AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

Key Policy Questions on the Reduction of the Lifetime Allowance: AMPS Thoughts

1. AMPS Comments: General

1.1. Whilst a reduction in the Standard Lifetime Allowance (SLA) is a simple concept to propose, the interaction of the SLA with the current complicated legislation and various scenarios there will be, means such a change causes a whole ripple effect through the legislation.

1.2. We fully support the wish to continue to protect those with rights currently threatened by the drop in SLA, but to achieve this will be difficult and needs careful consideration.

1.3. In the short time we have been given to present our thoughts and ideas, the below is our initial thinking to your questions. We may have missed something given the time constraints, but we hope the below helps or at least helps focus on the issues that need to be considered carefully. We would, however, strongly recommend that more time is taken to iron out these issues properly.

1.4. We are more than happy to contribute further in your deliberations, whether by telephone or meetings.

Would it be preferable to reduce the LTA from April 2011 or 2012?

Whilst the Govn is minded to reduce the LTA from 2012, views are sought on the relative burdens for schemes, employers and individuals of implementation in April 2011 versus 2012. 2012 provides more time ahead of implementation for individuals to receive appropriate advice and consider applying for protection, and potentially staggers requests on schemes. However it could also be more inefficient, with individuals potentially needing to be advised twice and schemes potentially needing to be make two sets of systems changes. There may also be adverse behavioural and fiscal risks associated with a delay to 2012. We envisage Finance Bill 2011 legislating for the change regardless of whether it is to be reduced from 2011 or 2012.

2. AMPS Comments:

2.1. It is important to give individual's time to get advice and consider their options.

2.2. It is also going to take a while before all the quirks are worked through and providers and schemes need time to be able to put out sufficient client communications and amend their systems / procedures.

2.3. Also it is important HMRC rewrite their manual (RPSM) etc in layman's language (as they intend) well in advance of the change.

2.4. Our view is that most firms would welcome the ability to stagger systems changes.

2.5. Taking into account all the above, we would say April 2012 is a fairly ambitious (but achievable) target, but April 2011 is not.

2.6. You may be concerned about the potential for behavioural and fiscal risk to the Treasury in implementing in 2012 rather than 2011. The risk is more in increased contributions (or more likely, a delay in reducing contributions) and the tax relief at stake, but we would have thought the fact that the SLA is going to be reduced has this dampening impact (along with the current and proposed contribution restrictions). When the reduction occurs is not, we think, material.

2.7. Safeguards can also clearly be built in to any new 'Protection' regime.

Are there any issues with the 'pension growth protection' as described in para B.8? Will this be sufficient, including for those who currently have pension pots between £1.5-£1.8m, or is some form of potentially more burdensome 'grandfathering' of pots also necessary (not obvious that it is if 'pension growth protection' were to give you a personalised LTA at £1.8m)?

3. AMPS Comments:

3.1. Firstly, we would emphasise that it is very important that those with existing Enhanced Protection and Primary Protection under Schedule 36 of FA2004 continue to be protected, and are no worse off (or no better off) because of the reduction in SLA (as proposed in B5 of your summary document).

3.2. For those with Primary Protection, there have been suggestions their position could be achieved by revised Lifetime Allowance Enhancement Factors (LAEF) being issued (uplifting their total Lifetime Allowance as a % of SLA by 20% to reflect the reduction in SLA), or by some form of indexing. The issue here is how you deal with previously vested rights (and the Lifetime Allowance already used up).

3.3. Similarly those with lump sum protection need to be catered for. This includes those with 'Scheme-specific lump sum protection', which was not mentioned in Annex B).

3.4. We discuss the practicalities on all these issues later on in our comments under your last question in Part 5.

Alternative approach:

3.5. For those with no current protection but over or near £1.5m of rights, rather than introduce a new form of protection, would it not be easier (and fairer) to simply allow people a second chance to apply for Enhanced Protection?

3.6. And allow those with rights over £1.5m (but who did not have Primary / Enhanced Protection under the current rules) who want to retain the chance to continue contributing to apply for a new form of Primary Protection?

3.6.1. This could be achieved by granting revised Lifetime Allowance Enhancement Factors (LAEF) being issued (up to 20% of SLA to reflect the reduction in SLA, so those currently with rights of more than £1.8m without Enhanced / Primary Protection would be capped at 20% of SLA).

