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**SMALL SELF-ADMINISTERED SCHEMES**

**by**

**Francis W. Ghiloni BSc, FFA**

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## INTRODUCTION

This paper is about Small Self-Administered Schemes (SSASs) which are a specialised version of occupational pension schemes.

It is an area in which I have been involved, on and off, for a number of years now and one which I have always found interesting and, at times, highly entertaining.

Although SSASs have been more widely discussed in the past year or so than before, they are still seen as a fairly specialised area. The paper is, however, not directed at SSAS experts but more towards the novice - some knowledge of pensions is assumed, however. Furthermore I have deliberately taken a pro-SSAS view in the hope that this may generate more discussion.

I originally presented a paper on SSASs to the Glasgow Actuarial Students' Society in February 1990. The preparation of the paper had covered a period which was 'fairly momentous' for the SSAS industry and this resulted in a number of re-writes. When I was asked to present an updated version to the Staple Inn Society I was confident that I would at least not re-experience the problems of having large chunks of the text rendered inappropriate by 'government intervention'.

How wrong can one be? As you will gather from the content of the paper, there has again been an announcement made (26th July 1990) which will materially affect the SSAS industry.

I have attempted to make the content of the paper as up-to-date as possible but with the timescales involved the paper will land on your desk nine weeks or so out of date - this is a long time in the life of the SSAS industry if the last twelve months are anything to go by! However, I hope that this will not detract from the usefulness of the paper.

Although the opinions (and any errors) contained in the paper are my own, I must thank a number of people who have helped in its production:-

Jean Colraine for her powers of deduction when coping with my handwriting, and Alan MacKenzie for his help in the print/production of the paper. Stewart Ritchie for his comments and explanations both personally and on behalf of the Association of Pensioner Trustees (APT).

Finally, my colleagues, Tommy Adams and, in particular, Gavin Stewart for their comments/additions/amendments to the text and their support in times when I thought the paper 'a dead duck' and when they thought the text had been finalised!

## 1. THE BACKGROUND

1.1 A Small Self-Administered Scheme (SSAS) is an occupational pension scheme approved under Section 591 of ICTA88. It is designated 'small' if it has eleven or fewer members. The members are normally controlling directors and senior executives of a company (typically, the company is a family run business). They are also, more often than not, Trustees of the SSAS and therefore have substantial control over the scheme funds. It is this control that concerns the Superannuation Funds Office (SFO). As a result of the Financial Services Act, in most SSASs all members should be Trustees - if not, those who are should be authorised as they can take investment decisions affecting other member's pension benefits. In practice, this requirement often appears to be ignored. Some schemes with more than eleven members can also be referred to as 'small' if a number of the members are not considered to be entitled to substantial benefits when compared to the other members. Such schemes would be subject to the same restrictions and controls as a 'normal' SSAS.

Invariably, a SSAS is a money-purchase arrangement.

1.2 The term 'self administered' is something of a misnomer, the administration normally being carried out by a specialised consultant/consulting actuary or, in the case of 'hybrid' schemes, by a life office.

1.3 Controlling directors have only been allowed to be members of occupational schemes since 1973. In 1979 following what the Superannuation Funds Office described as 'about three years experience with applications for tax approval of Small Self Administered Schemes', the SFO issued Memorandum 58. This set down the guidelines by which SSASs were to be governed.

Since then the SFO have further defined their requirements in a number of areas and part of the regulations governing SSASs is established through case histories. It is also constantly evolving (i.e. being changed).

1.4 In late 1987 the SFO issued a Consultative Document which outlined a number of possible changes to the rules governing SSASs. By 1st July 1990 the final rules had still not been published. In late 1989, when the rules governing Self Administered Personal Pensions (also known as Self Invested Personal Pensions) were published, it was believed that the SSAS rules were 'just around the corner'. Then out of the blue, the feet were taken from under the SSAS industry. The DSS announced that the government was accepting the OPB recommendations contained in the report 'Protecting Pensions' (published in February 1989) and was applying them to SSASs as well as other occupational pension schemes, despite the OPB suggestion that there should be some exemptions for SSASs.

These recommendations included a restriction on self-investment to 5% of the scheme assets.

1.5 The subsequent relaxation of the application of the DSS proposals to some SSASs again opened up the question as to what, if anything, would come out of the 1987 Consultative Document.

1.6 In July 1990 the Savings and Investment Division of the Inland Revenue published draft regulations on Small Self-Administered Schemes which, to an extent, take account of the 1987 Consultative Document. However, the Revenue and the DSS appear to be working independently of one another.

1.7 The 1987 Consultative Document, the DSS proposals and the APT response and the latest draft regulations are covered in *Chapters 6 and 7*.

1.8 One way in which the SFO monitor SSASs is by requiring the appointment for each scheme of a special Trustee, the Pensioner Trustee. A Pensioner Trustee is 'an individual or body widely involved with occupational pension schemes, and having dealings with the SFO, who is prepared to give an undertaking to the SFO that he will not consent to any termination of a scheme of which he is trustee, otherwise than in accordance with the approved terms of the winding-up rule'. The appointment of a Pensioner Trustee to a particular scheme must be approved by the SFO.

1.9 The 1987 Consultative Document proposed that the role of Pensioner Trustee might be extended to monitor SSAS investment more closely. However, the Revenue have decided not to proceed with this, as outlined in *Chapter 7*.

1.10 Finally, it is worth discussing why a SSAS is chosen in preference to certain other forms of pension provision.

1.11 A SSAS is normally established for a small family run business because of one or more of three main opportunities of self-investment it provides:-

1. *Through the SSAS making a loan to the sponsoring company out of the scheme funds.*
2. *Through the SSAS purchasing commercial property and leasing it for occupation by the sponsoring company.*
3. *Through the SSAS purchasing shares in the sponsoring company.*

1.12 Although not uniquely available to SSASs, these opportunities for self-investment are particularly attractive to directors of 'small' companies. However, the actual investment in these areas is not necessarily as great as one might expect (*see Chapter 4*).

