Open Market Option - Customer Understanding

Presentation of research findings

Prepared for Just Retirement
September 2007
Background and objectives

- To gauge awareness and understanding, amongst those who are approaching retirement or who have recently retired, of the Open Market Option and the paperwork that surrounds it.
- To gain copies of documentation provided to those interviewed, prior to the point of taking their annuity, to determine whether they could have increased their annuity had they taken the Open Market Option.
- Specifically:
  - To gauge customer understanding of an annuity.
  - To investigate customer recall of the process of taking out an annuity.
  - To evaluate the paperwork received by customers prior to the annuity process.
  - To gauge response and attitudes to example documentation.
  - To explore attitudes towards the advisory process.
  - To gauge awareness and understanding of the Open Market Option.
Who did we talk to, how and when?

- All respondents were at the point of retirement or had retired within the last year, all recalled the process of taking an annuity.

- Qualitative element
  - 10 depth interviews, face to face, 60 minutes
  - Interviews conducted in South East and North London
  - All were asked to bring their paperwork to the interview

- Quantitative element
  - 26 interviews conducted by hall test and telephone
  - All interviews lasted 10 minutes
  - Interviews across South London, Durham and Suffolk
  - All respondents had been in at least one pension scheme invested with an insurance company

- All fieldwork conducted between 30th August and 15th September 2007

- Across the total 36 interviews 25 were retired and 11 were approaching retirement
What’s retirement like

- Overwhelmingly positive whether approaching retirement or in retirement
- Because pre retirement tends to be a very ‘driven’ lifestage with demands from family and work, retirement is seen to be a lifestage that offers a chance to be free to do what you want to do
- There is, for the first time in many people’s lives, time to do what you want to do
- There were lots of comments made about no clock watching, no rushing from one activity to the next
- Freedom and choice are two key motivators
- A minority mentioned that it is not all fun. There are some negatives. The sense of having no structure to the day can be a difficult adjustment that has to be made. Others respondents mentioned missing the social side of the work place and colleagues still working have little time to meet up and keep in contact
What they said

Choice – that is what retirement is all about for me….we go on holiday more, we help our daughter out with the children.

It’s fantastic, I am still doing a little work, I didn’t want to get bored. The only thing is before I would spend money without thinking to much, now I have to be very careful.

I have three grandchildren, and an elderly mother at home so my time will never be boring.

I decided to retire when my husband said he was going to cut back, I wasn’t well and I was still trying to work and run around and I thought this is crazy, I’d had my business for 30 years and realised it wasn’t the be all and end all.

If you can’t enjoy life now, when can you!!

For the past 17 years I worked 6 days a week and I always thought I would feel guilty if I was having pleasure during the working week but I don’t.

I found the transition into retirement quite difficult.

Its peace of mind, not having to make plans, sitting back and relaxing.
Planning for retirement

- Across the interviews the majority claimed to start really getting serious about preparing financially for retirement about ten years before they retired.
- For a minority retirement had come earlier than expected either through ill health or redundancy.
- With hindsight most wished they had done more to plan for their retirement – whether through pensions, investments or property but they do recognise that during the ‘family forming’ years money is tight and it is difficult to have much spare.
- There is a general wariness about pensions, and very few claimed to have taken much interest in how much they would get and the process they would go through, until a few months before retiring.

With hindsight I should have done more, but we had children at private school, and university, it was only after that I started paying into an AVC.
During people’s working life most paid into a small number of schemes.

The quantitative results show one quarter of respondents paid into one pension, around 40% paid into two or three schemes and a third of respondents paid into more than three schemes.

Results were similar with the depth interviews.

There were mixed reactions about the amount that had been paid into the schemes. At one end of the spectrum there were those who knew how much they have contributed on a monthly basis and at the other end those with no idea what premiums have been paid.

The reason for having a number of schemes varied but tended to be moving jobs or on the advice of an adviser to set up a new scheme.

There was some confusion about the type of pension schemes held but generally the provider names were known (perhaps prompted by the respondents having to bring documents from the companies with them to the interviews).
Q2. How many pension schemes have you paid into during your working life? (This can be personal pensions, stakeholder pensions, company schemes)

Base - all respondents (36)

- More than three: 31%
- Two to Three: 42%
- One: 27%
- None: 0%
What they said

I have three pensions, one small one and two that are medium. The reason there are more than one is that 15 years ago we were expecting sizeable pots but that went out the window, I was only going to get a third of what I thought at 65 so I started paying into other pensions.

I paid into a pension with Norwich Union, I have no idea how much I paid into it.

I had a company pension with Xerox, a top hat pension, but when I left I cashed it in to start my own business, then I started two other pensions – Clerical Medical and another with Scottish Equitable.

I had one with my old company, I didn’t pay any more into it but later I set up a private pension with Sun Alliance. I was putting in about £500 a month for about 12 years, I realised I wanted to be able to do things in retirement.

I have two personal pensions one with NPI and one with Scottish Mutual, oh and another with Standard Life, with hindsight I should have paid in more or invested in property.

The first one was with Standard Life, that matured at 60 and I’ve got another one with Scottish Equitable.
Awareness and understanding of annuities

- When asked the question ‘Have you heard the word annuity before?’ there was high awareness, with three quarters of those interviewed claiming to be aware of the word.
- 25% of the total sample (all within a few months to retirement or had retired) had not heard the term before.
- Interestingly, when asked to describe what the word annuity means, over half of those who had heard the term could not describe the meaning.
- Those who were confused, generally knew it was something to do with the pension but descriptions varied and included:
  - An insurance policy
  - Choosing to buy an ISA or shares
  - Getting a lump sum payment
  - Extra money towards the pension
- The minority who had heard the term and could describe it knew that it was a lifetime regular income bought with a lump sum.
Q8. Have you heard of the word ‘annuity’ before?
Base - all respondents (36)
Some confusion over the word annuity

Well I don't know about an annuity they may have told me about it but what was sent to me in the post was so complicated I can’t tell you what it is.

You can hold onto your pension or put it into shares, ISAs, it’s your choice.

Well I’ve heard the word, they say you will have to take out an annuity, well you are blinded by that, you don’t know what it is. I have heard about it but I couldn’t explain it.

An insurance policy against how long I live.

If you take out an annuity I think you get some extra money towards your pension.

You give them your pension and you get a lump sum payment.

I find it all very confusing. Annuity is something that you get from your pension it is paid out I think yearly…or is it monthly? I’m not sure. I’m organising one with Scottish Widows I am just so confused by it and I am not stupid when it comes to financial matters.

I have heard of an annuity but I don’t know what it means.
These people are less confused

Money you get from a lump sum – with interest for life

You buy an income for life

It's something to do with your pension, and what you do with it but I don't know anymore

You give a lump sum to get a guaranteed income over a certain period of time

It's what you get when you retire
Importance of having an annuity

- Consumers thought it was important to have a regular income in retirement.
- They want to know that the regular outgoings will be covered by a regular income.
- On a scale of 1 to 10 (not at all important through to very important) the six out of the ten depth interviews gave a 10 rating. The others gave a rating between 7 to 9.
- There was a feeling that if you were given all the pension as a lump sum it might get spent rather too quickly. Just one mentioned that they would have used their pension fund to buy property if allowed but this would still have been to have a regular income from rent charged.
- When the researcher confirmed that therefore having an annuity was important in retirement, half of the ten respondents said they didn’t want an annuity they preferred a pension for the regular income – and this was after a prompted discussion about what an annuity is – highlighting the confusion surrounding the term.
The importance of an annuity

I wouldn’t want the worry of what to do with all the funds at retirement. I don’t have the knowledge and if you go to an IFA you can’t trust them. I always feel they want to sell me something that is in their interest rather than mine. I’m happy for the insurance company to work out how much I can have every month.

It’s very very important to me to have a regular amount of money every month it’s what I am used to.

I have a regular income from my pension which is essential but I’m not interested in an annuity.

It think it’s better to have a regular income than take it all as a lump sum at the start, but you are gambling because it is a risk how old you are going to live until – you tell me!

Actually I do need a regular income but I would rather have had all my pension and I would have invested in property and got the income from the rent – I think I would have done better than my pension.

Yes I had the option to take a lump sum or whether to take weekly or monthly payments – I took the regular money because you would be tempted to spend the lump sum, I did wonder about investing it but we both decided it was better to have the guarantee.
Awareness of the annuity process

- All but one respondent in the research recalled receiving paperwork about what they needed to do to get their pension.
- Some were not aware of the process that they would have to go through before receiving the packs and had assumed the pension they had been saving for over the years somehow materialised into a regular paid out pension in retirement.
- Those interviewed face to face all mentioned how much paperwork had been sent to them and they admitted that they had not read it all, it was too daunting and full of jargon.
- Most were left completely confused by it all, others had passed it across to advisers to help them.
- No one had found the process simple.
Q4. Have you received a pack (letters/documents/forms) from the company(s) you have saved with telling you about your options at retirement and that you have the opportunity to use your savings to secure the best retirement income available on the market at the point of retirement?

Base - those approaching retirement (11)
Q4. Did you receive a pack (letters/documents/forms) from the pension company(s) telling you what you need to do with your pension on retirement?

Base - those retired (25)
Awareness of the process

I had no idea that I had to do anything to get my money as an income in retirement, silly really I should have thought about it.

I knew that you could take a cash lump sum and take that anywhere to get a pension or spend it, but the rest of the funds I assumed stayed with the company.

