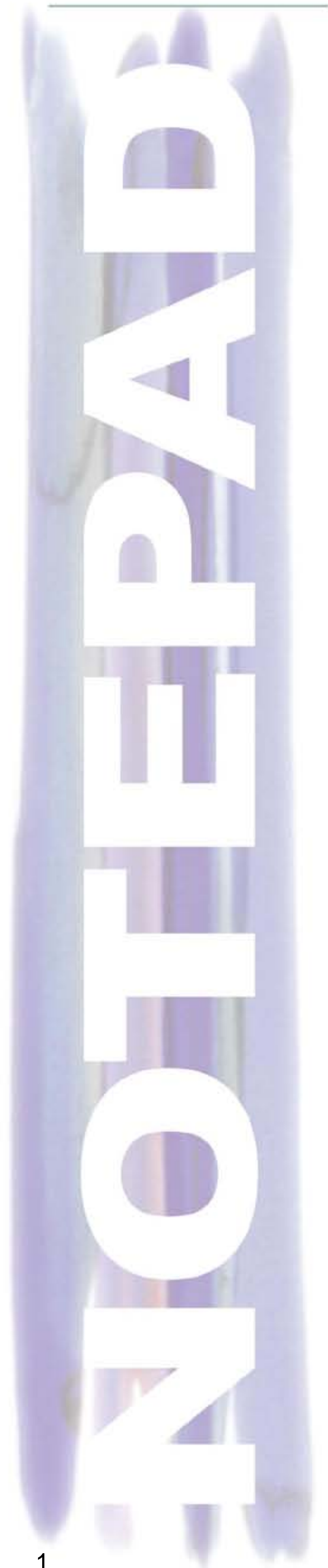
LAYTONS

SOLICITORS

PENSIONS NOTEPAD

Spring 2010



1. Last call! Minimum pension age is going up to 55

One of the last of the 2006 pensions tax changes will come into force on 6 April 2010. From that date, the earliest age from which a registered pension scheme can pay benefits (in normal circumstances) will go up from 50 to 55.

The only exceptions will be (i) ill-health pensions, and (ii) cases where on 5 April 2010 a member had an unqualified right to draw benefits before age 55 (i.e. without needing anyone's consent) and that right was embodied in the scheme rules in force on 10 December 2003 (the date when the change to the minimum pension age was first announced).

Because 6 April 2010 follows immediately after the Easter break, HMRC has kindly announced a concession whereby members whose 50th birthday falls on 2, 3, 4 or 5 April will be allowed to draw their pension under the old rules, even if they cannot actually trigger payment until 6 April.

Most schemes are likely to have amended their rules to cover this point; but any that have not done so should now be addressing this as a matter of urgency. The transitional protections that were introduced with the "A-Day" reforms can only extend until 5 April 2011.

Scheme administrators should also be considering whether to contact any members who are aged between 50 and 55 (or approaching 50) and under the existing scheme rules, have an option to retire earlier than age 55.

2. Breaking the “final salary link”: new case law

In recent years, many companies who sponsor final salary pension schemes have been looking for ways to reduce, or at least cap, the cost. In many cases this has involved terminating the accrual of benefits under the existing scheme, and perhaps offering a defined contribution scheme for future service.

Frequently, an important element in this calculation is "breaking the final salary link". That is, the intended outcome is that when members retire, they will get a pension based on their service up to the closure date and their salary at the closure date, rather than their salary at the point of retirement.

Two recent cases (one in the High Court, the other before the Pensions Ombudsman) have focussed on this area, and have given a useful reminder that the issues can be far from straightforward.

Any modification of a pension scheme is potentially subject to the restrictions in section 67 of the Pensions Act 1995 (and supporting regulations) which, broadly speaking, prevent any modification that "would or might adversely affect the subsisting rights of any member of the scheme or any survivor of a member ..." without the member's consent, or an "actuarial equivalence" statement from the scheme actuary.