1.13 The benefits that such investments by the pension scheme can give to the sponsoring company are normally the main reasons that a SSAS is chosen once the need for pension provision has been established. They are also the reasons why the SFO monitor SSASs particularly closely. These three forms of 'self-investment' are discussed in the following Chapter.

## **2. INVESTMENT IN THE COMPANY'S BUSINESS**

### **Loans to the Company**

**2.1** A reason frequently given in the past by owners of a family run business for not establishing a pension scheme was that they did not want to 'tie up' funds which may subsequently be required for the business. This argument can be partially dismissed by pointing to the availability of a policy loanback under an Executive Pension Plan with a life office.

**2.2** Here, the life office lends to the sponsoring employer up to 50% of the value of the funds in an Executive Pension Plan. The loan is made out of the insurance company's own funds. The 50% limit is imposed by the SFO and the loan is normally only available on policies in respect of 'controlling' or 20% directors. The director must authorise the loan because it is his pension provision that is acting as security. If the employer defaults on the loan the policy proceeds are appropriately reduced.

**2.3** This is the only circumstance I know of where the proceeds of a pension policy can actually be 'assigned' (although this phrase is not used).

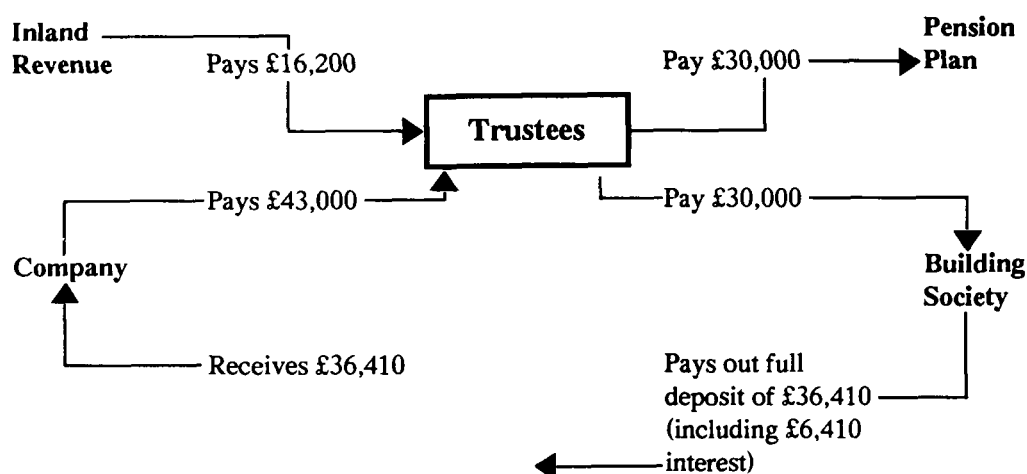
**2.4** The policy loanback still requires 50% of the funds to be invested in a policy with a life office and may require the amount of the loan to be invested in a deposit based fund. There has recently been a statement from the SFO that a life office cannot offer a loanback if a consequence of this is that the investment return will be affected, which implies that the life office requirement to have an amount equal to the loanback invested in a deposit based fund would be disallowed. This currently only applies to personal pensions but it could be extended to director arrangements.

**2.5** The SSAS loanback can go further than this. Currently up to 50% of the scheme assets can be lent back to the employer. The other 50% can be invested in whatever areas the Trustees consider suitable, (subject to certain SFO restrictions). Thus, there need be no requirement to invest in a pension policy with a life office. However, the benefits provided by 'hybrid' SSASs (see later) can make the small contribution required to a life office worthwhile.

**2.6** A case study can show how the loanback facility can be of great benefit:-

Carlotti Bros., a small ice-cream manufacturer, is run by two brothers, Paulo and Alfredo. They are doing well having managed to 'put out' a considerable number of contracts in the past few years. They have now started thinking about putting someone (sorry, something) away to save for retirement. At the same time, they are also considering expanding into mobile sales (yes, this means "purchasing an ice-cream van"!)). Here's how the SSAS helps them to do both rather than just one or the other.

DIAGRAM 1



Carlotti Bros. pays £20,000 per annum to the SSAS, half to an Executive Pension Plan with a (well known, recently launched, Glasgow based!) life office, half on deposit with a Building Society. The contributions accumulate free of tax at an average 10% per annum (yes interest rates have finally come down) so that at the end of three years the fund is worth £72,820 and half is available to be lent back to the company. After tax relief at 27% (Mrs. Thatcher is no longer in power!) on contributions, the brothers have actually only paid £43,800 net. In return, they have £36,410 available to cover the cost of equipment for their expansion plans - and can look forward to a generous pension. Their net outlay over the three year period is only £7,390.

2.7 Obviously, in this example Carlotti Bros. will have to service the loan of £36,410 made by the SSAS and will in time have to repay it. However, this will not be lining someone else's pockets but will be building up their pension provision and the terms can be agreed to suit the brothers' commitments.

## Property Purchase

2.8 Acquiring the company's own premises is one of the most useful prospects opened up by a SSAS. Rent is a drain on resources. Ownership, on the other hand, by increasing the company's asset value, may present Capital Gains Tax problems later on. Equally, if the property is owned by the directors personally there may be Inheritance Tax problems, when the property is 'passed on' to the family.

2.9 There are problems with the SSAS owning the company's premises. The assets of the SSAS must be available to be used to provide benefits as they arise. Thus, for example, if there is only one member in a Scheme the property would have to be sold before the member retires, or certainly within five years of that date. If there is more than one member there is less of a problem as the property can be 'handed-down' to the younger members.



