

“Money Purchase Benefits”: impact of proposed new definition on certain "SSAS" type pension schemes.

(Submission by Nick White, Pensions Law Limited on behalf of the Association of Member Directed Pension Schemes (AMPS))

About AMPS

AMPS is the main trade body that represents self-invested pension providers such as Small Self-Administered Scheme (SSAS) practitioners and Self Invested Personal Pension (SIPP) operators. We have around 200 member firms from the largest pension providers to the more boutique companies, together with others involved with the industry.

This is an initial submission, intended just to outline to DWP a problem that might otherwise be "below the radar", given that the issues arising from the Bridge decision are perceived mostly to affect much larger occupational pension schemes. This submission is made in response to the consultation on draft regulations published on 31 October 2013, as it seems likely that those regulations will be the most convenient vehicle for dealing with the problem we have identified.

In this submission, the term "SSAS" is used in a broad and non-technical way, to mean schemes with typically fewer than 12 members and a high degree of member involvement in the running of the scheme and selection of investments, such schemes being typically aimed at owner directors of small to medium businesses.

Summary of the Problem

A number of existing SSAS already offer a form of pension which is:

- "scheme pension" for the purposes of the tax legislation; but
- is carefully drafted so as not to involve a potential asset/liability mismatch.

Such a pension does not fall within section 181B and therefore is not a "money purchase benefit" once the new definition is brought into effect. That causes unintended problems in 2 areas:

- scheme funding and related requirements in Part 3 Pensions Act 2004. Many SSAS will be exempt from Part 3 anyway, because they meet the definition of a "small scheme" in reg 17(h) of the Scheme Funding regulations (SI 2005/3377) or have fewer than 2 members, but many other SSAS rely on being classified as "money purchase" to be exempt. Losing exemption could impose a funding requirement that none of the parties to the schemes were expecting to apply and that would fundamentally alter the rights and obligations of both the sponsoring employers and the beneficiaries;
- the requirement to provide increases to pensions in payment in section 51 Pensions Act 1995. There is no exemption for "small schemes" or schemes with fewer than 2 members, so most SSAS offering scheme pension are facing a problem here. Again, none of the parties would be expecting such increases to be mandatory, and many if not all affected members would actually find the requirement hindered the flexibility they were seeking when electing to take this form of scheme pension in the first place.

In more detail....

The definition of "scheme pension" in the tax legislation is more flexible than is often realised. In particular:

- para 2(4)(b), sch28 FA04 states clearly that a scheme pension can be reduced so long as it is “a reduction in the rate of the pension which applies to all the scheme pensions being paid to or in respect of members of the pension scheme”;
- a scheme may offer a single scheme pension, in which case that pension can simply be reduced at any time.

Nothing in the tax legislation prevents the rate of a "scheme pension" being calculated/reviewed by reference to an "individual pot" designated as available for its provision, with the pension increasing or decreasing on a review from time to time, taking into account scheme- and member-specific information: investment performance, changes in the member's health, as well as the member's own wishes as to the level of income.

A large number of professional SSAS administrators have taken advantage of this flexibility since 2006 to offer clients the ability to take a pension which is "scheme pension" for the purposes of the tax legislation but which mimics to a large degree the flexibility in income levels offered by income withdrawal.

Examples of where such an arrangement might be suitable are:

- a member expected to live for more than 12 months but far less than the mortality assumptions underlying the GAD rates used for conventional income withdrawal: scheme pension allows a rate of pension to be set which reflects his individual life expectancy;
- a member whose pension is linked to investments that produce a reliable income in excess of the maximum he can take under conventional income withdrawal, e.g. a lease to a blue chip tenant with an upward only rent review provision.

Unfortunately it seems that, in the drafting of new section 181B PSA 1993, an assumption was made that a "scheme pension" necessarily involves an asset/liability mismatch. The relevant parts of section 181B are as follows....

"...(2) A benefit other than a pension in payment falls within this section if its rate or amount is calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for the purposes of its provision to or in respect of the member.

(3) A benefit which is a pension in payment falls within this section if:

(a) its provision to or in respect of the member is secured by an annuity contract or insurance policy made or taken out with an insurer, and

(b) at all times before coming into payment the pension was a benefit falling within this section by virtue of subsection (2).

...(5) In this section references to a pension do not include income withdrawal or dependants' income withdrawal (within the meaning of paragraphs 7 and 21 of Schedule 28 to the Finance Act 2004)."

We see that income withdrawal is subject only to the test in (2), i.e. it is money purchase if "its rate or amount is calculated solely by reference to assets which... must necessarily suffice for the purposes of its provision...".

However a scheme pension is subject to the test in (3) and is only money purchase if it is "secured" with an insurer.

This is not consistent with what we understood to be the objective of DWP, i.e. to modify the definition of money purchase benefits **only** to the extent necessary to counteract the decision

in Bridge that a benefit can be within the existing definition of money purchase even if it gives rise to an asset/liability mismatch.

We think that it would be better not to use definitions from the tax legislation as building blocks in the definition in section 181B. We submit that the crux, both before and after a benefit comes into payment, is simply whether *"its rate or amount is calculated solely by reference to assets which... must necessarily suffice for the purposes of its provision..."*.

We suggest that, ideally, section 181B itself could be simplified as follows:

"... (2) A benefit ~~other than a pension in payment~~ falls within this section if its rate or amount is calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for the purposes of its provision to or in respect of the member.

(3) A benefit which is a pension in payment also falls within this section if:

(a) its provision to or in respect of the member is secured by an annuity contract or insurance policy made or taken out with an insurer, and

(b) at all times before coming into payment the pension was a benefit falling within this section by virtue of subsection (2).

~~... (5) In this section references to a pension do not include income withdrawal or dependants' income withdrawal (within the meaning of paragraphs 7 and 21 of Schedule 28 to the Finance Act 2004).~~"

However, we recognise that this is a slightly wider redrafting of the primary legislation than is needed to cure the specific problem faced by SSAS. As an alternative therefore we suggest that DWP might include in the proposed regulations a provision that simply disapplies section 29 Pensions Act 2011 in relation to any pension in payment *"if its rate or amount is calculated solely by reference to assets which (because of the nature of the calculation) must necessarily suffice for the purposes of its provision to or in respect of the member"*.

These are just initial thoughts. The main aim of this submission is to explain the extent of the problem for SSAS and how it has arisen, not to prescribe how it should be dealt with. We would be very pleased to work with DWP officials and their lawyers to find a solution that causes as little additional work and disruption as possible for all involved.

Nick White, AMPS, 6/12/13