Current issues

November 2021

Articles this month:

Autumn Budget 2021: pensions

There was little that was pensions-related in the Autumn Budget.[1] The biggest news may be the Treasury's plans to address the anomalous treatment of low earners under the 'relief at source' and 'net pay arrangements' systems for contribution tax relief. The Government will also bring forward proposals for changes to the automatic enrolment charge cap, '*to better accommodate well-designed performance fees and enable investments into the UK's most productive assets, while continuing to protect savers.*'

The pensions press was uncharacteristically muted in the lead up to the Autumn Budget, as though pundits could not summon the energy for the usual frenzied speculation about radical tax reform, allowance cuts, or an end to tax-free lump sums. Chancellor of the Exchequer Sunak was scolded by the Deputy Speaker for the number of measures that were announced to the news media ahead of his statement to Parliament, so it may simply be a case of people assuming that everything worthy of note had already been aired.

The 'net pay anomaly'

There are two main methods by which pension scheme members obtain tax relief on their contributions: relief at source (RAS), and net pay arrangements (NPA). Under RAS, contributions are deducted from post-tax earnings, and pension scheme administrators claim from Her Majesty's Revenue and Customs (HMRC) an amount equal to basic-rate tax on those contributions on their members' behalf (higher- and additional-rate taxpayers can obtain any balancing relief that is due via their tax returns). The crux of the aforementioned anomaly is that the basic-rate claim is made *even for non-taxpayers*.

This valuable perk of the RAS system (tax 'relief' when no tax was paid) is not available to similarly low-earning members of NPA schemes, a fact that gained new notoriety with the advent of automatic enrolment, as millions more of the lower-paid were defaulted into pensions saving. The Government made a manifesto promise, on the way into the December 2019 general election, to explore resolutions to the problem, and duly made a 'call for evidence' in August 2020.

The outcome of this exercise was announced as part of the Autumn Budget. HMRC will make changes to its IT systems enabling it to identify low earners who contribute via NPA, and to start paying them top-up payments during the 2025/26

[1] <www.gov.uk/government/publications/autumn-budget-and-spending-review-2021-documents>.

tax year, in respect of their contributions in 2024/25. The Government is also planning to invest in modernization of HMRC's admin systems, to make the operation of pensions tax relief more efficient.

Productive finance & the DC charge cap

The Government would like to make it easier for money purchase schemes to invest in less-liquid assets, such as infrastructure. It has already, earlier this year, made some changes to the charge-capping rules, so as to better accommodate performance fees.[2] In his Budget speech and 'red book' document the Chancellor indicated that in a consultation exercise slated to begin '*before the end of the year*' the Government will advance further changes to the charge cap, '*to enable pension savers to benefit from better growth in their long-term investments.*'

Ameliorating the tax consequences of the *McCloud* remedies

The Court of Appeal, in a December 2018 ruling known as the '*McCloud*' judgment, confirmed that transitional provisions made during the 2014/15 reforms to the main public-service pension schemes were unlawfully discriminatory. The unfunded arrangements made for teachers, police officers, firefighters, NHS staff, etc. had (in broad terms) allowed older members to remain in their legacy, final salary schemes, whilst younger members were placed into new career-average revalued earnings (CARE) schemes for future service. The funded arrangements for local government employees took a different approach, moving everyone into the CARE schemes immediately, irrespective of age, but with underpins protecting older members who would have done better under the final salary rules.

The Government's response to *McCloud* is to provide members of the unfunded schemes with a 'deferred choice underpin', allowing them to choose, at retirement, which benefits are better for them, based on personal circumstances and preferences. The Local Government Pension Scheme (LGPS) solution involves revising the underpins so that they do not discriminate against younger members. Both approaches have tax implications.

Alongside the Budget, HMRC published a policy paper, *Taxation of Public Service Pension Reform Remedy*, introducing legislation intended to ensure that the pensions tax framework applies as intended to the '*McCloud*' remedies.[3] The *Finance Bill 2021-22* will permit modification of the pension tax rules to put members in the position they would have been in had they always had the benefits ultimately received so that, for example,

- any compensation payments that are due are exempt from tax charges;
- lifetime allowance protection is appropriately calculated;
- any (retrospective) annual allowance charges are no higher than they would been had members accrued their chosen benefits during the relevant tax years; and
- pensions and lump sums are not treated as unauthorized member payments.

