



Punter Southall
CONSULTING ACTUARIES

High earners & contributors

Pensions Survey

October 2010

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Introduction

In April 2009, the then Chancellor of the Exchequer, Alistair Darling, announced that tax relief on pension contributions was to be restricted for high earners. Since then, it has been a long journey for employers, trustees and affected individuals, with details of the proposals being slow to emerge and a complete change of direction being announced in June 2010: the original plans for a charge affecting only those with incomes over £130,000 are now almost certain to be replaced by an approach based on a reduced annual allowance.

During July and August 2010, we asked our clients and contacts to let us know how they felt about the changes and the impact they would have on their pension schemes and remuneration strategies. We have set out our findings in this report. We also included some of the preliminary findings in our response to HM Treasury and HM Revenue and Customs on their recent consultation on a possible reduced annual allowance approach.

There were over 130 respondents to the survey, who together have given us a cross-section of the views of the pensions industry. The respondents include finance directors, trustees and pensions managers, with backgrounds ranging from charities to FTSE 100 businesses.

We are publishing the final results of our survey as we await a statement from HM Treasury confirming their approach. This statement was originally expected by the end of September, but we understand that it has now been delayed until at least mid October. We will update you as soon as we learn more.

Our specialist team is able to advise on all aspects of the changes: from remuneration packages to scheme administration issues to individual advice. If you wish to discuss any aspect of the survey or the changes in general, please contact _taxchanges@puntersouthall.com and one of our advisers will be happy to help.



Jane Beverley
Principal and Head of Research

If you would like to discuss the findings of this survey, or any of the issues it raises, please email _taxchanges@puntersouthall.com or get in touch with your usual Punter Southall contact.

Key findings

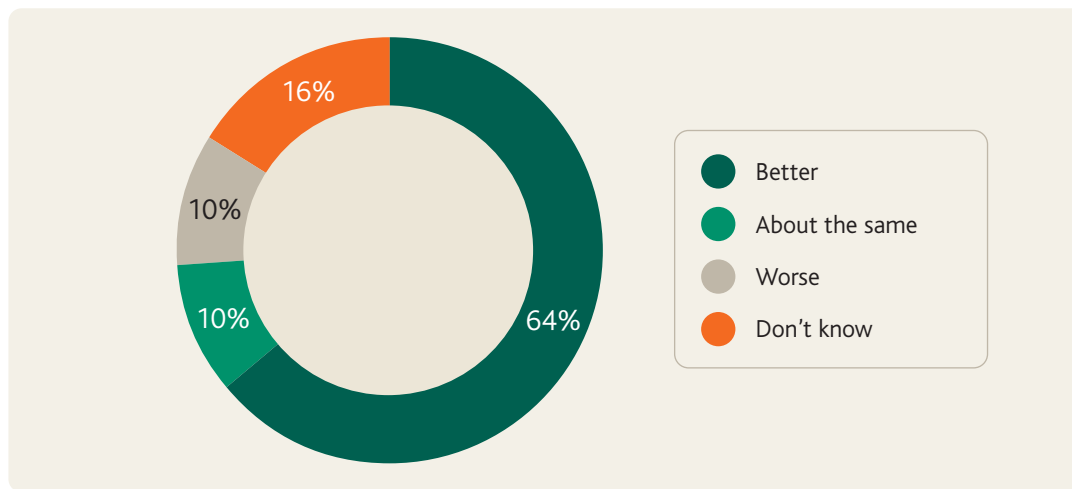
- 64% of respondents believe that a reduced annual allowance is an improvement over previous proposals for a 'high income excess relief charge' targeted only at those with incomes over £130,000.
- Nearly 70% of respondents believe it would be desirable for the annual allowance test to be redesigned so that increases to accrued benefits in line with price inflation are excluded from the definition of future accrual, but opinion is divided over other features of the design.
- Over 80% of respondents believe that the changes will result in an increase in the numbers of queries and requests for calculations for members, with nearly half of these believing that the increase will be significant.
- 65% of respondents envisage problems if they need to carry out 'scheme pays' calculations to pay the tax on members' behalf and reduce their benefits accordingly.
- Over 70% of respondents have taken steps to identify which of their pension scheme members may be affected by the changes, although over half will need to repeat the exercise as they based the analysis on the previous proposals.
- A third of respondents have communicated with individuals about the changes and a further 54% intend to in the future, with only 9% having no plans to do so.
- The most common option to be considered for remuneration packages is the provision of additional salary as an alternative to pension contributions.
- Three-quarters of respondents expect the changes to reduce the overall level of provision for individuals.

1. The reduced annual allowance

In his Emergency Budget on 22 June 2010, George Osborne announced that the previous Chancellor’s proposals to restrict pensions tax relief were to be reviewed, with the original plans for a charge affecting only those with incomes over £130,000 likely to be replaced by an alternative approach, most likely a reduced annual allowance.

Our survey asked for views on the change of direction and also considered what features would be desirable in a revised annual allowance calculation.

1.1 How do you think an approach based on a reduced annual allowance compares to the previous proposals for restricting pensions tax relief?



117 respondents answered this question.

Analysis:

64% of respondents believe that a reduced annual allowance is an improvement over the previous proposals with only 10% believing that the revised proposals make things worse.

The main reason cited in favour of the change was that basing the tax charge on a reduced annual allowance would be much simpler to communicate and administer, with all members being treated in the same way and less complexity in the calculations themselves. The alternative high income excess relief charge that had been proposed promised to be an administrative headache, with confusion over who would be affected and the calculations themselves being relatively involved due to the use of age-related factors and the introduction of a whole new set of legislation to govern the regime. The annual allowance has been around for four years so some administrators and members may already be familiar with the calculations; but there may still be the need for advice and training as such calculations have been relatively rare to date and therefore the legislation has been largely untested.

