ASSOCIATION OF CONSULTING ACTUARIES

Association of Consulting Actuaries Limited · First Floor (129) · 40 Gracechurch Street · London · EC3V 0BT
Tel: +44 (0)20 3102 6761 × Email: acahelp@aca.org.uk × Web: www.aca.org.uk

To: Beverley Davies By email to pensions.policy@hmrc.gov.uk

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Dear Beverley

Finance Bill provisions

I am writing on behalf of the Association of Consulting Actuaries with comments on the provisions in the Finance Bill relating to Collective Money Purchase arrangements (previously known as CDC schemes), at https://www.gov.uk/government/publications/pension-schemes-collective-money-purchase-benefits .

Thank you for your extension to the deadline, and we hope you find our comments useful. We would be happy to discuss this matter further if you wish – if so, please contact me on 020 7432 6621 or at karen.goldschmidt@lcp.uk.com.

Yours sincerely

Karen Goldschmidt FIA

Chair ACA pensions tax committee
On behalf of the Association of Consulting Actuaries Limited

About the Association of Consulting Actuaries

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes. Members also advise thousands of smaller pension arrangements and individuals (many in self-employment) as well as advising life and general insurers.

Appendix General comments

- This is a very new type of arrangement working across current structures, akin to money purchase in the accumulation phase for AA purposes, then like DB at and after crystallisation in terms of benefit that can be provided and how Lifetime Allowance is used up.
  The AA approach seems appropriate given the way CDC accrued benefits can (effectively) rise and fall but we do note that the amount of AA usage (**PIA, pension input amount) created could arbitrarily reflect** how contributions are "constructed" for a scheme. Contributions could be paid as a flat percentage rate across members for a whole scheme, or say an age-related rate per member. As drafted it would appear the benefit outcomes for identical members could be the same under either contribution construction, but would have different AA consequences.
  We also highlight below areas where sticking with the money purchase provisions might give unfair outcomes (the **MPAA i**s one particular area) – but HMRC will need to consider the balance between fairness and simple legislative change.
- Not all details are available on how DWP envisage CDC schemes operate; so further comment may be necessary in the light of **final provisions in the Bill and regulations** made under its powers.
  One important example of this is that Paragraph 167 of the 2019 DWP consultation response [1] suggests that the DWP is considering **drawdown** as an option on wind up, but there is not yet clarity on the conditions and extent to which drawdown will be permitted (including whether available only for ex-CMP pensions already in payment, or for accrued pensions not yet crystallised if and when the member reaches NMPA) - this is to be set out in regulations still to be made under the relevant clause of the Bill . We have made comment but this could change depending on those regulations.
- Appropriate provisions on **reductions and increases** to scheme pension are particularly important given that CDC scheme pensions are likely to reduce and (proportionately) increase more from year to year than "normal" scheme pensions; and this should not cause tax penalty or excessive administration. The operation of the Bill provisions seem to ease this solely in the circumstances of the same reduction or increase applying to **all** scheme pensions in the scheme.
  We give a couple of reasons towards the end of this note (in the section on BCE3) why the easements need to be wider.
- There have been mentions of **"buffers"** eg **"** eg para 113 of the above response. This could be meant in two different ways. The first might be a capital buffer in order to dampen volatility: in drafting this response we assume there will be no such provision (or if there is, that it will be identifiable as a conventional CDC contribution per member providing benefit eg for AA purposes.)
  There may further be a buffer built up solely for the purposes of meeting expenses on wind-up. We assume that this will not count as contributions for AA purposes nor unauthorised member payments, neither at the point of payment nor when used.
- We believe that the likely structure for some schemes will be that benefits are provided from what is effectively a **"Sectionalised Scheme**" (in the DWP sense – although we understand that this counts as one scheme for pensions tax law purposes) with the CDC pension funded for on a pooled basis in one Section and retirement lump sum funded for and provided in another Section so effectively as a cash balance arrangement for tax purposes. It could be envisaged that Sections might be included in a scheme, with separated funding, to provide say legacy defined benefit arrangements. We have not at this stage checked that the provisions safely accommodated that position.
- Overall, we hope there will be **further opportunities to review the tax legislation, for an area where the benefit structure is very new, and DWP regulation with permitted structures are not yet available, and the expertise** and experience to tie this together with pensions tax law is very limited.

