SPC news

ISSUE NO. 5, 2005

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SPC response to discussion paper on inheritance tax

SPC has responded to HM Revenue & Customs' discussion paper on inheritance tax and the new pension taxation regime.

A review of the application of inheritance tax in the light of the new pension taxation regime is understandable. A key aim of this review must be complete clarity and simplicity of treatment of pension rights for inheritance tax purposes. Simplicity is important in its own right, but also because it is necessary for consistency with one of the starting points for introducing the new pension taxation regime, namely to encourage pension provision by avoiding complex tax rules.

Paragraph 32 of the discussion paper suggests that HM Revenue and Customs will no longer be able to make the simplifying assumptions in tax payers' favour which have underpinned practice to date. We suggest that the current position in fact certainly could and should be maintained in cases of **death before age 75**. It would be wholly unacceptable if legal personal representatives had to *prove* that the deceased member's decision not to fully draw pension was not an inheritance tax avoidance measure, as referred to in paragraph 28. There are many reasons, unconnected with tax planning, why an annuity might not have been purchased, whether before or after age 75. As examples:-

- To await the possibility that annuity rates will improve in the short to medium term;
- To await the possibility that specific asset values in a pension arrangement will improve;
- Desire to participate in anticipated investment growth before purchasing an annuity;
- It is not an appropriate time to realise a specific investment, e.g. a commercial property being used in the member's (or a family) business or residential property in which the member lives;
- There is no current requirement for an income from the pension fund because the member is still working or because the member has other sources of income;
- Contingency planning for Long Term Care (especially if the member has no close family and wishes to delay purchasing an annuity until he or she has to, with a view to maximising the level of income);
- Religious beliefs.

In practice, however, it will very often be impossible to prove the motives of the deceased and the scope for HM Revenue and Customs to apply assumptions not in the tax payer's favour would be enormous, and not justified by the introduction of the new pension taxation regime.

We therefore suggest complete exemption from inheritance tax on death before age 75. Failing that, the requirement should be for HM Revenue and Customs to prove that the member was seeking to avoid inheritance tax.

On **death after age 75** we suggest that there should be no liability to inheritance tax, unless HM Revenue and Customs can prove an intention to avoid the tax.

Reaching the age of 75 is of no fundamental significance. A healthy individual of 75 should be treated no worse than a healthy individual who is not yet 75. There is the argument that age 75 *is* important in the context of inheritance tax because it is the point at which alternatively secured pension becomes available. This must be kept in proportion, however. Alternatively secured pension was introduced to accommodate the religious beliefs of a very small minority and should not have a knock-on effect of prejudicing the inheritance tax position of the great majority.

For our response in full, please click here.

For a copy of the discussion paper itself please click here.

We have welcomed an invitation from HM Revenue and Customs to a meeting to discuss the way forward. ■

SPC London Evening Meetings: hand-out available

SPC's London evening on October 19th 2005 had as its subject "Learn About Money". This was a briefing by Stuart Royston (Chief Executive of the Life Academy – until recently The Pre-Retirement Association -) on "Learn About Money", the Life Academy's much praised financial education package.

The meeting was very kindly hosted by Jardine Lloyd Thompson Benefit Solutions.

If you would like a copy of the handout, please contact Eileen Damsell in St. Bartholomew House. ■

Draft Pension Taxation Regulations

SPC has responded to the draft pension taxation regulations published by HM Revenue & Customs in July, August and September.

For a copy of the comments click on the relevant month.

For a copy of the draft regulations themselves, please click here. ■

SPC obtains clarification on short service refund lump sums on protected rights

Through the Administration Committee, SPC has been in touch with HM Revenue & Customs on the interaction of the proposed taxation requirements on short service refund lump sums and DWP requirements on protected rights.

Both sets of requirements seem quite clear when taken on their own, but given the apparent consequences of the combination of these regulations. There needs to be clarity as to the intended meaning.

1) FA04 requires a SSRLS to extinguish all of a member's scheme benefit.
2) Contracting-out rules do not allow Protected Rights to be commuted on leaving service, nor can they be bought back into the state scheme. (DWP has confirmed that no change to current policy is planned).

Does it therefore follow that schemes which are contracted out on a Protected Rights basis cannot provide SSRLSs to members?

HM Revenue and Customs has indicated that paragraph 5(1)(d) of Part 1, Schedule 29, Finance Act 2004 requires the lump sum to extinguish the member's entitlement to benefits under the pension scheme in order for it to constitute a "Short Service Refund Lump Sum". Where a scheme is contracted-out on a money purchase basis, the member cannot be bought back into the state scheme by the payment of a CEP. The member's Protected Rights (normally the money purchase "pot" referable to the National Insurance savings and any age-related payments made by the Revenue) would continue to be held by the scheme and the member would receive a refund of his or her contributions less (usually) the savings in his or her NI contributions, which have been applied to provide Protected Rights. As a refund would not extinguish the member's entitlement in these circumstances, the payment of the refund would not fall within the definition of a "Short Service Refund Lump Sum". ■

HMRC replies to SPC request for relaxation of tax spreading rules

SPC News No. 4 2005 outlined SPC's request to HM Revenue & Customs that it relax the tax spreading rules on employer contributions to address scheme deficits.