3.6.2. For example, someone at the cut-off date (and no existing protection):

- **with rights of £1.65m, would get an Enhanced Lifetime Allowance of an additional 10% of SLA (a LAEF of '0.1' granted by HMRC); and**

- **with rights of £2m would only get 20% of SLA (a LAEF of '0.2').**

3.6.3. This would be easy to legislate for, as you would simply add in another LAEF circumstance after Section 237, FA2004. HMRC will also have the systems to cope with this as there is an existing mechanism to apply for the existing LAEF circumstances.

3.6.4. You would not need to require contributions to cease in our view, as this would follow anyhow given they would be at their cap already. You would however need to deal with pension sharing issues, as with the current Primary Protection rules.

3.7. Doing this would produce a consistency in approach with the existing protections and the way schemes and advisers track Lifetime Allowance usage, and could be integrated into existing administrative processes and systems. It would also be simpler than in 2006 (as no old HMRC limit tests to consider).

3.8. It would also mean you only in effect have one system of protection, rather than two different types (2006 and 2012). This is important for ease of administration and understanding, and or reference.

Other issues:

3.9. You would need to decide the cut-off for the ceasing of contributions / active accrual if re-opening Enhanced Protection (or sticking with your proposed 'Pension Growth Protection').

3.9.1. We would suggest this should be the date you announce this, but amend legislation to permit the refund of contributions made after then (both personal and employer) for a limited timescale.

3.9.2. Or you could go back further, with a refund provision.

3.10. The position is clearly more complicated for occupational pension schemes, where it will take time to cease active membership or a defined benefit accrual exists.

3.11. With both your proposed 'Pension Growth Protection' and our suggested approach above you would need to also introduce a similar round of lump sum protection (see our comments on Pension Commencement Lump Sums - PCLS - under Part 5, particularly Point 5.16).

3.12. With our suggested approach, you would need to give people applying now for a second round of Enhanced Protection the opportunity to fall back on the new 'Primary' if Enhanced were to be lost (in the event of making a contribution). This would be as occurred with the 2006 Protection regime).

What is a reasonable 'start-date' for protection? From Oct 14? From April 2011? From April 2012? (where the answer here will clearly vary depending on the form of protection e.g., grandfathering of an existing pot could conceivably be dated back to Oct 14, but people would need more time to commit to leaving 'active' membership of pensions in return for 'pension growth protection'). What is a reasonable amount of notice on the protection regime to give individuals, companies and pension schemes time to respond? (where again the answer might vary...) There are interactions here with the behavioural/fiscal risks point around the timing of the reduction per se.

4. AMPS Comments:

4.1. **It makes sense that any new type of protection should commence from the same date as the reduced SLA comes in i.e. 6th April 2012. Thus giving time for individuals to decide and if applicable ensure pension contributions have.**

4.2. **As the original Primary and Enhanced Protection could be applied for within a three year period it seems logical that any new type of protection is given a three year application period.**

4.3. **If re-opening Enhanced Protection as suggested, please see our comments above in Point 3.9 in answer to the last question.**

4.4. **The important point is to give the flexibility of refunding to allow those who want to opt for the protection a reasonable time to change their mind, or un-wind contributions made before they were aware of the options open to them.**

Are there any other technical issues e.g., around the maintenance of existing protections, or interactions with the tax-free lump sum that we need to consider, or provide further clarity on?

5 AMPS Comments:

Lifetime Allowance – those already with Primary Protection:

5.1. **Clearly those members with Primary Protection need to have their 'Enhanced' Lifetime Allowance adjusted to reflect the drop in SLA (currently, they will have a Lifetime Allowance Enhancement Factor –**

LAEF - on a HMRC certificate, which is used to calculate the extra % of SLA they are entitled to).

5.2. It is not, however, as simple as just increasing the level of their Lifetime Allowance by a factor of 20% i.e. the difference between the current LTA of £1.8m and the proposed new LTA of £1.5m. Doing this would have a distorting effect on those who have already crystallised benefits between 6th April 2006 and 5th April 2012. This is because Lifetime Allowance usage is tracked (and certificated) as a % of SLA. Similar issues arise with splitting due to a Pension Sharing Order.

5.3. This is perhaps best illustrated through an Example.

Example 1:

Two Members both had £3m of (unvested) rights on 5th April 2006.

Both were granted Primary Protection under the existing legislation with a LAEF of '1' (i.e. they both have a Lifetime Allowance of 200% of SLA – as their rights were twice as much as the new SLA of £1.5m being introduced on 6th April 2006).

By 2010/11, both Members rights have grown to £3.6m.

Member 1 vests all his rights, taking £3.6m. This uses up 200% of SLA (£1.8m now) and uses up all his Lifetime Allowance.