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/789051/response-delivering-collective-defined-contribution-pension-schemes.pdf

Detailed comments

We deal with items in the order of the Act provisions. For ease of comprehension we have copied across the relevant sections of FA04 with prospective amendments highlighted, followed by our comment.

1. Relating to winding up using drawdown

165 (1) and 167 (1)
COMMENT: If the intention is for drawdown to be available on wind up, then it would seem necessary to amend pension rule 3 and pension death benefit rule 2 to permit drawdown ("in lieu of" scheme pension or from uncrystallised benefits as the case may be).

(Or, for pensions in payment, is the mechanism envisaged that the scheme pension simply stops (so unauthorised with due penalty due applying to nil future scheme pension flow so nil) and the available assets source a fund for drawdown without being an arrangement, which does not seem to fit with usual FA04 structure; or if the mechanism is to be by transfer, then it needs an approach that does not lead to unauthorised benefits or other penalty situations.)

2. Allocation of unallocated employer contributions (connected members)

Edits to 172C – we have not reviewed these.

3. Unauthorised borrowing: money purchase arrangements

> **182** (7) If the arrangement is a money purchase arrangement other than a cash balance arrangement, the value of the uncrystallised rights under the arrangement is the aggregate of the amount of such of the sums, and the market value of such of the assets, held for the purposes of the arrangement as represent those rights.
> (8) If the arrangement is a hybrid arrangement under which benefits of one of any two or three of the varieties of benefits specified in subsection (9) (but not defined benefits) may be provided, the value of the uncrystallised rights under the arrangement is the greater or greatest of –
> (a) their value calculated under subsection (6) (on the assumption that benefits within subsection (9)(a) are provided), and
> (b) their value calculated under subsection (7) (on the assumption that benefits within subsection (9)(b) are provided) and
> (c) their value calculated under subsection (7) (on the assumption that benefits within subsection (9)(c) are provided).
> (9) The varieties of benefits mentioned in subsection (8) are —
> (a) cash balance benefits,
> (b) collective money purchase benefits, and
> (c) money purchase benefits not falling within paragraph (a) or (b).

We have had two different comments from members about 182(7):
"S182(7) covers arrangements where "the arrangement is a money purchase arrangement other than a cash balance arrangement," and therefore would include CMPB. It is not clear to me what "sums, and the market value of such of the assets, held for the purposes of the arrangement as represent those rights" would be in the case of uncrystallised CMPB rights. It would seem to me more consistent for uncrystallised CMPBs to be valued in a very similar way to uncrystallised drawdown rights (subsection 6) and CMPB rights in payment (subsection 4), i.e. 20 times the rate of CMPB scheme pension assuming the member was old enough to retire in good health without reduction. If not, we need some explanation of what the sums and assets are in respect of an arrangement when those sums and assets are held collectively – I have seen a similar confusion before where that phrase is used in a DB context."; and

"We agree that any limit on borrowing should be assessed against the sums, and the market value of such of the assets. However, that limit should be assessed against the total assets held under the scheme, not those in any given arrangement. The former is known. The latter could be calculated, but the scheme rules would not necessarily set this out."

4. Valuation of uncrystallised rights for purposes of section 210

> ***212*** *(1) Rights are uncrystallised if the member is not entitled to the present payment of benefits in respect of the rights.*
> *…*
> *(5) If this subsection applies [as it does for CMP], the value of the member's uncrystallised rights under the arrangement on the date is the aggregate of -*
> *(a) the amount of such of the sums held for the purposes of the arrangement on the date as represent those rights, and*
> *(b) the market value of such of the assets held for the purposes of the arrangement on the date as represent those rights.*

COMMENT: Section 212 and 210 drives various tax provisions for uncrystallised benefits including: the assessment of unauthorised charges ability to take trivial commutation and (potentially if future protections are created) valuations for the purpose of protections.
This subsection has not been amended, which means that for uncrystallised benefits by default because the CMP arrangement counts as Money Purchase, one looks to "the sums and assets held etc". For these purposes it might be more appropriate to use a DB-type approach.

If maintaining a "sums and assets" approach, we note that this would require an individual valuation. It would be possible to calculate this, but the scheme rules would not necessarily set this out - we assume HMRC would expect in the context of a pooled fund that this would derive from the actuary's basis driving global benefit allocation and adjustment.

