

PREMIER PENSIONS MANAGEMENT

LEGISLATION UPDATE : 2/04

Pensions Simplification Timeline

Summary of Provisions

6 April 2005

The Pensions Regulator

TPR replaced OPRA with a range of additions powers.

TPR's main objectives are to:

- protect members' pension benefits
- reduce the risk of claims against the pension protection fund (PPF)
- improve the understanding of pension matters
- improve the administration of pension schemes

Anyone involved in running the scheme has to notify TPR of a breach (or potential breach) of the law.

TPR is producing Codes of Practice (COP) which dictate how a well-run scheme would go about meeting the legislative obligation. COP are not law but failure to comply with a code can be used as evidence in court.

For more details see: www.thepensionsregulator.gov.uk/codesandguidance

A list of notifiable events can be found in Statutory Instrument 2005/900 at www.opsi.gov.uk/si/si2005/20050900.htm

Extending Employment Rights

TUPE applies if an employer acquires a business, where the employees were provided access to an occupational pension scheme and the employer made, or would have made, contributions (other than those required as a condition of contracting-out) to the scheme in respect of any money purchase benefits.

The new employer has three options for the replacement pension provision as follows:

- a defined benefit scheme providing benefits at least equivalent to that required to contract-out of State Second Pension.

- a defined contribution scheme with matching contributions up to 6% of basic pay.
- contribute to a stakeholder arrangement of which the employee is, or is eligible to be, a member at the same rate as above.

For more details see: www.dti.gov.uk/er/individual/tupe-pl699.htm

Priority order on scheme wind-up

The order in which an underfunded scheme must allocate assets when it begins to wind up is amended. This is similar to the benefits payable from the Pension Protection Fund (PPF). The new priority order is:

- 1 Expenses and debts to third parties
- 2 Annuities secured before 6 April 1997
- 3 The cost of securing liabilities for pensions or other benefits under the PPF (other than those covered in 2 above)
- 4 AVCs (other than those covered in 2 and 3 above)
- 5 Other pensions or benefits

Pension Protection Fund (PPF)

The aim of the PPF is to protect members of defined benefits and hybrid schemes. Once it has been established that no other alternatives are viable the PPF pays compensation if the employer becomes insolvent and the Pensions Scheme is underfunded. It is funded by levies payable by defined benefit and hybrid schemes:

- Admin levy – To cover the set up costs of the PPF
- 'Initial' levy – Flat rate amount per active, deferred member and pensioner of the scheme.
- Risk based levy – This will be based on the size of the fund, how well it is funded and the credit rating of the sponsoring company.

For more details see www.ppf.gov.uk

Indexation Requirements (LPI)

The Pensions Act 2004 introduced changes to Limited Price Indexation from 6 April 2005, the main changes are as follows:

- No indexation requirement for money purchase pensions coming into payment after 5 April 2005, including protected rights benefits. No change to those in payment before 6 April 2005.
- Final salary pensions built up for service after 5 April 2005 are subject to RPI indexation capped at 2.5%. Funds built up prior to 6 April 2005 retain RPI indexation capped at 5%.

30 December 2005

Scheme Funding and Investment

There are four main aspects.

Statutory Funding Objective (SFO)

- This will replace the Minimum Funding Requirement (MFR) for defined benefit schemes.
- Funding measures and strategy needs to meet the SFO and will be scheme specific (unlike the universal MFR) agreed between the trustees and employer based on actuarial advice.
- Full actuarial valuations will be required every three years (with interim reports yearly).
- New funding rules will be coupled with new controls on repayments of surplus.

Statement of Funding Objectives

Trustees of defined benefits schemes must prepare and maintain a Statement of Funding Principles detailing:

- Their scheme's funding objective
- The impact of the funding policy on the investment strategy
- The method and assumptions used to value liabilities
- How the employer's agreement on funding is sought
- The period over which any deficit is being funded.

Contribution Controls

There are a range of requirements, depending on the type of scheme:

- For occupational schemes, trustees must establish and maintain a schedule of contributions for final salary schemes, or a payment schedule for defined contribution, setting out the amounts payable and the due date.
- For Personal Pension schemes employers need only monitor payments where payroll deductions are involved.
- Failure to make due payments need only be reported to the regulator 'within a reasonable period' where the trustees/employer believe it is 'of material significance'.

Statement of Investment Principles

Occupational trustees are required to prepare and maintain a Statement of Investment Principles (SIP) and it has to:

- Be reviewed every three years
- Cover the kinds and balance of investments to be made
- Cover the trustees' risk appetite and returns expected
- Cover the trustees' ethical stance and voting policy.

As it is now, professional advice is required on the SIP content.

6 April 2006

Internal Dispute Resolution

The Pensions Act simplifies this process, giving Trustees the option of a one-stage process rather than the previous two-stage process.

All occupational and trust-based stakeholder pension schemes must have a dispute resolution procedure in place, unless:

- Every member is a trustee of the scheme
- The scheme has no more than one member or
- The scheme is of a prescribed description.

The trustees or managers must decide on the dispute within a reasonable time period, and must give their decision to the applicant within a reasonable time period of the decision being made.