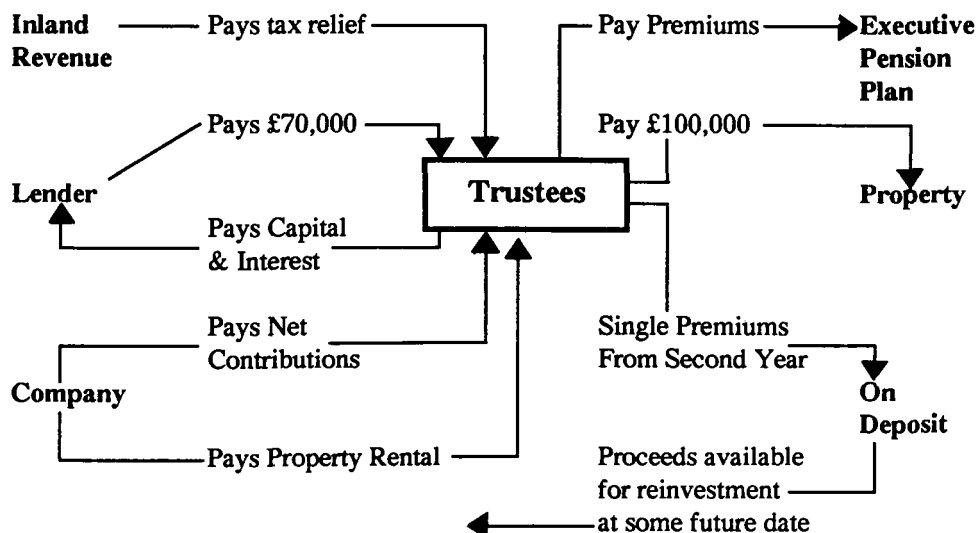
**2.10** The main problem that could arise is where the property is of a specialised nature and may not be readily marketable when necessary. However, such considerations should be taken into account before the decision is made that the SSAS will purchase the property - the SFO will take account of such matters when considering approval, even if the company and the trustees don't!

**2.11** Overall the ideal solution appears to be to transfer the premises to the tax-free environment of the SSAS and lease them back. In this way, the company enjoys the benefits of ownership whilst leaving the net asset value lower. At the same time, instead of swelling some outside landlord's profits, rent serves to increase the growth of the director's tax-free fund. The property can be 'gradually passed on' to the younger members within the confines of the SSAS by being used as assets for the younger members benefits - this may actually be a transfer from father to son (or mother to daughter!).

**2.12** If the company or one of the directors already owns the premises, title can be transferred to the SSAS. Alternatively the SSAS can buy property on the open-market if suitable accommodation is available. To spread the cost of purchase, the SSAS has the facility to borrow funds from a bank or other lender. This borrowing is normally restricted to three times the regular annual contribution, perhaps to ensure that the scheme can service it but more likely as an arbitrary SFO limit.

**2.13** An alternative is to finance the property by a large one-off contribution (if there is sufficient past service) or through a transfer value from another scheme. The value of the property should not normally represent more than 50% of the scheme assets, although it can do so for a period of years after the property is purchased on the understanding that it will reduce to 50% through time. Let's look at how such a deal can work:-

DIAGRAM 2



Pringle Smoked Foods, headed by three young and dynamic entrepreneurs (no, they are not actuaries), is a small company which has traded successfully for several years from rented premises several miles from town. It now needs room to expand and build new smoke rooms. It would also like its own more prestigious, premises nearer town so that people could buy direct. An ideal location has been found, and the company could probably afford to service the loan needed to meet the £100,000 price tag. On the other hand, such a commitment would rule out pension arrangements which the directors are also considering. Here is how the SSAS provides a solution.

The Company sets up the Small Self-Administered Scheme for the three directors as a vehicle to purchase the new premises. To finance the arrangements, the company pays a regular contribution of £25,000 and an equal additional single contribution at the outset, i.e. a total of £50,000 is paid in the first year. Out of the regular contribution, the company agrees to pay £10,000 per annum to an ABC Life Executive Pension Plan. The balance of the contributions is available for property purchase; in particular £40,000 is available initially and £30,000 of this is paid as a deposit with £70,000 being borrowed from one of the major banks. The remaining £10,000 of the contributions along with the annual rental for the property, which is payable by the company to the SSAS, is applied towards repaying the interest and capital on the ten year loan.

From the second year of the SSAS, part of the £25,000 regular contribution is available for investment in other areas.

2.14 With this tax-efficient arrangement, the directors have been successful in achieving three important objectives at the one time:

- \* *Purchasing the new premises.*
- \* *Taking advantage of the taxation concessions.*
- \* *Benefiting from a substantial personal investment for retirement.*

## Share Purchase

2.15 The third area of self-investment that can be achieved through a SSAS is purchase of shares of the sponsoring employer. This can be particularly advantageous as shown below:-

At a Board Meeting of a small, but successful, private company, one of the directors advises that he has to sell his 20% holding in the company.

To avoid this 20% shareholding from being sold on the open market (and therefore losing partial control of the company) the directors decide that it would be preferable if they bought the shareholding. Unfortunately, the directors do not have sufficient funds immediately available.

Some years earlier, the company had taken out a Small Self Administered Scheme to provide retirement benefits for the directors.

When the pension scheme commenced, the trustees of the scheme, who were also the directors of the company, invested their contributions in with profits policies, a managed fund and a Building Society account. As the trustees are able to easily realise the managed fund and Building Society account, they are able to provide sufficient capital to purchase the shareholding.

