ASSOCIATION OF CONSULTING ACTUARIES

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10 November 2016

Pam Bryson
Pension Protection and Stewardship
Department for Work and Pensions
1st Floor, Caxton House,
Tothill Street
London SW1H 9NA

Dear Ms Bryson

The Draft Pension Protection Fund (Modification) (Amendment) Regulations 2017

I am writing on behalf of the Association of Consulting Actuaries in response to the consultation on the above regulations dated September 2016.

In general, we agree that the regulations as drafted reflect the Government's policy intention and current practice in relation to extending the Pension Protection Fund (PPF) compensation cap for longer-serving members of qualifying schemes. Nevertheless, we have identified a number of points which we feel require further consideration before the regulations are finalised.

Our comments on the specific questions you raised are set out in Appendix 1, along with some other comments not formally covered by the consultation. These include some important pension tax implications which should be assessed by HMRC and the PPF.

We hope that you find our comments of assistance and would be happy to discuss them further if that is helpful. Please contact either me on 020 7432 6635 (david.everett@lcp.uk.com) or my colleague Tyron Potts who prepared the non-pensions tax aspects of this response on 01527 300027 (tyron.potts@bwllp.co.uk) or Jillian Pegrum who prepared the pension tax aspects of this response on 01252 768175 (jillian.pegrum@aonhewitt.com).

Yours sincerely

David Everett
Chairman, Pension Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

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APPENDIX

The Draft Pension Protection Fund (Modification) (Amendment) Regulations 2017

General Comments

Data

We note that there are practical issues arising from a lack of service history data for some schemes which have transferred to the Pension Protection Fund (PPF). When the relevant parts of the Pensions Act 2014 have been brought into force, the Board of the PPF would appear able to take a pragmatic line for the purpose of determining whether, and by how much, length of service exceeds 20 years (Pensions Act 2014, Schedule 20, Paragraph 3(10)).

Whilst we appreciate the difficulties in legislating for the approach that the PPF should take, and the practical reasons for giving the PPF Board control over the approach to determining service length, we would appreciate that in actual situations, the PPF gives an opportunity to those who have been involved with the scheme's operation prior to it entering the PPF, to comment on this aspect of calculating members' compensation.

Pensions tax implications

The Tax Acts apply to the PPF in the same way as to a registered pension scheme, subject to specific amendments set out in The Pension Protection Fund (Tax) Regulations 2006 (SI 2006/575) – so PPF compensation falls within the regime of the Annual Allowance (AA) and Lifetime Allowance (LTA) etc. It is important that the one-off increase in compensation at 6 April 2017 for long-service members does not have an unfair tax impact for them – and ideally does not cause the PPF undue additional and complex administration.

We set out below aspirations for how government should ensure the tax law operates in this area. HMRC might be able to clarify in guidance that legislation already achieves some of these, or else there may need to be some changes to the PPF tax regulation noted above.

As a general point, to date a member with only PPF compensation and no benefits in other schemes would not have incurred LTA charges, but nevertheless, some individuals starting to draw PPF compensation will have had (and already started to draw) large benefits elsewhere – so we assume that the PPF has a full set-up to deal with checking whether LTA charges apply to compensation, and if it does, to pay that charge to HMRC on behalf of the member and correspondingly make a reduction to the compensation paid. We note that with the recent reductions in the LTA and the introduction of the service-related compensation cap at 6 April 2017 some individuals with only capped PPF compensation could find these trigger an LTA charge.

The following list of aspirations bears in mind that in many cases the individual concerned will already have had some AA and LTA used up by the scheme benefits to which the compensation relates, ahead of entering the PPF, and the compensation will never re-attain the level of the benefits that had been tested.

- For an individual, the jump in compensation at 6 April 2017 could be large, but there should be no using up of AA by (indeed no application of the AA legislation at all in relation to) the

compensation a member receives once the scheme goes into the PPF. We believe that ensuring this would involve a simple amendment to the above regulations.

