AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

AMPS REPRESENTATION PAPER:

THE CHANGE TO NORMAL MINIMUM PENSION AGE AND ITS IMPACT ON MEMBERS AGED BETWEEN 50 AND 55

(DECEMBER 2009)

Summary

Normal Minimum Pension Age, the age from which individuals can normally first start to draw pension benefits, increases from age 50 to 55 with effect from 6th April 2010.

The impact of this change depends on how pensions legislation is interpreted.

The legislation is ambiguous to the extent that there are two key ways in which the legislation can be interpreted.

Interpretation A, which we believe is favoured by HMRC, creates significant problems for affected members and pensions administrators.

Interpretation B, we believe, creates no significant problems.

AMPS is asking the Government for Interpretation B to be adopted, as this would be largely beneficial for all.

Urgent action required

We understand that HMRC is due to issue guidance to the pensions industry regarding the implementation of the change in Normal Minimum Pension Age.

We understand that the guidance will relate to the adoption of Interpretation A.

Before such guidance is issued we ask that due and proper consideration is given to this representation paper advocating the adoption of Interpretation B.

If, after due and proper consideration the relevant authorities still believe Interpretation A to be the correct interpretation, we would suggest that the guidance issued by HMRC must contain a robust rationale as to why their legal interpretation favours Interpretation A and that use of Interpretation A is preferable over the adoption of Interpretation B. This is essential to allow the pensions industry and affected members to make decisions regarding this issue with sufficient confidence.

AMPS would also expect to receive a response to our representation paper, giving direct answers to each one of the Interpretation A problem areas we have identified, stating why it is not a problem that requires resolution.

Distribution
This is a public document available on the AMPS website: www.ampsonline.co.uk

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Introduction

The minimum age from which pension benefits can be taken from a registered pension scheme is increasing with effect from 6th April 2010 from the current age of 50 to 55.

This paper:

- Analyses the meaning of the defined term Normal Minimum Pension Age (referred to in this report as "NMPA") in the tax legislation governing registered pension schemes.

- Highlights that pensions legislation is open to interpretation such that two key alternative interpretations can be arrived at.

- Identifies that Interpretation A, which appears to be that favoured by HMRC, creates significant negative impacts on affected members and also considerable hardship for pension scheme administrators.

- Proposes the adoption of Interpretation B, which does not create negative impact on affected members, hardship for administrators and overcomes unintended consequences of the current pensions legislation.

Affected members means those members of registered pension schemes whose 55th birthday is after 6th April 2010 and before 6th April 2015.

Relevant legislation

It is worth setting out in full the 3 key sections of Part 4 of the Finance Act 2004 (the "Act"):

- Section 279(1) states:

  "In this Part-
  …."normal minimum pension age" means-
  (a) before 6th April 2010, 50, and
  (b) on and after that date, 55,…."

- Section 165(1) states:

  "These are the rules relating to the payment of pensions by a registered pension scheme to a member of the pension scheme ("the pension rules").
  Pension rule 1
  No payment of pension may be made before the day on which the member reaches normal minimum pension age, unless the ill-health condition was met immediately before the member became entitled to a pension under the pension scheme…."

- Paragraph 1(1) of Schedule 29 states:

  "For the purposes of this Part a lump sum is a pension commencement lump sum if-
  ….(d) it is paid when the member has reached normal minimum pension age (or the ill-health condition is satisfied),…."

Using an example as a basis for discussion

Let us take as an example of an affected member X, whose 50th birthday is on 1st April 2010. On that date he elects to crystallise his entire £100,000 money purchase fund by:

- designation of £75,000 for pension (in the form of income withdrawal); and

- application of the remaining £25,000 to provide a pension commencement lump sum.

The two alternative interpretations of "reaching" NMPA

In the case of member X, Interpretation A, assumed to be the interpretation held by HMRC, is that although he "reaches" NMPA on 1 April 2010, he then "unreaches" NMPA on 6th April 2010. The test of reaching NMPA is a continuous one, in that one is supposed to ask afresh each day whether the member's age is greater than NMPA and, if it is not, then one is not allowed to take into account the fact that he reached it on a previous day when it was lower.

The view of AMPS, for the reasons set out further in this report, is that this interpretation is incorrect or, at best, uncertain and that the better interpretation (Interpretation B) is that once a member "reaches" NMPA he can never subsequently "unreach" it.

