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## INTRODUCTION OF THE UPPER ACCRUAL POINT

### 1 INTRODUCTION

The Government is in the process of reforming the State Second Pension (S2P). Unfortunately, certain changes coming into force on 6 April 2009 will have unintended consequences for occupational pension schemes. In this Alert we explain what is happening and the action which schemes may need to consider taking now.

### 2 KEY POINTS

- With effect from 6 April 2009, the “upper earnings limit” (UEL) will be replaced by the “upper accrual point”<sup>1</sup> (UAP) for the purposes of the calculation of National Insurance contribution rebates for those contracted out of S2P (see section 3).
- Also from 6 April 2009, the UEL will be raised to match the threshold for higher rate income tax (on current figures, this represents a weekly rise of £74<sup>2</sup>).
- Schemes which make reference to the UEL in their rules may need to consider making an amendment before 6 April 2009 (see sections 4 and 5).

<sup>1</sup> The UAP for 2009/10 is £770 per week

<sup>2</sup> The UEL for 2008/9 is £770 per week; the UEL for 2009/10 is £844 per week

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### 3 BACKGROUND

In the May 2006 White Paper<sup>3</sup>, the Government announced reforms to S2P. Its intention is to make S2P a simple, flat rate top-up to the basic State pension by around 2030.

It was envisaged that the changes necessary to implement this would be made in 2012 (or the date at which the link between the basic State pension and earnings is restored).

However, in the 2007 Budget, the Government stated that, with effect from 6 April 2009, the UEL would be harmonised with the threshold for higher rate income tax<sup>4</sup>, "simplifying the system"<sup>5</sup>.

To ensure that the reforms to S2P take place as originally intended, with effect from 6 April 2009, a new threshold is being introduced, the UAP. The UAP replaces the UEL for the purposes of the calculation of National Insurance contribution rebates for employees contracted-out of S2P (the UEL Change). Without this measure, there would have been a small increase in the S2P payable to those earning above the UEL and in the rebates received by those same earners and their employers who are contracted-out.

### 4 WHAT DOES THIS MEAN?

Any schemes which make specific reference in their rules to earnings between the "lower earnings limit" (LEL) and the UEL (or to benefits calculated by reference to the UEL) could be unintentionally affected by the above amendments.

#### *Schemes contracted-out on a money purchase basis*

If a scheme's rules make specific reference to earnings between the LEL and the UEL for the purpose of calculating protected rights contributions (minimum payments) then, from 6 April 2009, the higher UEL is likely to apply automatically. This may well

<sup>3</sup> See our Alert, "The Pensions White Paper" dated 25 May 2006

<sup>4</sup> £37,400 for 2009/10 (Personal Allowance of £6,475)

<sup>5</sup> This measure was also noted in the Budget 2008. See our Alert, "Budget 2008: What's in it for Pensions?" dated 14 March 2008

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mean that more of the member's pension pot than expected will become classified as "protected rights". The difficulty with this is that protected rights are subject to a number of restrictions in comparison with ordinary scheme benefits.

### *Salary-related schemes with underpins*

Some schemes are contracted out on a salary-related basis but, rather than meeting the reference scheme test, they adopt it as an underpin. It is the underpin which generally makes reference to the UEL.

In relation to these schemes, the UEL Change will potentially mean that the underpin increases to a higher level than is necessary.

### *Other schemes*

References in scheme rules to the UEL generally need to be assessed in context to see whether the Government's UEL Change would cause difficulties.

It should be noted that any schemes whose rules simply cross-refer to the relevant legislation governing contracting-out should not be affected as the statutory amendments would generally be incorporated into the rules automatically.

## **5 ACTION TO BE TAKEN**

We have spoken to the Department for Work and Pensions who have agreed that it was not their intention to cause difficulties for pension schemes by introducing the UAP or implementing the UEL Change. They are currently considering whether it is possible either to alter the legislation to make a rule amendment less urgent for occupational pension schemes, or to enable schemes to be amended by resolution rather than by deed (or perhaps both?).

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We will, of course, let you know of any developments. In the meantime, affected schemes should be considering whether they need to amend their rules. If an amendment is required, as things currently stand, it would (technically) need to be completed before 6 April 2009.