The greatest challenge in implementing a reduced annual allowance approach will be retaining the simplicity that has made it a popular replacement for the high income excess relief charge, while at the same time correcting some existing anomalies and potential areas for avoidance, which will become more significant if the level of the annual allowance is reduced. There is always a balance to be struck between fairness and simplicity, and our survey results suggest that it may be proportionate to favour simplicity in this case rather than to burden members and trustees with an even more complicated regime.

Survey response:

“Easier to administer although it will capture a lot more of the membership.”

Survey response:

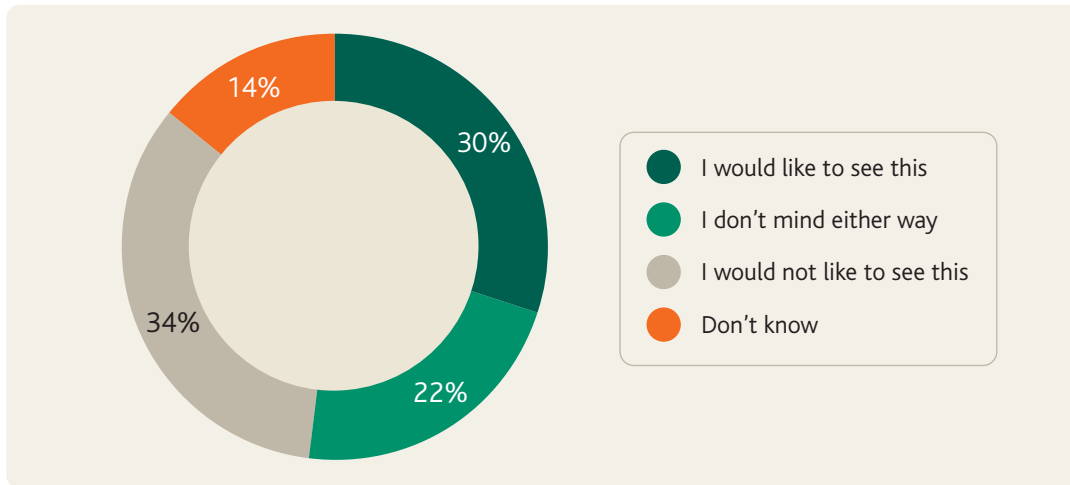
“At least all people will be able to accrue something subject to the cap.”

Survey response:

“Will affect far more moderate earners who may not have the income to pay additional tax charges.”

1.2 What features would you like to see in the revised annual allowance calculation?

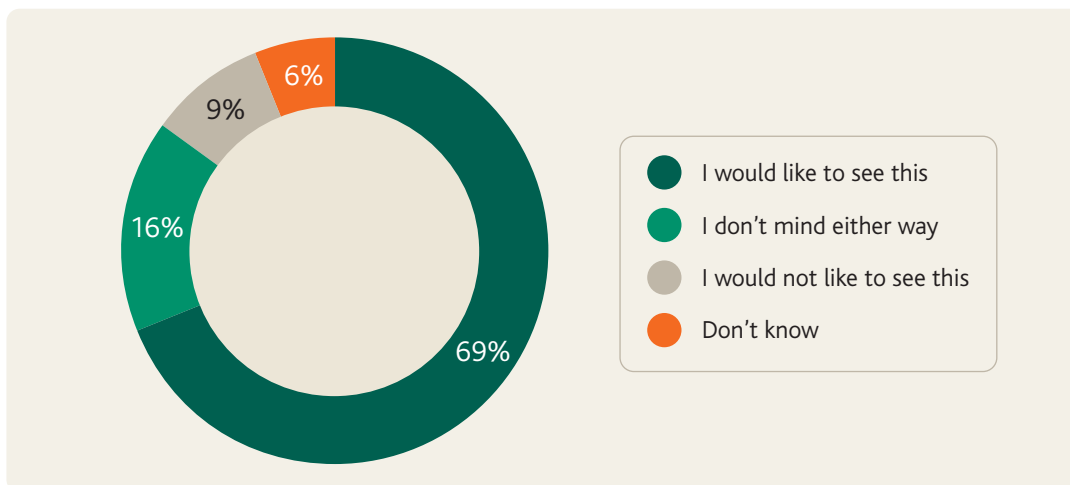
- Age-related valuation factors for defined benefit accrual



86 respondents answered this question.

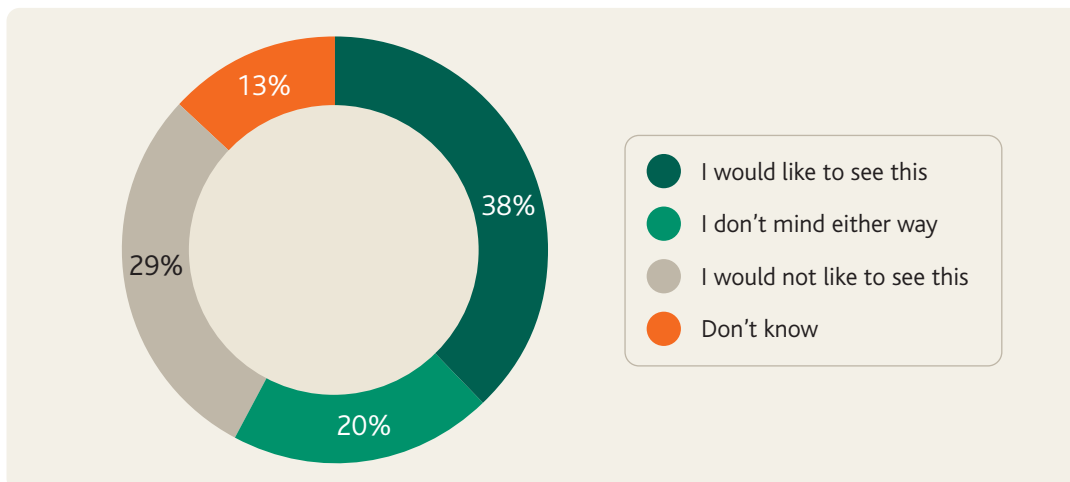
Survey response:
"The uncertainty regarding the level of annual allowance and if age related factors are to be introduced is totally unreasonable."

