in light of the Pension Schemes Act 1993, the Finance Act 2004 and the scheme documentation for the transferring and receiving schemes. The Ombudsman considered:

- statutory transfer rights under PSA 1993, and the requirements for the receiving scheme to qualify as an “occupational pension scheme” in relation to this right, specifically:
  - whether or not the scheme passed the “purpose” and “founder” tests set out in the High Court case of Pi Consulting. Very broadly, was the purpose of the scheme to provide benefits and was it established by a relevant employer? and
  - whether the member was an “earner” entitled to transfer credits under PSA 1993. In all three cases, none of the members were earners, as they were not receiving remuneration in exchange for employment by the employer in relation to the receivingscheme;
- whether or not the transfer was an authorised payment under the Finance Act 2004 i.e. to a registered pension scheme or a qualifying recognised overseas pension scheme (QROPS), for the purposes of the scheme or to represent membership rights under it? In particular, the Ombudsman pointed out that if a significant proportion of the amount transferred would be going to the introducer of the receiving scheme or to others in fees, this would probably not be a “recognised transfer”, as most of the amount would not be for the purposes of the scheme or to represent rights under it; and
- where trustees have discretion to make a transfer they have to properly consider and exercise it regardless of suspicions of pension liberation. In Stobie, the scheme had failed to do so and simply refused the transfer as they were suspicious of the receiving scheme.

The Ombudsman suggested in all three cases that transferring schemes should undertake detailed analysis in order to determine if a member has a right to a transfer including obtain the rules and other documentation relating to the receiving scheme.

In Winning (PO-5799 and PO-5930) in April 2015, the Ombudsman decided, where the member had the right to a CETV, that it was not maladministration for the trustees to effect a transfer to a registered occupational scheme at the request of the member even though it turned out to be for pension liberation purposes.

In Harrison (PO-1384) in April 2015, the Ombudsman confirmed that even if the member does not fulfil the conditions for a statutory right to transfer but there is a contractual right to transfer under the scheme rules then a transfer must be made if the member so requests. This decision also emphasises the importance of undertaking a detailed analysis to establish whether the member has a statutory right or contractual right to transfer. Trustees cannot refuse to transfer purely on the basis of a suspicion of pension liberation without a detailed analysis of the right to transfer. TPR's guidance can only be relied on to justify this detailed analysis and it cannot be used to quash the legal right to transfer (whether statutory or contractual).

2.5 HIGH COURT DECISION – HUGHES V ROYAL LONDON

In February 2016 the High Court upheld a member's appeal against a determination of the Pensions Ombudsman that she did not have a legal right to transfer. The key issue was whether the member was an "earner" for the purposes of acquiring a transfer credit in the new scheme. A number of earlier Ombudsman decision had turned on the "earner" point (see 2.4 above).The decision in Hughes may make it much easier for members to transfer out into shell schemes.

The case has fairly typical facts and the Ombudsman's determination followed the standard pattern for complaints of this type. Ms H wanted to transfer the assets in her personal pension with Royal London to a small occupational pension scheme. The new scheme was established by a "shell employer". The Ombudsman had concluded that Ms H did not have a statutory right to transfer as she was not an "earner" in a relevant employment for the purposes of the new scheme. The company was not trading and although Ms H had an agreement to receive remuneration she had not actually received any salary from the company.

The High Court decision turned on the definition of "transfer credits" in section 181 of PSA 1993 which provides:

"transfer credits" means rights allowed to an earner under the rules of an occupational pension scheme by reference to:

a) a transfer to the scheme of, or transfer payment to the trustees or managers of the scheme in respect of, any of his rights (including transfer credits allowed) under another occupational pension scheme or a personal pension scheme, other than rights attributable (directly or indirectly) to a pension credit...."

Morgan J found that this did not require the individual to be an "earner" under the rules of the receiving scheme (which was essentially what the Ombudsman had held in the Hughes case and in his previous determinations) but merely to be an "earner" from any employment. Ms H was an "earner" as she had earnings from another source and this meant that she did have a statutory right to transfer.

The Ombudsman took the rare step of issuing a statement following the Hughes judgment:

"The Pensions Ombudsman Service has around 200 live cases which are affected by the ruling, so we welcome the clarity that it brings to those using our Service and to the industry generally.

In particular, it provides instruction to trustees and administrators that, assuming the other requirements for a statutory transfer right are made out, members do not need to be in receipt of earnings from an employer sponsoring the occupational pension scheme to which they wish to transfer their pension. Earnings from another source are sufficient.

