

# Premier Pensions Management Limited

## Current Issues

March 2011

Premier Pensions Management Ltd



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## Change from RPI to CPI Increases – Last updated **March 2011**

- In July 2010 the Government announced that for Public Sector pension schemes, pension increases and the revaluation of deferred pensions will be limited to CPI rather than RPI increases. The change is extended to private schemes.

- The constituents of the two indices differ eg- CPI excludes house price increases. Usually RPI exceeds CPI, on average by approximately 0.6%. Change to CPI therefore reduces costs.

- The Government has no intention of introducing a statutory override to force schemes to change specific scheme rules to meet CPI requirements.

- If schemes wish to move from an RPI basis to a CPI basis, the Government has proposed that the change becomes a 'listed change' under Pensions Act 2004 consultation requirements.



## Change from RPI to CPI Increases

- Schemes that retain RPI increases will not be required to provide a CPI increase in years when CPI exceeds RPI.
- It appears that schemes with rules that refer to increases in line with legislation will automatically be subject to the change. **As a general rule members should be notified of any automatic switch to CPI.**
- **On 8 December 2010, the Government issued the 2010 Revaluation Order which used CPI as the base index to set minimum revaluation for deferred pensions excluding GMPs. It came into force on 1 January 2011.**
- **For schemes returning RPI as the revaluation basis, Aries will be publishing RPI based revaluation orders.**



## End of the Default Retirement Age – Last updated January 2011

- Age Discrimination introduced in 2006 – A number of exemptions applied to pension schemes. For example maximum and minimum entry ages.

- Also permitted a Default Retirement Age of 65. Six months prior to this the employer is required to notify employees that retirement is approaching (Default Retirement Age associated retirement procedure). Employees can request continued employment but employer can reject it and is not required to give a reason for the rejection.

- Retirement ages under 65 required ‘objective justification’ proof that it is a proportionate means of achieving a legitimate aim.

- Legitimate aim:
  - economic factors – efficiency of running business
  - health and safety issues

- Proportionate
  - does it achieve the aim?
  - is there no alternative?



## End of the Default Retirement Age

- By all accounts not easy to demonstrate objective justification.

- In July, Government announced that the DRA will be phased out from 6 April 2011. Employees notified of retirement prior to this date where retirement falls before 1 October 2011 are not affected. The DRA associated retirement procedures will be scrapped.

- Employers can now:
  - Remove a compulsory retirement age
  - Retain a compulsory retirement age but have to objectively justify it

- May have recruitment issues. Current legislation allows an employer not to recruit someone who is less than 6 months short of 65. If scrapped, it may lead to an increase in unsuccessful job applications and legal challenges to the decision.



## End of the Default Retirement Age

- In the absence of a compulsory retirement age, how do employers terminate employment? Some legal advisers are suggesting that there will need to be greater reliance on the performance management regime, and clear documentation to support a decision.

- The Government may produce guidance or a code of practice regarding how employers and employees discuss retirement.

- The consultation process has now ended and the Government has confirmed that it will press ahead with the planned changes. ACAS has produced new guidance for employers on how to manage the new procedures as has the DWP. This is available at [www.businesslink.gov.uk/agepositive](http://www.businesslink.gov.uk/agepositive)



## Restricting Pensions Tax Relief – Last updated **March 2011**

- New legislation has been introduced to restrict the level of tax exempt savings in UK pension plans.
- Annual allowance to be reduced from £255,000 to £50,000 for 2011/2012 tax year.
- Lifetime allowance to be reduced from £1.8m to £1.5m from April 2012. People with savings above £1.5m or with funds below this who believe investment returns will take their funds above this level can apply for a personal lifetime allowance. They will have to cease building up benefits in all registered schemes from 6 April 2012.
- A flat factor of 16:1 to be used to value a DB pension against the Annual Allowance (previously 10:1)
- A three year carry forward rule of unused allowances will apply.



# Restricting Pensions Tax Relief

- Where the tax payable (annual allowance charge) exceeds £2,000, members can choose to pay the full cost from their pension benefit.
- Schemes can decide the basis on which benefits can be adjusted but the method must be fair and reasonable. Members cannot be directly charged for the work involved in this process .
- Schemes can determine the Pension Input Period for calculating the value of each year's Annual Input Amount. This is a complex area and by default many schemes will have a PIP year which runs from 7 April in one year to 6 April in the next.
- Originally trustees had until 6 April 2011 to elect for a scheme specific PIP and to communicate this to members . However, HMRC has now changed its mind and extended the deadline up to the date on which the Finance Bill 2011 receives Royal Assent. This is expected to be 1 July.



# Restricting Pensions Tax Relief

- For DC schemes it would appear that unless a scheme wide decision is taken, members may have individual PIP years based on when their first contribution to the scheme is made. Legal advice should be taken to clarify the position.



# EXAMPLE CALCULATION OF PENSION INPUT AMOUNTS

## Calculating Pension Input Amounts

Calculate the increase in the annual pension entitlement. This is the difference between:

- a) the annual pension earned at the beginning of the Pension Input Period, revalued to the end of the Pension Input Period in line with CPI
- b) the annual pension earned at the end of the Pension Input Period

### Example

Accrual rate	=	1/60
Years service at beginning of PIP	=	34
Pensionable Salary at beginning of PIP	=	£60,000
Pensionable Salary at end of PIP	=	£72,000
CPI over PIP	=	2.5%

### Calculation

Pension at beginning of PIP	=	$\frac{34}{60} \times £60,000$	=	£34,000
Pension Revalued to end of PIP	=	$£34,000 \times 1.025$	=	£34,850
Pension at end of PIP	=	$\frac{35}{60} \times £72,000$	=	£42,000
Pension Input Amount	=	$£42,000 - £34,850$	=	$£7,150 \times 16 = £114,400$
Amount Taxable	=	$£114,400 - £50,000$	=	£64,400

**NB:**  
Any unused allowance from previous 3 PIPs can be offset against current year PIA. If benefits still exceed annual allowance, the benefit is added to the member's salary and subject to tax at the member's marginal rate.  
  