- Inflation protection for defined benefit accrual



85 respondents answered this question.

- Removal of the exemption from the charge in the year of retirement



87 respondents answered this question.

Survey response:
"Time to compromise!"

Analysis:

While there is a general consensus that the revised approach is preferable to the previous approach, opinion is inevitably divided about the details – in particular whether the factors should be flat or age-related and whether the current exemption from the charge in the year of retirement should be removed.

However, in view of the significant proportion of respondents who 'don't mind either way' about these details and a number of comments that compromise may be needed to reach a strong consensus view, these differences of opinion should not prevent a solution being reached that is broadly acceptable as preferable to the previous proposals.

There is also significant support for the annual allowance test to be redesigned so that increases to accrued benefits in line with price inflation are excluded from the definition of future accrual, with nearly 70% of respondents believing this change to be desirable. Excluding inflationary increases from the test would be expected to reduce the total tax collected if all else was equal, but this could be compensated for by setting the annual allowance at a lower level or using a higher factor to value defined benefit accrual. There will therefore be winners and losers under either approach, with those with significant accrued benefits being most likely to benefit from the granting of inflation protection.

2. Scheme administration issues

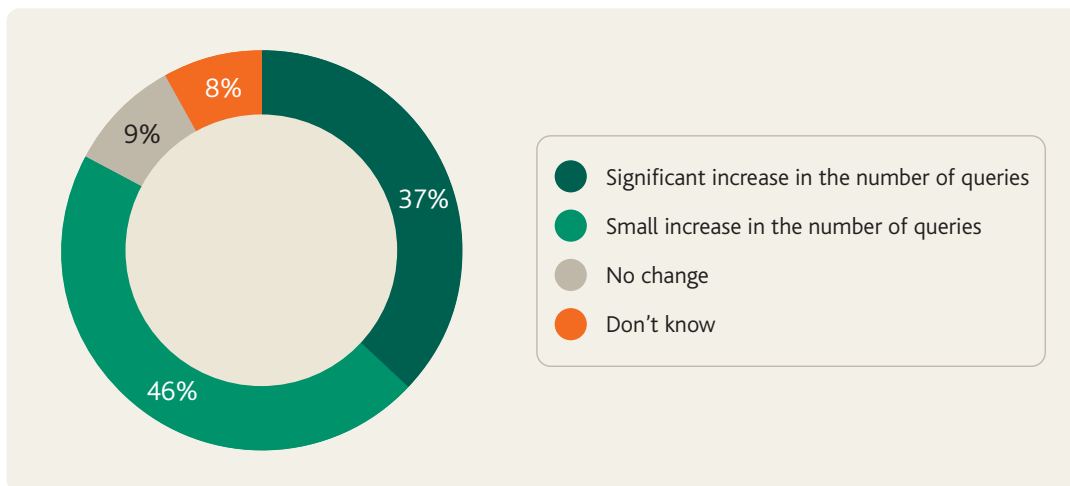
After the pensions tax simplification that took effect from 6 April 2006 ('A-Day'), trustees and scheme administrators were hoping for some long-term stability in the pensions tax legislation. Every change requires procedures to be reviewed, perhaps with changes to member calculations or letters. This is not only an issue for those directly involved in the administration, as the sponsoring employer will ultimately be required to pay for the additional costs.

It is not yet clear what, if any, new information requirements will be placed on pension schemes from April 2012 to ensure members correctly disclose the value of their pension accrual on their tax return, but it is clear that there will be a need to provide at least some individuals with extra information.

Further, the original proposals included the requirement for schemes to give members with a tax charge over £15,000 the option of the scheme paying the charge on their behalf, with a corresponding reduction to the member's scheme benefits: an option known as 'scheme pays'. This option has also been put forward in the consultation document as one method of dealing with the large tax charges that may be incurred by individuals.

Our survey asked for views on the impact of the changes on scheme administration and on the 'scheme pays' option.

2.1 What impact do you believe a lower annual allowance will have on the number of queries and requests for calculations for members?



95 respondents answered this question.

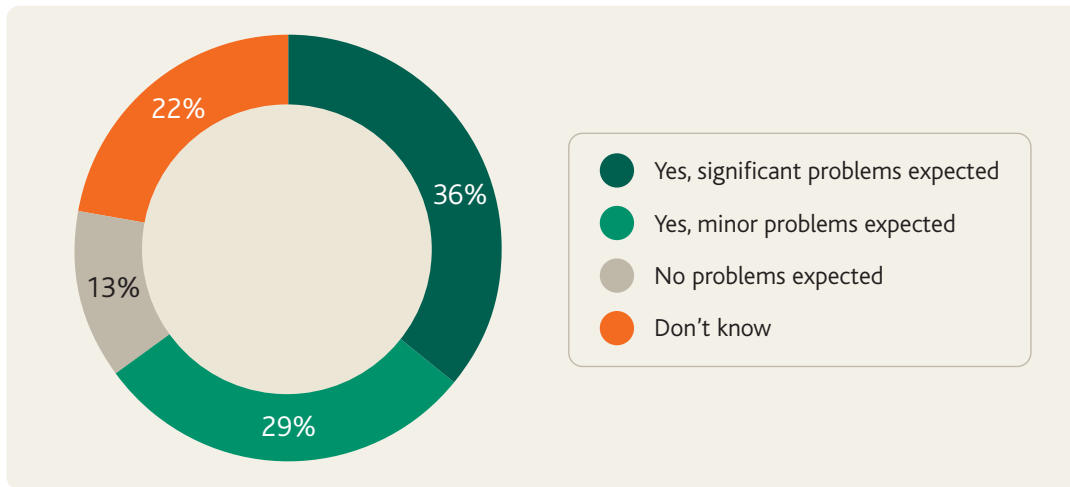
Analysis:

Over 80% of respondents believe that the changes will result in an increase in the numbers of queries and requests for calculations for members, with nearly half of these believing that the increase will be significant.