Another advantage of this transaction is that because the pension scheme is a tax-exempt, approved pension scheme, any gains made by the Scheme when selling the shares will be free of Capital Gains Tax thus enhancing the directors eventual retirement benefits. The Trustees, who are also the directors, control the shares purchased.

**2.16** The purchase of shares in the sponsoring company is vetted particularly closely by the Inland Revenue to ensure that there is no question of tax avoidance at the time of sale.

**2.17** Such share purchase has to be cleared in advance by the company's accountant with the Inland Revenue under Section 707 of the Income and Corporation Taxes Act 1988. This should be done before the SFO is approached to approve the purchase as a scheme investment.

**2.18** Shares in the sponsoring employer (or associated employers) cannot, when aggregated with loanbacks, amount to more than 50% of the scheme assets (at present!).

### **3. PROVIDERS OF SMALL SELF-ADMINISTERED SCHEMES**

**3.1** A SSAS offers an alternative to the fully insured Executive Pension Plan (EPP) by giving directors (of small companies in particular) the opportunity to make their own investment decisions.

The introduction of SSASs led to a partial move away from EPPs and 'hybrid' SSASs were then introduced by life offices to counter this.

There are, therefore, two varieties of the SSAS - the 'fully self-administered' SSAS and the 'hybrid' SSAS.

**3.2** For the fully self-administered variety, it is normal practice for a firm of consulting actuaries or specialised brokers to be appointed to act as financial advisers and also to carry out the role of Pensioner Trustee. The consulting actuary will charge a fee for his service and this will include the cost of providing the Pensioner Trustee service.

**3.3** The 'hybrid' variety is provided by insurance companies. Initially, they required at least 50% of the contributions to the SSAS to be applied to a pension policy with them. In return for this, the insurance company carried out Pensioner Trustee duties (normally through a subsidiary company) and charged a substantially lower fee than the consulting actuary.

**3.4** The requirement to invest in an insurance company policy has been substantially relaxed, and now many 'hybrid' SSASs only require an EPP premium of between £3,000 - £5,000 per annum. Their fees, however, have not substantially increased. (Perhaps this reflects pressure to reduce the EPP investment and the belief on the part of insurance companies that 'a little' is better than nothing).

**3.5** So, let us take a look at the services provided and the charges made under these two alternatives.

**3.6** In October 1988, Pensions Management magazine carried a survey on the self-administered variety of SSASs. This showed that there is a wide variation in the level of charges levied.

**3.7** Initial charges range from £1,000 plus VAT up to £3,000 plus £150 per member plus VAT. Recurring charges range from £140 to around £2,000 and these are levied annually.

3.8 The services included normally cover:

- *initial feasibility study*
- *pensioner trusteeship*
- *initial actuarial services (including actuarial report)*
- *documentation and Revenue negotiations*
- *record keeping.*

3.9 Other services which can be provided at additional cost include:

- *recurring actuarial services*
- *accountancy services*
- *legal services*
- *investment management.*

3.10 There is a requirement to submit an actuarial report to the SFO at least every three years and the cost of this is normally charged on a 'time spent' basis at rates of up to £100 per hour. Thus, the recurring charge is really in the range £260 to £2,170 or more.

3.11 The survey showed that the majority of companies involved in this area had more than 100 schemes on their books.

3.12 The survey also covered 'hybrid' schemes. The initial fees here range from Nil(!) to £1,500. However, in the latter case there was a reduction of £100 for each member who had an 'insured' element within the scheme.

3.13 The recurring charges range from Nil (which requires a substantial insured premium - £10,000 per annum) to £1,250. This latter company's recurring fee actually ranges from Nil to £1,250 and so the upper limit is slightly misleading.

3.14 The services provided in respect of these fees are similar to those provided for the 'self-administered' variety. When you consider that the minimum insured investment required ranges from Nil to £10,000 per annum the fees charged on 'hybrids' look very competitive.

3.15 This is more the case when you consider that the hourly rate charged for triennial actuarial reports is of the order of £50 - £60 rather than the £75 - £100 charged by consulting actuaries.

## 4. SMALL SELF-ADMINISTERED SCHEME INVESTMENTS

4.1 In late 1988 the Association of Pensioner Trustees carried out an analysis of the assets held under the schemes administered by its members. The results of this analysis are reproduced in the Appendix, with the kind permission of the APT.

4.2 It can be seen that investments are held in five main areas:-

- *life office managed funds (14.4%)*
- *insurance policies (i.e. EPPs) (16.1%)*
- *loans to the employer or associated companies (12.2%)*
- *commercial property associated with employer (14.2%)*
- *cash deposits (19.2%).*

4.3 The Pensions Management survey, referred to in *Chapter 3*, included details of the investments of fully self-administered schemes. This showed a not too dissimilar breakdown with 17.5% in managed funds, 13.2% in loanbacks, 25.6% in property (including that not associated with the employer) and 20.9% in cash.

4.4 Both these results bear out the popularity of investing in company property and loanbacks to the sponsoring employer. Purchase of the sponsoring employer's shares is far less common with under 1% of overall assets so invested.

4.5 What may be surprising at first glance is the amount being held on deposit. At around 20% this seems extremely high. However, most trustees would say that the funds are being set aside for a future intended investment - for example, purchase of additional property. In reality the funds are in cash because the directors want to know that 'the money is there if they need it'. They are not incurring any great risk by investing it in equities, nor are they tying it up in insurance policies. This suggests that far less would be put into pension provision if the SSAS option were not available.

4.6 These funds offer a great marketing opportunity for life offices and other investment institutions to offer 'safe and accessible' investment vehicles. This is in fact now occurring as more and more Trustee Investment Bonds hit the market. I would expect that in the next three to five years we will see a reduction in the percentage of funds held on deposit.

4.7 Overall, there are about 25,000 schemes covering some 40,000 members with total assets in excess of £3 billion. Pretty impressive numbers!