Government is considering ways in which a member may be able to pay the charge from their pension entitlement.



## Auto Enrolment and NEST – Last updated November 2010



Process commences 1 October 2012 with large employers (120,000 or more workers) required to auto enrol eligible workers.



A “staging process” determines the date by which employers of different sizes are required to auto enrol. By September 2016 all existing employers will have passed their staging dates.



Employees aged over 22 and under State Pension Age, on a salary above £7,475 (2011 figure) must be enrolled. These are “qualifying jobholders”



Employees aged between 16 and 22 years, on a salary above £7,475 can opt-in and access employer contributions.



Employees earning less than £7,475 may opt in with employer contributions optional.



## Auto Enrolment and NEST

- Minimum contribution requirements for DC arrangements are 8% of qualifying earnings with at least a 3% employer contribution. Qualifying earnings are earnings between £5,715 and £38,185 (2010/2011 terms). Employee to pay 4% with 1% paid as tax relief by the government.

- There is a 'phasing' mechanism for the introduction of contributions:

Staging Period	Phased Minimum Contribution	
	Employer	Employee
October 2012 – September 2016	1%	1%
October 2016 – September 2017	2%	3%
October 2017 Onwards	3%	5%

- Employers will be required to register their qualifying scheme with the Pensions Regulator. There will be easy certification procedures where DC contributions do not have to be linked to 'qualifying earnings' – e.g. a scheme providing 9% of Pensionable Pay, where the employer pays a 4% contribution.



## Auto Enrolment and NEST

- Employees can opt out but must be automatically re-enrolled after three years.
- The National Employers Savings Trust (NEST) is available for employers that do not wish to provide their own qualifying scheme. Launch date around Spring 2011.
- An initial contribution cap of £3,600 applies to NEST. However, this was the limit in 2005 terms and will be adjusted in line with earnings growth. By 2017 limits will be removed.
- Phased contributions identified above will also apply to NEST.
- Employee contributions deducted from NET PAY. Nest will reclaim basic tax relief and add to the members' savings account. Any higher rate tax must be reclaimed through the self assessment process.



## Auto Enrolment and NEST



Legislation throws up a number of issues, particularly for the employer and its HR and payroll systems.

- Identifying members who will need to be auto-enrolled and cost assessment
- Should an existing scheme be used as the auto enrolment vehicle or NEST
- If the existing scheme, are modifications required?
- Identifying eligible job-holders (age 22, on salary over £7,475)
- Monitoring changes in income, particularly part-time workers
- Flagging systems for opted-out members
- If NEST is used, adjusting payroll systems so that contributions can be deducted from net pay.



## A-Day Transitional Period Ending – Last updated November 2010

- The A-Day legislation (Finance Act 2004) introduced a new tax regime for occupational pension schemes.
- For example, the Lifetime Allowance was introduced to determine the amount of tax favoured pension savings. This replaced the previous maximum pension accrual of 2/3rds final remuneration.
- Some schemes did not want to convert to the new regime immediately, relying on Modification Regulations to retain the pre A-Day limits for a five year period ending on 6 April 2011.
- From 6 April 2011 the Modification Regulations will cease to apply and the A-Day regime will take automatic effect. Schemes relying on the Modification Regulations may then find they are required to provide more generous benefits than they intended. For example, the removal of the earnings cap may lead to increased benefits.
- If they have not done so, schemes should disapply the Modification Regulations and ensure that scheme rules reflect what is required.



## Gender Equality in Insurance Premiums (New)

- The European Court of Justice (ECJ) in the case of Association belge des Consommateurs Test-Achats concluded that it is a breach of EU law to set gender based insurance premiums.
- Particular focus has been given to gender based premium rates for motor insurance with male rates reflecting the higher risk of accidents for men compared to women, particularly at younger ages.
- The legislation will extend to the pensions arena and impact annuity prices where currently rates are more favourable for men, and possibly actuarial factors.
- The legislation allows insurance companies until 21 December 2012 to change their practices. Pension schemes will need to consider what changes are required.



## HMRC Approval in Amendment Powers (New)

- A scheme's amendment powers may state that an amendment cannot be made without Inland Revenue / HMRC agreement, consent or approval. This provision was applicable before 6 April 2006 under the old tax regime.
- Since 2006 HMRC has not been able to give consent but under the transitional regulations, such a provision has been disregarded.
- With the transitional regulations running out in April 2011, trustees of schemes containing this provision should consider passing a resolution removing this requirement before any further rule amendments are made.



## Contracting-out Rebates (New)



The DWP has announced that the NI contribution rebate for DB pension schemes will be 4.8% for the five year period commencing 6 April 2012.



The rate will be split 1.4% for the employee and 3.4% for the employer.



Current rates are 5.3% split 1.6% for the employee and 3.7% for the employer.



For contracted- out schemes with active members, this effectively leads to an increase in costs.



## Previous Topics

We detail below topics covered in our previous Current Issues.

Issue	Date
Monitoring Employer Support	February 2011
Compulsory Annuities Scrapped	February 2011
Section 251 – Return of Surplus	February 2011
Regulatory guidance – Record Keeping	February 2011
Principles for Investment Governance of work based DC Pension Schemes	February 2011
Disclosure of Information	February 2011