We have now had a response.

HMRC indicates that the question of whether or not to retain the practice currently operated under HMRC discretion for approved pension schemes, to spread relief on exceptional contributions over a period of years, was considered very carefully when drafting the pension simplification legislation and was not retained lightly. It suggests that it would be premature to re-examine policy in this area before the new legislation has taken effect.

The new rules will allow employers to claim a deduction for contributions paid to registered pension schemes. There is no cap or limit on the amount of contributions which an employer can make in respect of its employees and contributions paid will be allowed as a deduction when calculating taxable profits. Where an employer makes an exceptionally large contribution to a registered pension scheme, HMRC would not wish to deny a deduction for it.

Under the new pension taxation regime, contributions will help to generate surpluses which may remain in schemes. HMRC suggests that, as more funding is necessary, the surplus could cushion that and contributions could be gradually increased without the need for large, one-off injections of funds, as had to happen in the past.

HMRC summarises:

- There will be a single set of rules for all registered pension schemes, to allow tax relief on employer contributions paid in any one accounting period. These will follow the well understood rules for allowing deductions for business expenses.
- The new rules do not deny tax relief but merely smooth its flow.
- Employers will also be able to more than double their normal contributions in any year and receive tax relief in the year of payment.
- But employers will still on occasion want to make larger special contributions, for example to rectify actuarial deficiencies. Such deficiencies relate to more than one year, so it is right that these special contributions should not wholly be allowed as a deduction in the year in which they are paid, but spread over a number of years. ■

SPC sponsors workshop on new pension taxation regime

SPC co-sponsored a workshop on October 4th at the London office of Hewitt, 6 More London Place, for whose support we are grateful.

The workshop was arranged in co-operation with ACA, PMI and HM Revenue & Customs. The latter provided all the speakers.

The workshop was aimed at those ➥

operationally responsible for making sure schemes are administratively compliant with the new pension taxation regime from A-day.

The agenda for the workshop covered:-

- The role of the scheme administrator (for self-administered schemes this would be the trustees).
- The role of the practitioner (this would be those people actually using HM Revenue & Customs' electronic systems).
- A talk and demonstration of how the new on-line service would operate, for instance getting started, sending event reports, accounting for tax forms and pension scheme returns.
- A high level summary of protection for certain individuals under the new system.
- Getting to A-day and beyond, including a timeline of all actions needed and identification of specific responsibilities.

The workshop was fully booked, with an attendance of 85. ■

SPC Response to the consultation document on the risk based PPF levy

SPC has responded to the Pension Protection Fund's consultation document on the risk based PPF levy.

On a strictly technical level, we considered it to be a thorough and well constructed discussion of the factors relevant to the introduction of a risk-based levy.

On a broader view, however, we have concerns. The first question, on which the Board seeks views, is whether the risk-based levy should be constructed in a way which combines the principles of fairness, simplicity and proportionality. We readily agree that it is important to include all these principles in constructing the risk-based levy, but we would add one more. That is affordability.

We had not yet seen the proposed scaling factors, but it seemed very likely that the annual burden of the levy would be far higher than the £300m quoted by the government when it proposed the establishment of the Pension Protection Fund.

The proposed maximum levy for a poorly funded scheme with a weak employer is 3% of pension protection fund liabilities. Typically, liabilities might be 10 times salaries, so that the levy would be 30% of salaries. This is a very significant cost burden and is in addition to the contributions which the employer is making to the scheme. We would expect this to force a number of companies into insolvency, which is undesirable in itself, and will also significantly increase the burden on the Pension Protection Fund and therefore on remaining levy payers.

Related to our first point, it is important to ensure that the burden of the levy is spread reasonably across various sizes of scheme. Any steps to temper the demands on smaller schemes and to make special arrangements for the largest schemes must not leave medium schemes carrying a disproportionate burden.

The consultation document states in a number of places that the PPF Board intends the levy structure to reward well funded schemes and eliminate perverse incentives. However, the intention to include an "underfunding amount" of 1% of the value of PPF liabilities on schemes with a funding level greater than 104%, regardless of the actual funding level, is a potential funding disincentive to employers. A scheme which is, say, 130% funded, but has a weak sponsoring employer, will pay a significantly greater levy than one which is 104% funded with a strong sponsoring employer. Once a scheme is more than 104% funded on the PPF basis, there is no benefit in levy terms in improving scheme funding, yet improving the financial position of the employer does reduce the levy. We suggested that the 1% should only apply to schemes with a funding level between 104% and a specified higher percentage, so that schemes with a funding level above that specified higher level would not have any "underfunding" component within their risk-based levy assessment.

The section of the consultation paper on asset risk suggests that the Board wishes to have a levy which favours investment in bonds over investment in equities.

We believe that the emphasis on bonds is too heavy. Bonds give relatively low and relatively certain returns. If a scheme is more than solvent on the PPF basis, it will probably remain solvent if it is invested in bonds. However, the same is probably true if the scheme is below the PPF solvency level. At present most schemes will be below solvency. If schemes are encouraged to invest in bonds, any possibility that investment returns will help to improve the position will be slight and the entire burden of improving the situation will fall on sponsoring employers.

