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Back to the Simple Life

The Emergency Budget (22 June) surprised many of the cynics who are not used to seeing Governments deliver on their promises. Of course there is many a slip 'twixt cup and lip' and there is some way to go from Budget Statement to law.

Against a background of economic restraint, there were many proposals to change pensions. The outstanding feature appeared to be an attempt to return to the simplicity of the 2004 tax reforms.

The following is a summary of the main proposals as they affect pensions.

Higher rate relief

The original proposals were to apply from 6 April 2011 and affected anyone who had income of over £130,000 if the total of income and pension contributions exceeded £150,000. The member was to be taxed at 1 per cent for every £1,000 that the aggregate exceeded £150,000, to a minimum of the basic rate.

In the period to 2011 and starting in April 2009, a pension scheme member was subject to a tax charge (higher rate minus the basic rate) if income was at least £130,000 and the aggregate contribution exceeded £20,000 and the 'normal pattern of saving'. This rule was known as an

'anti-forestalling' measure.

All these terms required laborious definition and there were some fairly basic questions (such as how to identify a contribution under a defined benefit scheme) that required a less than straightforward answer.

The measure was unpopular because although pensions are very tax efficient, it seems less than fair to relieve contributions at basic rate and tax the emerging pension at higher rates.

The new Coalition Government has retained the rules that apply prior to 6 April 2011, but is proposing a change to the rules from 2011. It wishes to raise the same tax revenue, but believes that we should all 'share the pain'. In a nutshell, they propose that the annual allowance be reduced to somewhere in the region of £30,000 to £45,000. This means that regardless of income, any aggregate contribution that exceeds the annual allowance will be taxed at 40 per cent in today's terms.

IN THIS EDITION:

- Back to the simple life (the Emergency Budget) 1
 - Higher rate relief
 - Ending 'annuitisation'
 - Inflation link
 - Increases to private pensions
 - State pension age
 - Tax threshold
 - NIC threshold
 - Automatic enrolment
 - Anti-avoidance
- Why shouldn't we be paid? (remunerating trustees) 3
- Regulatory activities 4
- Transfer rules to be changed 5

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Back to the Simple Life (continued...)

The annual allowance is not new, but today it stands at £255,000. The 'contribution' to a defined benefit scheme will be derived from the benefit accrued over the year and multiplied by a factor which is likely to be age-related.

There will now be a rush to pay large contributions before April 2011. This will particularly be in respect of individuals who have income of less than £130,000 and especially those whose income is just over £100,000: they will qualify for higher rate relief and reinstatement of personal allowance (an effective rate of 60 per cent).

Ending 'annuitisation'

More accurately, the Emergency Budget proposed ending 'the effective obligation to annuitise' money purchase pension funds by age 75.

In fact, as the legislation currently stands, there is no requirement to buy an annuity at 75, but the range of tax impediments after that age means that few will find the alternative – an alternatively secured pension – attractive. The real disincentives apply to death benefits and are a consequence of the previous Government's mantra that a 'pension is a pension' and is not tax-subsidised for the purposes of estate planning. The combination of income taxes and inheritance tax revealed a possible tax charge of 82 per cent on accumulated funds on death.

The Emergency Budget proposals immediately postpone the

'annuitisation date' to 77 pending a more structural change in 2011 when the requirement will be abolished altogether and with it, the current range of income taxes and inheritance tax.

The proposals come with a health warning. The new rules postponing the annuitisation date will only apply if the member's 75th birthday falls after 21 June 2010 and the pension commencement lump sum must be claimed before age 75.

Other measures affecting pensions:

Inflation link

The basic state pension will increase by the greater of the increase of the Consumer Prices Index (CPI), the Index of National Average Earnings and 2.5% from 2011. This means that the new basis will affect the new pension figures published in April 2012 and based on the indices measured up until the previous September.

The CPI differs from the RPI mainly in excluding mortgage payments and council tax. It tends to be more stable and increases at a lower rate. The earnings index would usually exceed the other indices and is likely to be the measure most often adopted. Most commentators would suggest that pensioner inflation comfortably exceeds all three measures and this is why nervous glances are being directed to the winter fuel allowance and travel concessions.

The State earnings-related pension

and State Second Pension will increase with the CPI.

Increases to private pensions

There was no immediate announcement in respect of private pension schemes, but within three weeks it was being reported that the Government intended to reduce the requirement to increase pensions in payment to the lower of the increase in the CPI and 2.5 per cent (from the lower of the increase in RPI and 2.5 per cent). The last time this provision was amended, the change only affected future accrual which cushioned the impact, but it was being reported that the change to the CPI measure would affect pensions already accrued and in payment as well as future accrual.

There has been no consultation to date and it is therefore unclear if the change will simply take the form of an overriding amendment: it would be difficult to modify past accrual because the benefit would inevitably be reduced by the change.

The increase in the CPI has on average been 0.7 per cent lower than the increase in the RPI over the last 20 years. This would have led to a pension lower by 14 per cent or 20 per cent over 30 years.

Source: Office for National Statistics.

There are two sides to every coin, of course, and an assortment of commentators suggested that the measure could reduce scheme deficits by £50 billion to £100 billion for the FTSE 350 companies. The annual cost would reduce by 5 per cent.



Back to the Simple Life (continued...)