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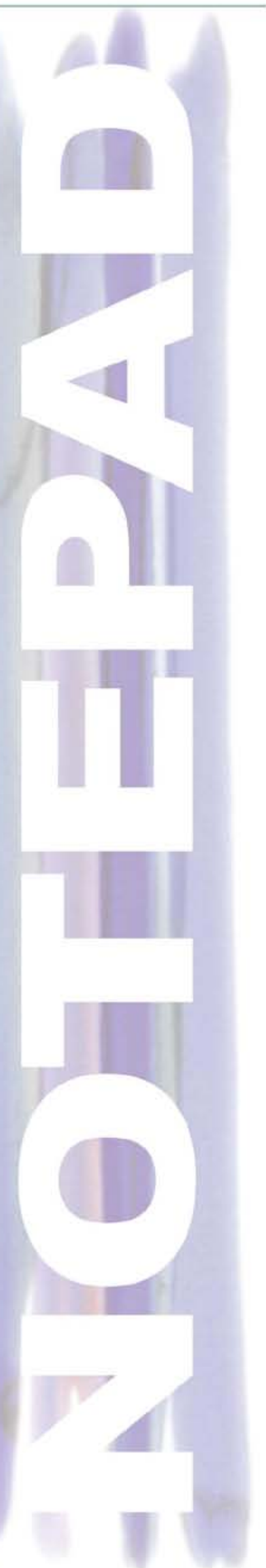


"Subsisting rights" means the benefits the member would be entitled to on the assumption that he left pensionable service immediately before the modification takes effect. So as far as section 67 is concerned, the law effectively assumes that breaking the final salary link is a legitimate outcome of modifying a scheme.

But scheme amendment powers are often subject to their own restrictions, contained in the trust deed, and it is never safe to assume that these will allow the final salary link to be broken.

To take an example, the terms of the amendment power might say that no amendment can be made which would have the effect of reducing any benefits that have been secured by contributions paid before the effective date of the modification. One question here is, what does "secured" mean? Does it mean that the benefits due to a member in respect of the last year must be based on his salary today, or on his projected salary at his normal retirement age? In the cases of *Courage Group's Pension Schemes* and *IMG Pension Plan*, the High Court decided that the latter was the correct approach, and the final salary link could not be broken..

But more recently, the Pensions Ombudsman in the case of *Barton* considered a scheme rule which would prevent any amendment that would "reduce the aggregate value of the retirement benefits payable under the Scheme to any Member … in respect of contributions already received by the Trustees". Although the language is very similar, the Ombudsman decided (perhaps surprisingly) that in this case the final salary link could be broken.

The apparent conflict between these cases is certainly not helpful, even though decisions of the Ombudsman do not create binding precedents in the way that court judgements do.

It seems this will remain a difficult area for some time to come, and it will be essential to explore all the implications of any proposal to break the final salary link, before proceeding.

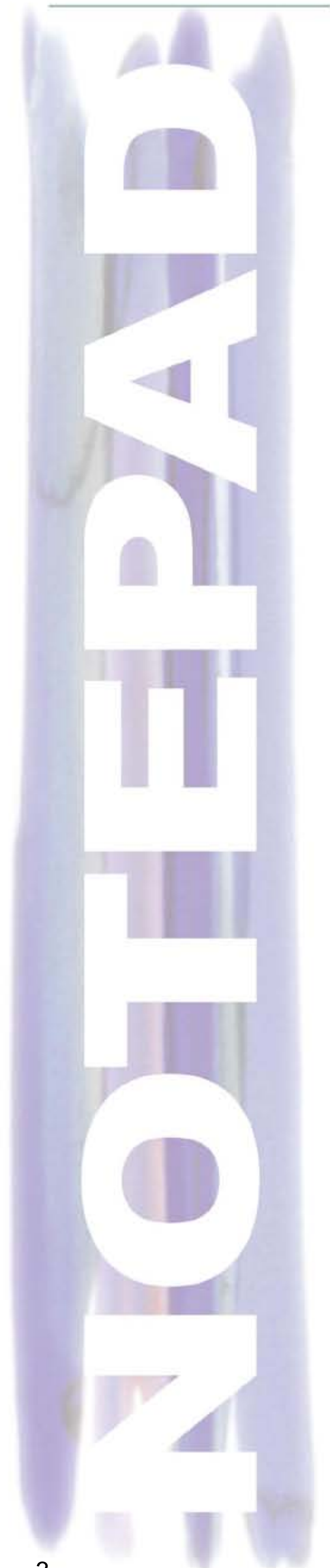
3. Loans by SIPPs – new tax trap

One of the original aims of the "A-Day" reforms was to sweep away most of the restrictions on investment by pension schemes. However, a rapid U-turn saw residential property reclassified as "taxable property" in which registered pension schemes, including self-invested personal pension schemes ("SIPPs"), could not invest without incurring punitive tax charges.