If schemes invested in equities, and this produced poor returns, solvency levels would fall and the result would be a higher levy. We suggest that it would be more appropriate for the PPF Board to adopt a more even-handed approach to bond and equity investment, and to allow schemes which follow unsuccessful investment strategies to be penalised through the proposed levy structure and the resultant requirement for increased funding. Further distorting the investment decision-making process could have significant unintended consequences both for pension schemes and the economy.

The consultation document raises the possibility that schemes could adapt their own MFR valuation results, but rejects it in favour of a simplified PPF adjustment process. The simplified approach would not take into account, and indeed could not take into account, significant membership movements since the effective date of the MFR valuation. Nor could it take into account any extra funding received in the same period. This could pose particular problems for smaller schemes. The scheme actuary will be aware of these (and any other significant changes) and so be best placed to take account of them in any adjustment of valuation results. We suggested, therefore, that it could be preferable to provide for a Section 179 valuation or a scheme actuary's certificate to inform the levy calculation with the default being the simplified adjustment process. Allowing this approach would facilitate more schemes being able to provide a fairly accurate assessment of their funding position by year-end.

If the first year's levy is calculated on the basis of an old MFR valuation, we suggest that there must be provision for an adjustment (upwards or downwards) of subsequent payments.

For a copy of our response in full, please click here. ■

PPF levy: FAQs issued on 30 September 2005

The Pension Protection Fund (PPF) issued answers to a number of frequently asked questions and unresolved issues on "section 179" valuations for PPF levy purposes on its website on 30 September.

The main issues are as follows:-

- The Normal Pension Age for section 179 valuation purposes should be assumed to be the same as the MFR Pension Age (i.e. the age at which the member will first become entitled to receive a full pension on retirement of unreduced scheme benefits but disregarding any entitlement in the case of illness, incapacity or redundancy). This means that retirement benefits from schemes which have a "normal pension age" of 65, but which offer unfettered early retirement at 60, should be valued as payable from age 60.
- Approximate actuarial calculations are likely to be acceptable, but fully audited assets remain a requirement albeit not necessarily at the same date as the liability valuation.
- Active members are to be valued as if they become deferreds.
- The PPF has re-asserted the principle that the section 179 valuation is of scheme benefits subject to specified limitations, rather than the benefits which the PPF would actually pay.
- Trustee-owned insurance policies must be included in scheme assets and liabilities, even if they are not shown in the accounts. ■

PPF response to concerns on levy formula

The Pension Protection Fund (PPF) has published new valuation guidance and a consultation update which refine the levy calculation process and respond to some concerns raised. These are essentially designed to reduce the cost of compliance and uncertainty about the calculations, rather than change the fundamental principles. Nothing is said about the overall levy to be raised and hence the scaling factor to apply to the basic formula.

Some points of particular significance are as follows:-

- The deadline for submitting valuations and multi-employer elections for the purposes of the levy year beginning 1 April 2006 has been put back to 31 March 2006, as has the Dun & Bradstreet risk assessment date.
- The proposed formula to apply where more than one employer participates in the scheme is published. The formula essentially weights the Dun & Bradstreet ratings of all the employers by member numbers, less 10% where the employers are jointly and severally liable. This will create difficulties for companies where the strongest company in the group is not the largest employer.
- PPF has acknowledged the need for some mechanism by which "contingent assets", e.g. extra security provided outside the scheme by means such as a letter of credit, can be credited. However, it is still working on whether provisions which meet its requirements can be developed. These may need to be stronger than simple guarantees by the parent, e.g. involving third parties such as banks.
- Contingent asset issues are particularly important for overseas parented companies. However, because of the proposed multi-employer formula, how this develops will also affect many UK groups of companies where the largest employer by numbers is not the strongest entity.
- A degree of approximation will be acceptable in producing "s179" levy valuations for levy purposes, including rolling forward earlier data. The approximations will need to be "prudent" and "unlikely to understate the liability", which may mean some rounding up. The cost of this in levy will need to be compared with the cost of accurate calculations. Audited accounts are still needed.
- Where significant extra contributions have been paid into the scheme since the last valuation, it will be possible to gain credit for these without a fresh valuation or accounts, subject to actuarial certification. Employers about to make special contributions should be able to get credit for those paid up to 28 February 2006 for the 1 April 2006 year.
- The formula for the rolling up of a prior MFR valuation, which applies in the absence of a s179 valuation, is published, allowing employers to determine whether submission of a fresh valuation is advantageous.
- The Dun & Bradstreet Failure Score remains the basis for assessing the likelihood of employer insolvency. PPF officials are, however, aware of concerns about the lack of transparency and consistency in relation to these. ■

SPC response to draft code of practice on modification of subsisting rights

SPC has submitted a response to the Pensions Regulator's draft code of practice on modification of subsisting rights.

For a copy of the response, please click here.

For a copy of the draft regulations themselves, please click here. ■

SPC response to draft cross-border activities regulations

The key part of our response was to emphasise that it is essential that the proposed definition of "seconded worker" is re-addressed. The proposal that postings must not exceed 12 months is far too restrictive. The obvious response by employers would be to terminate any secondment which would otherwise exceed 12 months, in order to avoid the "full funding" requirements of the EU Pensions Directive. The consequence of this would be a reduction in cross-border activity, which is the opposite of the EU's intention.