Member 2 does not vest anything.

In 2012/13 the SLA is reduced to £1.5m.

Member 2's rights are still worth £3.6m. To maintain Member 2's position, their Lifetime Allowance needs to be increased to 240% of the new SLA (240% of £1.5m = £3.6m, which is equivalent to 200% of the old SLA of £1.8m).

But you cannot increase Member 1's Lifetime Allowance as a % of SLA (or an increased factor of SLA), because he has no Lifetime Allowance left. The complication is that up until now, Member 1's Lifetime Allowance usage has been expressed and tracked as % of the old SLAs. He has used up 200% SLA.

If you increased his Lifetime Allowance to 240% of the new lower SLA he would effectively be getting increased Lifetime Allowance.

If Member 1 had vested some, but not all, of his rights the position would be different. But the same principle would apply.

5.4. To work therefore, any increase in Lifetime Allowance as a % of SLA would need to have a corresponding uplift to the % of SLA stated as being used up previously. In effect, you only want to be uplifting the 'available' Lifetime Allowance on 6th April 2012 (not their Lifetime Allowance as a whole).

5.5. This clearly means we are potentially getting into extra complications.

5.6. You would therefore need to look at amending Section 219(5) of FA2004 (the clause which rolls-up Lifetime Allowance usage by the rise in SLA, the consequence of which is we track usage by percentages of SLA). But you would only do this for those with existing Primary Protection (with others, the majority, still covered by the clause as currently worded).

5.7. You would need to ensure that from 2012/13 onwards, the roll-up was by reference to £1.8m for those with Primary Protection, not the current SLA of £1.5m. In practice, administrators could apply an uplift to the existing % of SLA values on the certificates, rather than having to change to a new mechanism of calculation.

5.8. Another example may help.

Example 2:

Member 3 has £2.25m pension rights on 5th April 2006. He has Primary Protection with a LAEF equivalent to 150% of SLA.

Member 3 vests £1.6m in 2007/08.

He uses up 100% of SLA (2/3rds of his Enhanced Lifetime Allowance). He has a certificate saying he has used up 100% SLA on certificate.

In 2012/13, the SLA reduces to £1.5m.

He should get a revised Lifetime Allowance of £2.25m x £1.8m / £1.5m = £2.7m. This can be achieved by either revised LAEF or similar indexing.

But his existing certificate and records says he has used up 100% of SLA (now £1.5m). This represents around 59% (i.e. £1.6m / £2.7m) of his new Lifetime Allowance.

The legislation needs to take that £1.6m (the amount previously crystallised) and index up by £1.8m / £1.6m = £1.8m (2/3rds of their Lifetime Allowance).

In practice, the administrator can take the 100% SLA figure (£1.5m) and index up with £1.8m / £1.5m (which produces the same result).

5.9. The same applies to those with Enhanced Protection, but also with Dormant Primary Protection. You will need to amend the Dormant Primary Protection in the same way.

Pension Commencement Lump Sum Issues:

5.10. Thought needs to be given to how this SLA reduction interacts with the various tax-free lump sum (Pension Commencement Lump Sum - PCLS) rules, and in particular those with various lump sum protections due to rights held on 5th April 2006. It is not just those with existing lump sum protection affected, but also potentially non-protected members who have already breached the £1.5m unvested fund mark (see Point 5.16).

5.11. With some of the PCLS protection rules, the maximum amount payable is linked to 5th April 2006 entitlements, indexed up by the rise in SLA. Clearly, lowering the SLA from 2012/13 reduces retrospectively their entitlements (where still not drawn).

5.12. If we take each circumstance in turn.

5.13. Lump sum protection (as greater than £375,000 crystallised and uncrystallised lump sum rights on 5th April 2006) with Primary Protection (*Paragraph 28 of Schedule 36, FA2004*):

5.13.1. Here the maximum PCLS payable is set by the monetary value of that individual's uncrystallised lump sum rights under all pension schemes on 5th April 2006, indexed up by the rise in SLA from £1.5m. This is an overall limit over all schemes, and can be staggered in over time. When calculating the maximum left, any earlier PCLS paid is also indexed up by the rise in the SLA (but from the SLA in the tax year that earlier PCLS was paid from, not necessarily £1.5m).

5.13.2. To ensure these individuals are no worse off, there needs to be a break from SLA with the indexing from 2012/13 tax year onwards. From that point onwards, the index should be to a flat £1.8m (or by reference to the SLA for 2011/12 for all later years). This would be

for both the overall maximum at 5th April 2006 and the indexing up of previous PCLS payments.