I decided to retire early, at 57, so I rang the companies who had my pensions and asked them how much money I had and what my options were to draw the pension. They sent me legions of paperwork and asked me to choose some options. There was so much to read and I didn’t understand the terminology – I had to ring them. I did get some advice from a lady at work, she looked at them and said it was better to keep the pensions separate as it would cost me a lot to merge them together.

I remember getting a letter and lots to read, I was interested in taking some as a tax free cash lump sum. I decided as I had three pensions that I would get advice from an IFA, well my wife suggested it. My adviser got a lot of calculations and said I should go with Legal & General as they came out top, I went with his advice but it is taking a long time to sort.

I wasn’t sure if I could get a pension from another company but I was advised by the broker to stay with Norwich Union – I don’t know whether he got more commission.

I phoned one company about my pension, and they went off on this jargon and when they’d finished you think - oh Christ !!!
Awareness of the process

One of my pensions is with Abbey Life, it’s only minimal, I stopped paying into it and switched to Norwich Union. When I came to retire it was a nightmare dealing with Abbey Life.

Yes they sent me a letter about the pension with a lot of stuff (paperwork). I think it talked about choices I had to make but I didn’t really worry about that, I just asked them to sort it – it was with Norwich Union, they were very good.

I used the financial adviser because it didn’t cost me anything and he said he could get me more money.

I think they sent me a letter to tell me what to do, but they sent far too much information. I had to make phone calls to them to ask about this figure and that figure. Nothing is black and white, they tell you they can’t explain it fully because they are not financial advisers. I asked a friend who is a financial adviser but he wasn’t much help it dragged on for months.

When they sent me a pack what I did was I phoned my accountant and he put me on to a financial adviser and I followed the financial adviser’s advice – I sold the money to another company.
Attitudes to existing packs

- Immediate reactions were that the packs sent out 4 months before and 6 weeks before are too long.
- Consumers claim to get lost in too much print and cannot extract for themselves the salient points.
- There is perceived to be too much jargon and too much small print and this tends to put consumers off bothering to read it in any detail, at best, it gets skim read.
- There is a sense that it is ‘typical’ communication from an insurance company, that it is generic and therefore not specific enough to the individual to bother reading it all through.
- It is thought useful to have a wake up letter to start people thinking about preparing for their retirement.
The existing packs

Someone who doesn’t understand what is going on is not going to understand this for example what is a ‘disinvestments charge’

I don’t understand this bit – what’s a protected rights fund?, and does the word ‘level’ means the same as ‘fixed’, at some point reading all this I’d think ‘oh crickey’ and my head would be spining

It’s far too long and too complicated, it needs to be restructured so it is easier to digest

It’s difficult, there is so much attached, it’s great big lumps of text and the words are familiar yet when you think about it you realise they don’t mean anything

Having a wake up letter is a good idea but that one is a waste of time, it is too long and complicated

That bit on the letter (wake up) is good - it will send you your forecast at a later date that is reasonably clear
The existing packs

These letters (ABI) are in your typical insurance company small print that nobody reads.

I don’t remember seeing anything about going to other providers – oh it’s on the back page, will anyone get to the fourth page? It should have a big heading here saying you do have a choice this is in practically small print.

The letters sent out are just generic, they should send out a personal letter. You have invested with them for years and should be treated as an individual, my husband's letter and mine were the same, it means you don’t bother reading most of it.

Just give people the general terms, ‘this is what it is and in brief this is how it works’ and then when they express an interest in one or two of the things then go into more detail and explains.

It took a lady at my work a whole day to go through my pack, I didn't understand any of it.
The draft ‘new’ letter

- This letter immediately generated a more positive reaction than the packs consumers had received or the ABI existing material
- It was welcomed because it was a much shorter, cleaner, bullet point format, highlighting importance points
- Jargon was perceived to be limited, which helped consumers understand the points being made
- Spontaneously, the letter raised a number of issues that the respondents were not aware of including
  - Shopping around
  - Perhaps getting a better deal if you smoked or were in ill-health
- The comments made had not come through spontaneously when consumers had read and commented on the existing packs
That is much easier to understand, it would still be improved if it could all fit on one page.

This letter explains that you can go anywhere you want, it is telling you to think twice, I wasn’t aware that you could shop around.

The letter looks clear, but what are those questions about? I am interested in that because of my own health, I’ll get onto that now you have shown me, they never tell you these things, you have to find them out yourself.

That’s interesting you can have more pension if you smoke…I haven’t seen that before, I suppose it’s logical. If you smoke your life expectancy isn’t so good. My husband had a triple heart bypass and is on medication I wonder if he could have got more.

I already like this one better than the other two, its clearer, the spacing is better…it has the key things in large and underlined, it is less frightening.

I think they should put this bit in bold -consider getting the best deal -
The draft ‘new’ letter

The tone is much more friendly, less ‘legal’, less technical, that’s good

Basically it is advising me of my options. It gives me my options clearly and precisely, I didn’t know anything about that health part

I don’t understand the term – enhanced pension/best enhanced - I would have to think about that. And I have no idea where to find an ‘impaired annuity’ provider

If this letter replaces the other one you showed us going out initially then it is much clearer and would encourage you to stop and think
Obtaining advice

- Two thirds of those interviewed had received advice about what to do about their pensions as they approached retirement.
- A range of people were used to obtain advice including family, friends, employers, solicitor and accountant.
- The main source of advice was from financial advisers.
- Those who had used them did listen to their advice and to an extent abdicated their responsibility for decisions to the adviser because it was seen to be too complex.
- There was some concern that IFAs decisions are based on commission but there was a feeling that they have to trust their advice.

Having seen those letters you would be mad to try to sort this yourself, you would need a financial adviser to help.
Q6. Have you/did you receive advice on what to do at retirement with your pensions savings as you approached retirement?

Base - all respondents (36)
Attitudes towards moving providers

- 73% of those approaching retirement in the research plan to stay with the same pension provider for their retirement income. Half of those not switching claimed to be aware that they can move.

- Similarly among those already retired, almost 80% did not move providers for their retirement income and just a minority thought you could move.

- One third of all those interviewed claimed to be aware that they had the right to use the pension savings to buy the highest retirement income on the market.

- The in depth interviews suggest that there is little awareness about the options to switch to another provider to get a better annuity and this is borne out as the research moves to discuss specifically the open market option.

- We also know from the in depth interviews that some consumers interpret the option to move to another provider as the choice about taking the cash lump sum and reinvesting that in an investment product.

- A minority did understand about the choice to move funds because they had taken the advice of an IFA.
Q5. Are you planning to take your retirement income from the same company(s) that you invested your pensions savings with?

Base - those approaching retirement (11)
Q5a. Did you know that this is not compulsory and that in many cases a higher income will be available elsewhere?

Base - those approaching retirement who plan to take retirement income from the same company(s) they invested their pensions savings with (8 respondents)
Q5. Did you stay with the same pension company(s) that you invested with before retiring?

Base - those retired (25)

Yes: 76%
No: 24%
Q5a. Were you aware that this was not compulsory and that in many cases a higher income may have been available elsewhere?

Base - those retired who stayed with the same pension company(s) they invested with before retiring (19)
Q7. Were you aware that you had/have the right to use your pensions savings to buy the highest retirement income available from any pension company when you reached/reach retirement?

Base - all respondents (36)

Yes: 31%
No: 69%
Understanding of ‘Open Market Option’

- Around a third believed that their packs had mentioned that you could shop around for the best deal.
- And about a quarter of the respondents stated that they had heard the term open market option.
- Interestingly when asked to explain the open market option spontaneously there was confusion. Some thought it was the options given at retirement of:
  - Taking a cash lump sum or taking it all in pension
  - Taking an indexed pension or not
  - Taking a pension for your spouse
- Even among those who had used an IFA and were more aware of the term they still had a relatively limited understanding of what it meant.
- Very low awareness that health could impact on the amount of pension received.
Q9. Have you heard of the term ‘open market option’ in relation to your pension(s)/annuity? Explain
Base - all respondents (36)
Awareness of OMO from packs

Q10. Did the pack (letters/documents) that you received from your pensions savings company tell you that you could shop around to get the best retirement income for you?

Base - all respondents (36)
Perceptions of the open market option

The options are you can receive a lump sum, or you can have it monthly like I am or you can have a bit of both. Maybe there were more options in the paperwork but I didn’t notice.

I think I have heard of that I think there was a public announcement on the TV or radio. I always read the financial pages.

I’ve not heard that term before – open market option – it’s not the sort of thing you could guess what it means.

Yes, I have heard of that it means you can choose to have it indexed linked or take the option to give some to your wife if you die, I think you personally take a smaller regular amount.

It says you can go to another provider does it mean you can shop about like with car insurance – I don’t know how that would work?

(having read description) I certainly haven’t heard of that before, I didn’t know about the choices.
Perceptions of the open market option

I think I have heard that – open market option – but don’t ask me what it means, is it to do with trying to get the best deal?

I have an IFA but I don’t remember him using that term, he did talk about having a level one (pension) but I am diabetic, Type 2 and he didn’t mention about one based on health or lifestyle.

I’ve certainly not heard about it before I’m surprised that there are these choices.

Yes, I am aware of that, my IFA advised me that I could get a better pension by moving to another company, I didn’t know anything about the health part.

Well I never really considered moving I never considered a better deal somewhere else.