We therefore suggested that the words "of not more than 12 months" be deleted from part (c) of the definition in regulation 2. Instead there should be a simple requirement based on intention to return to the UK (as in the current requirements in Revenue Practice Notes-IR12 (2001)).

We are confident that DWP will address our concerns.

We also saw two difficulties with the definition of "European Employer", when taken in conjunction with section 287 of the Pensions Act 2004.

Firstly, since this definition is not restricted to non-UK employers, the effect of section 287(1) of the Pensions Act 2004 would be to prohibit trustees' acceptance of any contribution from such an employer, even in respect of UK based employees, until appropriately authorised under part 7 of the Act. So, for example, for a single employer scheme with 1000 active members in total, where only one member is currently seconded to another EU state, even if the trustees submit applications for approval under sections 288 and 289 at the earliest opportunity, they would have to refuse to also accept contributions in respect of the remaining 999 UK based employees for potentially 5 months. This is perverse, and it should therefore be clarified that the non-acceptance of contributions should only relate to members who are "qualifying persons" or "qualifying self-employed persons".

Secondly, by virtue of draft regulation 3(1), the term "European Employer" would include anybody employing "qualifying persons" or "qualifying self-employed persons", even where they were not members of the pension scheme. So, the same situation as in our example above would arise, even if the scheme membership comprised only the 999 UK based employees, as long as the employer continued to also employ the seconded employee. This would clearly be an absurd outcome.

For a copy of the draft regulations themselves, please click here. ■

MFR regulations and SI 2005/2159

MFR Regulation 7(1)(a) clearly refers to the liabilities mentioned in section 73(4) of the Pensions Act 1995 which, since 6 April 2005, excludes money purchase benefits – hence the change to regulation 6(1) of the MFR Regulations being introduced by SI 2005/2159. However, DWP has failed to delete at the same time regulation 7(8A) of the MFR Regulations, which states that "The amount of the liabilities of the scheme in respect of any money purchase benefits shall be calculated in accordance with the guidance given in GN 27", i.e. the Actuarial Profession's Guidance Note 27.

Paragraph 3.4 of GN27 explicitly refers to the valuation of money purchase liabilities.

Clearly, MFR Regulation 7(8A) also needs to be deleted, with a corresponding revision to GN27.

One could argue that the effect of MFR Regulation 7(1)(a) overrides regulation 7(8A), but the mere existence of 7(8A) and paragraph 3.4 of GN27 is likely to lead to potential confusion as to the treatment of money purchase liabilities.

We have raised this with DWP, which has confirmed that regulation 7(8A) of the MFR regulations is now obsolete, given the changes made to section 73 with effect from 6 April 2005. DWP will therefore consider removing regulation 7(8A) at a convenient opportunity, after liaison with the Actuarial Profession. ■

SPC response to draft cash transfer sums and contribution refunds regulations

SPC has responded to the draft Occupational Pension Schemes (Early Leavers: Cash Transfer Sums and Contribution Refunds) Regulations 2005.

For a copy of the response click here.

For a copy of the draft regulations themselves, please click here. ■

SPC response to draft code of practice on member-nominated trustees and directors

SPC has responded to the Pension Regulator's draft code of practice on putting arrangements in place for member-nominated trustees and directors. *For a copy of the response, click* here.

The draft code itself can be obtained by clicking here. ■

SPC raises queries on notifiable events

We have raised with the Pensions Regulator some questions on the wording of regulation 2 (1) (e) of the Notifiable Events Regulations.

We understand that Trustees / Managers are required to notify the Regulator of a benefit payment in excess of the lower of 5% of scheme assets and £1.5 m where:

- The scheme is eligible for entry to the Pension Protection Fund, **and**
- Under the last PPF / MFR valuation, the value of scheme assets was less than the value of the scheme's PPF / MFR liabilities, **or**
- The trustees / managers have incurred a duty to report a materially significant late payment under the schedule of contributions within 12 months of the benefit payment in question.

We sought the Regulator's comments on the following issues:

Issue 1 - augmentation

We assume that there is no requirement for augmentation to be a feature of the benefit payment since this is dealt with under Regulation 2 (1) (d).

We sought confirmation that this is correct.

Issue 2 - discretion

We assume that there is no differentiation between benefits paid as of right (e.g. at normal retirement date) and the exercise of any discretionary powers (e.g. the granting of benefits paid earlier than normal retirement date where there is no automatic right to take such benefits). In other words, a "decision to grant" means the same as "bring in to payment".

We sought confirmation that this is correct.

Issue 3 – "member"

We understand that this regulation applies equally on death - we read "member" to include contingent beneficiaries. Technically, the regulation will fall back on the definition of "member" under Section 124 of Pensions Act 1995 (via Section 318 of Pensions Act 2004) and only includes an active, deferred, pensioner or credit member. However, this seems incompatible with the perceived objective of the regulations i.e. reporting large amounts paid out.

We asked for confirmation that we are correct in assuming that reference to "member" does include benefits paid on behalf of a member in the event of death.