The additional queries and calculations will inevitably lead to higher administration costs. This raises the question of whether the introduction of the new tax charge is an efficient use of resources: the expense of calculating and enforcing the tax charge is likely to be significant.

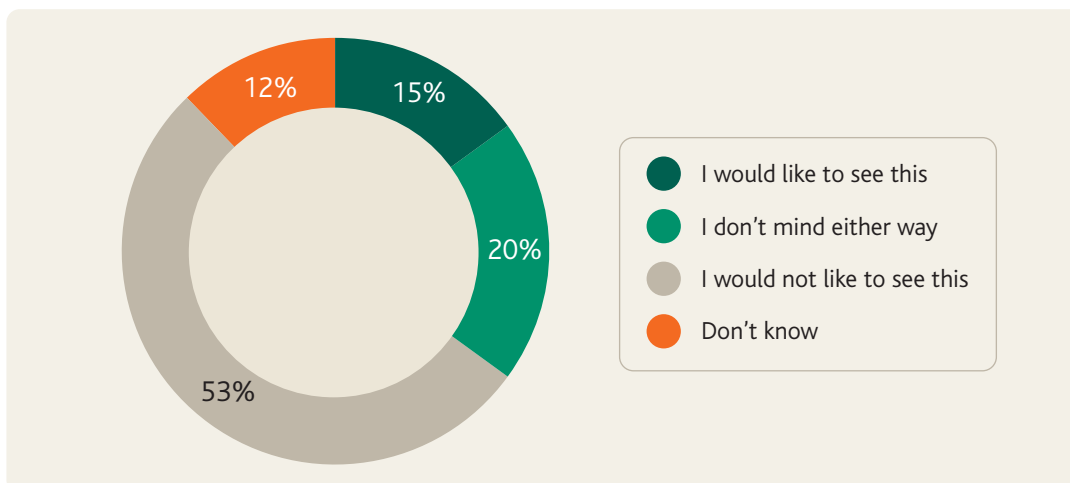
Survey response:
"A nuisance after all the A day changes."

2.2 Do you envisage any problems if you need to carry out 'scheme pays' calculations?



96 respondents answered this question.

2.3 Would you like to see a 'scheme pays' option in the revised annual allowance calculation?



84 respondents answered this question.

Analysis:

65% of respondents envisage problems if they need to carry out 'scheme pays' calculations, and over 20% are not sure whether there will be problems. It is perhaps not surprising therefore that half of respondents would not like to see the 'scheme pays' option introduced.

However, despite these practical issues, 15% of respondents would like to see 'scheme pays' introduced; 'scheme pays' does provide a means for affected individuals to manage their tax charge as many members may find it difficult or undesirable to pay the charge out of other savings when they will not receive their pension until many years in the future (if indeed they receive it at all).

This emphasises the need for clarity from HM Treasury as soon as possible over whether there will be a mandatory requirement for trustees to provide such an option and, if so, how the calculations are to be carried out and over what timescales. Administrators need time to prepare for any changes to their procedures and members need time to take advice over how they will meet the charge.

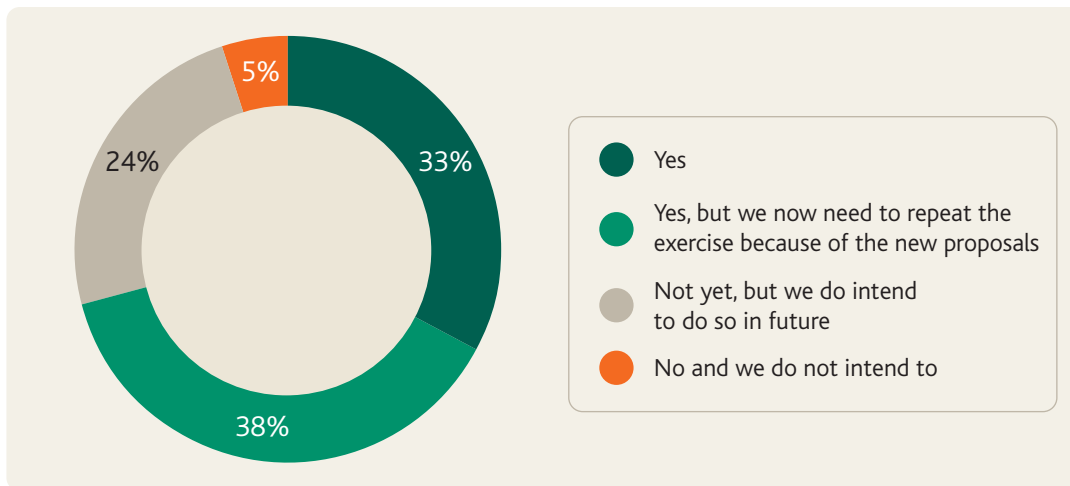
3. Options for remuneration

The restriction of pensions tax relief and the introduction of the 50% tax band mean that employers should reconsider their remuneration packages for affected individuals, who are likely to include their key staff and their highest earners.