I wasn’t aware that you could move around. I don’t know if I would have got a better deal because I find they charge for admin so I don’t know how much money I would have got.
Provider awareness

Who offers annuities?

- General awareness that insurance companies would offer annuities
- Majority mentioned the company they were with
- Minority were aware of other companies offering annuities (or pensions in retirement) and spontaneously mentioned:
  - Norwich Union, Standard Life, Scottish Equitable, Scottish Widows, Friends Provident, Standard Life, Prudential

Who offers impaired or enhanced annuities

- No one was aware of any company who might offer a better annuity product because of ill health, smoking etc
- There was an expectation that you could go on a search engine and find one, if you knew what to put in and what you were looking for
Q11. Were you aware that if you smoked or had medical issues you could possibly get a higher pension income for the rest of your life?

Base - all respondents (36)
Brand loyalty vs ‘better deal’

- In the depth interviews when asked whether respondents would switch for a better deal the general reaction was that it would be very sensible to move companies if it meant the annuity payments would be higher.
- Most thought they would switch providers for around 10% or more.
- In the research, when prompted on a value, over half thought they would switch if it meant £5 or more added to their pension.
- Very few had brand loyalty to the pension provider however they acknowledged that given the lack of trust in the financial industry, sometimes it is ‘better the devil you know’.
- A couple mentioned that they had been with their pension provider for years and had little cause for concern so would stay with them.
- And given the lack of understanding of the process today the majority stated that they would stay with the same provider as it appeared too complicated to read all the documents, work out where you could get a better deal and move the funds.

That’s a very tricky question, generally speaking people don’t like change, they are frightened of it, I wouldn’t have changed without my IFA.

We’ve been with Prudential for years, even had our first mortgage with them, they seem best of a bad bunch really.
Raising awareness of annuities

- The reactions concerning the need to raise awareness about the annuity process at the point of retiring was very consistent
- All agreed that more should be done to help people understand there are choices to be made and to encourage people to take time to consider their own actions
- Raising awareness of the true meaning of the open market option, including the possibilities of enhanced and impaired life annuities was seen as critical
- Whilst some mentioned that pension providers should be more explicit about the choices available, there was an understanding by a minority of respondents that it might not be in the interest of providers to do this
- There were a couple of mentions that the employer should highlight the process and particularly the need to shop around
- The general view was that the Government should lead the campaign in the same way they have done with ‘healthy eating’ etc
- A small number mentioned that the literature and documents on the State pension that they had received around retirement date were very clear and could be used as an example of communication done well
Send something out that is short and punchy, put it on a bus, on the radio, in the Mail...people get fed up with working their way through all the bumf to understand what is being said.

I was with Clerical Medical and Scottish Equitable neither of them mentioned I could get a better rate because I am a smoker luckily I have an IFA and he asked me and said it was better to move to Partnership Assurance, I hadn’t heard of them but they gave me a better pension.

I never considered moving, I never considered you might get a better deal elsewhere, I am always interested in anything where there is a chance of getting more money.

That leaflet is excellent and maybe the Pensions Governing body could get that letter and send it out to people like me. The forecast I got from the State was excellent.

They should put the options you read out (on the showcard) in the letter. Highlight the important bits as people are lazy when we read.

Employers should say ‘look be aware of this Leaflet’ and give a number you can call for more advice. If could be free for ten minutes then chargeable if you want to know more.
Retirement is approached generally with great anticipation and very few fears. People arrive at this lifestage with at least a couple of pensions and have little awareness of the process they will go through to take out a ‘retirement income’

The term annuity whilst seems familiar has little understanding for the majority. Those with a financial adviser were more enlightened.

Receiving information from their providers about what to do is perceived as important but the current material is seen as too complex and difficult to digest. There is a strong preference for short, jargon free information highlighting on one page the choices that need to be made in retirement.

In reality there appears to be little understanding about the option to move the pension pot to another provider. Even among the third that claim to know they can move funds there is confusion about what can be moved. Some interpret this option to be about moving the ‘tax free cash lump sum’. The minority that had moved their pension pot had used the services of an IFA.
Conclusions

- Very few could explain what the term ‘open market option’ means. And awareness that smokers and those with ill health might be able to receive a higher annuity rate was very low.

- There is a general concern that actually there is a large gap in knowledge about the choices that need to be made at retirement and there is an interest to be better informed.
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Removing the Requirement to annuitise by age 75

Response to HM Treasury Consultation from Just Retirement

Just Retirement welcomes the opportunity to respond to the consultation on removing the requirement to annuitise by age 75. It is encouraging to see the comprehensive attention currently being paid to pensions and retirement provision and the focus on simplifying many aspects of pension provision while introducing greater flexibility for individuals to manage their pensions successfully.

Summary

- Continuation of capped drawdown beyond age 75 presents a significant risk to income
  - A tapered limit for capped drawdown would protect against this risk
  - Desire for simplicity which leads to a single capped rate would dictate a significantly lower limit than currently applies
- Minimum Income Requirement should be set at a level equal to median full-time earnings for an individual up to State Pension Age
  - There should not be a significant reduction for single people due to the increased costs associated with living alone
- Annuities still offer the most appropriate method of delivering secure income for life within the context of pension provision for the majority of individuals
- There is significant potential for improving the operation of the Open Market Option through improving promotion, clarity of information, availability of guidance, streamlining of advice and underwriting processes and utilising technological solutions to improve efficiency
  - Such improvement would facilitate lower minimum purchase prices, further releasing the potential for increased income
- Regulations surrounding retirement products should be set to be sufficiently flexible to facilitate innovation in annuity income shapes
Introduction

Just Retirement

Just Retirement launched in August 2004 and since then has consistently been the leading provider of enhanced annuities in the UK. Enhanced annuity sales of £668 million in 2009 accounted for 12.3% of Open Market Option sales, placing the company 6th overall in the Open Market Option sector. In the second quarter of 2010, this position had improved to 3rd overall.

The company has actively pursued improvements in the Open Market Option by:-

- Campaigning for greater awareness of the right to shop around through our Campaign for Better Annuities
- Campaigning for improvements in the wake-up letters
- Supporting advisers with improvements to their processes to enable more efficient and appropriate advice
- Providing substantial support for real-time rate comparison portals for advisers to streamline processes
- Developing a rate comparison tool to support a non-advised process for smaller funds, which is currently available under the Premier Retirement Services name
- Actively supporting the development of the Origo Options initiative to improve transfer times between providers

Retirement income and annuities

Annuities are the most widespread form of retirement income provision for individuals with defined contribution (DC) funds at retirement, with conventional annuities accounting for 93% of all pension income contracts sold in 2009 and 83% of all premiums. This is in the main because good advice demonstrates the value of the annuity when compared to the alternatives.

The vast majority of individuals in DC schemes have relatively small funds, with 88% of annuity purchases being below £50,000. Annuities offer genuine security to people wishing to provide for their retirement and are often the only reasonable option for those with funds below £300,000:-

- Secure income
- Guaranteed for life, however long that may be
- No exposure to investment volatility
- A range of options to provide for individual circumstances and security for dependants
- Clarity and simplicity

These characteristics, when explained properly, are exceptionally popular with a large audience.
The arguments against annuities are often quoted as:

- Inflexibility
- Poor returns

These arguments may be persuasive for those who can afford to risk substantial losses while money remains invested and who have no significant possibility of outliving their funds. The majority of individuals, however, are not in this position.
A new tax framework for retirement (Chapter 2)

A.1 The level of an appropriate annual drawdown limit for capped drawdown.

Principle 1 in Box 2.A states that “the purpose of tax-relieved pension saving is to provide an income in retirement”. Hence the level of an appropriate annual limit for drawdown should be dictated by the suitability of the product as a generator of income in retirement. This should imply sustainable income through life, rather than an income stream that would be expected to decline or run out after a temporary period.

The distinction between capped drawdown and flexible drawdown contained in the proposals, suggests that the capped drawdown limits should very much be set with an eye on sustainability of income, as the implication is that it is only when the MIR is satisfied that rapid depletion of drawdown funds should be available. We support that implication.

The appropriate annual drawdown limit is tied to a number of factors:

1. The age at which drawdown commences
2. The length of time in drawdown
3. The frequency of reviews of income limits

The issues are thrown into focus by the removal of the break at age 75; because it is as mortality rates become significant (ie at higher ages) that the deficiencies of drawdown as a deliverer of retirement income become critical.

Some specimen calculations are shown below to illustrate key issues. The calculations use industry standard mortality assumptions, ignore expenses, and assume an interest rate of 4% pa is factored into annuity rates. None of these assumptions is especially critical for the overall message.

The table below shows an example where drawdown commences at age 65 and is reviewed every 3 years. At each review the income is reset to equal the annuity which would be available at that time. The drawdown is assumed to deliver the same investment return as the annuity. The figures shown are the income after the review as a percentage of the income before review.

<table>
<thead>
<tr>
<th>Age at review</th>
<th>68</th>
<th>71</th>
<th>74</th>
<th>77</th>
<th>80</th>
<th>83</th>
<th>86</th>
<th>89</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income %</td>
<td>97.2</td>
<td>96.4</td>
<td>95.2</td>
<td>93.5</td>
<td>91.0</td>
<td>87.1</td>
<td>81.3</td>
<td>72.6</td>
</tr>
</tbody>
</table>

Of course the resultant outcome for someone who remains in drawdown from age 65 is the cumulative impact of all the above reductions. This is shown in the chart below, as a percentage of the initial annuity income available. For example, this shows that by the age 85 the income delivered from drawdown will be only 66% of the income which could have been guaranteed by annuity purchase at outset. The clear risk is that at those ages individuals will, to the extent of that
reduction, be more in need of welfare support to meet the cost of care, etc. In addition, an individual still in drawdown at that age has complex decisions to make concerning the best option for them, at a time when they may be becoming less able to deal with such decisions.