Issue 4 - Insured elements

Notwithstanding the methodology of valuing the benefits (see issue 7 below) we can anticipate that the value of the benefits paid on behalf of a member could well exceed the notification threshold. However, it is likely that some or all of the benefit to be paid out will be re-imbursed by an insurance policy.

We asked whether the Regulator would expect to be notified where the net (after re-imbursement from insurance) amount is less than the threshold, despite the explicit wording of this regulation?

Issue 5 - aggregation

Our reading of regulation 2 (1) (c) would suggest that notification could be required for single and multiple transactions on transfer, i.e. a bulk transfer as well as an individual transfer. It would therefore follow that this should be applied to regulation 2 (1) (e). In the case of a redundancy exercise for example, it could be that a small number of those made redundant would have the right to immediate early retirement on the same day. The aggregate cost could be well in excess of the notification threshold.

We asked for confirmation that notification is required even where the thresholds are not exceeded on an individual member basis.

Issue 6 – future benefits

We believe that the words "…or a right to benefits…" could be open to interpretation. It is not clear to us if this regulation is designed to encompass the following situations:

- A decision to allow entry to an occupational scheme whether by contractual right or the exercise of discretion. A new entrant could be deemed to have been granted a right to future retirement (or even immediate death in service benefits) which may be in excess of the notification threshold.
- A decision to allow a member to move to another category of membership with, say, an enhanced accrual which could in aggregate exceed the notification threshold.

Is this correct and, if so, should notification be made at the time of the decision or at the time of payment?

Issue 7 – "cost"

It is not clear to us how trustees can readily establish the cost for the purposes of identifying benefits in excess of the threshold. We can easily identify the tax free cash sum element, and indeed the actual cost of buying out a pensioner from commencement. We sought the Regulator's comments on valuing the following:

- The pension element. We assume that it is not simply the annual amount, but are not sure how to convert the pension for the purposes of this regulation. Could we use the Revenue simplified standard of 20:1 for all age ranges or is an actuarial assessment required in each case, perhaps on the CETV basis? Alternatively, we could use a market buy out cost. Unless a simplified approach is used, we believe that there will be a huge cost to the industry in obtaining either an actuarial assessment or quotation from a provider in cases which are potentially notifiable.
- Pensions which are already in payment and are subsequently bought out. We would assume that the actual buy out cost is sufficient for this purpose.
- Benefits which are attributable to a member, but not paid to the member or contingent beneficiaries. For example where untaxed lump sums and pension (by whichever valuation method is appropriate) paid to the member would be less than the threshold, yet when aggregated with tax (e.g. Lifetime Allowance charge) remitted to HMRC on behalf of the member would be notifiable.

Issue 8 – application

We believe, therefore that this regulation applies to a benefit payment in the following circumstances:

- Retirement – Early, normal and late
- Death in service, deferment and retirement
- On the granting of a right to future benefits (issue 5 above)

We sought confirmation that this is correct.

The Regulator responded as follows:-

Issue 1 – augmentation

The events at sub-paragraphs (d) and (e) of regulation 2(1) are not mutually exclusive. Where augmentation occurs which results in the payment of benefit in excess of the limits shown at regulation 2(1)(e) there is a notifiable event. Therefore if the trustees augment benefits having acted on the advice of the actuary in securing additional funding where it was advised, *but* the resulting payment fell with sub-paragraph (e), notification is still required.

Issue 2 – discretion

It is correct that there is no differentiation between benefits paid as of right and the exercise of any discretionary powers. Therefore the duty to notify could potentially arise both at normal retirement date and on early retirement whether or not granted by the trustees at their discretion.

Issue 3 – "member"

The assumption is correct that the reference to "member" in regulation 2(1)(e) includes benefits paid on behalf of a member in the event of death.

Issue 4 – Insured elements

As our concern is with the cost to the scheme we would expect to be notified of all benefits paid out of scheme funds. If the "insurance" reimburses the scheme we would expect to be notified, but with an explanation that "x"% of the benefit will be reimbursed by an insurance fund. However if the insurance pays the benefit direct to the beneficiary and any "top-up" payment from the scheme is less than the limits in sub paragraph (e) of regulation 2(1) we would not expect to be notified.

Issue 5 – aggregation

We can confirm that the collective impact is not required to be notified in respect of regulation 2(1)(e). The legislation refers to "a member" and therefore there is only a requirement to notify if the threshold is exceeded in respect of an individual member. Therefore in the scenario outlined, of early retirement being granted to a number of members as part of a redundancy package, the need to notify would only arise if any one of those individual member's benefits exceeded the threshold as opposed to the aggregate amount.

Issue 6 – future benefits

We can confirm that in the situation outlined, of a new entrant being granted a right to future retirement or immediate death in service benefits which could potentially be in excess of the notification threshold, the Regulator would not expect to be notified. In other words only an actual right is notifiable (not a contingent right).

In the situation outlined, of a member moving to another category of membership with an enhance accrual which could in aggregate potentially exceed the notification threshold, the Regulator would not expect to be notified as this is also a contingent right.

The Regulator would therefore expect to be notified in both the above situations at the time the trustees actually grant the rights, assuming they exceed the limits at that time.