The long wait for a solution to the net-pay anomaly will disappoint many, but may be less surprising to those familiar with the chequered history of changes to HMRC's IT systems. It appears that the planned 'bonuses' will be paid directly to low earners, rather than (as with basic-rate RAS claims) into their pension pots, so will not help with the problem of under-saving unless additional steps are taken. The scepticism that will no doubt be aroused when low-earning members of NPA schemes—even those with defined benefits—are invited to claim this 'free money' might partly explain the Treasury's low estimate of the costs, which seem to assume that only ~24 per cent of those entitled will take up the offer.

Some of the historical barriers to illiquid investments are easing, and we have seen great examples already of DC schemes accessing these assets to improve outcomes for their members. Now is the time to explore this exciting development for those with the governance capacity to do so. Although costs and charges are likely to be higher than in most existing DC funds, we believe that in this instance it is possible for DC savers to pay more and get more.

[2] The *Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021* (SI 2021 No. 1070).

[3] <www.gov.uk/government/publications/taxation-of-public-service-pension-reform-remedy/taxation-of-public-service-pension-reform-remedy>.

Simpler annual statements mandatory from October 2022

The Department for Work and Pensions (DWP) has confirmed that trustees and other providers of workplace money purchase pension schemes will have to provide their members with simpler annual benefit statements.[4] Amendment Regulations were laid before Parliament and come into force on 1 October 2022.[5] Statutory guidance has also been published.[6]

The DWP staged a consultation exercise on draft legislation and guidance from May to June 2021. The final requirements are largely as discussed (for details, please see *Current Issues* June 2021[7]). In summary, the mandatory contents of money purchase benefit statements will have to be structured in future so that, when printed, it occupies no more than two sides (one double-sided sheet) of A4-sized paper. The statutory guidance contains, amongst other things, a template that shows how the information should be presented. Statement providers can use their own branding and colour schemes provided they do not impede comprehension, or cause their statements to exceed the maximum length.

The main development to the consultation proposals is the change of effective date. The Amendment Regulations were originally drafted so as to come into force on 6 April 2022. Mindful of concerns expressed about the time that some statement providers would need to prepare for the new approach, the effective date of the changes has been amended to 1 October 2022.

There are some other, less significant, changes, such as the following:

- the legislation and guidance now say that the obligations apply to (pure) money purchase '*automatic enrolment schemes*', not just '*qualifying schemes*' (automatic enrolment schemes are qualifying schemes that meet some additional conditions);
- the draft legislation did not mention the existence of statutory guidance and the requirement to '*have regard to*' it, whereas the finalized Amendment Regulations do; and
- the guidance has been revised to clarify which items are mandatory, the additional details that providers are encouraged to include, and the ability to make further information available either by signposting or by 'layering' it within supplementary materials given along with the statement.

We welcome the outcome of the consultation exercise, particularly the delayed introduction of the simpler annual benefit statements obligation, giving trustees more time to get them right. We are supportive of the two-page benefit statements and the implicit advantages for members, but maintain that they should be rolled out to all DC schemes, not just those used for auto-enrolment purposes. The DWP should take the opportunity to reconsider that decision when it conducts its first statutory review of the rules (required by 1 October 2027, at the latest).

[4] <www.gov.uk/government/consultations/simpler-annual-benefit-statements-draft-regulations-and-statutory-guidance>.
[5] The *Occupational and Personal Pension Schemes (Disclosure of Information) (Statements of Benefits: Money Purchase Benefits) (Amendment) Regulations 2021* (SI 2021 No. 1150).
[6] <www.gov.uk/government/publications/how-to-provide-simpler-annual-benefit-statements>.
[7] <www.hymans.co.uk/media/uploads/Current_Issues_-_June_2021.pdf>.

September inflation

The rate of inflation for the year to September 2021 on the Consumer Prices Index (CPI) basis was 3.1 per cent; it will be the magic number for many statutory increase provisions. For comparison purposes, the rate of inflation based on the Retail Prices Index (RPI) was 4.9 per cent, and 2.9 per cent using the Consumer Prices Index including owner occupiers' housing costs (CPIH).

State pensions

As noted in last month's *Current Issues*, the Government has introduced legislation to temporarily override the earnings link in the State pension rules, for fear that the bounce back from 2020's COVID-induced low would oblige it to provide increases of around 8 per cent in April 2022. Removing the earnings-based facet of the 'triple lock' means that the 2022 increase should be the higher of 2.5 per cent or the rise in CPI-based inflation, with the CPI now clearly the winner. That should mean that the basic State pension increases from £137.60 to £141.85 per week, and the new (single-tier) State pension goes from £179.60 to £185.15 per week.