## 5. ARE SMALL SELF-ADMINISTERED SCHEMES JUSTIFIABLE?

5.1 Up to now, most of what I have said has been factual. Now we look at such thorny questions as:-

- *why should SSASs be allowed?*
- *are SSASs used as tax avoidance vehicles?*
- *what about the 'conflict of interests' problem?*

5.2 It is apparent that there is a substantial established SSAS market. The question is whether the 40,000 or so members of SSASs would have made the same level of provision if a SSAS had not been available to them - I don't think so.

5.3 The point that has to be borne in mind is that it is these directors' own companies that are involved. It is therefore their own money that is being put into any pension provision and the question of priorities will inevitably arise. Most of these directors are going to want to put their money into the business and it is a SSAS that allows them to do this and make provision for their retirement.

5.4 I have questioned a number of companies with a SSAS and the directors stated quite categorically that if the SSAS facility had not been available they would not have allocated nearly as much to retirement provision. Indeed, this was 'exponentially' the case - i.e. the higher the contribution to the SSAS the lower the percentage that would have been paid had the SSAS not been available.

5.5 However, there is no getting away from the fact that there have been some abuses. Examples of this include a scheme set up with a large initial transfer value lending back 50% of the funds to the sponsoring employer and the employer going into liquidation shortly thereafter. Then, the director set up a new company, a new SSAS and asked for the funds under the first SSAS to be transferred to the second SSAS with a potential new loan.

5.6 Another involved a scheme that wanted to make a loan to a 'non-associated' company at very competitive rates. It transpired that the 'non-associated' company was owned by the 'girlfriend' of the director in the SSAS! Although the transaction did not take place it was obvious there was an intention to 'bend the rules'.

5.7 These are examples of minor abuse. A more serious problem involved a scheme which through time was reduced to one member who was no longer a director. He was forced to take early retirement through ill-health. However, there was a loanback to the sponsoring employer outstanding and they refused to

repay it. What is more worrying is that the managing trustees refused to treat the matter with the seriousness it deserved - mainly because they were the sponsoring employer.

5.8 It is circumstances like this that cause concern. However, if the APT's response to the DSS proposals had been accepted we could avoid such problems (*see Chapter 6*).

5.9 Probably the most frequent type of abuse is where the rules are simply just ignored. An example of this is where a property is purchased by the SSAS and leased back to the employer. Once the scheme accounts are made available, it becomes apparent that the employer has not been paying rent. The latest draft regulations contain reporting requirements which should avoid such problems. However, such abuses may only really be avoided by changing the role of the Pensioner Trustee to be more of a watchdog.

5.10 As regards tax avoidance, the main point that has to be remembered is that any transactions between the SSAS and someone connected with the sponsoring employer are closely monitored by both the SFO and the local Inspector of Taxes responsible for the employer. There should therefore be sufficient checks involved to detect tax avoidance. However, it may be that with the limited resources currently available to the SFO this is proving to be a problem.

5.11 Without question, situations can arise where there will be a conflict of interests because the Trustees are also directors/owners of the sponsoring employer. However, I believe that most of these can be avoided, or their implications significantly reduced, by the suggestions put forward by the APT in response to the DSS (*see Chapter 6*).

5.12 Overall, I believe that the fact that 40,000 directors have made provision for their retirement that might not have otherwise done so, fully justifies the existence of SSASs. This is particularly so if membership is restricted to 20% directors which will reduce the risk of defrauding members.



## 6. THE FUTURE FOR SMALL SELF-ADMINISTERED SCHEMES

6.1 On 4th September 1987, the SFO published a consultative document entitled 'Occupational Pensions: Small Self-Administered Schemes. A consultative document'. This document outlined certain changes the SFO intended to make to the framework within which SSASs operated. It was intended that interested parties should comment on the proposals contained in the document and then regulations would be published. Comments were requested by 25th September 1987!

6.2 The main proposals were:

(i) Regulations would 'proscribe completely' certain investments and would detail the conditions applying to certain other investments.

(ii) Regulations would require more detailed information to be provided, and to be provided automatically, about certain transactions and investments.

(iii) The conditions applicable to Pensioner Trustees would be set out and the role would be made more widely available.

(iv) Two new conditions would be introduced regarding investment, namely

(a) *all loans must be properly 'secured'.*

(b) *in the first two years after the establishment of a scheme, all loans to the employer must not exceed 25% of the Scheme assets excluding the value of transfer payments and assigned policies.*

6.3 One particular paragraph makes interesting reading:

*'As a transitional measure, where a scheme currently holds assets that will be prohibited by the Regulations, those assets may be retained (provided that they are consistent with existing practice). But once such assets are disposed of they should not be replaced by assets of a similar nature'.*

This was obviously intended to avoid retrospective legislation - this can be contrasted with recent pensions proposals (see 6.6).

6.4 The proposal that transfer values should be ignored when determining the size of the funds available for a loanback, reflects SFO worries about possible tax abuses. Normally, if a member leaves a scheme early he cannot get access to his benefits until he retires, but if he takes a transfer value into a SSAS then 50% of the assets are immediately available to be ploughed back into his company.

These funds would not be available other than through the SSAS.

6.5 So there we were, December 1989 all sitting patiently waiting for the new SSAS regulations, more than two years after the consultative document was published ( and replies required!). I was thinking to myself, 'if these regulations don't come out soon, the content of this paper may be a little off'! Suddenly, the hand of fate decided to add some spice to my paper.