An example of a "right to benefits" would be where the rules permit a member to retire at 60, where normal retirement age is 65, with the trustees' permission. The member may apply for this permission at 59 in order to plan for his retirement if granted this would be a decision to grant him a right to benefits at age 60. If the value of these benefits **at the time the permission was granted** exceeded the threshold this would be notifiable. If the member decided **not** to take this actual right – this is his choice, however it would still be notifiable and ought to have been notified before the member has made his decision.

Issue 7 – "cost"

When establishing the cost for the purpose of identifying benefits in excess of the threshold, the Regulator would expect benefits to be valued as follows:-

- The pension element – market buy out cost.
- Pensions in payment and subsequently bought out – the actual buy out cost.
- Benefits attributable to a member but not paid to the member or contingent beneficiaries – the Regulator would want to know the cost to the scheme so in the example outlined we would expect the amount paid to the member to be added to the tax paid by the scheme in order to assess whether it exceeds the threshold (unless the scheme successfully recouped the tax from the member).

Issue 8 – application

We can confirm that regulation 2(1)(e) does apply in the following circumstances:-

- Retirement – Early, normal and late
- Death in service, deferment and retirement where paid from the scheme.
- On the granting of a right to **actual** benefits (rather than contingent benefits).

Following up, we queried why the Regulator expects the pension element to be valued on the market buy-out cost basis for the purpose of establishing whether it is over 5% of the value of scheme assets.

The Regulator believes that establishing the buy out cost is not overly burdensome as the bases are set down in Actuarial Guidance Note 9 (GN9) and the figures from the most recent valuation could be used as a reasonable estimate.

It considers that the Revenue simplified standard basis of 20:1 could throw up anomalies as, for example, it would not take into account any escalation or indexation.

If, in a particular situation the trustees considered that the actual cost to the scheme of providing a member's pension would be less than 5% of the scheme assets, but that on a buy-out basis the value is over 5%, they should still report this as a notifiable event, but point out in their report that the pension is to be paid from the scheme funds and that they believe that the actual cost to the scheme will be less than 5% of the assets.

The Regulator will be undertaking an annual review of the code of practice on notifiable events and valuation is an issue that it will be addressing at that time. ■

SPC response to draft internal control regulations

SPC has submitted a response to the draft Occupational Pension Schemes (Internal Controls) Regulations 2005.

For a copy of the response click here.

For a copy of the draft regulations themselves, click here. ■

Financial services regulation round-up

FSA Consultation Paper 05/10: Reviewing the FSA Handbook

The changes proposed in the consultation paper are generally welcome, but will be of limited value to SPC Members in view of the overall distinction in FSA rules between private and non-private (wholesale) customers. The great majority of the clients of SPC Members fall into the non-private category, but the distinction between non-private and private customers means that perhaps 10% of clients fall into the non-private category and our Members must therefore also follow the provisions of the Handbook relating to private customers.

This problem would not exist if categorisation of clients was aligned with the definitions for mortgage and general insurance introduced by the Insurance Mediation Directive.

Change to the rulebook is being introduced incrementally. There have already been the changes to ICOB. There are the current changes and then there will be further changes required by MIFID. On each occasion firms will need to change systems and procedures. This will give rise to costs, which ultimately will fall on consumers.

We particularly welcome the proposed changes on systems and controls and we agree with the proposed changes on money laundering and approved persons, in the latter case particularly in respect of corporate advisers.

Deleting the money laundering sourcebook would save duplication, since firms have in any event to refer to the Joint Money Laundering Steering Group for practical guidance on adhering to the rules. It makes much more sense for firms to solely adhere to the JMLSG notes for guidance, as they are recognised by the courts and approved by the Treasury.

The overhaul of the approved persons regime is also welcome. However, changing the scope of the "customer functions" so that this only incorporates individuals, who deal with private customers, may only have limited effect amongst our members, since most would be unlikely to restrict investment advice to non-private clients.

We expect the changes on training and competence to have less impact. In fact, we question whether removing the TC2 requirement in respect of non-private customers will be of benefit. Prescribing minimum requirements for investment advisers has created a more level playing field for the industry and has raised minimum standards. By removing this requirement, the

SPC response to the draft consultation by employers regulations

SPC has responded to the consultation by DWP on the requirement by employers to consult on changes to occupational and personal pension schemes.

For a copy of the response click here.

For a copy of DWP's consultation document click here. ■

prospect of clients receiving advice from unqualified advisers increases.

FSA Rules for Third Party Processors

FSA is changing its rules for third party processors (TPPs) carrying on regulated insurance mediation activities (in relation to non-investment insuance contracts) for another authorised firm (the main firm) under an outsourcing agreement.

FSA rules used to require a TPP to disclose to the consumer its existence and involvement in the transaction, but this has now been changed in the new rules.

Many members of SPC are pension administrators and may well hold themselves out in some cases as being the client to pension scheme members, so the change in the rules might have been useful to them. However, we note that it only applies to non-investment contracts of insurance. We see no reason why TPPs who are pension administrators should not be able to take advantage of this.

We strongly request that the rules also be changed in respect of investment contracts of insurance. Otherwise, we suggest a General Waiver (which previously existed for general insurer TPPs).

FSA Quarterly Consultation Paper 05/9

We commented on chapter 2 of the consultation paper, which specifically proposed changes to COB to recognise new pension taxation legislation.