The original proposals to restrict pensions tax relief completely for individuals with an annual income over £130,000 caused employers and affected individuals to question whether pensions had any place in the remuneration packages for high earners. The revised proposals allow everyone to receive some tax-relieved provision so represent an improvement for many, but they raise new challenges to ensure that scheme design and overall remuneration packages are structured as effectively as possible within the new regime.

Our survey asked what actions were being taken to deal with the affected individuals and for views on how the changes would affect remuneration packages overall.

3.1 Have you taken any steps to identify which of your active pension scheme members may be affected by any changes to tax relief planned from April 2011?

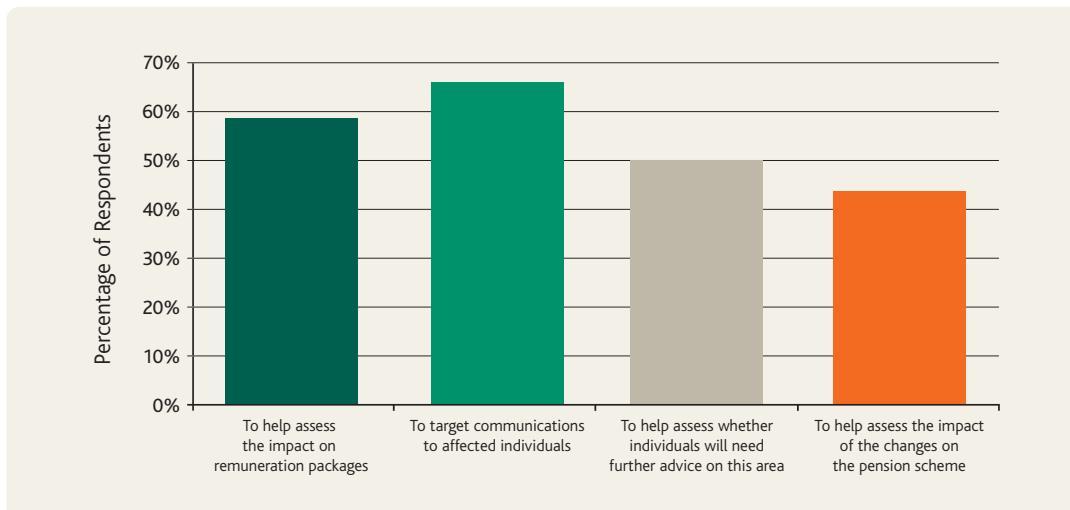


Survey response:

“Until the detail is known we cannot ascertain the full impact on our membership.”

104 respondents answered this question.

3.2 If you have taken steps to identify affected individuals, why have you done this?



82 respondents answered this question. Respondents were able to select as many or as few options as applied to them.

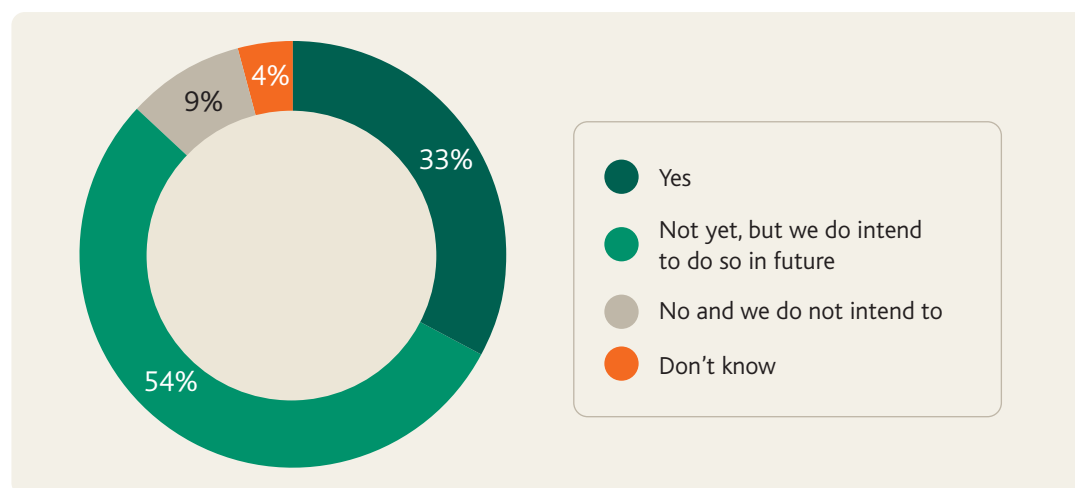
Analysis:

Over 70% of respondents have taken steps to identify which of their pension scheme members may be affected by the changes, although over half will need to repeat the exercise as they based the analysis on the previous proposals.

The reasons for carrying out this analysis were split fairly evenly across the needs of the various parties – with consideration being given to remuneration packages, communication exercises, pension scheme issues and the needs of the individuals.

The experiences of respondents who now need to carry out further work in light of the changes and who are trying to plan for the impact of the changes throw a spotlight on the difficulties and planning blight arising from the lack of detail about the proposals. With many of the details expected to be finalised over the next few months, all affected parties will need to take advice and act quickly as information becomes available.