5. The alternative chargeable amount – where a member has triggered the MPAA

> ***227B*** *(1 [not reproduced here]):*

COMMENT: An observation - defining AA in ss2 as one thing and then as something else is ss5 may lead to confusion and error …(We suggest "input amount D", or possibly "input amount AZ" if the order is important ("AC" is already used elsewhere in the Act).)

As noted above, the interaction with the Money Purchase Annual Allowance is an area where the legislation could move away from treating CMP arrangements as if Money Purchase - This is a matter of balance of fairness and complexity:

- One issue is, where the Money Purchase Annual Allowance applies for a member, the extent to which contributions to a CMP arrangement should be included within the money-purchase sub-total, and therefore use up the member's Money Purchase Annual Allowance of £4,000. (This may be taken as particularly unfair given that the MPAA is a measure to prevent using flexibility to churn relief, and that flexibility is not usually available from a CMP arrangement; and the potentially notional way the CMP contributions are set – see general introduction.)
- Another issue relates to whether in the context of this wind up situation designation to drawdown should be exempted as a trigger of the Money Purchase Annual Allowance. (Some pensioners from past CMP crystallisation may be active members of other money purchase arrangements.)

6. Authorised payments – provisions allowing reduction to scheme pension

> ***Schedule 28 Scheme pension***
> *2 (unchanged provisions)*
> *(2) A pension payable to the member is a scheme pension for the purposes of this Part if*
> *— ..*

(b) it satisfies the condition in sub-paragraph (3).
(3) The condition is that (subject to sub-paragraph (4))—
(a) the pension is payable (at least annually) until the member's death or until the later of the member's death and the end of a term certain not exceeding ten years, and
(b) the rate of pension payable at any time during any relevant 12 month period is not less than the rate payable at the relevant time.

(3A) "The relevant time" is—
(a) in the case of the first relevant 12 month period, the day on which the member becomes entitled to the pension, and
(b) in the case of any other relevant 12 month period, immediately before the beginning of that period.
….
(4) None of the following prevent the pension satisfying the condition in sub-paragraph (3)—
…
(b) a reduction in the rate of the pension which applies to all the scheme pensions being paid to or in respect of members of the pension scheme, .
(h) the reduction of the pension in any other circumstances prescribed by regulations made by the Board of Inland Revenue.
..
(4A) In sub-paragraph (4) references to the reduction of a pension include its ceasing to be payable (whether temporarily or permanently).

(8) Regulations under sub-paragraph (4)(e) or (h) may include provision having effect in relation to times before they are made.

COMMENT: We would have expected an amendment to Sch 28 paragraph 2(4), given that the ability to reduce pensions in payment is fundamental to CMP schemes. If 2(4) (b) is intended to provide the exemption to aid this, we note this only applies if the same reduction applies to all scheme pensions in the scheme, please see our comments below on BCE3 to see some reasons why a scheme might provide differential increases/reductions (and also our general point about other Sections of a scheme having scheme pension derived from DB arrangements.

***2A** (1) Where this paragraph applies in relation to a pension payable to the member, the pension scheme is to be treated as making an unauthorised payment to the member of the appropriate amount. {READER NOTE – the appropriate amount relates to original tax free lump sum taken alongside the scheme pension]]*

(2) This paragraph applies to a pension if it fails to satisfy the condition in sub-paragraph (3) of paragraph 2 -
(a) by reason of not complying with paragraph (a) of that sub-paragraph, or
(b) by reason of not complying with paragraph (b) of that sub-paragraph because a substantial reduction occurs in the rate of the pension,
or if it is a pension which is reduced in accordance with paragraph (a) of sub-paragraph (4) of paragraph 2, or the rate of which is reduced in accordance with paragraph (b) of that sub-paragraph, and the reduction is part of avoidance arrangements. [*]

(3) For the purposes of sub-paragraph (2)(b) a substantial reduction occurs in the rate of a pension if the rate at which the pension is payable at any time during any relevant 12 month period (within the meaning of paragraph 2(7)) is less than 80% of the rate payable when the member became entitled to the pension.

(3A) But for the purposes of sub-paragraph (2)(b), no substantial reduction occurs in the rate of a pension if—
(a) the pension is payable in respect of a collective money purchase arrangement, and
(b) the reduction is in accordance with the rules of the scheme.