By way of illustration, if one asks the question on 7 April 2010:

- using Interpretation A, one must break the question into two separate parts:
  1. "what is NMPA now?" (to which the answer is "55"); and then
  2. "has the member reached that age?" (to which the answer is "No").
- using Interpretation B, one simply takes the question as a whole:
  1. "has X reached NMPA?" (to which the answer is "Yes, he reached it on 1 April 2010").

Problems with Interpretation A

1) Payment of pension commencement lump sums (PCLS) after 5/4/2010 become unauthorised payments

Interpretation A is taken to mean that if the PCLS for member X is not in fact paid before 6 April 2010, it cannot be paid at all, because on or after that date para 1(1) of Schedule 29 is viewed as saying:

> "*For the purposes of this Part a lump sum is a pension commencement lump sum if-….(d) it is paid when the member has reached [55]*".

Example; in the case of member X, who reaches NMPA on 1st April 2010, he crystallises his benefits on that date but for administrative reasons the PCLS cannot physically be paid until after 5th April 2010. At the time the lump sum is paid member X is no longer deemed to be of NMPA. Therefore the lump sum would not be a PCLS but an unauthorised payment which would be subject to tax charges.

Adoption of Interpretation B would avoid this issue completely.

2) Conflict with amending legislation to allow PCLS payments up to six months prior and 12 months after a benefit crystallisation event.

Pensions legislation contained within Finance Act 2004 originally only allowed three months from the date of a benefit crystallisation in which to pay a PCLS. Following representations from the pensions industry it was accepted that this was impractical. To ease administration burden, legislation was amended (Paragraph 11 of Schedule 20 of Finance Act 2007 which amends Para 1(1)(c), Part 1, Sch29, FA2004). The effect of the amendment being that a PCLS could be paid up to six months prior or 12 months following the date of the Benefit Crystallisation Event (BCE).

A key driver behind the amendment to allow a PCLS to be paid up to six months prior to a benefit crystallisation was in recognition of a common practice within the occupational pension scheme sector. To illustrate this; member Y is retiring at age 50 and is given the opportunity to secure benefits through purchase of an annuity on the open market. As an open market annuity purchase can take time to arrange, the amending legislation allows the member's pension scheme to make payment of the PCLS on his retirement day i.e. 50th birthday, with the annuity being set up say two months later. As it is the date the annuity is set up that determines the date of the benefit crystallisation event, in this example the PCLS has been paid two months prior to the benefit crystallisation event.

If this scenario were to occur with a PCLS being paid in say March 2010 but the open market option annuity could not be set up before 6/4/2010 for an affected member, then under Interpretation A, the annuity purchase could not proceed post 5/4/2010 as the member would not then be of NMPA and the PCLS would therefore be deemed an unauthorised payment and be subject to a tax charge.

In addition, the problem highlighted in 1) above prevents the use of the 12 month window in which to pay a PCLS and for any benefit crystallisations occurring after 5th January 2010 not even the original three month window would apply.

Interpretation A clearly conflicts with the policy intent to allow flexibility around the timing of the payment of the PCLS.

Adoption of Interpretation B would avoid these issues completely.

3) Annuity set up timescales may mean affected members will suffer.

The point at which an annuity is set up determines the date of the benefit crystallisation event. Therefore under Interpretation A it is imperative that if an annuity purchase has been chosen as the method of securing income, that it is set up prior to 6/4/2010.

Recent reports of an ABI initiative to improve the timescale involved in setting up annuities indicated that the average time is 11 days. However, the worst firm covered in the study took 28 days.

Therefore affected members are at the mercy of administrators to expedite the purchase of an annuity by 5/4/2010. It would of course be prudent for affected members to have finalised their annuity selection by the end of February at the latest, given the indicated timescales. However, for those affected members whose 50th birthday occurs after the end of February, the less likely it is that an annuity can be established prior to 6/4/2010 the closer their 50th birthday is to 6/4/2010.

An unintended consequence may be that affected members may be forced to forgo best advice of looking for the best annuity on the open market in favour of accepting an inferior rate from their existing pension provider simply because it may be set up within the deadline.

Adoption of Interpretation B would avoid these issue completely.

4) Easter bank holidays will prohibit some affected members from being able to comply with legislation.

Legislation permits anyone of NMPA to draw benefits. For affected members Interpretation A requires benefit crystallisation and payment of the PCLS to have been made before 6/4/2010. In addition to the administrative difficulties of setting up annuities and making payment of any PCLS prior to 6/4/2010, the reality is that the practical deadline is not 6/4/2010 but Thursday 1st April 20101 due to the Easter bank holidays.

Further more, those whose 50th birthday falls on or after 1st April will not be able to set up an annuity or receive a PCLS prior to 6/4/2010.