State pension age

The law was already in place to increase the State Pension Age in stages between 2024 and 2046 to 68. First, it had to be equalised between men and women from 2020. The new Coalition Government is consulting on the feasibility of starting the process in 2016 and extending the target date to age 70.

The Government has also announced its intention to get rid of the default retirement age of 65 from 2011.

Tax threshold

There are some adjustments to national insurance contributions and tax thresholds. For taxpayers under the age of 65, the personal

allowance will increase by £1,000 to £7,475. According to PN1 Budget Press Notice this will take 880,000 individuals out of tax, but the basic rate limit will be reduced so that higher rate taxpayers do not benefit.

NIC threshold

The upper earnings limit and upper profits threshold (self-employed) will be aligned with the reduced higher rate tax threshold, but the secondary threshold (that determines employer liability to NIC) will increase above the usual indexation. This means that the threshold for employers and employees will diverge.

Automatic enrolment

A promise to review the

implementation of automatic enrolment has alarmed some groups, but given hope to those who wish to see small companies and certain age groups taken out of the rules. 'The Times' newspaper on June 26th commented that to tinker with its universality would be 'dangerous'.

Anti-avoidance

In a rather mysterious paragraph in the Budget Book, the Government stated that action to tackle arrangements using trusts and other vehicles to reward employees to avoid, defer or reduce liability to income tax and NIC will include employer-financed retirement benefit schemes (non-registered schemes).

Why shouldn't we be paid?

The governance of pension schemes has moved a long way since the 1995 Pensions Act. The days of the enthusiastic amateur are long gone and part of The Pensions Regulator's remit is to improve trustees' knowledge and understanding.

Trustees are not expected to be experts, but they have to be able to assimilate and understand what they are being told by their professional advisers.

Now comes a report in 'The Financial Times' (26 April 2010) which reports a growing number of lay trustees who believe they should be paid for their increasing expertise. A recent survey carried out by The Pensions Corporation and Engaged Investor magazine (The Future of Pension Schemes) has revealed that 62 per cent of more than 240 respondents wanted

payment for their efforts. The respondents included defined benefit schemes and consultants and trustees. In 2007, a similar survey put the figure at 46 per cent.

David Collinson at Pension Corporation said that 'trustees have had an increasing series of responsibilities placed on them over the past few years, not least the obligation to understand all the de-risking options open to them and how they work'. He also cited additional responsibilities to support the argument.

Legally there is nothing to prevent trustees being paid reasonable expenses for undertaking their responsibilities and they may be paid over and above this amount if the trust deed allows it (otherwise there is a general requirement that they must not 'profit from the scheme' other than as beneficiaries or members). If this becomes too complicated, there is always an option for employers to pay trustees for their work in delivering pension benefits.

Regulatory Activities

The Pensions Regulator has issued its first contribution notice to an employer whom it perceived was trying to evade a statutory debt. The case was in respect of the Bonas Group.

The facts were that an overseas EU employer placed its subsidiary UK company into a 'pre-pack insolvency' without informing the trustees or The Pensions Regulator. A 'pre-pack insolvency' is the sale of an insolvent company that is negotiated immediately before the administrator's appointment and completed on the appointment of the administrator.

The Regulator concluded that the parent company had not engaged openly with the trustees or Regulator. The UK company failed because of its pension liabilities and The Pensions Regulator in finding that the parent company had controlled the decision-making concluded that the process was designed to avoid a statutory debt. Some surprise was expressed that for such a high profile case the contribution notice was only for £5 million.

Of much greater financial significance was the financial support direction handed down to 25 companies

worldwide in the Nortel group. The Determinations Panel of the Regulator found that the UK pension was insufficiently resourced and ordered the 'target companies' to provide financial support of up to £2.1 billion (the shortfall measured on a buy-out basis). As a consequence the group had benefited from the under-resourcing of the UK scheme.

Guidance

Meanwhile, the Regulator has published guidance on member record-keeping. As trailed in an earlier consultation, it includes targets for common standards of data. It advises of regulatory powers to investigate standards within schemes including sampling and data audit and reminds us of potential enforcement action where there is a breach of legislation. The guidance sets a deadline of December 2012 for resolving outstanding data issues and enhancing education material on its website.

Separate guidance has been published for consultation and is designed to

improve the effectiveness of trustees in relation to the employer covenant in relation to a defined benefit scheme. It offers guidance on assessing, monitoring and taking action in relation to the covenant. The guidance includes case studies. It has been supplemented by guidance on understanding support in multi-employer schemes which the Regulator acknowledges is a complex area covering such areas as monitoring, withdrawal of employers and trustee responsibilities. It stresses the importance of professional advisers.

The Regulator has also published a revised Internal Controls Guidance and this highlights procedures for monitoring and acting on deterioration in the employer covenant as a key risk area.



Transfer rules to be changed

From 6 April 2010, the normal minimum pension age for taking benefits from a registered pension scheme is 55. From 6 April 2006 to 5 April 2010, this age had been 50.

By an extraordinary application of the law of unintended consequences,

somebody at HMRC noticed that the legislation prevented an individual transferring assets of an income drawdown fund or an annuity before age 55 to another provider.

Much lobbying followed and with commendable speed, HMRC has

announced the Government's intention to revise the legislation and restore common sense. Transfers in advance of the legislation will not be charged.