As a method for setting the maximum income level in drawdown we would propose the following:

- Define a review period (eg 3 years)
- Define a set of annuity factors, along the lines of the current “GAD factor” approach
- Base maximum income levels on the idea that at the following review it should be possible to purchase an annuity to secure that same income amount (on consistent assumptions).
- Define the maximum income available from drawdown in line with the above concept, allowing for a risk allowance (eg 3%) in the calculation of the cost of annuity purchase at review.

The table below shows the maximum income that would result from the above basis, at specimen ages, expressed as a percentage of the annuity income that could be purchased at that age, and also shows the cumulative impact of remaining in drawdown as opposed to buying an annuity at age 65:

<table>
<thead>
<tr>
<th>Age at Review:</th>
<th>65</th>
<th>68</th>
<th>71</th>
<th>74</th>
<th>77</th>
<th>80</th>
<th>83</th>
<th>86</th>
<th>89</th>
</tr>
</thead>
<tbody>
<tr>
<td>Max Income %:</td>
<td>95</td>
<td>95</td>
<td>94</td>
<td>92</td>
<td>91</td>
<td>88</td>
<td>84</td>
<td>79</td>
<td>72</td>
</tr>
<tr>
<td>Cumulative Effect:</td>
<td>95</td>
<td>90</td>
<td>85</td>
<td>78</td>
<td>71</td>
<td>62</td>
<td>52</td>
<td>41</td>
<td>30</td>
</tr>
</tbody>
</table>

The above implies that if (for example) someone aged 74 wished to remain in drawdown, then the maximum income available would be 92% of the benchmark annuity calculation. On consistent assumptions the implication then is that they would be able to remain in drawdown for 3 years and at the end of that period acquire an annuity for an unchanged income (after a 3% risk allowance). If
they decide to remain in drawdown for a further 3 years then the maximum income available would only be 91% of that amount, for the following 3 years.

As with any drawdown structure the ultimate problem is that the income supportable will fall over time, for those who remain in drawdown. The chart below shows the profile of income for some entering at age 65 and staying in drawdown.

![Chart showing the profile of income for drawdown and annuity income](chart.jpg)

The above calculations make no allowance for potential investment outperformance within drawdown. In principle, investment outperformance comes at the expense of increased risk. In addition, drawdown vehicles tend to be more costly to administer than annuities, and tend to involve a higher cost of advice. Hence, any claimed outperformance has an additional hurdle to overcome before it represents genuine outperformance. Furthermore, the risks in drawdown arising from poor investment performance in the early years are very high, as a result of pound-cost averaging operating in reverse. It is therefore suggested that no allowance for potential outperformance is incorporated into considerations of the maximum income available from capped drawdown, and indeed that a risk allowance is incorporated into the maximum income calculation, as above.

The fundamental issues in relation to Question A.1 are therefore as follows:

- Drawdown vehicles cannot, by their very nature, offer a stable income stream for life at any level above the running rate of interest generated by the capital.
- Annuities can do this because of the mortality cross-subsidy.
- This distinction becomes especially pressing at ages 75-80 and upwards, because of the relationship between age and mortality rates.
• It is in the same age ranges that care needs start to become an increasing factor for elderly people, so reductions in pension income at those ages are likely to translate into increased welfare costs for Government.

• Also from those age ranges, many elderly people start to suffer from increasing cognitive problems, rendering them less able to make complex financial choices and more vulnerable.

• It is therefore appropriate for the limit on capped drawdown to be below an annuity benchmark level at all ages, and for it to be increasingly below such a benchmark as age increases. An approach to this question has been outlined above.

While we appreciate a desire for simplicity in the new regime, this would suggest a capped drawdown limit substantially below the current level in order to protect those at higher ages from rapid fund depletion.

A.2 Its intended approach to reforming the pensions tax framework, in line with its commitment to end the effective requirement to purchase an annuity at age 75.

We believe the proposal for the tax regime is appropriate subject to the following points with regard to lump sum benefits payable on death:-

1. The size of annuity funds at retirement indicates that most annuitants have not benefited from higher rate relief on contributions prior to retirement and a recovery charge of 55% on annuity or pension protection lump sums is, therefore, penal. Additionally this charge will distort decisions on whether to select death benefits in the form of guaranteed payment periods (currently a maximum of 10 years) or annuity protection. At the very least it should be permissible to offer value protection in the form of continued annuity payments (even if this implies a longer than 10 year period) with the tax treatment being in line with guaranteed payment periods.

2. Current annuitants with annuity protection on their policies entered the arrangement with an expectation of a recovery charge of 35% and, from the date of implementation of the new rules, will be significantly disadvantaged. These annuitants will also not benefit from the removal of the age 75 limit since their income was set assuming the protection would cease at age 75.
   a. It is appropriate to maintain the recovery charge at 35% for these annuitants since
      i. Numbers with annuity protection are very low
      ii. There is a definite cut-off date for these benefits
Minimum Income Requirement (Chapter 3)

A.3 What income should be considered ‘secure’ for the purposes of the MIR and whether proposals for the life annuity income that can be considered for the MIR are practical and appropriate.

As per the proposal we believe that the following vehicles should be considered secure:-

1. State pension benefits, excluding State Pension Credit
2. Defined benefit occupational pensions with escalation and, if applicable, a spouse pension payable in the event of the member’s death
3. Lifetime Annuities with escalation of at least LPI and, if applicable, a spouse pension payable in the event of the annuitant’s death

Level, non-escalating, pensions or elements of pensions from DB or DC arrangements may be included but should be substantially discounted from face value of the income payable, dependent on the age of the individual.

Additionally, while the consultation paper suggests that only pension income will qualify for the MIR, Purchased Life Annuities provide a guaranteed lifetime income with the same features as a pension lifetime annuity, excepting the tax treatment. Given the nature of this vehicle, there is a strong case to treat any existing Purchased Life Annuity with an escalation rate of RPI or fixed at greater than 2.5% as qualifying towards MIR.

A.4 What an appropriate level for the MIR should be and how the MIR should be adjusted for different ages.

Principles

The level of the Minimum Income Requirement should:

1. Be simple to monitor, update and understand
2. Be robust and integrated with other measures
3. Provide for a comfortable standard of living in retirement
4. Aim to avoid relative poverty
5. Remove the possibility of qualifying for State Pension Credit for a considerable period beyond average life expectancy (at least 10 years)

The MIR should not be viewed as a benchmark for allowing pensioners to live in poverty while avoiding the ability to claim state benefits as this would be particularly difficult for future administrations as well as the pensions industry and would require further dramatic remedies at some point in the future. It is, therefore, reasonable to set the MIR at a level to ensure they do not
fall below the government’s own definition of relative poverty at any point during a reasonable lifespan.

Since there is to be a Care Commission report in July 2011, consideration of inclusion of the cost of care in the MIR should be deferred until this report is complete but the regulations surrounding provision of income from pension funds should be amended to allow for suitable insurance to meet the ongoing costs of care from retirement income products. The need to provide for future care requires consideration of all assets, including additional flexibility in pension income and the ability to release funds from property in the appropriate circumstances. This area does, however, support the case for a high Minimum Income Requirement.

**Benchmark**

For simplicity the MIR each year should be set with reference to a widely available benchmark that is used for other purposes.

The most obvious choice, therefore, is the level of median earnings as determined by the Annual Survey of Hours and Earnings (ASHE). A summary of these for April 2009 is shown below.

Once retirement income commences payment, it may rise at RPI or at a fixed rate. Given that the qualification for MIR is an income rising in line with the Limited Price Index capped at 2.5% p.a., the level of relative poverty will, in general, rise more quickly (in line with average earnings). Over rolling 10 year periods starting in 1971, growth in AEI has never been less than 1% p.a. higher than the growth in RPI and has been as high as 2.8% p.a. greater.

The level of MIR should be set so as to ensure that income does not fall below the relative poverty level during a reasonable lifespan.

The charts below indicate that even if AEI growth were no higher than 1% above the capped escalation rate, relative poverty would be achieved after 31 years if the MIR were even 80% of Median Earnings. If the gap between AEI growth and RPI growth is equal to its average between 1988 and 2008, relative poverty would be achieved after 13 years if MIR were 80% of median earnings and 23 years if it were 100% of median earnings.
Comparison of MIR with poverty measures if AEI growth 3.5% p.a.

 Median earnings £25,800

Comparison of MIR with poverty measures if AEI growth as per 1988 to 2008 average

 Median earnings £25,800
For a 65 (or 66 year old), 23 years of remaining life is eminently possible and for a couple of this age, the survival of one beyond 23 years is highly probable.

**Level of Minimum Income Requirement**

*As a result of the above, we recommend that the MIR at State Pension Age is set at 100% of median full-time earnings for the UK.*

This level would also be appropriate for lower ages since MIR would have to be provided without the benefit of State Pension (which would not be available until State Pension Age) and, although the income would then decrease relative to median earnings, the commencement of Basic State Pension at SPA would restore the balance from this age and the level of BSP is set by reference to the average earnings index. The fund size required at age 55 to provide an income equal to MIR would be in the order of £800,000 at current rates.