We note proposals to amend the rules surrounding income withdrawal and short-term annuities (COB 5.3.29G).

At present, advice on income withdrawal requires additional suitability issues to be covered by the adviser. Although not part of the rules (because of the delay in following up on proposals set out in CP170), most firms comply with guidance issued by PIA in Regulatory Update 55 (August 1998) and provide either a Type A or Type B Critical Yield as a way of supporting the recommendation. Further, most firms advising in this area recognise that income withdrawal advice should be given by experienced advisers (following on from the CPD guidance given in RU55) and some firms choose not to advise in this area because it is considered to carry too much risk.

By including short-term annuities within the definition of income withdrawal, many advisory firms may decide that the imposition of additional suitability requirements (including, potentially, critical yield calculations) may make this area too complex to advise on. However, short-term annuities are less risky than taking income drawdown because an annuity is purchased rather than withdrawals depleting the fund.

Further, if advisers do give advice in this area, there is the potential for confusion when they consider the critical yield calculation as it will be unclear to them how the critical yield should be calculated. Indeed, the old guidance on calculations will need to be reviewed in the light of changes to pensions legislation, because most firms advising on income withdrawal give critical yield figures - and the FSA's own consumer factsheet refers to critical yields.

Historically, the purchase of an annuity not using the whole of the pension fund has been known as phased retirement (albeit a lifetime annuity rather than a short-term annuity is purchased) and it is possible that positioning short-term annuities alongside income withdrawal in the Rules will put off many advisers from giving advice in this area. This might disadvantage some investors, who would otherwise have been good candidates for short term annuities.

Rather than positioning short-term annuities alongside income withdrawal, we suggest that it might be appropriate for separate suitability guidance to be provided, explaining the issues which should be considered by financial advisers (and which are not the same as for income withdrawal).

FSA Consultation Paper 05/8: Suitability Standards for Advice on Personal Pensions

We welcome the proposals in this consultation paper, although we believe that their impact will in practice be heavily influenced by how far FSA's supervisory staff view it as justifying changes in advisory practice in specific cases.

We would like it to be clearer whether a recommendation of a personal pension, as opposed to a stakeholder pension, is acceptable because it is uneconomical for the adviser to cover the latter.

RU 64 placed excessive emphasis on charges, to the extent of deterring advice. At a time when consumers continued to favour commission over fees this inevitably led to a reduction in pension advice as the commission available under stakeholder charges was often insufficient to cover the cost of the advice.

We believe that the introduction of the Menu provides the openness necessary for consumers to better understand the costs and benefits of advice on the products on offer. Consequently, RU64 is no longer necessary and the removal of RU64 should stimulate greater adviser activity and increased pension savings. ■

SPC response to draft age equality regulations

All our comments related to chapter 7 of the consultation document on the draft regulations, on occupational pensions.

In general, the proposals in this chapter are extremely welcome. We agree with the assessment at the end of chapter 7 that pension schemes will be able to operate largely as they do now.

Paragraph 7.1 states that personal pensions (i.e. pension schemes other than those provided by the employer) are not covered, except for any employer contributions into such pensions. This leaves unclear the position of group personal pension schemes (GPPs) and stakeholder pension schemes. These schemes are provided by the employer, but they do not fall within the definition of occupational pension schemes.

We suggest that the exemptions proposed for occupational pension schemes should extend to group personal pension schemes and stakeholder schemes.

For employers with GPP/stakeholder arrangements, the key risks in terms of this legislation lie with contribution scales and the ages at which contributions start and cease to be payable. Age-related contribution scales are, on the face of it, discriminatory, although the underlying intention is to generate a broadly similar level of benefit regardless of the member's age. ➥

However, flat-rate contributions might equally be argued to be discriminatory since a given amount of contribution will ultimately secure a larger amount of benefit for a younger member than for an older member.

Exceptionally, discrimination may be objectively justified by reference to legitimate business aims, if it is appropriate and necessary in the circumstances. Particularly where the scale is based on actuarial advice, age-related contributions can be strongly argued to be either non-discriminatory or to constitute justifiable discrimination.

The same is likely to apply to flat-rate contribution scales, though it might take some test cases to establish exactly what the new legislation allows.

Setting a minimum age for access to the scheme will, again, need to be objectively justified. However, the draft regulations specifically allow benefit provision to be based on length of service, where the objective is to reward loyalty or encourage motivation. On this basis, service-related entry criteria appear preferable to age-related.

As to the age at which contributions cease, the proposals appear to allow for an upper limit to be justified. This is welcome.

Additionally, and not related to our comment above on GPPs/stakeholders, there is no exemption in schedule 2 to the draft regulations, specifically permitting cessation of pension accrual if a certain age has been passed. We suggest that there should be such an exemption, by means of an additional provision, (e), in paragraph 9 of schedule 2.

For a copy of the draft regulations themselves, please click here. ■

Pension complexity and compliance issues now of major concern to employers: SPC survey shows

Complexity and compliance are rivalling cost as the two biggest obstacles to employer involvement in pensions - a recent survey of SPC members has revealed.

Slightly over 50% (54%) of responses to the research, conducted in July on-line, indicated that cost was the biggest obstacle to employers setting up pension schemes.