It seems likely that most transferring members will meet this requirement so, beyond verification of earnings and the provision of risk warnings, trustees and administrators will be conscious that under current legislation they cannot refuse such a transfer – even if they have significant concerns that it may be for the purposes of pension liberation.

Members with similar complaints will benefit from the ruling but should note that providers may need to seek further information and wish to ensure the risks are fully understood, before a transfer is made."

Summary
This brief Chapter has outlined the development of pensions liberation in recent years. It began with an explanation of this type of pension scam. It also covered the voluntary code of practice in this area and finally noted some recent determinations made by the Pensions Ombudsman and decision of the High Court.

Self Test Questions

- Name a recent Ombudsman case that covered liberation.
- Where does the right to a transfer come from?
- What are the three principles of the voluntary code?

CHAPTER 3

Possible Impact of Leaving the EU on Pensions

INTRODUCTION

In this Chapter, we briefly consider how the withdrawal of the United Kingdom from the European Union (EU) may impact on retirement provision.

On 23 June 2016, the UK voted to leave the EU. The consequences of the outcome of the referendum ultimately depend on the type of exit model adopted and any transitional provisions that are agreed in the meantime.

Article 50 of the Treaty on European Union allows a member state to withdraw from the EU 'in accordance with its own constitutional requirements'. Once the article 50 notice is delivered, the formal negotiation procedure commences and the start of the two year exit period begins.

The immediate impact on pension schemes is likely to be financial in relation to market volatility and the ramifications this has on scheme funding. The legal and day-to-day operational implications are likely to be minimal. However, in the longer term there are areas where UK pensions legislation and regulation derives from EU law and could therefore be subject to amendment or repeal.

As a result of the referendum outcome there exists considerable volatility in relation to share prices, interest rates and inward investment to the UK; all of which have an impact on pension scheme funding. Pension schemes are long-term investment vehicles and typically investment strategies account for short-term market volatility and uncertainty. As a result, the immediate market ramifications of the referendum should not cause problems for DB pension schemes. However, in the medium term, if it becomes apparent that market volatility is to continue for a longer period of time, trustees may need to revise scheme funding strategies in order to capture opportunity or protect from risk.

In terms of valuation, the impact of economic changes may affect scheme funding and actuarial valuation assumptions such as discount rates and inflation. Moreover, it is speculated that overseas financial institutions which are headquartered in the UK may decide to relocate their headquarters away from the UK. If such financial institutions are counterparties to hedging arrangements with pension schemes, the implications of this may require revision of these contracts. Many schemes will also see an impact on the employer covenant (i.e. the legal obligation and ability of a pension scheme's sponsoring employer to support the scheme's liabilities). Trustees of DC schemes should be keeping their scheme investments under review to ensure they remain appropriate for their members. Members of DC schemes may see sudden falls in the value of their funds. As mentioned above, pension schemes are long term investments and although members should keep their investment choices under review, in most cases there would be no need for urgent action. The increased flexibility introduced in April 2015 gives those approaching retirement more choice as to how they manage their pensions savings. Trustees may see a change in behaviour and decision-making of those reaching retirement due to the market volatility.

A significant body of EU pensions law has already been incorporated into UK domestic legislation (for example, the scheme funding provisions in the Pensions Act 2004). Although the UK would no longer be bound by EU law following the withdrawal, it seems unlikely that provisions which protect pension savings and are generally considered to be working reasonably well would be repealed. However, the UK will have the opportunity to deviate from EU requirements and adopt its own domestic direction. Over time we may see the UK Parliament repealing some existing provisions in an attempt to “cut EU red tape”.

The Department for Exiting the EU issued a White Paper on 30 March 2017 detailing proposed legislation for the UK’s withdrawal of the EU: the European Union (Withdrawal Bill). The Bill, introduced on 19 July 2017, will repeal the European Communities Act 1972, the legislation through which the UK joined the European Economic Community, convert EU law as it stands at the moment the UK exits the EU into UK law and creates powers for parliament to make secondary legislation to enable corrections to be made to laws after the exit.

3.1 IMPACT ON UK LAW

In the longer term, there are some areas where UK law may diverge from EU regulations. Financial services legislation is heavily regulated by the EU however it is likely that financial service institutions will continue to comply with most EU regulations in order to continue participating in the European market. Below are some areas of UK pension law which are currently subject to EU law.