One of the traditional attractions of SIPPs is the ability to make loans back to the sponsoring employer. Such loans must be on arms-length terms and are frequently secured against assets of the employer.

HMRC has recently issued a "clarification" stating that if the employer defaults on such a loan, and the SIPP consequently obtains a charging order over residential property, HMRC will regard that as the SIPP acquiring an interest in taxable property, potentially giving rise to an "unauthorised payment charge" based on the market value of the property.

Further, actually enforcing the charge will be deemed to create further rights in the property, and potentially a further unauthorised payment charge.



4. The National Employment Savings Trust – auto-enrolment is coming (still)

Yet more changes have been announced to the introduction of personal accounts (now re-branded as the National Employment Savings Trust or "NEST") from October 2012.

If the proposals come into force in anything like their present form (which seems increasingly doubtful, the political consensus having largely evaporated) they will impose major new obligations on employers: most notably, the requirement to pay pension contributions for all workers (or rather "jobholders") who do not opt out; and the need to set up procedures for automatic enrolment of all workers, either in NEST, or in an acceptable occupational or personal pension scheme instead.

Jobholders are defined as employees or workers who ordinarily work in Great Britain under a contract; are aged at least 16 and under 75; and have "qualifying earnings" which are between £5,035 and £33,540 (figures to be reviewed annually).

Auto-enrolment must cover all jobholders who are aged between 22 and state pension age, and earn at least £5,035 per annum. They can be given the option to opt out (but no inducements must be offered!); and if they do, the opt-out process must be renewed every three years.

If workers are automatically enrolled into NEST, the employer must contribute at least 3% of their band earnings (as defined above). This obligation is going to be phased in over a period of 4 years). Members will have to pay 5%, up to a ceiling of £3,600 per annum.

If an occupational or personal pension scheme is offered instead of NEST, it must meet a quality test, which can be either on a defined benefit or defined contribution basis.

5. Equalisation of GMPs: clarity at last? (Answer: probably not)

In a surprise announcement on 28 January 2010, the Pensions Minister outlined the Government's position on the equalisation of guaranteed minimum pensions for men and women.

Hinting that legislation is planned, the Minister said, "It is the Government's opinion that, in order to secure full compliance with European law, trustees and others should act as if existing domestic legislation required equalisation in respect of differences resulting from GMPs whether or not real comparators exist".

Unfortunately the Minister did not offer any suggestions as to how this desirable result might be achieved. That was not altogether surprising, since all governments since 1990 have been ducking this question.

On the other hand, given the imminence of a general election, the announcement should perhaps be regarded more as a gesture than a serious plan to legislate.

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6. Regulatory round up

Some things to look out for in the next few months:-

a. HMRC has confirmed that the "notional earnings cap" for the tax year 2010-11 will be £123,600. However, this will be the last such figure published by them. For 2011-12 and subsequent years, schemes that have retained a notional earnings cap in their rules will need to calculate it for themselves.

b. Changes to the "employer debt" regulations are expected to come into force on 6 April 2010. These are intended to prevent an "exit debt" from being triggered by certain internal group restructurings, where there is no overall weakening of the employer covenant. However, the new regulations are highly prescriptive and it is unclear how popular they will be in practice, compared to existing options such as apportionment or withdrawal arrangements.

c. Also effective from 6 April 2010, the range of "listed changes" to a pension scheme on which employers will be obliged to go through a formal consultation process, will be extended to include changing the definition of pensionable earnings.

d. The Pensions Regulator has recently issued:

- a statement, "Understanding and managing the risks of securities lending", focusing on the need for Trustees to be aware of whether their fund managers are engaging in stock lending programmes, and to understand what is going on, and the risks; and
- a consultation paper on proposals to tighten up "best practice" on scheme record keeping.

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