However no less than 46% indicated that complexity and compliance were the biggest obstacles - demonstrating employers' increasing concerns over these two areas.

Roger Mattingly, Chairman of the SPC PR Committee, which oversaw the survey, commented:

"There are important pointers on pension policy here. Successive governments share some of the blame for creating the cost obstacle (for example by imposing benefits which were not part of original scheme design and by worsening the tax treatment of schemes), but important elements in the cost equation are outside its control (for example improving pensioner mortality and declining investment returns).

"However, the complexity and compliance burden is decided by the Government. The Pensions Act 2004 is very far from the simplification which we hoped for when Alan Pickering began his simplification review, but the government can still make a big difference by ensuring that codes of practice, most of which are still in draft, do not become regulations by the back door.

"It is also essential that the new pension taxation regime does not slide into the complexity which forced the abandonment of the old rules. We need a tax system which makes it as easy as possible to administer pensions for as many people as possible. We need to avoid falling into the trap of creating complexity for everybody by seeking to block off every tax loop hole, real or imagined, and complicating the whole system as a result." ■

Update on PAYE processes and age-related rebates

We have recently issued two General Circulars, following meetings between SPC and HM Revenue & Customs, concerning the modernisation of its IT system, handling submission of employers' year-end returns and the associated payment of age-related rebates.

If you would like a copy of either of the General Circulars, click here or here. ■

HM Revenue & Customs delays action on VAT input tax

We reported in SPC News No. 4, 2005 that HM Revenue & Customs had issued a business brief on the rules on recovery of input tax by employers, which provide funded pension schemes. The business brief was concerned with growing HM Revenue & Customs' concerns that businesses are applying the 30:70 split more generously than it intended. The new arrangements were due to come into effect on October 1st 2005.

HM Revenue & Customs has now announced that the effective date of the changes will be put back to January 1st 2005 and that there will be consultation on clarification of the guidance. ■

Section 255, Pensions Act 2004: Life assurance only members

We have raised with DWP concerns about the ability of occupational pension schemes to continue to operate, from 22 September 2005 a "death benefit or life assurance only" section for certain members. Many schemes have to date operated such sections during a waiting period for full scheme membership. Also, some schemes might operate a "death benefit or life assurance only" section for a particular category of employees whilst providing other categories with retirement benefits.

We have noted that:

- Section 255 of the Pensions Act 2004, which came into force on 22 September, requires trustees to limit scheme activities to "retirement-benefit activities". (There is an exemption for public service and one-member schemes, and for unapproved/unregistered/statutory schemes with less than 100 members)
- "Retirement-benefit activities" are operations related to "retirement benefits" and activities arising from operations related to "retirement benefits"
- "Retirement benefits" are defined as essentially meaning benefits which are payable on retirement, together with any SUPPLEMENTARY benefits provided on an "ancillary basis", which can include benefits payable on death.

The point at issue is the extent to which "life assurance only benefits" can be regarded as ancillary benefits, when they are the only benefits being provided for the particular member from the scheme. There is a view that the requirement for death benefits to be ancillary benefits applies at the scheme level rather than at member level. Therefore, provided the benefits provided across the scheme are predominantly not death benefits, then the requirements in Section 255 of the Pensions Act 2004 would not be breached. A scheme providing only death benefits would now fall out of the Pensions Act definition of occupational pension scheme.

DWP has already clarified that death benefit only schemes are no longer considered occupational pension schemes from 22 September, in line with the definition of "occupational pension scheme" in section 239 of the Pensions Act 2004. The more complex issue for DWP is the extent to which life assurance only benefits can be regarded as "ancillary" when they are the only benefits being provided for the particular member from the scheme.

DWP has not fully resolved this question, but it was not the over-riding policy intention that section 255 should unsettle current arrangements. Section 255 was introduced to implement, and follows, the wording of Article 7 of the Directive on the Activities and Supervision of Institutions of Occupational Retirement Provision.

We will continue to pursue this matter. ■

The Society of Pension Consultants

St Bartholomew House
92 Fleet Street
London EC4Y 1DG
TELEPHONE: **020 7353 1688**
FACSIMILE: **020 7353 9296**
EMAIL: **john.mortimer@spc.uk.com**
WEB: **http://www.spc.uk.com**

SPC News Editorial Committee:
Chairman, Secretary and
Chris Bellers (Friends Provident)
and contributors from Mercer

About SPC

SPC is the representative body for the providers of advice and services needed to establish and operate occupational and personal pension schemes and related benefit provision. Our Members include accounting firms, solicitors, life offices, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. Slightly more than half the Members are consultants and actuaries. SPC is the only body to focus on the whole range of pension related functions across the whole range of non-State provision, through such a wide spread of providers of advice and services. We have no remit to represent any particular type of provision.

The overwhelming majority of the 500 largest UK pension funds use the services of one or more of SPC's Members. Many thousands of individuals and smaller funds also do so. SPC's growing membership collectively employ some 14,000 people providing pension-related advice and services.

SPC's fundamental aims are:

(a) to draw upon the knowledge and experience of Members, so as to contribute to legislation and other general developments affecting pensions and related benefits, and

(b) to provide Members with services useful to their business.