5.13.3. (i.e. the definition of CSLA (Current Standard Lifetime Allowance) in both Sub-paras (6A) and (7) of Para 2 of Sch 29 FA2004, as inserted by Para 28(3) of Sch 36 in this circumstance, would need to be changed to read £1.8m or the 2011/12 SLA for tax years 2012/12 onwards).

5.14. Lump sum protection (as greater than £375,000 crystallised and uncrystallised lump sum rights on 5th April 2006) with Enhanced Protection (*Paragraphs 27 and 29 of Schedule 36, FA2004*):

5.14.1. There should be no issue here, as the PCLS payable is set as a % of uncrystallised funds / rights, with no reference to Lifetime Allowance usage.

5.15. Scheme-specific lump sum protection (*Paragraphs 31 to 34 of Schedule 36, FA2004*):

5.15.1. This is for members of occupational pension schemes on 5th April 2006 who had lump sum rights under the old rules of more than 25% of total rights under that scheme, but could not apply for either of the above two protections.

5.15.2. This works a little bit like the main lump sum protection under Primary Protection, in that maximum PCLS under that scheme (only) is set by 5th April 2006 monetary lump sum entitlement, indexed up by the rise in SLA.

5.15.3. An additional amount is payable if the current total value of the entitlements under the scheme (pension and lump sum) is more than the value of those entitlements at 5th April 2006, indexed up by the rise in SLA. This would be 25% of the difference (if any).

5.15.4. So both index references would need to be set to £1.8m (or 2011/12 SLA) for 2012/13 onwards.

5.15.5. (i.e. the definition of CSLA for both Sub-para (5) and (7) of Para 2 of Sch 29 FA2004, as inserted by Para 34(2) of Sch 36 FA2004 in this circumstance, would need to be changed to read £1.8m or the 2011/12 SLA for tax years 2012/12 onwards).

5.16. Normal PCLS Rules (but where individual already has over £1.5m of pension rights):

5.16.1. An individual who has no existing Primary / Enhanced / Lump sum Protection but has over £1.5m of pension rights now will potentially lose out on PCLS entitlement if the SLA is reduced to £1.5m.

5.16.2. If, say, a person currently has a SIPP holding £1.7m of funds can currently potentially take 25% of these funds as a PCLS if vesting now (assuming age 55+). This is because they will not hit 100% of SLA Lifetime Allowance usage (and will not be limited by the '*available portion of the member's lump sum allowance*' cap of Para 2(6) of Sch 29 FA2004) – essentially they will not be crystallising Lifetime Allowance up to 100% of SLA). They could have a maximum PCLS of £425,000.

5.16.3. From 2012/13 onwards, a person with a similar position would under the current wording of Para 2 of Sch 29 have a lower PCLS entitlement (even if they were given some form of Lifetime Allowance protection to cover the £200,000 crystallising over £1.5m). That is because after taking 25% of the first £1.5m they would hit 100% of SLA usage and hit the '*available portion of the member's lump sum allowance*' cap. They would be capped at £375,000.

5.16.4. To be fair, some form of PCLS protection is needed for people in that position; otherwise their position is being eroded retrospectively. We are happy to work with you to try and find a way to achieve this. Such individuals need their '*lump sum allowance*' upping to between 100% and 120% of SLA (the higher being the equivalent of 100% of an SLA of £1.8m) to maintain their position, but doing this could be very complicated to administer and need targeting correctly.

AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

About AMPS

The Association is a combination of two former associations from the self administered industry, the Association of Pensioneer Trustees (APT) and the SIPP Providers Group (SPG).

It was agreed to combine the two associations following the introduction of the Simplification and Taxation of Pension Schemes in order for the industry involved in the administration of, provision of and establishers of self administered arrangements to have a single cohesive voice rather than the possible fragmentation of a very professional group of pension specialists.

The Committee is drawn from all walks of the self administered industry and includes pension consultants, actuaries, lawyers and insurance company representatives

AMPS represents approximately 200 member organisations operating or providing services to Small Self Administered Schemes (SSAS) and Self Invested Personal Pensions (SIPP).

It is estimated that in excess of half a million individuals have pension provision in a member-directed pension scheme. SIPP products are suitable for a wide spectrum of the population and the SIPP market continues to experience growth of 20% each year based on data taken from industry publication surveys. Estimates for funds under management in these products is in excess of £50bn.

Employers sponsoring SSAS and SIPP membership are typically family-run businesses, employing up to 100 people, although the membership of these schemes is generally limited to the directors or owners of the businesses and their families.

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