Such affected members would be required to wait a further five years before having the option to draw benefits.

Adoption of Interpretation B would avoid this issue completely.

5) Suspension of ongoing instalments of pension

In acceptance that Interpretation A results in the need for the PCLS to be paid before 6/4/2010, as outlined in 1) above, consistency of interpretation is required when looking at the legitimacy of ongoing instalments of pension for member X. Interpretation A must therefore be taken to mean that on or after 6 April 2010, under Pension Rule 1:

> *"No payment of pension may be made before [1 April 2015]…"*

i.e. the pension must be suspended for nearly 5 years.

Note that Pension Rule 1 does not say "<u>the first</u> payment of pension may not be made before…..", it says simply "<u>no</u> payment of pension may be made before….".

Therefore, to adopt Interpretation A it is necessarily to say that no pension can be paid in the "gap" where a member "falls back" below NMPA. This is impractical enough for income withdrawal, but the restriction applies to all forms of authorised pension, including the vast number of conventional final salary "scheme pensions" being paid from large occupational schemes to affected members.

Whilst it is understood that it is not policy intent for pension payments to be suspended for affected members, the legislation does not reflect policy intent. We therefore contest that in adopting Interpretation A it will be necessary to amend primary legislation so as to legitimately allow the continued payment of pension in these circumstances.

We do not consider it necessary to amend primary legislation if Interpretation B were to be adopted. However, if the Government were minded to give parliamentary time to amending primary legislation in regard to this matter, that legislative opportunity would best be used to “clarify” beyond doubt in favour of Interpretation B.

Adoption of Interpretation B would avoid this issue completely.

6) Conflict with DWP interpretation of legislation regarding Protected Rights proportionality

AMPS has liaised with the Department of Work and Pensions (DWP) regarding the meaning of Section 28A (3A) of the Pension Schemes Act 1993. The DWP has clarified its interpretation of the legislation to mean that where a member has both Protected Rights and Non Protected

Rights funds held under a scheme, the Protected Rights fund must not be diminished at a faster rate than the Non Protected Rights fund.

This means that where benefits are taken from a Protected Rights fund a proportionate amount of benefits must also be taken from the Non Protected Rights fund. This rule extends to the situation where a member transfers either crystallised Protected Rights in to a scheme that is holding uncrystallised Non Protected Rights or uncrystallised Non Protected Rights are transferred into a scheme holding crystallised Protected Rights. In either situation DWP interpretation would require a proportionate amount of the Non Protected Rights fund to be immediately crystallised.

Under Interpretation A if any such transfers were made for an affected member after 5/4/2010, then if the Non Protected Rights funds were crystallised to conform to DWP proportionality rules, NMPA Interpretation A legislation would be breached. Alternatively, if NMPA Interpretation A rules were abided by, meaning that the Non Protected Rights is not crystallised, then DWP proportionality rules would be breached.

By adopting Interpretation A the consequence will be that affected members will no longer be able to gain the advantages of consolidating their Protected Right and Non Protected Rights funds in this situation. The removal of such flexibility is a retrograde step albeit that it is likely to be an unintended consequence rather than deliberate.

Adoption of Interpretation B would avoid this issue completely.

7) Inconsistency of approach in increasing the Normal Minimum Pension Age vs State Pension Age

The Pensions Act 1995 provided for the age of first entitlement to state pension for women to increase, from 60 to 65. Pensions Act 2007 built on this by providing for increases for both men and women, to 68. In both cases the increase was phased in by reference to an individual's date of birth, in such a way that no individual could gain but then lose again the right to draw pension.

An individual who elects to defer receipt of state second pension beyond state pension age does not risk his state pension age increasing, merely because he has not drawn benefits at the earliest age possible.

This approach is quite different to the one taken under Interpretation A where individuals gain but lose again the right to draw pension benefits.

Adoption of Interpretation B would avoid this issue completely.

8) Frustrating the policy objective

The policy objective behind the rise in NMPA was to encourage scheme members to draw benefits later and to stay in the workforce for longer. As the then Financial Secretary to the Treasury, Ruth Kelly, stated during the passage of the Finance Bill 2004:

> *"the increase in the normal pension age from 50 to 55 is an integral part of our simplification reform. It is part of the policy agenda put forward and advocated by the Department for Work and Pensions to encourage active ageing - rather than ageing actively - and to push up the distribution of ages at which people retire, so that on average people can stay in the work force longer…" (http://www.publications.parliament.uk/pa/cm200304/cmstand/a/st040617/pm/40617s08.htm)*

Adoption of Interpretation A could actually work against that objective. If affected members are told that they can only draw benefits before age 55 if they crystallise funds before 6 April 2010, that will tend to bring forward the age at which benefits, particularly the PCLS, are drawn, merely because members are having to allow for the possibility that they may need those funds over the next five or so years, not because they actually have a present need. In other words, anyone who was likely to draw benefits between 2010 and (as late as) 2015 may well draw them in 2010 because in HMRC adopting Interpretation A it is forcing them to make a decision now.