At this level, there is a low (but not zero) chance of income falling below the level of State Pension Credit.

*MIR should also include allowance for a high level of spouse’s pension for those who are married.* The alternative is to test each partner against the MIR separately at the point either partner wished to access flexible drawdown and this would not be practical. The level of spouse pension should be at least 67% of the annuitant’s own pension although there is an argument for 100%.

**A.5 Whether a different MIR should be set for individuals and couples.**

The figures above show that MIR equivalent to median earnings should avoid a drift into poverty and reliance on state benefits for couples. If a different level of MIR is selected for individuals, given the additional costs of living for individuals, we would suggest the limit is still related to median earnings and no lower than 80% of median earnings.

**A.6 How often the MIR level should be reviewed.**

Dependent on the level of MIR selected, we believe a review no less frequently than once every three years would be appropriate for new instances of flexible drawdown. A longer period may result in the MIR falling perhaps 20% below the level of median earnings, thus increasing the risk of a fall into relative poverty.

The revalued level of the MIR should apply, in common with other revaluations, from 6th April each year.
A.7 How to minimise unnecessary burdens for individuals and industry in the assessment of the MIR.

Early notification of the Minimum Income Requirement is a pre-requisite to support thorough advice.

Obtaining the necessary confirmation of pension amounts should rest with the individual, although it is likely that this task will fall to the adviser in the vast majority of cases.
The UK annuity market (Chapter 4)

A.8 Whether other legislative or regulatory barriers remain whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance risks.

There are certain aspects of the regulations surrounding payment of lifetime annuities that restrict the ability to provide flexibility of income on specific events. In general, we would like to see a structure that improves providers’ flexibility to introduce specific features for specific circumstances even if these are only likely to be attractive to a small proportion of annuitants. These would include, but are not restricted to:

- A step up in income in the event of a diagnosed need for care
  - This would enable income to increase to help pay for the cost of care
  - Brief investigation of this issue suggests the amount of the step-up could be substantial
  - This is a particularly important issue given the increasing focus on the costs of care and the likelihood that individuals will have a greater responsibility for providing for their own care following the report of the Care Commission in July 2011

- A step down or up in income on certain events
  - Current rules prevent income to the annuitant reducing or increasing in the event of the death of the spouse or dependant as the spouse or dependant is only a contingent beneficiary of the pension rather than joint owner. As an example, someone whose spouse has a large pension with no dependant’s pension, but who themselves only have limited pension savings, may wish to purchase an annuity which increases on the death of their spouse.
  - A facility to reduce income on the death of either annuitant or spouse would result in a higher initial income than is currently available under an annuity with spouse’s pension. This may be appropriate for couples planning together, where living costs will fall should one of them die.

- Greater flexibility in allowing income to fall in line with other indices or factors such as population mortality, which may allow a higher income to be paid early in retirement when an annuitant may have more need of the income. Allowing income to fall if population longevity increases may significantly reduce the capital requirements on annuity providers, and so permit them to offer better annuity rates, with comparatively little impact on the insurance protection provided to the customer (which is primarily to protect them against running out of income through being one of the longest survivors within their birth cohort).

- An easement of the drawdown cap where a limited period annuity is used to ensure that a natural income could be provided for the limited period in question without the necessity to hold back income. This could be achieved in the approach suggested earlier in our
comments by removing the risk element from the basis used in determining the income cap for drawdown.

The ideal approach to encouraging attractive products would be one where clear principles are defined, and any product design which is consistent with those principles is acceptable. However, it may be difficult to cope with all potential avoidance mechanisms through this route without imposing costs on Government in commenting on ideas. One possibility is to remove most constraints on product design provided that the product contains an absolute guarantee of a minimum level of income for life. Setting such a guarantee at a meaningful level prevents mechanisms which are aimed at depleting funds too quickly, but setting the guarantee too high would limit product flexibility too much. For example, a product might avoid design constraints provided that it guarantees that income of at least (say) 75% of the starting level will be provided for life, except in defined circumstances (eg to permit reductions on death of spouse).

A.9 How the industry, Government and advice bodies such as CFEB can work to ensure that individuals make appropriate choices about what to do with their retirement savings in the absence of the requirement to purchase an annuity by age 75.

Just Retirement research shows that people are willing to shop around for even quite small increases in income but are put off by:-

- Lack of availability of information and guidance
- Difficulty in comparing rates (easy comparison not generally possible)
- Perception of time taken by the process
- Perception of cost of the process
- Confusion over wake-up letters
- Lack of awareness of what switching might mean for them and the fact that they may qualify for an enhancement if they have medical or lifestyle conditions
  - This situation is exacerbated by their experience in the protection market where medical and lifestyle conditions effectively incur a penalty in the form of higher premiums

Our research indicates individuals would shop around if the amount of improvement is of the order of £5 per week. To an extent this reinforces the need to provide clarity and simplicity in the wake-up process on the benefits of shopping around and simple health and lifestyle questions. Our research demonstrates that significant improvements to the wake-up letter can yield significant results both in terms of the numbers that will read their letter and the action they will take when they do.

In general we believe compulsory use of the Open Market Option would be a good idea but requires a much improved information, guidance and advice framework in order to be effective:-
• Widespread promotion of the benefit of shopping around for a higher annuity
• A structure to support volumes of quotes on an appropriate basis needs to be in place to facilitate easy comparison of rates
  o This is highly likely to involve web-based portals giving access to a wide range of rates and enabling individuals to submit medical information for use by all providers
• Guidance or information needs to be easily available at suitable cost
  o This would include an easy way of collecting medical information
  o Alternatives to full advice, such as assisted purchase, may be a pre-requisite
• Wake-up letters need to be shorter and simpler to avoid confusion leading to inertia
  o In the event of compulsory OMO, inertia could result in large numbers of individuals doing nothing at all
• Concise details of the pension fund for each individual prior to retirement, including:-
  o Open Market value of the fund
    ▪ Protected Rights (before April 2012)
    ▪ Non-Protected Rights
  o GMP details (for Section 32)
    ▪ Pre-88
    ▪ Post-88
    ▪ Revaluation rate
  o PCLS entitlement
  o Type of plan
  o Details of any part of fund arising from pension sharing order or if benefits arise from death of a member
• Focus on communication to ensure people do actually shop around
• Consideration of easing the requirements of the Retail Distribution Review which prohibit advisers from taking commission on investment advice
  o There is a concern that this requirement will deter large numbers with smaller funds from seeking appropriate advice as a fee would be payable regardless of the improvement in income achieved

Greater volume of Open Market business as a result of better promotion, clearer information and guidance and more efficient transaction capability will serve to remove issues around minimum acceptable premiums, which are currently claimed to lock individuals into their existing pension provider. We believe it is entirely possible to reduce minimum acceptable premiums at least to the level required by NEST (£1,500 annuity premium) if these issues are addressed.

Substantial weight should be required to be provided, in any promotional material, to the sustainability of income delivered by a product over the long term. It is essential, for informed decisions to be taken, that a thorough explanation is provided (wherever a guaranteed annuity is not taken) of how the income available from a drawdown vehicle is inherently likely to fall for those who survive. Our view is that this issue is difficult and not well understood, but is absolutely critical to the taking of well-founded decisions.

It is also essential that the downside risks of investment underperformance are emphasised. In an accumulation phase it is possible to argue that people need to take investment risk in order to give a prospect of good performance, and that they are in a position to react if investment performance is
poor. By contrast, in a decumulation phase individuals have very little chance to correct the situation (except by ensuring reduced income) in the event that they take investment risks which do not pay off. It is also that case that increasingly, as they age, the investment horizon over which investment outperformance may generate benefits is continually shortening, and the relationship between risk and return is steadily shifting towards a balance which favours the taking of less investment risk.

A.10 Whether the proposed reforms have unintended consequences that may affect the market’s ability to supply annuities at attractive rates or prevent the annuity market being able to meet likely demand for annuities.

A risk exists that a high cap on drawdowns may encourage its use even by those for whom it is arguably unsuitable. This risk is increased if, post-implementation of the Retail Distribution Review, significant numbers enter drawdown without advice and continue in drawdown beyond age 75.

Given the change in tax treatment on death and the possible reduction in drawdown limits, consideration should be given to a transitional period in which:

- Existing drawdown limits continue for those currently in USP until their 75th birthday, or at least until the end of the current 5 year review period
- The tax recovery charge on lump sums payable on death remains at 35% for those currently in an annuity with annuity or pension protection and those in USP

Current interim arrangements for those aged 75 on or after 22nd June 2010 still require PCLS to be taken on or before the 75th birthday. Will those who turn 75 between now and application of the new legislation be able to take PCLS if they have not already done so?

Tax relief on contributions will still cease at age 75. Will it be possible for individuals to become members of a new pension scheme after their 75th birthday? In particular, will transfers to new arrangements be available after the 75th birthday? This would be a requirement for many of those wishing to move into drawdown after their 75th birthday, for example where current scheme rules do not permit drawdown or PCLS to be taken.

