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sponsoring employer loan

Although a registered pension scheme can lend money to other parties, it cannot typically lend to a connected party. The one exception is where a Sponsoring Employer Loan is granted by a Small Self-Administered Scheme (a SSAS). In these situations, subject to certain strict criteria, a SSAS can lend up to 50% of the net asset value of the pension scheme to its Sponsoring Employer.

Where to start

It is a common situation for a company to seek funding for various reasons: expansion, restructure, investment, etc. Where typically a company may approach a bank or other lending institution for finance, it can instead look to obtain a loan from a pension scheme for which it acts as a sponsoring employer. The approach in doing so should be similar in that the agreement is not automatic: the Trustees of the SSAS will still need to approve the loan and be satisfied as to its bona fides. From the perspective of the SSAS, the loan is classed as an investment, and the Trustees therefore need to consider whether granting the loan is in the best interests of the members and beneficiaries.

Purpose of the Loan

HMRC does not stipulate what a loan must be used for. This potentially gives wide scope to the parties involved in terms of how the monies are to be used. It is incumbent on the Trustees, however, to be satisfied as to the commerciality of the arrangement. Trustees should consider whether the purpose of the loan is genuinely for the reasons specified and not, for example, to shore up an otherwise failing business. In addition, the Trustees should be satisfied that the monies are not being used for some form of secondary transaction, whereby the loan is being used as a means to circumvent other restrictions such as granting loans to members of the pension scheme. If necessary, the Trustees should obtain independent evidence or verification as to the business plans of the company to substantiate the information being given to them.

Terms of the Loan

Sponsoring Employer loans are governed by very strict criteria set out by HMRC. In all, there are five key tests:

Security — The amount of the loan must be secured throughout the term as a first charge on assets equal to the loan including the interest.

Interest — The interest rate must be the 'prescribed rate', which is broadly 1% above the average of the base lending rate of 6 specified high street banks.

Term: The repayment period of the loan must not be longer than 5 years from the date the loan was made.

Amount: The maximum loan is restricted to 50% of the net asset value of the SSAS immediately before the loan is made.

Payment: All loans must be payable at least in equal instalments of capital and interest for each complete year of the loan.

Although Trustees have discretion to operate strictly with reference to these parameters, in reality the expectation on the Trustees is that they will act prudently. For example, the nature of the loan, the security offered to guarantee it, or the investment strategy of the SSAS, may lead the Trustees to consider it appropriate to charge a higher rate of interest, to reduce the term, or reduce the amount that they are willing to lend.

Different Types of Security

HMRC stipulates that the amount of the loan must be secured throughout the full term as a first charge on assets either owned by the sponsoring employer or by some other person. At the time the loan is granted, the security must be of at least equal value to the face value of the loan, including interest. There must be no other charge in the asset that takes priority over the charge secured by the scheme.

The asset, or assets, do not need to necessarily hold their value throughout the term of the loan. Provided there is no artificial reduction in the value of the security, the asset value can drop below the value of the loan, plus interest, throughout the life of the loan without issue.

As HMRC does not restrict the type of assets that can be used, in theory any asset where the Trustees can secure a first charge could be used – not simply commercial property, for example. In practice, however, Trustees need to be confident that a first charge can be recorded against the asset and also consider where that charge might be registered. While an asset might appear to have sufficient value, if there is no mechanism by which a charge can be registered securely then the Trustees may need to reconsider the use of those assets.

Problems with Repayment

HMRC accepts that not all loans will be repaid in accordance with the terms of an agreement due to individual circumstances attributable to the borrower. The loan can be rolled over once if it reaches the end of the term without having been fully repaid, and further security does not have to be provided even if it has fallen in value below that of the loan.

Arrears are therefore not automatically classed as unauthorised payments and Trustees would need to ensure that they deal with the Sponsoring Employer in a manner similar to how they might treat an arm's length debtor.