COMMENT If 2(4)(b) is to be the route by which CMP scheme pensions can be reduced, then we note that the new 3(A) seems to cut out the anti-avoidance measure introduced in the phrase at the end of 2A(2) at [*]. Whether this needs to be brought back in depends on the contents of the Pensions Bill and regulation and the amount of scrutiny of scheme rules (if any) from this perspective.

7. PCLS provisions

Schedule 29 Part 1 - Lump sum rule

Pension commencement lump sum

1 *(1) For the purposes of this Part a lump sum is a pension commencement lump sum if -*

(aa) the member becomes entitled to it in connection with becoming entitled to a relevant pension (or dies after becoming entitled to it but before becoming entitled to the relevant pension in connection with which it was anticipated that the member would become entitled to it),

(b) it is paid when all or part of the member's lifetime allowance is available (but see sub-paragraph (3A)),

(c) it is paid within the period beginning six months before, and ending one year after, the day on which the member becomes entitled to it,

(d) it is paid when the member has reached normal minimum pension age (or the ill-health condition is satisfied), and

(f) it is not an excluded lump sum (see subparagraphs (4) and (4A)).

(4A) A lump sum is an excluded lump sum if— (a) the pension in connection with which the member becomes entitled to it is income withdrawal, and (b) the sums or assets designated as available for the payment of the pension were sums or assets out of which benefits were provided under a collective money purchase arrangement.

COMMENTS: We note that scope to draw PCLS will be calculated using a "DB" type approach.

We assume 4A applies only for a wind-up situation: See general comment about whether drawdown will be permitted. In addition, (a comment made by one of our members): it is not obvious that "benefits were provided under a collective money purchase arrangement" relates solely to benefits that had been put in payment. We think this would be clearer if it said something along the lines of "the sums or assets designated as available for the payment of the pension were sums or assets which relate to benefits which had been crystallised under a collective money purchase arrangement to the extent that they would have related to pension payments after the date of designation".
There might also be an issue where a member has a single (in HMRC terms) collective money purchase arrangement and chooses to only crystallise part of it.

8. Wind up and drawdown

Schedule 32 [broadly: wind up, pensioner benefit turns to drawdown]

Benefit crystallisation events 1, 2 and 4: prevention of overlap

…

2B (1) This paragraph applies for the purposes of benefit crystallisation event 1 where—

(a) the designation was in connection with the winding-up of the scheme, and

(b) the sums or assets designated were sums or assets out of which benefits were provided under a collective money purchase arrangement.

(2) The amount crystallised by the event is to be reduced by the amount (or an appropriate proportion of the amount) previously crystallised on the individual becoming entitled to a scheme pension under the collective money purchase arrangement.

COMMENT: See general comment about whether drawdown will be permitted.

As drafted (and in current market valuation conditions), this provision for a pensioner that has his scheme pension replaced with drawdown seems likely to lead to the member incurring LTA usage solely because of the different tax law approach to the calculation for scheme pension and drawdown– we can give examples. While this is consistent with the position had the member chosen to draw a transfer value before retirement and go to drawdown, it might not be considered appropriate in a situation arising outside the member's control. (This is a matter of balancing fairness and simple legislative change.)

The intention of the phrase "(or an appropriate proportion of the amount)" within paragraph 2B(2) is not clear, and how it is to be calculated needs to be defined.

9. Lifetime Allowance BCE on reaching age 75 without crystallising

COMMENT: We have not reviewed the changes proposed in 14ZA relating to hybrid arrangements but believe edits may be needed in line with our comments on 14A (1) below

It would seem more appropriate to use a scheme pension-type approach consistent with the approach used at retirement (BCE2).

14A (1) *For the purposes of benefit crystallisation event 5B "remaining unused funds" means -*
(a) in relation to a cash balance arrangement, a sum equal to what would, on the valuation assumption in section 277(a), be available for the provision of benefits to or in respect of the member if the member became entitled to them on reaching the age of 75, and
(aa) in relation to a collective money purchase arrangement, means such of the sums and assets held for the purposes of the arrangement as have not been applied towards the provision of a scheme pension or a dependants' scheme pension, and
(b) in relation to any other arrangement, such of the sums and assets held for the purposes of the arrangement as are not member-designated funds and have not been applied towards the provision of a scheme pension or a dependants' scheme pension.