For more information see:

<http://www.thepensionsregulator.gov.uk/codesAndGuidance/codes/index.aspx>

Employment Consultation

Employees are to be consulted before certain changes are made to pension schemes. For example, if employer cuts contributions to PPS by 2%, or to less than 3%. The changes will apply from:

- April 2006 where the employer has 150 or more employees
- April 2007 where the employer has 100 or more employees
- April 2008 where the employer has 50 or more employees
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Changes to AVCs

Occupational Pension Schemes (OPS) can continue to offer AVCs if they wish, but they are not obliged to as an individual will be able to contribute to a number of pensions concurrently. Also, members will now be able to take a tax-free lump sum from AVC funds.

Relaxing Protected Rights Rules

The Pensions Act allows a tax-free lump sum to be taken from Protected Rights funds and reduces the minimum age at which benefits can be taken from age 60 to age 50 (age 55 from 2010).

Changing Preservation Requirements

Members of Occupational Pension Schemes, leaving with pensionable service greater than three months and less than two years, will have a right to opt for a transfer value or a refund of contributions. If the Trustees wish, they will be able to pay a refund where a member does not opt for a transfer.

Trustee Knowledge & Understanding

The Pensions Regulator has issued a draft Code of Practice requiring trustees of Occupational Pension Schemes to be, amongst other things, conversant with:

- The trust deed & rules of the scheme
- Documents detailing the current policy on the administration of the scheme
- Any statement of investment principles.

Trustees must also have a knowledge and understanding of the law relating to:

- Pensions and trusts
- The principles relating to the investment of the assets of occupational pension schemes.

There will be no mandatory qualification, although trustees who hold themselves out as experts will need to demonstrate to The Pensions Regulator that they are appropriately qualified. The Government plans to introduce e-learning for trustees, which could potentially lead to a qualification in the future.

There may be exemptions for schemes where all members are Trustees eg SSAS, and small money purchase schemes.

Member Nominated Trustees (MNT)

Schemes will no longer be able to opt out of the MNT requirement, although existing exemptions will continue to apply eg one-life schemes.

Trustees of Occupational Pension Schemes are required to ensure that at least one-third of trustees are member-nominated and at least one-third of directors of the trustee company are member-nominated.

The arrangements must include a nomination process, a selection process and other statutory requirements.

For more details see:

<http://www.thepensionsregulator.gov.uk/codesAndGuidance/codes/consultation.aspx>

New Allowances

There are two main pension allowances.

- (i) A yearly ceiling on the total payments made by or on behalf of an individual without tax penalty. Notional payments for final salary pensions are calculated on the increase in value over a year by valuing benefits on a 10:1 basis. Payments in the year before full benefits are drawn from a scheme are excluded from the annual allowance.
- (ii) A Lifetime allowance, which is the value of pension savings anyone can draw in their lifetime without tax penalty.
Details of both these allowances are shown in the table below:

Tax Year	2006/07	2007/08	2008/09	2009/10	2010/11
Annual Allowance	£215,000	£225,000	£235,000	£245,000	£255,000
Lifetime – All employee	£1,500,000	£1,600,000	£1,650,000	£1,750,000	£1,800,000

Tax charges

Annual allowance charge

A 40% tax charge on the member of a pension scheme based on the amount of payments (member plus employer) in excess of the annual allowance. It is possible to protect the fund from the annual allowance charge by registering for either Primary or Enhanced Protection (see www.hmrc.gov.uk for more details).

Lifetime Allowance Charge

25% of the excess over the lifetime allowance if used to provide income. 55% of the excess over the lifetime allowance if drawn as a lump sum.

Unauthorised Payments Charge

40% income tax charge levied on the recipient of the authorised payment.

Unauthorised Payments Surcharge

15% income tax charge payable with the unauthorised payments charge, where the value of unauthorised payments in a year amounts to 35% or more of the fund.

Contributions and tax relief

Relevant UK individuals who are active members of registered pension schemes will be entitled to tax relief. A person is a relevant UK individual if they are under 75 and:

- They have relevant UK earnings chargeable to income tax for that year
- They are resident in the UK at some time during that year
- They were resident in the UK both when they became a member of the pension scheme and at some time during the previous five years
- They or their spouse have, for the tax year, earnings from overseas Crown employment subject to UK tax.

Individual contributions will receive tax relief up to the greater of £3,600 and 100% of earnings. Contributions over 100% of earnings are possible, though pension providers are not required to accept them and no tax relief would be available. Tax relief on employer contributions is potentially unlimited, though the granting of the relief will be down to local Tax Offices.

Pension Age

The minimum retirement age of 50 for all registered pension schemes will increase to 55 from 6 April 2010.

Members who have an agreed retirement age lower than the minimum, because they have a special occupation, eg professional sportspeople, will have some protection, when taking benefits at an early retirement age. The individual's lifetime allowance will be reduced by 2.5% for each year below the normal minimum pension age.