Increases and revaluation

The 3.1 per cent increase in the CPI will be picked up by the Revaluation Order that will come into force on 1 January 2022, to determine the minimum statutory revaluation for deferred members of private sector, defined benefit (DB) occupational pension schemes who reach normal pension age during that year. From there, it will feed through to the legislation specifying the minimum increase to DB pensions in payment in private-sector schemes. In both cases, however, statutory caps will apply, limiting minimum uplifts to 2.5 per cent: in the case of revaluation, the cap applies to benefits accrued after 5 April 2009; and for pension increases, to accruals since 5 April 2005.

The CPI rate of inflation will be relevant also in the public sector. It will feed through to next year's Pensions Increase (Review) Order, whence it will determine increases to public-sector pensions in payment, as well as the revaluation of deferred benefits in the legacy final salary schemes (the *McCloud* discrimination case has ensured that those schemes are not quite so 'legacy' as intended, for the moment). Uplifts are uncapped in the public sector.

A pot-pourri of revaluation calculations apply to past years' accruals under the reformed, career-average revalued earnings (CARE) schemes in the public sector. Depending on the scheme, revaluation may be determined by reference to changes in prices or earnings (or even, theoretically, a bit of both). For now, the CPI is the Government's preferred measure of prices inflation.

Increases to guaranteed minimum pensions (GMPs) in payment are also, effectively, tied to CPI inflation. Again, there is a divergence in practice between the public and private sectors. In private sector schemes, typically, GMPs will be increased separately from non-GMPs, by the minimum amount required by law. The legislation obliges pension schemes to increase GMPs only so far as they are attributable to service after 5 April 1988, and only up to a 3 per cent cap.

For those entitled to the old, two-tier State pension, the 'missing' increases are effectively made up for by the Department for Work and Pensions when it calculates their State pensions every year. That arrangement fell away with the introduction of the new State pension (NSP), which is applicable to those reaching State pensionable age after 5 April 2016. However, when the Government examined its obligations toward public-sector pensioners entitled to the NSP, it concluded that it should direct their schemes to fully index-link their GMPs alongside their other pensions in payment. That treatment may carry over to some private-sector pension schemes that take their lead on increases from the public sector.

Pensions tax allowances

In light of the economic effects of the COVID-19 pandemic, the Government decided to freeze the standard lifetime allowance at its 2020/21 level (£1,073,100) for tax years up to and including 2025/26. In the calculation of pension input amounts for the 2022/23 tax year, for annual-allowance purposes, opening values in DB and cash balance arrangements will be uprated by 3.1 per cent.

Pensions Ombudsman guide to communicating with members

The Pension Ombudsman's office has published a two-page guide to *Communicating with Members*, in which it uses its experience to give tips that will help pensions providers resolve disputes informally, and avoid ending up dealing with a complaint to the Ombudsman.[8]

The tips include trying to look at disputes from the member's perspective, communicating clearly and explaining any areas where the trustees and member disagree. The guide also refers readers to a new section on the Ombudsman's website, '*How to avoid the Ombudsman*', which collects guidance on common areas of complaints, and links to instructive determinations, publications, and case studies.[9]

The guidance is a useful reminder of the steps that trustees can take to resolve disputes without requiring the Ombudsman to step in.

Regulator updates guidance webpages

The Pension Regulator has updated its main COVID-related guidance page to say that the Coronavirus Job Retention Scheme (CJRS) has now ended, and has removed the guidance provided during the pandemic.[10] It is now referring employers and trustees to its pre-COVID guidance (and for those who still want access to deleted material, the National Archives website[11]).

The guidance that has been removed included advice for trustees of defined contribution (DC) schemes on the implications of diverting member contributions away from 'gated' (closed) funds, re-directing contributions back to the original 'gated' fund when it reopens, and on transfers from a gated fund. This guidance has now been replicated in an appendix to the Regulator's *Code Related Guidance No.13: Investment Governance*. [12]

The guidance is materially unchanged: as a general rule, the Regulator suggests that a default arrangement is likely to be created (giving rise to charge-cap considerations and the requirement for a default-specific statement of investment principles), unless members were made aware before they selected the original fund that their contributions could be diverted to alternative funds in certain situations, or were contacted and their consent obtained before the contributions were diverted. In addition, it indicates that, once the gated fund re-opens, the act of re-directing contributions back to the original investment choice could inadvertently make that (original) fund a default arrangement.