3.3 Have you communicated with individuals about the changes to tax relief planned from April 2011?



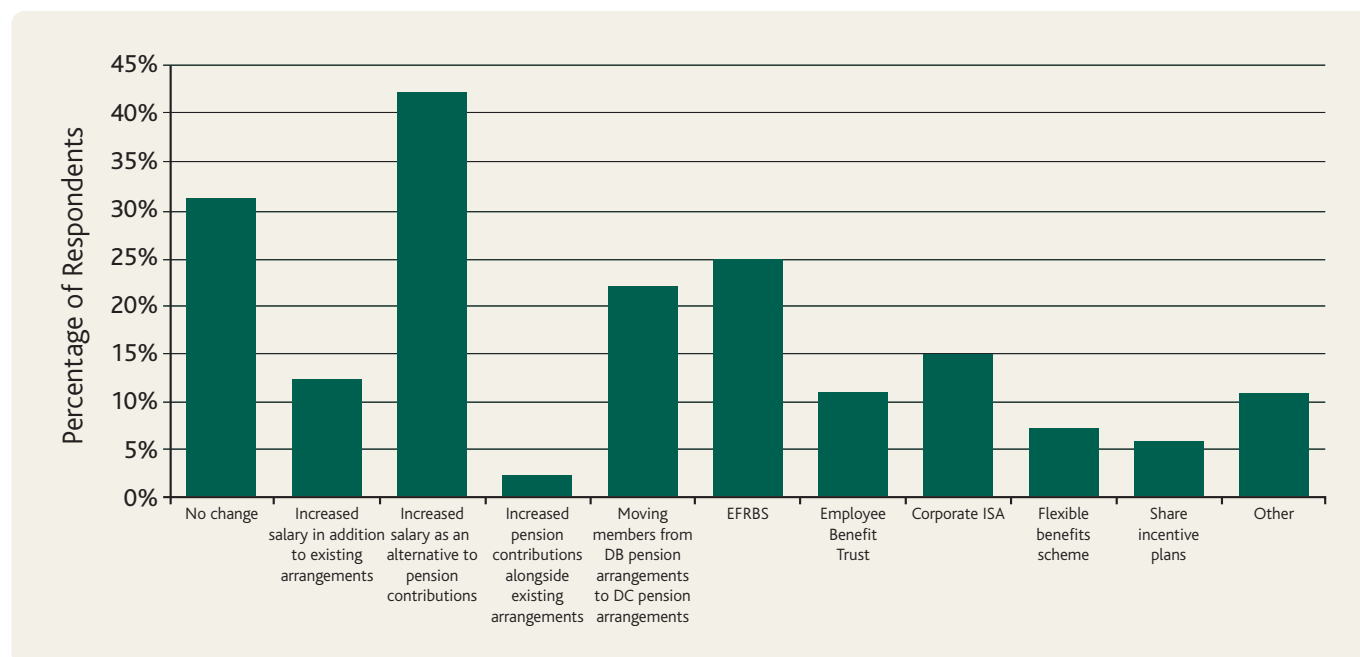
102 respondents answered this question.

Analysis:

A third of respondents have communicated with individuals about the changes and a further 54% intend to in the future, with only 9% having no plans to do so. This is an encouraging result because it shows that employers and trustees are actively engaging with individuals about the changes. Without an effective communication strategy, employers may find that individuals have an unpleasant surprise when they discover they have incurred a tax bill, which could result in an expensive benefit being at best unappreciated and at worst resented.

Again, this is an area where the ongoing uncertainty over the details of the proposals is causing real planning blight. While communications at this stage cannot provide members with definitive answers, there is a need to interact with individuals sooner rather than later as some may even already be accruing benefits which may be assessed against the new limit. Well-drafted communications and effective targeting of additional resources such as individual advice can mitigate any possible damage to employee relations resulting from the charges.

3.4 What options are you considering for members' remuneration packages in light of the changes?



80 respondents answered this question. Respondents were able to select as many or as few options as applied to them.

Analysis:

The most common option to be considered for remuneration packages is the provision of additional salary as an alternative to pension contributions. This is a simple and easily understood method of delivering remuneration to members, but may not always be the most tax efficient (and consequently attractive) method for the employee.

Employers are also considering alternative ways of providing pensions. Many of the issues with the reduced annual allowance (and indeed with the previous proposals) are more significant for defined benefit schemes than for defined contribution schemes – for example, in a defined contribution scheme it is relatively straightforward to limit contributions to the annual allowance and members can be confident that they will receive their benefits regardless of the future strength of the employer. Taken in conjunction with other factors, it is unsurprising that many respondents are considering moving from defined benefit schemes to defined contribution schemes.

EFRBS are also a popular alternative being considered, despite uncertainties over their future under the new regime.

The majority of respondents have not considered vehicles such as Employee Benefit Trusts or share incentive plans. While they are unlikely to be suitable for many, employers and individuals should consider the full suite of options that are available to them before committing to any one course of action.

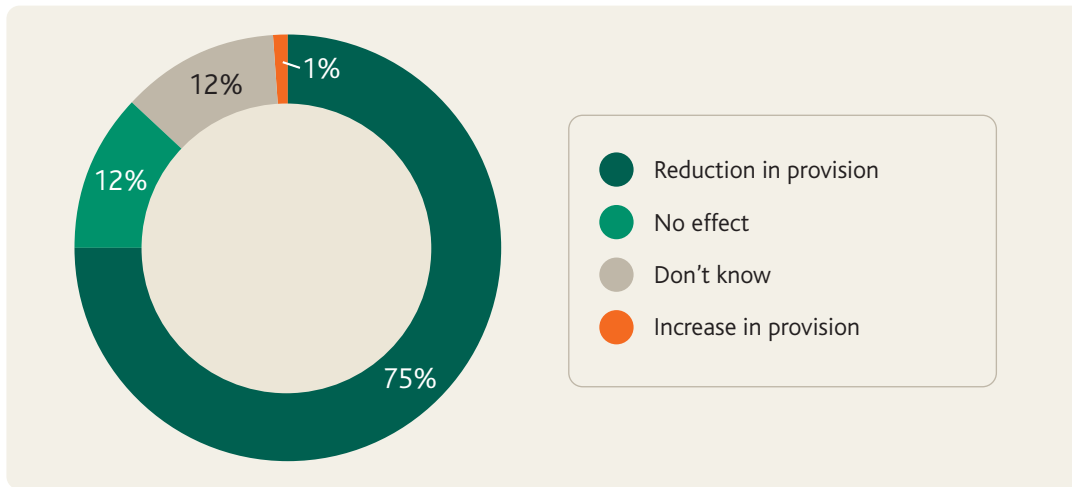
Finally, many individuals may be disappointed to see that one of the most common options under consideration is 'no change' to remuneration, with the additional tax being entirely shouldered by the individual. Whether this is a genuine option will depend on the industry in question. This view is likely to be a starting point of negotiation with some high earners who may see the overall tax and National Insurance increases as a catalyst to seek an increase in pay or another job to maintain their net income at the level that applied before the latest tax changes.

