PPF TN Technical News

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Pension Protection Fund

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Welcome...

…to **Technical News**, the Pension Protection Fund's (PPF) newsletter on topical issues including practical guidance for schemes in PPF assessment periods. Our aim is to provide you with regular updates about topics of interest.

In addition to the regular features, this edition reports on Stand Alone Lump Sums (SALS), Separate Scheme Lump Sums (SSLS), updates to the Data Interface Layout (DIL) and General Data Protection Regulation (GDPR) compliance. It further clarifies the treatment of Guaranteed Minimum Pension (GMP) during assessment following on from an article on GMP step-ups in **Issue 5** and considers members who are close to, or exceeding, the lifetime allowance during the PPF assessment period.

The issues discussed in this edition are specific to PPF-eligible schemes. Please speak to your Scheme Delivery Associate if you require any support on these issues in respect of FAS qualifying schemes.

If there are any technical issues about which you would like to hear from us, please do submit a comment via our website **here** and where appropriate we will consider including an update in a future edition.

Stand Alone Lump Sums (SALS)

In our experience the terms Separate Scheme Lump Sums and Stand Alone Lump Sums have sometimes been used interchangeably. However, they relate to very different types of lump sum benefit and should not be confused.

Before 6 April 2006 pension schemes were, under certain conditions, allowed to pay out all of a member's benefits as a tax-free lump sum, known as a Stand Alone Lump Sum. This changed on 6 April 2006 when the tax simplification provisions of the Finance Act 2004 came into effect. Since then, the most that can be paid out as a tax-free lump sum is 25 per cent of the total value of the benefits, subject to transitional protection.

However, members who had a right to a SALS prior to 6 April 2006 were able to retain that right after 5 April 2006, provided that certain conditions were met. These conditions are set out in articles 25 to 25D of the Taxation of Pension Schemes (Transitional Provisions) Order 2006.

A lump sum will qualify as a SALS where:

a) the lump sum is paid to the member from a registered pension scheme on or after 6 April 2006;

b) the lump sum is paid when the member has reached normal minimum pension age, or the ill-health condition has been met;

c) on 5 April 2006 all the member's uncrystallised rights under the scheme and any other scheme relating to the same employment could have been paid as a tax-free lump sum;

d) there has been no relevant benefit accrual for the member under the scheme after 5 April 2006;

e) the entitlement to the lump sum is a single benefit crystallisation event that crystallises all of the member's rights under the scheme which were not crystallised on 6 April 2006; and

f) the member did not have lump sum rights of more than £375,000 on 5 April 2006 where either primary or enhanced protection applies when the lump sum is paid.

If any of the above conditions aren't met the payment can no longer be considered a SALS. So it is important that any members with SALS are identified during the assessment period. This will help the PPF to ensure the above conditions are taken into account before making any payments.

In some circumstances PPF members are entitled to compensation payable at multiple Normal Pension Ages (NPAs), known as tranches. This generally happens as a result of equalisation or where scheme rules provide different benefits for different membership categories. A problem arises where SALS members have more than one tranche. If the member takes the lump sum separately (in two parts) neither payment would be regarded as a SALS as both would infringe condition e) above, and therefore both would be regarded as unauthorised payments. This problem can be overcome by ensuring the member takes all of their benefits simultaneously, either by taking one or more benefits early, or by postponing one or more benefits to a later date. For this reason, it is important that SALS members are identified during the assessment period.

There may also be situations where SALS members have already breached the conditions of payment before transferring to the PPF. For example, the member may have been entitled to both a lump sum and pension from the scheme on 5 April 2006, or the member may have accrued additional benefits in the scheme on or after 6 April 2006. This condition is often breached where there has been a bulk transfer of SALS from a stand-alone lump sum scheme to a scheme in which the SALS members have accrued pension benefits. Every effort should be made to ensure that any of these issues are resolved before the scheme transfers to the PPF.

Separate Scheme Lump Sums (SSLS)

Outside the PPF some schemes offer an SSLS as well as periodic pension and further allow members to commute periodic pension for an additional lump sum, on the condition that the total lump sum from the scheme will not exceed the permitted maximum for a pension commencement lump sum.

However, this is not the case in the PPF. Schedule 7 of the Pensions Act 2004 specifically prevents a member from commuting any tranche of periodic compensation with an attached SSLS at the same Normal Pension Age (NPA).

During an assessment period the Trustees are required to provide the lower of (i) the member's benefit entitlement under the admissible rules and (ii) the member's PPF compensation.

Therefore during the assessment period Trustees should not offer members who have periodic pension with an attached SSLS the option to commute pension for an additional lump sum. The SSLS would be the only cash sum payable in these circumstances. This is subject to the limited exception described below.

If the member has accrued periodic pension with mixed NPAs, and an SSLS with a single NPA, it may be possible to commute the periodic pension with a different NPA to the SSLS for an additional lump sum. If you think this may apply in respect of any member, please discuss this with your Scheme Delivery Associate.

Guaranteed Minimum Pension (GMP) in Assessment

It is common for scheme rules to prevent the Trustees from offering an early retirement pension in circumstances where the pension will not cover the Guaranteed Minimum Pension (GMP)*. However, some scheme rules do give Trustees an **option** or **obligation** to offer an early retirement pension even where the pension will not cover the GMP. The scheme rules will usually require the Trustees to reduce the initial rate of the pension to allow for a step up at GMP payment age.

If a member is granted an early retirement pension during an assessment period, the Trustees will need to provide the member with the lower of (i) the member's benefits under the admissible rules and (ii) the member's PPF compensation.