Adoption of Interpretation B would alleviate this issue.

9) Creating potential hardship during recession

There is continued speculation as to whether or not the UK has turned the corner in respect of economic recovery and how long that recovery may take. However, it is generally accepted that unemployment trends lag behind economic trends. Therefore the expectation is that even if the economic trend were to be positive, the unemployment trend is likely to be negative for some time to come.

A report by Age Concern (see: http://www.ageconcern.org.uk/AgeConcern/50-men-work-end-021209.asp) shows that the 50+ age group, men in particular, are especially hard hit by unemployment with a large percentage failing to secure employment again.

Age Concern was joined by Help the Aged, the Chartered Institute of Personnel (CIPD) and The Age and Employment Network (TAEN) in calling on the Government to use the Pre-Budget Report (PBR) to provide a new package of support to get people aged 50+ back into work.

Whilst the Government did take some action by announcing in the PBR that it would provide new support for the over 50s in the form of additional support available through Jobcentre Plus and specialist providers to ensure the over 50s move back into work quickly, Age Concern and Help the Aged remain critical. They commented: *"The Government needs to take more vigorous action if it wants to avoid creating a 'lost generation' of older workers shut out of the job market and forced into premature retirement."*

Whilst AMPS is not calling for the NMPA to be retained at age 50, we are calling on the Government to consider the negative impact of adopting Interpretation A will have at this particular juncture in the economic / unemployment cycle. We believe that allowing affected members the option of accessing a lump sum and, if required, income from their pension fund should they become unemployed can assist in helping their transition back to work. For example, by funding retraining and education, help establish their own business, or help alleviate financial hardship through accepting lower paid or part time work.

Adoption of Interpretation B would help alleviate this issue.

10) Risk of future litigation

AMPS believe that using Interpretation A is an incorrect interpretation of legislation or an uncertain one at best.

We are often reminded that under the Finance Act 2004 pensions legislation, HMRC no longer has discretion in applying rulings as under the previous pension regimes but must adhere to the law. Therefore in this matter HMRC will need to be certain that in adopting Interpretation A that it is adhering to the letter of the law.

Whilst the Government (Treasury / HMRC) may believe Interpretation A to be a correct interpretation, it is only an interpretation. Given the ambiguity of the current wording of the legislation, clarity can only be achieved through two main avenues. That being:

a) to amend primary legislation to provide clarity, or

b) a determination is made in a court of law.

As stated previously, if parliamentary time is to be spent on making the legislation clear, that time would best be spent on clarifying in favour of Interpretation B.

If, Interpretation A is adopted without amendment to legislation to clarify this interpretation, as Interpretation A is detrimental in nature an organisation or individual member may be moved to either apply Interpretation B and wait to be challenged by HMRC, which could lead to court action or seek clarification via the courts in consideration of applying Interpretation B.

A view can be taken on the chances of a court finding in favour of Interpretation B but we would consider them to be at least fair. The outcome would be good for affected members who are seeking to crystallise funds after 5/4/2010 but it would be an embarrassment for the authorities.

Furthermore, affected members who had crystallised pension funds prior to 6/4/2010 based on guidance from administrators and employers or advice from financial advisers which in turn has stemmed from guidance issued by HMRC aligned to Interpretation A, could well seek compensation for having unnecessarily crystallised their pension fund sooner that they otherwise might and thus would have forgone at least the opportunity of accruing a higher PCLS.

If Interpretation B is adopted, whilst the law may still remain ambiguous, because Interpretation B is not detrimental in nature, it is very unlikely that this interpretation would be challenged in a court of law.

Given the ambiguity of the legislation in this matter, and that there are two competing interpretations of that legislation, the pension industry, employers, advisers and individuals must have a higher degree of certainty with regard to the correct interpretation and urgently given the consequences of the hard deadline that would be imposed by adopting Interpretation A.

Adoption of Interpretation B would alleviate this issue.

Problems with Interpretation B

We can envisage very few problems with adopting Interpretation B. However, the following may be areas of consideration.