6.6 After initial rumours, it became apparent that the DSS acceptance and extension of the OPB report were also directed at SSASs and it appeared that this was to replace specific SSAS regulations. The main worry for the SSAS market was (and still is?) the self-investment restriction. This stated that no more than 5% of the assets of a scheme could be invested in the sponsoring (or an associated) employer. This means through loanbacks, share purchase or property purchase, combined. Furthermore, and of more significance, this restriction was/is to apply to existing schemes which would/will have to comply with the 5% ceiling by 31st December 1991.

6.7 This almost automatically ruled out two of the main areas of investment currently used by SSASs, company property and loanbacks, as shown by the survey quoted in Chapter 3.

6.8 I think it is fair to say that the APT (and indeed the whole SSAS industry) were taken aback by this. It was hard to understand how the process outlined by the 1987 Consultative Document could be so easily set aside. In fact, initially it was believed that an error had been made in not specifically exempting SSASs. The APT quickly arranged a meeting with the DSS and it became apparent that the inclusion of SSASs in the DSS proposals was a result of specific ministerial intervention.

6.9 Having established that the very existence of SSASs was under threat the APT produced a response to the DSS proposals. I believe that this response was the most practical approach - there was no point in standing up to defend the status quo. There have been abuses as I have said earlier. If non - 20% directors had never been allowed to participate in a SSAS then I might have had a different view. But, as long as there is the potential for one or two directors to control and manipulate the funds of non-directors there will be problems.

6.10 The APT response was as follows:-

- (a) Any restriction on investment policy should not be retrospective and that existing investments should be permitted to be held at their current amounts.
- (b) Property should not be included in the definition of self investment.

(c) There should be no investment restrictions on pension schemes where:-

- (i) *each member is a 20% director*
- (ii) *all members are trustees*
- (iii) *trustees' decisions require a 'nem con' vote*

(A 'nem con' vote means there is no dissenting voice. This is different from a unanimous vote. This condition has been designed to avoid the need for the Pensioner Trustee to be involved in all Trustee decisions. Such a requirement would be unworkable and, in some cases, the Pensioner Trustee is explicitly excluded from Trustee decisions).

(d) Where self investment is permitted, the present regulations should be extended to require a full transfer payment within two years of being requested.

6.11 Taking these in turn, (a) refers to the retrospective nature of the proposals. It has almost been an unwritten rule that legislation would not be retrospective. This has also applied to this government - c.f. maximum accrual of 30ths, new AVCs not being allowed to provide a tax-free cash sum, £60,000 earnings cap.

6.12 I am opposed to retrospective legislation. I believe it to be totally unjust (and perhaps immoral) to encourage the public to make provision for their retirement based on certain rules and regulations and then to arbitrarily change these rules and regulations.

6.13 The APT had asked for the retrospective nature of the proposals to be removed. To date this has not been the case but I still hope to see this accepted and I believe we should all fear the consequences if it is not. It appears that the Revenue have some sympathy with this view but not necessarily the DSS.

6.14 Point (b) of the response was based on the principle that property 'has an intrinsic value independent of the company's continuing prosperity'. The belief is, therefore, that even if the company goes to the wall the property would still be there backing the pension benefits, unlike a loanback to the company. This has some merit, but there could be problems if the property is of a specialised nature.

6.15 Point (c) is not as bold as may appear. What is being suggested is that the intended restrictions should not apply if these conditions are met. The conditions obviously seek to protect the rights of all members. However, there would still be a ban on holiday property and 'pride of possession' investments to

avoid possible tax abuses. Indeed, the current SSAS investment framework would still apply.

6.16 Point (d) is again looking at protecting the rights of members. Current legislation requires that a transfer must be made within one year of a request for one and so it may appear that the APT is seeking a relaxation of current regulations. To a certain extent this may be the case. I understand that the proposal is based on the fact that there is currently a 'get out' clause which allows Trustees to delay payment of a transfer value. However, this is only allowed in very limited circumstances (e.g. winding-up or if all other members would be adversely affected). I am informed by the OPB that, to date, this 'get out' clause has not been used and so the two year rule would apply very rarely.

6.17 Furthermore, current legislation allows the Trustees to only transfer part of the benefits if the member is not actually leaving the company, so the APT proposal would require a further change to legislation if a full transfer is required within two years of request. (This has been superseded by the 1990 Social Security Act.)

6.18 On 20th December, 1989 the DSS announced that "the proposed restrictions will not apply to SSAP's in cases where all members are trustees, each member is a '20 per cent director' as defined for Inland Revenue purposes and trustee decisions require a 'nem con' vote". Thus point (c) of the APT's response has been accepted.

6.19 However, the proposals still apply where these conditions are not met. In particular, as stated earlier, the principle that the regulations should not be retrospective has not yet been accepted.

6.20 The DSS are now in the process of carrying out a survey on self-investment in the pensions industry in general, through Ernst & Young. It was thought that until the results of this were known there would be no action on the 1987 Consultative Document. However, on hearing that I was about to present an updated paper, the Inland Revenue struck another blow - as outlined in *Chapter 7*!

6.21 My main worry about SSAS investments has been where there is a loanback which represents a significant portion of the assets backing a member's benefits and that member does not control 50% or more of the company. In these circumstances an additional restriction that could be imposed is that the loan cannot exceed 20% (say) of the assets of the scheme or that the loan must be repaid within one year of the 'significant portion' mentioned above occurring - this may have occurred because other members have left or retired.

6.22 If a company defaults on such a loan, there may be some merit in having a personal tax charge on the directors. Currently a tax charge can be

imposed if, for example, a scheme is not granted approval by the Inland Revenue. However, imposing a charge in the circumstances I have suggested, and having this as standard practice rather than at the Revenue's discretion, may further safeguard member's rights.

**6.23** Another possibility may be to say that a company cannot be sold if there is an outstanding loanback from the SSAS - however, this may be difficult to regulate.