If a member's early retirement pension is reduced to allow for a step up at GMP payment age, it is possible that this will reduce the pension below the level of the corresponding PPF compensation. In these circumstances, the Trustees will need to put the lower benefit into payment, but once the scheme transfers to the PPF, the member's benefit will need to be uplifted to the PPF level, and the member will need to be paid a lump sum in respect of the underpayments during the assessment period.

To avoid this potential complexity, the PPF would prefer that where the Trustees have an **option** under the scheme rules to offer an early retirement pension in circumstances where the pension will not cover the GMP, this is **not** offered during an assessment period. However, this is ultimately a decision for the Trustees, and the PPF cannot prevent the Trustees from offering early retirement in these circumstances. The PPF understands that where the Trustees have an **obligation** under the scheme rules to offer this benefit, the Trustees must continue to offer this benefit during the assessment period.

To clarify, for GMP to be covered, the pre 97 pension in payment must equal or exceed the member's GMP at GMP payment age.

Lifetime Allowance

When a member's compensation entitlement amounts to more than their available Lifetime Allowance (LTA) the PPF is responsible for ensuring that this is reported to HMRC and that the member is fully aware of the options available to them.

Members generally fall into two categories: those who have already used up all of their LTA and those who still have some LTA available. This is significant because members who have some available LTA can still commute up to 25 per cent of their compensation to lump sum without incurring a 55 per cent lifetime allowance tax charge where the lump sum is within their available LTA. A member can choose to commute some of their compensation above their LTA, but if they do they will incur the 55 per cent charge.

Any periodic compensation payments beyond their available LTA will incur a 25 per cent tax charge. This is calculated as a lump sum based on the value of the member's periodic compensation. The PPF pays the charge on the member's behalf and makes a lifetime deduction from the member's compensation. This deduction is calculated on the basis of its being non-escalating (i.e. a fixed monthly deduction that does not increase in line with indexation) and deductible for the lifetime of the member only (i.e. not impacting on any survivor compensation).

The PPF also needs to be aware of any 'protections' the member may have (e.g. Primary Protection, Enhanced Protection, Fixed Protection 2012).

When members retire in the assessment period with benefits in excess of their LTA it is clearly preferable that a consistent approach is taken. The PPF is able to advise in such cases and can supply a factor for use in specific cases to calculate the monthly lifetime deductions. Please speak to your Scheme Delivery Associate if you require any support in these cases.

Finance Update

Please note the following two updates for Trustees of pension schemes, including those in PPF assessment periods, in connection with the preparation and audit of their financial statements:

Statement of Recommended Practice – changes to fair value hierarchy disclosures: As expected, amendments to FRS 102 issued by the Financial Reporting Council (FRC) came into force on 1 January 2017. These amendments remove the UK categorisation of investments (categories a, b and c) and align the fair value hierarchy disclosure requirements with the Level 1, 2 and 3 structure set out in International Financial Reporting Standards (IFRS 13 specifically). Trustees should now find it easier to comply with these requirements and use standard reports produced by fund managers and custodians when drawing up their 2017 financial statements.

Consultation on auditing standards for pension schemes: The FRC has issued a consultation document on "Proposed Revisions to Practice Note 15 (Revised) – The Audit of Occupational Pension Schemes in the United Kingdom". The revisions are intended to "reflect the updated regulatory landscape, the implementation of FRS 102 and the implementation of revised International Standards on Auditing". The consultation runs until 30 June 2017. More details **here**.

Regulation Changes April 2017

New regulations come into force from 6 April 2017 which will affect PPF compensation in two main ways.

➜ Long Service Cap

Capped members who have 21 or more years' service in their former pension scheme will be entitled to an uplifted cap. The standard compensation cap will be increased by 3 per cent for each full year of service over 20 years, subject to a maximum of double the standard cap.

The compensation of existing pensioners who are impacted by this change has been recalculated, and existing pensioners will have received their uplifted compensation from 1 May 2017. This will include arrears for the period 6 to 30 April 2017. We have contacted all those who we believe are affected, however if any member we haven't contacted (who is in receipt of capped compensation) can provide evidence of pensionable service exceeding 21 years then we will review their compensation accordingly.

➜ Money Purchase Lump Sums

In the 2014 Budget changes were made in respect of small lump sums, which allowed payments of up to £10,000 as authorised lump sum payments. This had previously not applied to the PPF as the limit of **£2,000** for discharging money purchase benefits was written into legislation. From 6 April 2017 the legislation was amended to increase the limit to **£10,000** to bring our position into line with the wider industry.

General Data Protection Regulation (GDPR)

expected to come into force mid-2018

The GDPR places greater emphasis on the documentation that data controllers must keep to demonstrate their accountability.

Many of the GDPR's main concepts and principles are much the same as those in the current Data Protection Act (DPA), so if you are complying properly with the current law then most of your approach to compliance will remain valid under the GDPR and can be the starting point to build from. However, there are new elements and significant enhancements, so you will have to do some things for the first time and some things differently.

It is essential to start planning your approach to GDPR compliance as early as you can and to gain 'buy in' from key people in your organisation. You may need, for example, to put new procedures in place to deal with the GDPR's new transparency and individuals' rights provisions. The Information Commissioner's Office (ICO) provides guidance and supporting resources.

DIL Changes

Data Interface Layout (DIL) Version 7.1 is now in place. The latest version of the DIL incorporates changes as a result of the 'Bridge' regulations in respect of former money purchase benefits. For example these enable member records to be created with no escalation or no attached spouse's benefits to the former money purchase element where appropriate. The DIL has also been updated to capture information for Long Service Cap members and there are other minor changes including changes involving suspended members and overseas payments and some changes to the annuity tab. Additionally, a new Analyser has been built and will be available alongside the DIL and guidance.

The latest DIL Guidance can be accessed **here**.

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The information we provide is for guidance only and should not be taken as a definitive interpretation of the law.

PPF Technical Team, July 2017

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