Where benefits commence after the 75th birthday, is a further Benefit Crystallisation Event (BCE) triggered? As an example, consider a member of a Small Self-Administered Scheme (SSAS) who does not draw benefits at age 75. At age 75, a BCE is triggered under the proposed new rules, which is presumably based on the fund value at the time. If the member then commences a Scheme Pension at a later stage, the Lifetime Allowance (LTA) amount would normally be based on 20 times the annual income which may be a lot higher than the fund value at age 75. There may be scope for manipulating the proposed new rules to avoid LTA charges.
Further Information
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Before providing my response I feel some background to my involvement in subject matter would be helpful.

I am the Managing Director of a large regional IFA practice based in Rayleigh in Essex. I have 27 years experience in Financial Services, 24 of which have been as an adviser. I hold advanced CII Pension qualifications (G60, K10, K20 and CF9). My firm employs 28 people, 10 of which are authorised to advise, and is in its 41st year trading. The firm is one of the largest providers of At Retirement advice in the East and we currently manage approximately 500 drawdown accounts with many product providers, mainly via Personal Pension Plans, but with some SIPPs.

We provide retirement advice for 25 new clients per month, and approximately half of these enter into drawdown, with the majority of the balance purchasing conventional annuities, with a small take up of '3rd way' products. Our clients are from a wide socio-economic background.

We are also active in the pre retirement market managing Group Schemes and individual Personal Pensions.

As a consequence of our advice activities we are very aware of the perceptions of the public regarding Pension products, and especially the factors that deter many from buying pensions. As part of the remit of this consultation process is to encourage individuals to provide for themselves, I have taken this as the underlying theme in my response, and see better take up of Pensions as vital for social and economic reasons, and believe my ideas and suggestions would increase the popularity of Pensions significantly.

I am in whole hearted support of the idea to remove the age 75 rules on compulsory annuitisation (for simplicity I shall include ASP purchase in this). My extensive experience in the retail field leads me to conclude that one of the major deterents to investing in pensions is the perception of the loss of funds on death. Whilst the tax reliefs are there to promote pension saving as an income vehicle in retirement, the public still see the gross value of their pension fund as THEIR money, and irrespective of the amounts of relief/tax free growth recieved, they do not like the restrictions placed upon them regarding the loss of funds on death after the purchase of annuities.

Even people of fairly modest funds would like the ability to pass it on to their spouse or children, and whilst the actuarial argument put forward in the Consultation Document (P 17, 4.2) is generally correct, I'm afraid that the public really dont care about cross subsidising others, and would rather benefit those closest to them if at all possible. I am sure that even an actuary would rather leave his/her pension fund to their own loved ones rather than subsidise a pot of unknown annuitants!
It is vital here that we separate theory and ideology from the hopes and fears of real people, and try to understand what motivates them, if we are to be successful in encouraging more of the public to buy pensions.

I also find it perverse that the Defined Benefit sector operates a form of ‘recycling’ where the notional ‘fund’ of a member is recycled to other scheme members on death (or on death of the spouse), whereas there is no facility for this within the Defined Contribution area. I will expand on this later in relation to the proposed increase in the death ‘recovery charge’.

I now lay out my thoughts on the Questions posed in the Consultation Paper.

A.1

I believe the current level of 120% of GAD rates is appropriate for the early part of the retirement period. The majority of Drawdown purchasers do not continually use the maximum facility, our clients on average only draw about 75% of maximum GAD. Nevertheless, the facility to drawdown more, up to the higher limit if needed, is a welcome flexibility and is often used temporarily, for example someone retiring before state pension age who can then reduce it when attaining 65.

I do feel however that there is a potential for this to be ‘misused’ to the customer detriment. There are occasions, where despite warnings, people will draw more than is sensible, simply because they can, and in this regard I believe very strongly that a move back to triennial reviews (rather than quinquennial) would help limit the potential for consumer detriment, as if they were reducing their fund significantly the earlier review would reset this at a lower level at an earlier opportunity.

Triennial reviews are, in my view vital in helping to prevent funds being exhausted and to prevent the consumer falling back on the state.

I would like to make a proposal that I believe would help with the perception and take up of Pensions, and the potential impact of Long Term Care (LTC) costs to the Exchequer. That is to have the facility to significantly increase GAD rates at the point of needing LTC. The average life expectancy of people needing care is less than 3 years, it must surely be fair to allow them to draw a higher level of income to help towards this, either at a fixed level for all or, for example 25% or to be medically underwritten on a case by case basis. I believe this would be relatively simple to administer, most providers are experienced in obtaining the necessary medical evidence, and could be monitored by way of a simple GP or Care Home declaration that the plan holder is still in care. We have numerous clients who are in care, with drawdown funds they can’t sufficiently access to assist in the cost of care. Two of these are in local authority
care as they have insufficient funds to pay full costs, yet could do so if the GAD rates were higher. I see no reason why this could not be adopted. Providers may baulk at the cost if medical evidence were required, but they could choose to pass those cost on via a plan fee deducted from the fund at the point of accessing the higher GAD rate.

As far as GAD rates themselves are concerned, the continued reliance on 15 year Gilt Yields is in need of a review. Drawdown works (usually) because consumers will generally invest in a basket of real assets as well as fixed interest securities, which should provide better growth in the long term. Whilst it would be too risky to link GAD rates to real assets, would it not make sense to link GAD rates to a 'basket' of Fixed Interest securities that also include Investment Grade Corporate Bonds? This is the support mechanism for the temporary annuity market.

A.2

I am pleased to see that there is no suggestion to remove the 25% Tax Free Cash facility. This would be a huge mistake and have a massive negative impact on the public perception of pensions.

I accept that Drawdown income will continue to be taxed at income at the appropriate rates, there is little that can be done here.

I do disagree strongly however with the proposed 55% Death recovery Charge. Whilst I wholeheartedly agree that there should be some recovery of the reliefs given to the contributor if someone else were to benefit from the fund, I feel the 55% is punitive. This recovery charge can simply not be higher than the 40% Inheritance Tax Charge. It must be understood that many (if not the majority of) people in Drawdown will only ever have had basic rate relief, will be basic rate tax payers in retirement, and may not have an IHT liability. To tax them at 55% is punitive and will be a massive dis-incentive, especially once the media have voiced their opinion.

The current 35% tax charge is actually an incentive for people to fund pensions, as it is below the IHT rate. I strongly recommend that the recovery charge is maintained at current the current level.

I do have one significant proposal here, and this relates to the 'recycling' mentioned earlier in my response. We are dealing here with a whole generation of people at or about the point of retirement, who are generally well 'pensioned'. However, as you know, subsequent generations are massively 'under pensioned'. Would it therefore not make very good sense to incentivise the recycling of pension funds on death with a tax incentive? I propose that an additional feature to the current options on death whilst in drawdown would be to offer subsequent generations
(children or grand children) the option not to take the fund as 'cash' subject to the 35% charge, but to take it as a pension fund, without a tax charge, but without the ability to access a Tax Free Lump Sum at the recipients retirement.

I propose that recipients could select this as a total or partial option, ie take some 'cash' now net of 35% and some as a pension fund. It would be relatively easy to administer, the providers would simply transfer the amount selected into a new plan for the recipient, but with a 'nil tax free cash' certificate attaching to it, so that if subsequently transferred the recipient can not claim tax free cash in error.

This would be very popular, it would incentivise pension purchases today, and go some way to help solve the future pension crisis. I have been running this idea past clients for some time now and it has been universally approved of, and clients say they would have funded their pensions better if this had been available to them.

I believe that in view of the forthcoming caps on Pension contributions, and the fact that those with large funds already would have sought some form of protection, that the Lifetime Allowance be scrapped. The testing of this at crystallization and 75 is burdensome, and costly. It can't be fair to limit BOTH the input and the output of Pension funding. It is also a technical area that drives up industry training costs and creates consumer confusion. Additionally, removing would simplify the paperwork at the point of retirement. It is no wonder that OMOs are not purchased by many smaller annuitants. The sheer amount of paperwork that is send to consumers, who often can't warrant paying for advice, can be overwhelming. The majority of the public simply freeze when faced with this level of information and forms, and removing the LTA would simplify the process of crystallization, and might improve the rate of take up in OMOs.

A.3 to A.7

My response to this part of the Consultation will be somewhat shorter than the points covered above.
I do not see any need for the provision of Flexible Drawdown as detailed in the Consultation. I don’t understand why anybody would want to take payments larger than provided for by the capped drawdown provisions. Any benefits would be taxable (probably at 40% due to the MIR) and then the net sum, if not spent or gifted may remain in the estate in a taxable form, and then suffer IHT at 40%.

The majority of my wealthier clients (and FD would surely only be available to them due to the MIR requirements) still see their Drawdown as their primary source of retirement income. They want it to be sustainable and long term (other than those who have been deliberately drawing at the maximum to avoid the loss on death after 75) and rely on other assets to effectively ‘top up’ their pension income.

If the expected 8000 pa take up is based on the number of DC pots in the market place then this, if it were right, would be a significant overestimate. Most of our clients have several pots, on examination of our data base this would average at about 2.5 per person, so therefore the ‘real’ take up rate may be only 3200 pa. Standards Life’s experience in Ireland is that the real take up rate (with less restrictive MIR requirements than those proposed here) is insignificant.

Irrespective of whether there is a need or not for Flexible Drawdown, I believe it is a step too far. The variables involved in a fair and equitable delivery to consumers would appear to be insurmountable. The questions asked on P21 of the Consultation paper alone would need debating for a lengthy periods to come up with any fair outcome for all. The degree of ‘secure’ income proposed is far too restrictive, there must surely be some allowance for capital (but subject to review to ensure the capital is still in place), and to disregard level annuity income completely makes no sense. To secure the appropriate MIR income people will have to commit to expensive escalating annuities that they didn’t want to buy in the first place!