Whilst acknowledging the difficulty of paying a transfer from a gated fund, the Regulator does not think that the conditions are met for it to grant an extension to the statutory six-month deadline. Trustees are expected to treat these cases like any other transfer and do everything they can to process them promptly; fines could be imposed if they fail to take such steps as are reasonable to ensure that payment is made by the deadline.

The Regulator suggests that those 'reasonable steps' could involve offering the member a partial transfer if the receiving scheme is willing to accept the part due from the gated fund later. It says that trustees should report materially significant compliance failures, outlining their reasons and the steps taken to meet their obligations.

Changes have also been made to other parts of the Code-related guidance to reflect legislative changes that came into effect on 1 October, such as:

- amendments to the 'chair's statement' part of the section on communicating and reporting, regarding the new legal requirement for smaller DC schemes to carry out a more-detailed value-for-members assessment, and for all DC schemes to provide investment-return data; and,
- the addition of information about performance-fee smoothing.

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[8] <www.pensions-ombudsman.org.uk/sites/default/files/publication/files/Final%20TPO%20Communications%20guidance_0.pdf>.
[9] <www.pensions-ombudsman.org.uk/how-avoid-ombudsman>.
[10] <www.thepensionsregulator.gov.uk/en/covid-19-coronavirus-what-you-need-to-consider>.
[11] <webarchive.nationalarchives.gov.uk/ukgwa/*/https:/www.thepensionsregulator.gov.uk/en/covid-19-coronavirus-what-you-need-to-consider>.
[12] <www.thepensionsregulator.gov.uk/en/trustees/managing-dc-benefits/investment-guide-for-dc-pension-schemes-#479cab1373274a058382edacf977c91d>.

HMRC newsletters: October 2021

In *Countdown Bulletin 56*, Her Majesty's Revenue and Customs (HMRC) grants a stay of execution to its Scheme Cessation and Scheme Reconciliation eRooms.[13] The process of shutting down the eRooms was supposed to begin on 1 September 2021, but has been postponed until the end of November to allow scheme administrators more time to extract and required information. It also provides an email address (CRM.schemereconciliationservice@hmrc.gov.uk) for GMP-related queries that cannot be resolved via the 'GMP Checker' service.

Pension Schemes Newsletter 134[14] includes:

- a run-down of some pensions-related highlights of the Autumn Budget;
- the extension of some COVID-19-prompted tax-admin easements still farther, until 31 March 2022;
- guidance on the forthcoming task of migrating schemes from Pension Schemes Online to the successor Managing Pension Schemes service;
- the introduction of mandatory multi-factor authentication when accessing business tax accounts; and
- updated pensions flexibility and registration statistics.

[13] <www.gov.uk/government/publications/countdown-bulletin-56-october-2021/countdown-bulletin-56-october-2021>.
[14] <www.gov.uk/government/publications/pension-schemes-newsletter-134-october-2021/pension-schemes-newsletter-134-october-2021>.

And Finally…

To smile or not to smile, that is the question. Readers may have noticed that, following the recent cabinet reshuffle, the Ministry for Housing, Communities and Local Government has become the Department for Levelling Up, Housing and Communities, which if turned into an acronym is evocative of the sound of someone retching ('*DLUHC! I'm terribly sorry, it must've been something I ate.*').[15]

AF was struck by the photos of the ministerial team, *almost* all of whom look very cheery. Even Michael Gove, whose original depiction was reminiscent of a rabbit caught in the headlights of an oncoming lorry, now has one corner of his mouth slightly upturned in, if not a smile, then at least the near-facsimile of one.

The odd one out is Lord Greenhalgh, who looks very much like he was snapped by the paparazzi—or perhaps a feuding neighbour's video doorbell—against his will. Perhaps that *is* him smiling, in which case *AF* expresses the sympathy of a fellow sufferer, having become accustomed since early childhood to explaining that he isn't frowning, there's nothing wrong, and that's just how his face looks.

Ah, but another possible explanation presents itself immediately underneath the photo in question, where there appears the single, terse word, '*Unpaid*'. Maybe the noble Lord was snapped just as that news was delivered...

[15] <www.gov.uk/government/organisations/department-for-levelling-up-housing-and-communities>.