Form of retirement benefit

Schemes will be able to pay a commencement lump sum of up to 25% of the crystallised value (up to 25% of the lifetime allowance). This will allow schemes that currently do not provide cash eg FSAVCs, to do so. The DWP has confirmed that they intend to allow tax-free lump sum of 25% to be paid from protected rights funds at retirement.

The remaining fund must be used to provide income in one of the following ways:

- Secured – a guaranteed income (lifetime annuity or scheme pension)
- Unsecured pension – a non-guaranteed income prior to age 75 (income withdrawal)
- Alternatively secured pensions (ASP) – a non-guaranteed income available from age 75.

Minimum income for secured pension and ASP will be zero. Maximum income will be 120% (secured pensions) or 70% (ASP) of the yearly income available from a level single-life, non-guaranteed annuity based on the member's age, using rates provided by the Government Actuary's Department. The income levels must be reviewed every five years for unsecured pension and every year for ASP.

Trivial Commutation

Individuals will be able to commute small pension funds for cash where they do not exceed 1% of the lifetime allowance (£15,000 for tax year 2006/7). The total of all vested and unvested funds must be below this limit, with vested funds being valued at 25 x the yearly pension, or GAD maximum income level for funds in drawdown.

Commutation of small pension funds must be done within a single twelve month period between the member's 60th and 70th birthdays. Up to 25% of the fund can be paid tax-free with the remaining fund taxed as pension income in the year of commutation.

Ill health/incapacity

All schemes can provide benefits before normal minimum pension age on the grounds of ill-health, where the member is incapable of carrying on their occupation due to physical or mental impairment. Where the member's life expectancy is less than one year, benefits could be completely commuted for cash (if the scheme allows this), with no income tax liability (provided they are within the lifetime allowance).

Death Benefits

On death, uncrystallised pension benefits can be paid out as a lump sum up to the value of individual's lifetime allowance. The individual's available lifetime allowance would have been reduced by any crystallisation events that have already happened before death. Once the lifetime allowance has been used up, any further lump sum death benefits would be subject to the lifetime allowance charge 55%.

Where an individual dies whilst in unsecured pension, any remaining fund can be paid out less tax at 35%, without being tested against the lifetime allowance. Alternatively the fund can be used to pay dependants' pensions.

On death in Alternatively Secured Pension, if there are no dependants alive, the fund can be transferred to other members of the same pension scheme, or paid as a lump sum to a charity nominated by the member.

Pensions and divorce

For pension sharing orders in place at A-Day, when calculating the value of an individual's pre A-Day pension rights, the value of any pension allocated to a spouse on divorce will be ignored for the purposes of both spouses' lifetime allowances. Pension credits created after A-Day will count against the recipient's lifetime allowances, unless derived from the pension in payment as it will already have been tested against the lifetime allowance.

Investment

After A-Day, all pension schemes will be permitted to invest in all types of assets, including residential property. Any non-commercial use of an asset (for example where the individual lives rent free in a house owned by the pension scheme) will be regarded as a benefit in kind on the individual and taxed accordingly.

An occupational scheme can use up to 5% of the value of the scheme's assets to acquire shares in the sponsoring employer. Investments made before A-Day will not be affected by these changes. Scheme borrowing, whether by an occupational or individual scheme, will be restricted to 50% of the value of the assets, subject to DWP requirements (which may be more restrictive). There will no longer be an HM Revenue & Customs requirements for a pensioner trustee for Small Administered Schemes.

Unapproved schemes

Funded and unfunded unapproved retirement benefit schemes, FURBS & UURBS, will be known as employer-financed retirement benefits schemes in the new regime. Tax treatment for those schemes will be:

- Employer payments will not be taxable or subject to National Insurance at the time of payment
- No tax relief on employer contributions until benefits start to be paid
- Benefits will be subject to income tax.

FURBS & UURBS in existence at A-Day will have some transitional protection:

- Where an employee has paid tax on their employer's contributions to a FURBS, contributions can continue to be made and an adjustment will be made to the tax-free element of any lump sum benefit finally paid out.
- An existing UURBS may be rolled into a registered scheme within three months of A-Day without affecting the annual allowance.

Pension Issues

Pension Protection Fund (PPF)

Have you had an indication of the level of your Scheme's levy for 2006 and considered how this can be minimised?

Indexation Requirements (LPI)

For final salary style pension arrangements this is one of the few genuine cost reductions. Have your Trustees announced that these new provisions take effect yet?

Changes to AVCs

For members with significant AVCs which commenced after 1987 and are looking to early retire they will probably want to defer taking their AVC benefits until after April 2006 as otherwise, they would have to use all their account to secure a pension.

New Allowances

Traditionally, on death in service, Schemes have provided a mixture of lump sum and a spouses pension. It is now more tax effective for a higher lump sum to be provided instead of a spouses pension, as if this is paid in pension form – income tax would be deducted.

September 2004

*This update includes general information and cannot be relied upon for individual schemes issues.
You should contact your adviser or P Couchman at Premier Pensions Management Ltd, Capital
Business Centre, Units 14 & 15, 22 Carlton Road, South Croydon, Surrey, CR2 0BS.
DL: 020 8916 2129. Email: paul.couchman@premierpensions.co.uk,
if you require definitive advice*