4. Impact on saving and pensions

The proposals are the latest in a long line of changes to the pensions regime and, with auto-enrolment being phased in from 2012, the restriction of tax relief is likely to have consequences for the shape and level of pension savings in years to come.

Our survey asked for views on what impact the proposals may have on perceptions of pensions and on the overall savings patterns of individuals.

4.1 What impact do you think the changes currently proposed from April 2011 will have on the level of provision for individuals?



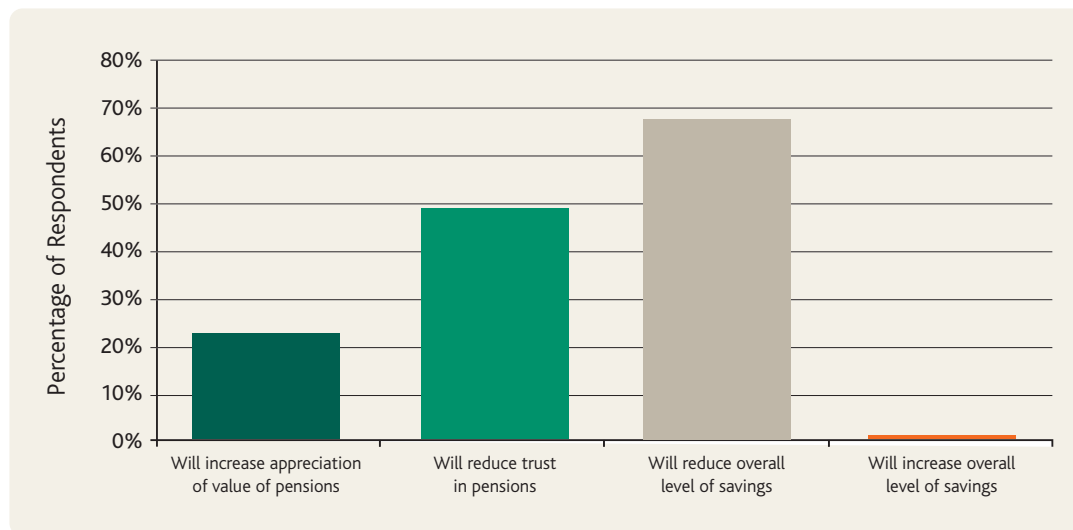
89 respondents answered this question.

Analysis:

Three-quarters of respondents expect the changes to reduce the overall level of provision for individuals. This may seem at odds with the Government's aim of increasing savings for retirement, but in fact the affected individuals are most likely to be higher earners in existing pension schemes rather than the target market for the 2012 employer duties reforms.

Survey response:
"Reducing tax relief works against the notion of using pensions to support yourself post-retirement."

4.2 What impact do you think the changes proposed from April 2011 will have on individuals' engagement with pension schemes?



Survey response:
“Acts as a disincentive to participate in a pension scheme.”

84 respondents answered this question. Respondents were able to select as many or as few options as applied to them.

Analysis:

A significant number of respondents believe that the changes will reduce the level of trust in pensions as well as the overall level of saving. This loss of trust may result in some key decision-makers disengaging from pension schemes, which could have a knock-on effect on pension provision for all. The reduced annual allowance approach does provide some hope as it allows even the highest earners the potential to save something towards a pension. However, the consultation document has also suggested a possible reduction to the lifetime allowance. Such a move could only further undermine the commitment of key decision-makers to their pension schemes.

A strong pension system should be built on stability and trust and HM Treasury should not take any action that may undermine this.

It is ironic that over 20% of respondents said that the proposals would increase people’s appreciation of the value of their pension benefits, just at the time when the tax relief on those benefits is being limited. This is the silver lining to the proposals: if people better understand the value of the benefits they are given then, in the long term, it is possible that those benefits are more likely to continue to be provided.

5. Actions for employers, trustees and individuals

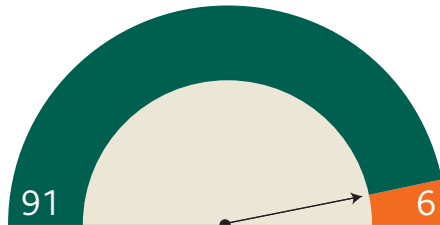
Employers, trustees and individuals have taken some steps towards dealing with the changes but that progress has been hindered by the lack of detail available on the proposals and it has been a long journey since the first announcement that tax relief was to be restricted.

Our survey asked what actions were being taken and what advice had been sought, as well as for views on the impact of the changes on all affected parties.

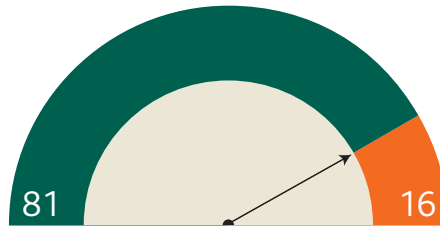
5.1 Have you received any advice about any of the following?

● Yes ● No

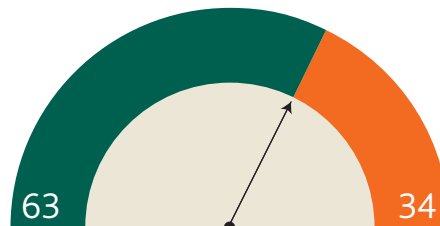
- The proposed reduction in the annual allowance planned from April 2011?