Scheme funding	The current technical provisions funding regime derives from the IORP Directive. There is unlikely to be any major change in the short or medium term but there would be scope for relaxing some of the more technical detail in future if desired.
Investment	Some of the investment requirements (including limits on employer-related investments and the requirement to diversify) derive from IORP. There are unlikely to be major changes to the current requirements in the foreseeable future. Many of the rules governing the financial services industry more generally also derive from the EU - it is unlikely there will be major changes here as the UK industry will need to continue to comply in order to operate in the European market. Once the position is clearer, a review of specific investment documents may be advisable.
GMP equalisation	The Government position that GMPs must be equalised is based on EU law. It may therefore be that this issue could disappear.
Equal treatment	There are unlikely to be major changes here on policy grounds. There may be an opportunity to relax some of the age discrimination provisions in order to allow pension schemes to operate with more certainty and not have to rely on justification arguments.
TUPE transfers	There will be scope for the Government to amend or relax the TUPE requirements and to give more clarity on early retirement (Beckmann) issues.
PPF	The PPF was established to fulfil the UK’s obligations under the EU Insolvency Directive. It is unlikely there will be any major changes to the PPF in the current climate.
	Sex based annuity factors It is an EU requirement for annuity providers (but not occupational pension schemes) to use gender-neutral actuarial factors.There would be scope for this to change and for providers to revert to gender-based factors.
Data protection	It is likely that current data protection legislation will remain in place (as well as new requirements equivalent to those under the EU General Data Protection Directive) so that UK business can continue to transfer data to the EU.

Summary
This brief Chapter has outlined some of the possible impacts for pension arrangements following a UK withdrawal from the EU. Clearly, it is an area that will be subject to considerable change and further implications will arise during the exit negotiations.

Self Test Questions

- What is Article 50?
- Identify some areas of UK law that may be impacted by withdrawal from the EU.

CHAPTER 4
Miscellaneous Current Issues

INTRODUCTION

In this Chapter, we briefly consider some of the other important current issues relating to retirement provision.

4.1 PENSIONS DASHBOARD

The Pensions Dashboard project, managed by the Association of British Insurers on behalf of HM Treasury, is designed to allow individuals to find all of their pension savings from private providers along with their State Pension on one electronic platform. Announced in the Budget 2016, the project is aimed at promoting greater transparency and facilitating better retirement planning. A prototype was released on 31 March 2017 and the Government aims to launch a fully functioning service by 2020.

4.2 DATA QUALITY AND THE SCHEME RETURN

Following a TPR survey on recording-keeping performance and administration of more than 530 trust-based occupational pension schemes published on 30 November 2016, TPR has asked trustees to report on record- keeping in their scheme return to help improve standards. TPR stressed in an accompanying press release that good record-keeping is essential to running a scheme and poor data quality runs the risk of increased costs, not managing funding or risks properly and putting members' benefits at risk. TPR stressed that it understands that schemes are looking to improve members' experience and engagement, and harness technology to assist in this process such as through the Pensions Dashboard (in 4.2 above), but that this relies on good data and good data security.

TPR released a quick guide to record keeping as part of a series of materials to educate trustees and clarified that it expects schemes to measure the presence and accuracy of their data, introduce policies to resolve issues that arise and to work with administrators to progress this issue.

4.3 GREEN PAPER: SECURITY AND SUSTAINABILITY IN DEFINED BENEFIT PENSION SCHEMES

On 20 February 2017, the Government issued its Green Paper following consultation with stakeholders in 2016 as well as a report on DB regulation produced by the Work & Pensions Select Committee in December 2016. The Green Paper was prompted in part by ongoing concerns from employers and trustees about affordability and scheme funding issues. However, it also sought to respond to the risk of poor outcomes for DB scheme members, witnessed in high-profile pensions cases over the last year.

In the Green Paper, the Government did not accept that there was a crisis in DB pensions, nor that the overall regulatory regime was unsatisfactory. Nonetheless, there was a case for change in a number of areas, including funding and investment, employer contributions and affordability, member protection and consolidation of schemes. Whilst it suggested that some of the options set out in the Green Paper were not necessarily "viable or desirable", it said it was keen to engage on a wide range of potential options for addressing existing concerns. Generally, the Green Paper sought to strike a balance between the interests of employers, trustees and members and presented a good opportunity for a meaningful debate. The consultation closed on 14 May 2017 and a White Paper is anticipated in late 2017.

Summary
This brief Chapter has outlined some of the other current issues and their impacts for pension arrangements

Self Test Questions

- Why does TPR consider that data quality is so important?
- What were the main conclusions from the recent Green Paper on DB Schemes?

Links to Appendices

As some of these documents are lengthy, then please cut and past the following links into your browser:

- **Appendix A – Pre April 2006 Inland Revenue Rules**
  https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm063130

- **Appendix B – tPR Codes of Practice**
  https://www.thepensionsregulator.gov.uk/en/document-library/codes-of-practice

- **Appendix C – Useful websites**
  https://www.cpc-learning-materials.com/useful-weblinks