

Talking points – DWP consultation

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With the 29 February 2008 deadline for responses to the DWP consultation on self-investment of protected rights now passed, it is widely expected that the findings will be implemented in October 2008.

However, we believe there is a danger that some important issues around investor protection and higher risk investments may have been overlooked by the DWP. These aspects and some of the other finer details of what can be expected are considered below along with the possible implications for both providers and advisers.

What follows reflects the content of our submission to the DWP on their draft proposals. A response to all submissions received by the DWP can be expected by the end of May 2008 - allowing time for amending regulations to be introduced by October 2008 if that remains the intention.

Background

The background to the reasons for the changes is given in the [consultation paper](#). Historically SIPPs have generally been prohibited from holding protected rights – which are derived mainly from the contracted-out rebate – on the grounds that protected rights should not be subject to the risk that can arise from self-investment especially as, until recently, according to the DWP “the administration of SIPPs has been subject to low levels of regulation”.

As the consultation paper admits, this is not a new issue. It was considered as part of a consultation exercise in 2005 and at that time “the Government considered the lack of a higher standard of prudential regulation as the major reason for not permitting SIPPs to hold protected rights”. In April last year, a new regulatory regime for personal pensions including SIPPs was introduced and “in the light of this new regime the current rules on SIPPs are considered unduly restrictive”.

Protected rights today

Currently only a limited number of organisations are able to establish an “appropriate scheme” to hold protected rights within a personal pension. This market has been dominated by life insurers since inception, and in turn has restricted access to mostly their own funds.

The inertia factor with these funds appears to be substantial, and until recently, benefits in respect of protected rights could not be taken until State Pension Age – both factors

leading to a longer than average source of income for the provider. Because many protected rights funds are quite small in size – typically under £50,000 and often less than £20,000 – once invested they can tend to disappear off the investor’s – and their adviser’s – radar leading to infrequent reviews.

It is however currently possible to allow the self-investment of protected rights using a personal pension where the protected rights element is set up as a contract of insurance.

Market size

Accurate statistics on the size of this market are hard to come by. The total market has been estimated at around £100 billion. In a survey in Pensions Management in July 1994 the total number of NI rebate payments invested in personal pensions in the calendar year 1993 across 40 providers was in excess of £1.25bn.

Allowing for investment growth on these funds – and on similar contributions each year since 1988 – and also take into account the protected rights that have accrued in contracted out occupational schemes – the £100 billion figure does not seem far fetched.

Implications for SIPP providers

Insurance based specialist SIPP operators are likely to have a much greater financial resources requirement partly as a result of the ICA provisions as compared with trust based SIPP operators. For the latter the capital requirement will usually be 13 weeks expenditure although it is possible to reduce this to 6 weeks expenditure on agreement with the FSA that the operator is not holding client money.

However not only will the solvency levels be different but importantly insurance based SIPPs will usually offer a higher level of investor protection. The compensation arrangements for life insurance investment contracts under the Financial Services Compensation Scheme will usually provide protection of at least 90% of the fund value with no upper limit whereas for trust based schemes any compensation will be limited to a maximum of £48,000. This point is often overlooked by advisers.

Our view

Given these continuing complications and the uneven playing field on investor protection, perhaps the DWP should think again – and come back with proposals that are consistent across all areas and all personal pension schemes including SIPP and proposals that are truly simplified.

If the DWP accepts this argument – and it is hard to see why they should not – then this may lead to some dampening down of enthusiasm amongst non-life insurance based SIPP operators around this market opportunity – and may even lead to a delay in the implementation of the amending legislation.

It seems entirely reasonable for there to be consistent treatment in respect of the compensation requirements for

protected rights funds. That would suggest that any SIPP operator prepared to accept such funds should have a capital requirement in respect of those funds at the same level as that expected of life insurers and pay comparable fees to the FSA.

The current DWP proposals also leave a number of other requirements around protected rights unaltered. In particular, protected rights will continue to have to be recorded separately for reporting purposes – complicating the work of investment managers and SIPP operators – and phasing of the purchase of annuities with protected rights monies will continue not to be permitted. Finally, the requirement to provide a 50% spouse's pension on death using unisex annuity rates will remain.