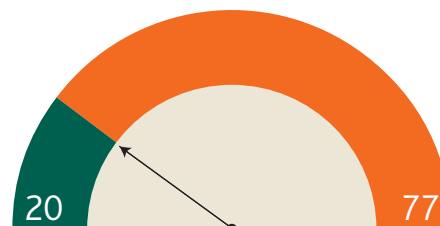
- The impact of the new 50% tax band



- The proposed increase in National Insurance



- The implications for foreign nationals in UK pension schemes



Analysis:

It is encouraging to see that over 90% of respondents have taken advice about the proposed reduction in the annual allowance. As more detail emerges, those who have already taken advice will need to start taking decisions about how they wish to react to the changes and will wish to continue to ensure that they are aware of the latest developments. The proposals are evolving and affected parties should ensure that they continue to stay informed so that they can react to any changes as quickly and effectively as possible.

Those who have not yet taken advice about the changes should consider whether it is now the time to seek that advice. Many parties have been waiting for clarity from HM Treasury, but individuals could already be accruing benefits that they will be paying tax on after April 2011 or making decisions now about, for example, whether to retire before the changes come into force.

Further, employers should be considering (perhaps as part of annual pay reviews) whether their existing remuneration packages may lead to members incurring tax and if so, whether changes should be made to the benefits offered.

Trustees may wish to consider whether they should be communicating with affected members and should be engaging with the employer now over aspects of pension scheme design which could help mitigate the charges.

Fewer respondents have taken advice about the impact of the new 50% tax band and the proposed increase in National Insurance, perhaps because these changes are easier to understand and perhaps viewed as unavoidable. However, employers and individuals should consider taking advice over ways of designing their remuneration and savings to maximise tax efficiency.

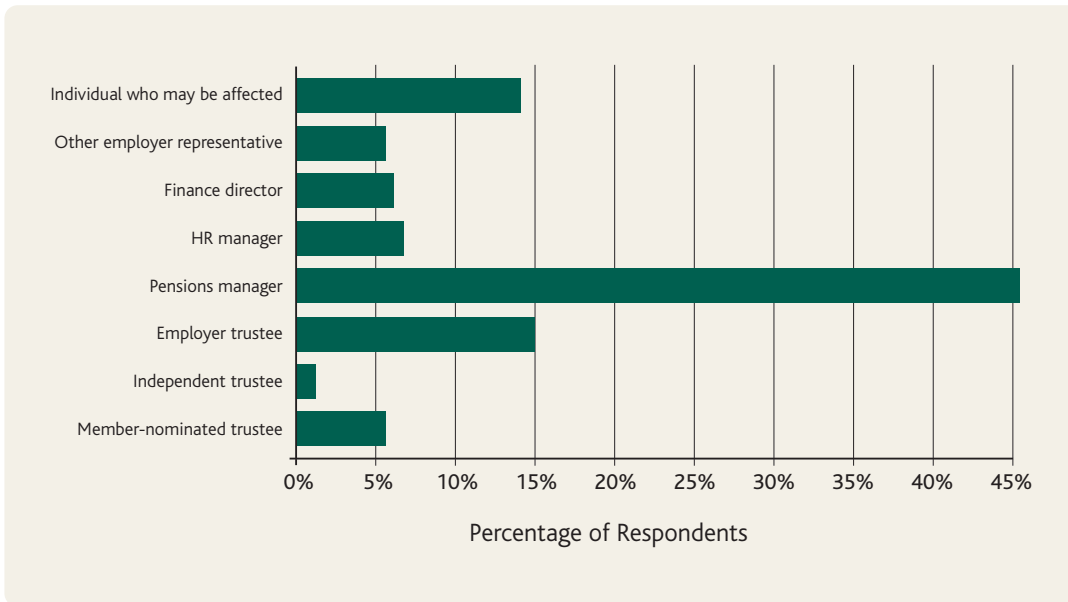
Only 21% of respondents have taken advice about the implications for foreign nationals in UK pension schemes. Employers and trustees are often surprised to discover that they have employees and members who are classed as foreign nationals and they should consider whether they need advice in this area.

The changes to pensions tax relief and to tax for higher earners have presented new challenges, but also give opportunities for employers to distinguish themselves through well-designed bespoke remuneration packages.

6. Survey participants

There were over 130 survey respondents (not all of whom answered every question), with the majority responding from final salary schemes.

The survey participants by involvement in the pension scheme were as follows:



Respondents were able to select as many options as applied to them.

Glossary

Annual Allowance

A limit set by HM Treasury on the total annual contributions (for defined contribution) or annual increases in benefit (for defined benefit) in a registered pension that can receive tax-advantaged treatment. The limit is currently £255,000, but the proposal is for it to be reduced to £30,000 - £45,000.

EFRBS – Employer-Financed Retirement Benefits Scheme

A scheme which is not a registered pension scheme and therefore none of the tax advantages of a registered pension scheme apply. Benefits accrued under an EFRBS will not be counted for the annual allowance nor will they be tested against the lifetime allowance.

HIERC – High Income Excess Relief Charge

A proposed new charge to income tax from April 2011 (now expected to be replaced by a reduction in the annual allowance) set to apply to individuals with incomes in excess of £130,000 and designed to restrict tax relief on pension contributions.

Lifetime Allowance

The maximum tax-advantaged value of benefits that can be taken at retirement from all UK registered pension schemes. Some members will have an enhanced lifetime allowance (e.g. those registered for primary or enhanced protection).

Scheme Pays

Proposed requirement for schemes to give members with a tax charge of over £15,000 the option of the scheme paying the charge on their behalf with a corresponding reduction to the member's scheme benefits. This aims to deal with large tax charges that individuals may incur.



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