Even once a fair basis of MIR can be determined, the administrative burden would be significant. The MIR would need periodic reviews, but these will not coincide with customer plan reviews, meaning that plan income levels may need amending outside the annual review.

I must point out that the administrative capabilities of virtually every provider in the market place would simply not be able to cope and mistakes would be significant. Much of our administrative time is already spent in rectifying incorrect income payments, incomplete reviews and fund switching errors.

Even if you were to continue with the proposal of Flexible Drawdown, there is no way it could be delivered in the time frame. Not only will providers need to create new systems they will need to train staff, and the adviser market would also require a more considerable lead in time. FD
will bring considerable additional complexity to the point of advice, that would need training and possibly, examination on.

In summary I would propose that the Flexible Drawdown concept be dropped completely, but failing that it is put back for further consideration. To try to implement it for 2011 would be a significant mistake.

A.8

I believe this is best commented on by providers.

A.9

It is difficult to know where to start in providing my views on this point, and I expect much of what I would want to say may not be particularly relevant to the Consultation.

I am concerned that the Consultation paper makes no references to either the part the FSA or Advisers play in the distribution of products and advice in the At Retirement market. There is a real chicken and egg conundrum here. Consumers frequently don’t seek advice as they perceive advice maybe (and probably is for smaller funds) too expensive, and advisers who want to provide advice can’t afford to, because the costs of providing compliant advice that meets FSA requirements is too high.

Whilst there have been historic problems regarding suitability of advice in the past, the adviser market is in much better shape today, and certainly will be post RDR. If the FSA policed their rules more effectively and properly dealt with those firms not providing suitable advice, then consumers could have more confidence in the adviser market place. By ‘advisers’ I do of course mean IFAs, as it is only they that can provide whole of market advice, which is crucial to buying the most suitable At Retirement product or products.

Why is delivering this advice so expensive? As well as meeting FSA general conduct of business and capital adequacy rules, the raft of prescriptive transaction specific rules, guidance and requirements is simply mind boggling. I challenge even the FSA to detail exactly what they want
to see on a transaction file to satisfy themselves there is minimal risk that the consumer MAY have been mis sold.

One of the most expensive ‘items’ for an IFA to deliver is a report to the client that enables them to understand our recommendations, that meets very prescriptive rules, and that shows that we have considered all the clients options. Whilst flexibility in retirement products is a good thing, the permutations of advice that could be given are probably infinite, yet we are expected to justify what has been excluded from our recommendations to satisfy their requirement that the remaining one is right for the client.

Naturally we eliminate some of the obviously unsuitable products and don’t dwell on them in our report, but these can still run to 40 pages with dozens of pages of appendices, illustrations and brochures. There is, to the best of my knowledge no ‘de minimis’ limit at which this is not required, nor a simplified set of rules, where for example only a conventional annuity is the practical option. There really does need to be some attention paid to this if the existing industry infrastructure is to help the large number of approaching retirees who are not all that affluent.

There are of course ‘execution only’ style businesses who will transact annuity/retirement business for a low cost, but I defy any of their customers to show that they have bought the right annuity/product for themselves. There is massive potential for ‘mis buying’.

We need to find a way to reduce the cost of providing advice, and I feel that (post RDR especially) the requirement for advisers to be a MINIMUM of QCA 4 qualified, AND new capital adequacy rules AND banning commission must surely mean that the remaining adviser community should be trusted enough to provide advice without the ridiculous level of prescriptive transactional rules. It must be remembered of course that the consumer has access to a FREE Ombudsman service which can make BINDING awards against advisers, and in the event of their default, the FSCS will meet liability for poor advice.

This triple layer ‘protection’ is simply too expensive, if advisers who have proved their ability by qualification (like accountants, solicitors or even doctors) could be trusted to give advice, with the protection of FOS as a backstop, and the prescriptive transactional rules reduced/eliminated, then we could afford to provide advice at more sensible prices. I believe it would typically halve the current fee level for a moderately affluent retiree.

But what is vital here is that the FSA actually MONITOR the market place to a sensible degree. Their reliance on data from FOS regarding complaints is simply ridiculous. By the time FOS are
involved hasn’t the damage already been done? In the 15 years we have been providing
drawdown advice the ONLY regulatory contact on this subject has been a 'desk based
monitoring’ telephone interview that lasted some 20 minutes. In this I was asked very sensible
questions about process/ qualification etc and they felt my answers did not warrant a follow up
visit!! Whist I’m flattered by this, you can see that it would not be difficult to evade detection
if you were not doing the job properly. The FSA need to focus on monitoring, not simply drafting
more and more verbose regulation (now called ‘guidance’).

This is why, despite a thriving market place and significant consumer demand, the Government
even think there is a need for a telephone advice service. Quite who you will use to staff this,
and how well qualified or experienced the staff will be remains to be seen. But I would expect
that many of the phone call responses will end in 'you need to see an adviser'. There are simply
too many variables to be able to deliver sound advice, over the telephone, especially in relation to
the subject matter of continuing income requirements post 75.

We need to help the good advisory firms deliver reliable advice at sensible prices to meet
government objectives. Especially in the area of buying a pension plan. It is perverse that a
consumer, in just a few clicks on a website can accrue £thousands of credit, yet if they want to
put £50 per month into a pension, they have to jump through hoops to be interviewed, fact
finded, risk assessed, identified, and have a lengthy suitability report. All to satisfy the FSAs
box ticking approach to show that the adviser probably hasn’t given poor advice!

Should you be interested in visiting our practice in order that we can show you just how
cumbersome and expensive the prescriptive regulatory regime is I would be only too happy to
arrange a meeting.

In summary, please let the good advisers do their jobs, we should be able to meet this new post
75 demand if unhindered by regulation. Perhaps a specific 'licence' to advise on this subject
matter is required, and firms that obtain it benefit from a lighter touch regulation?

A.10

I believe this is best commented on by providers.
I hope you will have found my views, and proposals interesting, and would welcome dialogue on any of the topics covered in this response

Martin Lamb Dip. PFS

Managing Director

Joseph R lamb Independent Financial Advisers Ltd
Dear Mr Deakin

HM Treasury Consultation Removing the Requirement to Annuitise by Age 75

I refer to the above HM Treasury consultation.

I note that the response deadline was 10 September 2010.

I should like to apologise for this late submission, but trust that it can still be taken into account.

The Law Society of Scotland’s Pensions Law Sub-Committee should like to respond to this consultation as follows

1. The Sub-Committee agrees with the Government proposed to abolish the requirement to purchase an annuity at age of 75. The current position simply provides insurance companies with profit. Many of the companies themselves have spoken out against the requirement. The notion that an alternative should be provided for a religious minority was confusing and discriminatory on both religious and age grounds as well as economic grounds as an alternatively secured pension was suitable only for those with larger funds.

The Sub-Committee cannot see any logical reason for having to move from income drawdown to alternatively secured pension at any given age.

The Sub-Committee is of the view that savings through a pension arrangement should be given fiscal encouragement and it is therefore appreciated that
protections must be put in place. This can be achieved without the indirect and inappropriate consequences of annuity purchase. On the death of the scheme member the remainder could be used tax-free to provide benefits for the spouse and/or dependants (as defined in the Finance Act 2004) or to charity.

2. With particular reference to the tax rate, the Sub Committee believes that the death tax rate at 55% is too high and will encourage members to extract their funds for tax reasons. The Sub Committee would suggest a figure of 40% to be more neutral.

3. The Sub-Committee notes that the retirement process starts in 13 weeks before the expected retirement date and accordingly this presents practical problems with regard to 6 April 2011 timescale.

4. For a capped drawdown, the Sub-Committee believes that the basis should be the same as for an unsecured pension, i.e. 120% and based on actual age even after age 75.

5. Settling on an MIR for flexible drawdown is, in the view of the Sub-Committee, difficult as the pattern of expenditure in retirement is high at the start when one is fit and becomes lower as one becomes less able and then increases as one enters into long term care.

   In order to avoid state intervention, the MIR would therefore have to be set at the highest level rather than around £15,000 which is likely to be the suggestion.

6. The Sub-Committee notes other options in place of a flexible drawdown. For example, the withdrawal of a lump sum to pay a premium for long term care. Another example may be to allow the direct inheritance of a pension fund on death to a child or grandchild.

   With regard to the pension generation gap, an option to boost the pension pots of younger generations is a desirable outcome. The Sub-Committee notes that if the death rate tax is retained at 55% and the child or grandchild is a higher rate tax payer, the marginal rate of tax is 25%. By way of practical example, £10000 becomes £4500 and if applied as a contribution grosses is up to £7500. If the tax was 25% on ‘transfers on death’ it is neutral for higher rate tax payers (“temporary” 50% rate) and as is an encouragement for basic rate tax payers.

7. The Sub-Committee further notes that if a flexible drawdown is introduced, then some thought is required over any potential impact on double taxation treaties given that the benefits may not be in a form that would fall within a traditional definition of ‘pension’ as a form of regular income in retirement. There is also an issue over the rate as the current basis depends on the form in which benefits are taken and no benefits need to be taken at age 75.
8. The Sub Committee notes that HMRC should provide a certificate in that they should have the necessary information with regard to the individual’s tax position.