(2) For the purposes of sub-paragraph (1)(aa), where any sums or assets have been applied as mentioned in that provision, any interest, dividends or other returns arising from them are to be treated as also having been so applied, whether or not they have yet been allocated to a member of the scheme.

(To be read in conjunction with the BCE definition

5. The individual reaching the age of 75 when prospectively entitled to a scheme pension or a lump sum (or both) under a defined benefits arrangement under any of the relevant pension schemes	*(RVF × DP) + DSLS*
5A. The individual reaching the age of 75 having designated sums or assets held for the purposes of a money purchase arrangement under any of the relevant pension schemes as available for the payment of drawdown pension to the individual	*The aggregate of the amount of the sums and the market value of the assets representing the individual's drawdown pension fund under the arrangement (if any), plus the aggregate of the amount of the sums and the market value of the assets representing the individual's flexi-access drawdown fund under the arrangement (if any), less the aggregate of amounts crystallised by benefit crystallisation event 1 in relation to the arrangement and the individual*

COMMENT Under a CDC scheme, it is the pension that is defined not the pot. It would be more appropriate to define the BCE5, for benefits still not drawn at 75, using a scheme pension DB-type approach consistent with the approach used at retirement (BCE2).

10. Increases to pensions causing a BCE3

Benefit crystallisation event 3: excepted *circumstances*
10
(A1) For the purposes of benefit crystallisation event 3 "excepted circumstances" exist if condition A or B is met.
(1) Condition A is that—
(za) the entitlement to payment of a scheme pension at an increased annual rate is under an arrangement that is not a collective money purchase arrangement,
(a) ~~that~~ at the time when the annual rate of the individual's pension is increased there are at least 50 pensioner members of the pension scheme, and
(b) ~~that~~ the individual is one of a class of at least 20 pensioner members of the pension scheme, and all the scheme pensions being paid under the pension scheme to pensioner members of that class are at that time increased at the same rate.

(2) A class may consist of all the pensioner members of the pension scheme.

(3) Sub-paragraph (4) applies where -

(a) the annual rate of the individual's pension is increased in excepted circumstances ("the excepted increase"),
(b) before the end of the period of 12 months beginning with the date of the excepted increase, the annual rate of *the individual's pension is increased in circumstances which would (apart from that sub-paragraph) be excepted circumstances ("the subsequent increase"), and*
(c) the class by virtue of which sub-paragraph (1)(b) is satisfied on the subsequent increase ("the new class") is not the class by virtue of which it was satisfied on the excepted increase.

(4) If the purpose, or one of the main purposes, of the individual's being included in the new class is to increase the annual rate of the individual's pension without benefit crystallisation event 3 occurring, the subsequent increase is not in excepted circumstances.

(5) Condition B is that— (a) the entitlement to payment of a scheme pension at an increased annual rate is under an arrangement that is a collective money purchase arrangement, and (b) at the time when the annual rate of the individual's pension is increased, all the scheme pensions being paid under collective money purchase arrangements are increased at the same rate.

COMMENT: BCE3 is a particularly important aspect for CMP scheme pensions and care should be taken that it is not triggered unwittingly or unfairly. The annual threshold test and permitted increase test are inappropriate, . Exemptions are important.
Under the drafting, the exemption where increases for 20 persons (within a 50 pensioner member scheme) are increased at the same rate does not apply to CMP. Instead, a CMP exemption applies only where every scheme pension under the scheme as a whole is increased at the same rate, at the same date.

In general some of our committee commented that this is appropriate in principle.
However, the drafting may need revision to allow for Sections (as noted in our general para).

A particular issue could be CMP within master trust. In order to continually provide new accrual benefits at a desirable expected increase level, a master trust could wish to tranche benefits so that each benefit tranche receives a different increase each year. This could still be done in such a way that pools risk in a fair way, by fixing the differential between the increases in each tranche. Condition B precludes such an approach. Alternatively, a master trust (or even an occupational pension scheme with an existing DB section,) might want to have two or more sub-schemes (Sections) within it, each of which were wholly self-contained, without cross risk-sharing between the two pools, and therefore the increases awarded in each sub-scheme would differ.
(Other approaches are possible)