**6.24** These worries may be of far less importance if the new draft regulations are adopted unaltered.

## 7. THE 1990 DRAFT REGULATIONS

7.1 On 26th July 1990 the Savings and Investment Division of the Inland Revenue wrote to the APT enclosing a copy of revised draft regulations on SSASs. The regulations, to be known as 'The Retirement Benefit Schemes (Restriction on Discretion to Approve) Regulations', are likely to be implemented this year - all comments have to be received by 31st October 1990.

7.2 The letter enclosing the draft regulations contained two important points that the regulations themselves do not, both referring to the 1987 Consultative Document. Firstly it confirmed that the intention to require all loans to the employer to be properly secured had been dropped. This is a significant relaxation and has been achieved through discussions with the APT. The Inland Revenue stated that what it has long been concerned about is 'the inadequacy of many loan documents, which in some cases led to doubts whether it was genuinely intended that the loan should be repaid'. It now intends to cater for this by requiring the content of loan documents to contain certain specified information (see later).

7.3 The second point contained in the letter is that the Inland Revenue have reviewed their intention to ease the requirements necessary to become a Pensioner Trustee. They now believe that the 'tests contained in Memorandum 58 are still the most appropriate'. I believe that this will mean that the APT can continue in broadly its present form and that it will remain as an effective voice for the SSAS industry. It reflects common sense on the part of the Revenue who now realise that 'opening up' the role of Pensioner Trustee would result in more work for the Revenue by way of explanation/guidance at a time when they are trying to reduce work by setting down regulations rather than leaving all matters to be covered through discretionary practice.

7.4 But what of the draft regulations themselves? They contain confirmation that the Inland Revenue will not approve more than one SSAS for any employer. This had been a relaxation many had been hoping for, not least because it would have helped deal with the consequences of the 5% self-investment restriction. It would have enabled one SSAS to be set up for 20% directors which would involve self-investment and another SSAS for other key employees not involving self-investment.

The main regulations of note centre on certain areas of investment and are discussed later.

7.5 Certain of the regulations simply put on a formal basis what has long been established practice e.g. Trustees' borrowing restricted to three times the ordinary annual contribution to the scheme and the unacceptability of certain types of investment (i.e. 'pride of possession' and residential property in most

circumstances).

**7.6** Regulation 7 effectively restricts SSASs from owning more than 30% of the voting rights, or receiving more than 30% of the dividend, of any private company. This is a totally 'new' regulation, one of two new regulations being introduced. The reason that this regulation is being introduced is stated to be to avoid a SSAS being used to give directors effective control of a company at no cost to themselves or being used to strip a company of profit. However, I am reliably informed that this just reflects what the Inland Revenue have been doing under discretionary practice for over a year.

**7.7** The second new regulation bans the sale of property to or purchase of property from a scheme member. This is being introduced to avoid what the Inland Revenue describes as transactions being undertaken at an 'artificial price' or involving a 'leakage to the scheme member of part of the pension funds'. Such transactions may have constituted a significant part of SSAS investments in the past but the fact that the restriction mirrors what applies under 'own-choice' personal pensions means that it is unlikely to be changed.

**7.8** One regulation stipulates that there can be no lending to a scheme member or to a person connected with him - this is as applies at present. The same regulation states that lending to the employer will only be approved if it is for a fixed term, at a commercial rate of interest and is evidenced by an agreement (in writing) which contains the conditions applying to the loan. One of the conditions must be that the loan will be repaid if the employer is in breach of the conditions of the agreement, ceases to carry on business or becomes insolvent. The regulation states that the loan must be 'necessary for the purposes of the employer's business'. However it does not state what will be viewed as 'necessary' - this appears to be an area where the Inland Revenue wish to keep their powers of discretion.

**7.9** The regulation on lending does not make reference as to how frequently loans to the employer can be made. The Inland Revenue has previously stated that the practice of having a loan repaid and then immediately re-made is acceptable once but not twice i.e. two 'roll-overs' are not allowed. This was because the Inland Revenue thought that such rollovers brought into question the main purpose of the scheme. I had thought that this would have been an area covered by regulation but it again appears that the Inland Revenue wish to rely on their powers of discretion.

**7.10** The regulation that is likely to be of most interest/concern to the SSAS industry states that self-investment, through loans to the employer and the purchase of shares in the employer, will be restricted to 25% of the scheme's assets. This compares to the current level of 50% and to the intention quoted in the 1987 Consultative Document that the 25% limit would only apply in the

first two years of a scheme. However, it compares favourably to the 5% self investment limit proposed by the DSS in that property is not included. The only problem seems to be that the 25% limit applies 'at any time' not just at the point of loan. This will be impractical to implement. The Inland Revenue state that this is unlikely to have a material impact on most schemes because the APT's annual survey shows that self-investment typically falls well short of 25%. However, I believe that whilst loanbacks may represent only around 19% of total SSAS funds (see *Chapter 4*) many schemes have made loans to the employer which, at the time of the loan, represented 50% of the scheme's assets. Therefore, I believe that this restriction will hit harder than the Inland Revenue state. One point of comfort, however, is the fact that transfer values do not appear to be excluded from the value of the assets that can be taken into account.

**7.11** The final regulation covers the reporting requirements for schemes. This requires the administrator of the SSAS to provide the Inland Revenue with such information and documentation as they require (which has still to be specified) within 90 days of the following transactions occurring:-

- (a) the acquisition of real or leasehold property*
- (b) the lending of money to an employer*
- (c) the acquisition of shares in a private company*
- (d) the borrowing of money*
- (e) the purchase from or sale to an employer of any property.*

**7.12** This regulation will result in the Inland Revenue being far more up to date with the asset position of SSASs, although I personally believe that the 90 day reporting timescale is on the generous side, at least from the point of view of actually advising that the transaction has taken place. However, I do wonder about the Revenue's ability to cope with the resulting information it will receive given its current staffing problems.