- In relation to LTA charges and the ability to take a tax free lump sum:
    - As the law stands, those who will draw higher compensation from the PPF after 5 April 2017 due to the increased cap will use up more LTA (ie be assessed as a higher BCE2 than otherwise). Usually they will be able to choose to take more tax free retirement lump sum ("pension commencement lump sum") than otherwise, and in some cases may incur an LTA charge. This is reasonable and what an individual may expect.
    - Those who by 6 April 2017 have already started to draw retirement benefits for which the LTA test (BCE2/6) happened **before** their scheme entered the PPF should not have the proposed uplift cause more usage of LTA – given that the new uplift will in broad principle simply be acting to bring their benefits back closer to, but still below, the level originally tested against the LTA (it may be that the regulations can already be read this way, if the jump in benefits on 6 April 2017 counts as an increase rather than a new tranche of benefit).
    - It might be appropriate (and simplest for PPF administration) that those who have already started to draw PPF compensation for which the LTA test (BCE2/6) occurred **after** entering the PPF have the jump at 6 April 2017 count as a new tranche of pension for tax law purposes (a "BCE2"), with an accompanying opportunity to exchange some for pension commencement lump sum.
- In relation to LTA protections (the cases involved may be rare but the tax at stake may be material if the individuals involved have savings in other schemes):
    - We believe that PPF compensation (and revaluation thereto) to date has been such that an individual's Enhanced Protection or Fixed Protection has not been jeopardised by entry to PPF. Regulations should retain this situation when members receive the proposed jump to compensation (whether in payment or due in future) at 6 April 2017.
    - For Primary and Individual Protections relying on valuation of PPF compensation, the regulations should ensure that the value at the relevant measurement date (for determining an individual's personal LTA underpin) should take appropriate account of the increased cap.

The above aspirations should apply similarly in principle, following employer insolvency, to benefits from a scheme while the scheme is in PPF assessment and also following a scheme leaving assessment because its wind up will be outside the PPF.

We would be happy to discuss the detail of the above (together with the rationale for these proposals) separately with HMRC. Our Pensions Tax Committee will liaise with HMRC (as it would be HMRC's responsibility to legislate).

Responses to Specific Questions in the consultation

Question 1: Do the amendments achieve the result described?

We note that, despite the intention that they should be subject to separate applications of the compensation cap, legislation was originally drafted so as to require benefits from different sources of entitlement to be combined before the application of a single cap.

We agree that the draft regulations achieve the intended aim of retrospectively amending this so as to ensure compensation arising from different sources of entitlement are not added together. However, we offer the following observations:

- Regulation 2(2) as drafted, and in particular the wording to be substituted for regulation 22(3) – which in turn replaces paragraph (6B) of Schedule 7, para 26(6) of the Pensions Act 2004 – could benefit from some further punctuation / formatting to aid clarity. The insertion of a semicolon and line break after ("sum or sums L") would ensure the intention that the description of a "relevant connected occupational scheme" is applied to both subparagraph (i) and (ii).

- The new paragraphs (6BA) and (6BB) as to be inserted achieve the stated aims in relation to separate application of the compensation cap for benefits arising from (a) the member's pensionable service and (b) a transferred-in pension credit.

- The regulations as drafted do not specifically reflect the (albeit somewhat theoretical) possibility that an individual might receive two or more pension credits from the same "transferor". However, our reading of the draft regulations is that in such circumstances the compensation cap would apply in aggregate to these pension credits. We assume this is the PPF's intention.

Question 2: Do the amendments achieve the result described?

We agree that new paragraph (6GA) will ensure that pensionable service attached to a second and any subsequent tranche of entitlement is included appropriately for the purpose of calculating a member's long-service compensation cap.

However, we suggest for clarity however that a definition of "relevant compensation or lump sum" is inserted so that the "latest time" specifically excludes the date(s) on which the member becomes entitled to any transferred-in pension credit. This will ensure that where a pension credit is payable later, it is clear that no adjustment to the cap applying to that credit benefit, is required.

Question 3: Do you think the Government should allow for an increase in the amount the PPF can discharge as a lump sum? Do you think this amendment achieves the end described?

We welcome this change and see no reason for the lump sum discharge limit to be out of line with that for ongoing schemes. We recognise that such a change could make the process of discharging Defined Contribution benefits significantly more efficient for schemes in PPF assessment.

We agree that the amendment in Regulation 3, as drafted, appears to achieve the desired outcome in that:

- the lump sum discharge limit is appropriately increased; and
- other references to PPF money purchase lump sums elsewhere in legislation refer back to Regulation 1 of the Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006.

Comment on the draft Pensions Act 2014 (Pension Protection Fund: Increased compensation cap for long service) (Pension Sharing on Divorce) (Transitional Provision) Order 2017

Although we note you are not formally consulting on these draft regulations, we have the following minor comments and observations:

- A space should be inserted between "5" and "to" in subparagraph (3)(a) of article 2.
- For clarity, reference to "that Act" in subparagraph (3)(c) of article 2, should be updated to "the 2008 Act".
- At subparagraph (6)(b) of article 2, the "reference in paragraph 25A of Schedule 7 to the 2004 Act" is non-existent (there is no direct and specific reference to paragraph 25A at Paragraph 11). Instead the wording of subparagraph 6(b) of the draft regulations should be updated to "paragraph 25A of that Schedule".

Comment on the draft Pensions Act 2014 (Commencement No. 9) Order 2016

Although we note you are not formally consulting on these draft regulations, we observe only that references to 2016 in the draft order should be updated to 2017.

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