1) Some affected members may have already taken action based on Interpretation A

It is possible that some affected members may have already crystallised their pension funds in order that their pension funds are not inaccessible for a further maximum of five years. We do not have access to statistics that can accurately demonstrate how many individuals may have already taken such action and that it was solely for the purpose of retaining access to funds. Anecdotally though we know that individuals delay taking action often leaving decisions until the last minute. We therefore anticipate that only a small proportion of affected members will have taken action based solely on Interpretation A as at December 2009.

By HMRC publicly announcing the adoption of Interpretation B as soon as is practical, it will limit the number of affected members who will have, in hindsight, unnecessarily crystallised their pension funds.

We do not consider that official adoption of Interpretation A would be validated on the basis that some affected members who have already taken action, would be disadvantaged by adopting Interpretation B. It would simply perpetuate all of the disadvantages of Interpretation A, as outlined above, on the majority of affected members who have not yet taken action. The emphasis must be doing what is best, not perpetuation problems.

2) Administrators and Employers may have already issued guidance based on Interpretation A

We appreciate that some administrators and employers may have already issued guidance to affected members based on Interpretation A.

Naturally there would be concerns about re-issuing guidance based on Interpretation B in terms of the practicalities and the cost.

We would anticipate though that as HMRC has yet to issue the much pensions industry called for official guidance on this issue, that many organisations have yet to issue formal guidance to affected members. Alternatively where they have issued such guidance they will have been prudent enough to add the caveat that the guidance is based on current interpretation of the law which may be subject to change.

It should be remembered that:

a) any re-issuance of guidance to affected members to reflect the adoption of Interpretation B, will be received positively by the majority of them.

b) the practicalities and cost of re-issuing guidance through the adoption of Interpretation B, are likely to be off-set by resolving the problems that will occur due to the adoption of Interpretation A. Under Interpretation A, inevitably the deadline date will be missed for some and complaints and possible litigation will ensue creating their own practical and cost issues.

c) the Financial Services Authority’s guiding principle is to treat customers fairly. Whilst there may be practical and cost implications of re-issuing guidance to reflect the adoption of Interpretation B, that may lead some organisations to favour Interpretation A, due consideration should be given to what is best for the member, as opposed to what is the most convenient for the administrator / employer.

3) Scheme rules may be written to reflect Interpretation A

We would expect most scheme rules to be written in such a way that unless they intend to be more restrictive than pensions legislation will allow, they will largely replicate the wording of the legislation i.e. they will refer to the member having <u>reached</u> NMPA.

Therefore for these schemes, adoption of Interpretation B would not cause an issue.

However, there may be some schemes that have written their rules that more specifically and clearly follow Interpretation A. As such scheme rules would be more restrictive than legislation if Interpretation B were to be adopted, there would not be a requirement to amend such scheme rules but the harsher implementation of the rules would still be applied to affected members.

Such schemes, on the other hand, may wish to make a rule amendment to adopt Interpretation B for the benefit of their members. Whilst it may be preferable to make such rule amendments prior to 6/4/2010, it may be more practical to amend the rules at a later date, e.g. in six months time, but affected members would be comforted by the fact that they would be restricted from crystallising benefits for a matter of a few months until the scheme rules were changed, rather than for up to five years.

General comments in favour of adopting Interpretation B

1) Absence of tax issues

As indicated previously the increase in NMPA appears to be chiefly driven by social policy regarding the aging population rather than tax issues relating to pension arrangements.

We would see that the tax position is largely neutral or insignificant to the extent that adoption of Interpretation B should not be hindered by concerns about tax issues.

2) Opportunity for demonstrating good will

We cannot see any overriding issue that should prevent the adoption of Interpretation B. It would appear to be largely a 'win' for all concerned, including the Government in that over recent years pensions have been negatively impacted by legislative change. For the Government to accept that Interpretation B is the correct interpretation to take, might be seen as a positive gesture towards the pensions industry and affected members.

Proposal

AMPS proposes that due to the overwhelming advantage of Interpretation B, as compared with Interpretation A which creates a host of problems, that Interpretation B is adopted as the correct interpretation of legislation.

This should be communicated as a matter of urgency so as to avoid perpetuating any of the problems identified with following Interpretation A.

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 pensions 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).

The size of the member-directed market is approximately:

- **24,889 SSASs with assets of £13.1bn (**Pensions Management Dec 2008 "SSAS" survey)

- **441,399 SIPPs in the UK with assets of £49.8bn** (Pensions Management June 2009 "SIPP" survey)

Note: These surveys understate actual figures as not all providers or schemes participate.
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.