**7.13** It is interesting to note that the draft regulations do not contain any proposed change to the role of the Pensioner Trustee. It appears that it is not intended to make such Trustees play the part of a watchdog more than has been the case in the past!

**7.14** The regulations do not contain any transitional arrangements but the views of the APT have been sought on this. There is a question mark over which schemes the regulations are intended to apply to :-

- *only schemes which receive exempt approval after a cut-off date*
- *all schemes, but only in respect of new investments after a cut-off date*
- *all schemes in respect of all investments.*

Hopefully, the last of these three options will not be the one chosen.



**7.15** One important point has to be noted. Regulations are introduced to provide 'black and white' guidance and to avoid total reliance on discretionary practice. However, it is extremely difficult to cover everything in regulations. The position of residential property is one such area where doubt may arise. For example, the purchase of a shop which has an upstairs storage room may appear to be acceptable - but when is a storage room a flat?!

**7.16** What is likely to happen now is that there will be test cases in the courts to 'fully clarify' the meaning of certain regulations. Not a very attractive proposition and not something that was likely to happen under discretionary practice.

**7.17** For those schemes not covered by the regulations, it is likely that the Revenue will continue to use their discretionary powers with the same net effect as for those schemes covered by the regulations!

**7.18** My main concern now is that the DSS and Inland Revenue do not appear to be talking to each other and therefore we will have 'layers' of regulations covering SSAs.

## 8. CONCLUSION

8.1 It would appear that, with the DSS having accepted the APT response to their proposals (at least in part), there is a continuing SSAS market. Indeed the DSS proposals have highlighted the existence of the SSAS market - they may, therefore, have actually benefited it!

8.2 I believe this reflects the success of the SSAS industry lobby. In particular, as part of this lobby, many companies wrote to their Member of Parliament expressing their concern at the consequences of the DSS proposals. This has been gratifyingly successful.

8.3 Overall, I believe that the number of members and the size of the funds involved more than justify the existence of Small Self-Administered Schemes and I believe that this is reflected in the partial acceptance of the APT response to the DSS proposals on self-investment.

SSASs are a good idea!

8.4 But what of the new draft regulations? How do they fit in with the DSS proposals and the partial acceptance of the APT response?

How will the Inland Revenue survey of self-investment by pension schemes affect SSASs?

What about the latest Draft Practice notes from the Inland Revenue. I see that these include a full chapter on SSASs (which at the time of writing is not available). What changes will arise out of this Chapter?!

To be included in a future paper - *any volunteers?*

# **SMALL SELF ADMINISTERED SCHEMES - APPENDIX**

## **ASSOCIATION OF PENSIONER TRUSTEES**

### **ANALYSIS OF ASSETS**

#### **RESULTS GROUPED BY NUMBER OF SCHEMES TO WHICH RESPONDENT IS PENSIONER TRUSTEE**

#### **ALL FIGURES EXPRESSED IN THOUSANDS OF POUNDS**

	1-9	10-24	25-49	50-99	100-249	250-499	> 500	TOTAL	%
GILT EDGED STOCKS	562	102	1973	14961	10128	11589	6240	45555	2.7
INDEX LINKED STOCKS	120	7	462	736	1488	685	38	3536	0.2
EQUITIES - QUOTED	2921	513	9867	35509	31744	33998	31885	146437	8.6
EQUITIES - NOT QUOTED	0	18	37	1106	856	2928	1720	6665	0.4
UNIT TRUSTS	744	293	8063	1298	19541	6175	13250	49364	2.9
LIFE OFFICE MANAGED FUNDS	2413	1270	15765	46137	35064	48994	96897	246540	14.4
IMMEDIATE ANNUITIES AT COST	110	66	2368	18929	1048	5488	1207	29216	1.7
OTHER INSURANCE POLICIES	0	1226	6420	6365	14332	60666	185767	274776	16.1
LOANS TO EMPLOYER OR ASSOCIATED COMPANIES	260	1157	4821	29211	39881	50613	82068	208011	12.2
EQUITIES OF EMPLOYER OR ASSOCIATED COMPANIES	20	18	512	3356	1617	2471	1193	9187	0.5
DIRECT INVESTMENT IN LAND AND BUILDINGS									
(I) COMMERCIAL - NOT ASSOCIATED WITH EMPLOYER	690	328	1276	21642	14405	33173	15687	87201	5.1
(II) COMMERCIAL - ASSOCIATED WITH EMPLOYER	2159	7345	7805	49475	21078	78956	77018	243836	14.2
(III) RESIDENTIAL	205	24	284	4376	302	7143	410	12744	0.7
(IV) AGRICULTURAL	40	32	217	4340	2122	4725	3360	14836	0.9
CASH DEPOSITS									
(INCLUDING MANAGED CASH FUND)	2192	10677	12253	62378	48607	90929	100591	327627	19.2
NON-INCOME PRODUCING ASSETS	0	28	13	1581	298	901	0	2821	0.2
	12436	23104	72136	301400	242511	439434	617331	1708352	

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	1-9	10-24	25-49	50-99	100-249	250-499	> 500	TOTAL
NUMBER OF RESPONDENTS	6	5	9	18	10	9	5	62
NUMBER OF SCHEMES	37	98	353	1383	1597	2743	6238	12499
NUMBER OF MEMBERS	88	220	853	3278	3621	6477	14533	29070
TOTAL ASSETS	12242	22888	73447	318418	260665	425380	595312	1708352
TOTAL CONTRIBUTION CASH FLOW	1582	3926	12471	43212	38154	70619	112221	282185
TOTAL ANNUAL OUTGO FOR PENSIONS	47	0	6307	1741	913	4922	75	14005