I trust that these comments are of some assistance to you.

Should you of course wish to discuss further, please don’t hesitate to contact me.

Yours Sincerely

Alan McCreadie
Deputy Director
Law Reform
Tel: 0131 476 8188
Email: alanmccreadie@lawscot.org.uk
Removing the requirement to annuitise by age 75.
1 About Legal & General

Legal & General is the one of the UK’s largest annuity providers; we manage assets of £22 billion for our annuities customers. Each year we pay more than 590,000 pension customers in excess of £1 billion in pension income. We recognise the importance of tailoring products to an individual’s needs so, as well as our standard rate product, we offer enhanced annuity rates to our clients who have health complications, and have championed the innovation of postcode pricing, whereby customers providing us with their postcode could receive a higher income. By using our expertise, experience and extensive data pool, we can offer customers an increased annuity rate over and above the standard rate, depending on where they live. This shows that an innovative approach to the individual annuity market is not only viable, but more importantly, beneficial to our customers. Whilst we offer annuities to customers with ‘pots’ as small as £5,000, the average size pot for our annuities customers is £30,000. This currently gives the average 65 year old male an annual income of approximately £1,800, which for many provides an important additional income to the state pension.

2 Executive Summary

We welcome the Government’s commitment to encourage higher savings and to fostering a culture of personal responsibility. Annuities perform an important social function by providing a lifetime income to pensioners and protecting them from the risk of outliving their savings. We are pleased that this consultation recognises the social and economic importance of annuities.

We believe that the removal of the compulsion to purchase an annuity by age 75 and the added flexibility provided through capped and flexible drawdown has the potential to deliver benefits. We support the Government in its objective of making the Defined Contribution (DC) decumulation process more flexible, and believe that these proposals should help to make saving in a pension plan more attractive.

Despite only affecting a small cohort of consumers (around 3% of total market annuity sales are to individuals aged over 75), we believe that simply removing the requirement to annuitise will result in more consumers and their advisers looking at alternative products. We believe that the guaranteed annuity (conventional and enhanced) is still the most appropriate product for many consumers and as the benefits of annuities are already underestimated by many consumers and their advisers, any un-intentional undermining of the pension annuity marketplace could be detrimental to the efforts to encourage individuals to save for their retirement.

We fully support the implementation of a Minimum Income Requirement (MIR). We see this as a crucial aspect of adding flexibility to the pensions system, whilst ensuring individuals do not outlive their savings and end up reliant upon the State.

This consultation raises a number of difficult practical issues. These include setting an appropriate level for the MIR, assigning responsibility for calculating MIR, and more broadly, assessing how the changes proposed here can be implemented so as to operate coherently.
within a financial services framework which is going through a period of far-reaching change. Government should not underestimate the practical challenges involved in these proposals.

3  **Appropriate annual drawdown (A1)**

Permitting greater flexibility pre and post age 75 is a positive step, but drawdown limits must be set so as to balance twin objectives of allowing fund depletion (hence minimising IHT planning arrangements) while not permitting fund exhaustion and recourse to state benefits.

The current annuity-based methodology described in point 2.5 of the consultation document provides guidance for the future USP regime but we believe the current 120% maximum limit leaves open the risk of fund exhaustion and requires review. A 100% limit would simply replicate annuity income, but an upper limit of 110% and a lower limit of 40% throughout the term of drawdown (with the minimum on full retirement only) may be a more realistic solution.

Income drawdown limits and levels will need regular review in the lifetime of each individual case; such reviews should be conducted annually from age 75.

4  **Intended approach to reforming pensions tax (A2)**

We support the ‘EET’ approach and the overriding principle of pensions providing retirement income rather than encouraging IHT planning. We therefore agree that the five principles set out in Box 2.A provide an appropriate basis for taxation in this area.

As a general rule, the higher the tax charge on funds remaining at death, the greater the incentive to withdraw funds as early as possible from the pension pot, risking subsequent fund exhaustion.

We therefore support the reduction of the expected recovery charge to around 55%. However, this may still seem a punitive rate for pensioners who have received tax relief at the basic rate throughout their working life. Moreover, we recognise there is a valid argument about regression: it is precisely these basic-rate taxpayers who will be least able under the MIR proposals to withdraw surplus pension funds so as to avoid recovery charges.

We therefore support broader industry proposals to consider a flat-rate recovery charge at 40% or to tax at the marginal rate of the pensioner’s final tax assessment.

5  **Removal of requirement to purchase an annuity**

5.1  **Helping individuals to make informed choices in the absence of the requirement to purchase an annuity by age 75 (A9)**

ABI data suggests that the efforts made by the industry to improve consumer awareness of retirement options and the ability to shop around the market for annuities are working. In this respect, the regulator should ensure that all companies are complying fully with the rules for
pre retirement communications. There is currently a proposal in circulation that aims to make
the Open Market Option (OMO) and shopping around the default for all consumers who are
in the process of purchasing an annuity. Whilst we believe that the OMO is the best option
for many, there is a significant risk that forcing consumers to shop around could result in
many ending up in a state of paralysis and not taking any action. In particular, obtaining
financial advice is already a problem for those with smaller pension funds. Therefore, we
would instead support the route of further developing the communication and education
process and encouraging consumers to shop around rather than compelling them to do so.

Whilst supporting OMO we also believe that insurers should ensure that consumers
understand the decisions they are making. Currently some insurers issue pre retirement
material that includes a default annuity quotation. Issuing such material with a simple tick
box to apply makes it easy for consumers not to consider their benefits and options carefully.
We do not believe this is in the interests of consumers and feel that all insurers should be
required to have some initial dialogue with the customer, to establish what sort of annuity
would be right for them.

6 Minimum Income Requirement (MIR)

6.1 What should be considered ‘secure’ for the purposes of the MIR (A3)

We are strong supporters of the MIR concept and would agree with the proposal for the MIR
to be a requirement throughout life, as this would reduce some of the administrative burden
of implementing this change. We believe that the most suitable vehicle for securing the MIR
is the conventional non-profit annuity (standard or enhanced). We would not include any
other variants such as fixed term annuities or investment linked annuities for this purpose, as
these do not offer the same security of lifelong, guaranteed income.

In respect of pension annuities, the suggestion that annuities qualifying for MIR inclusion
would need to be indexed raises issues due to the cost of such an option. However we
agree that it is appropriate to include some form of indexation/escalation for the purposes of
the MIR. [We suggest that any annuity purchased for the purposes of meeting the MIR
should escalate at least at a fixed rate of 2.5%, although requiring full indexation in line with
National Average Earnings (NAE) or at least Retail Price Index (RPI) may be more
appropriate.] We would however draw your attention to the potential unforeseen
consequences of indexation, covered below in section 8.

State and Defined Benefit (DB) scheme benefits clearly form an important part of an
individual’s retirement plans and therefore should be included in the calculation of the MIR
but only if these benefits are in payment at the time an MIR calculation is required. As
statutory indexation applies to DB benefits in payment we do not believe any further
requirements regarding indexation are required.
6.2 Appropriate level for the MIR (A4)

Setting the level for the MIR depends ultimately on the Government’s preferred policy outcome. We see the following considerations as important:

- Willingness to accept future risk of pensioners exhausting savings and falling back on the state.
- The impact of rising longevity, with longer retirements and potentially high care costs.
- Retirees’ expectations about replacement income levels.
- The extent to which these reforms are designed to be widespread in their effect, or simply limited to high net worth individuals.

It is a valid policy objective that consumers should only expect to be able to access this additional flexibility if they have already met expectations for a decent retirement income. In a DB occupational scheme, members with maximum service can expect to retire on approximately two thirds of their final pensionable income. Two thirds of average income therefore seems a fair yardstick for most peoples’ expectations of a replacement income in retirement. Average gross individual earned income in the UK is approximately £2,000 per calendar month. Two thirds of this would equate to £1,300 per month or £300 per week. In the absence of care needs this should satisfy the policy requirement to keep pensioners above benefit thresholds, provided escalation is built in.

On an individual basis, we believe the minimum level at which the MIR could be set would be at the two-thirds average expectation of around £300 per week or £16,000 per annum.

In the context of risk, improving life expectancy is an important factor and so in setting the level of the MIR we would also highlight the growing concerns around the provision of long-term care. Consumers have little understanding of the future costs of long-term care and so we have factored both aspects into potential solutions for setting the level of the MIR. According to Partnership Assurance, on average an individual can expect to pay around £24,908 (£479 per week) a year for a residential care home, rising to over £34,000 (£653 per week) if nursing is required. This equates to approximately £570 per week or £30,000 per annum. This ‘with care’ cost presents an alternative, much higher benchmark for setting the MIR.

Taking the mid-point between two-thirds of average earnings and the ‘with care’ cost, we arrive at an intermediate figure of £23,000 (£442 per week). This approximates to 100% of average UK earnings, and represents a sensible compromise, in our view.

For couples, bearing in mind the need for care could be for both partners, it seems sensible to factor in a further 50% contingency. Therefore the minimum level at which the MIR could be set would be £450 per week (£23,000 pa) or £855 per week (£44,500 pa) to cover the cost of residential/nursing care. An intermediate figure would £650 per week (£34,000 pa).

We do not support different MIR levels set by reference to age. This would add an unnecessary level of complexity, and age is already taken into account in the pricing of any annuity purchased.

We would recommend that a further in-depth impact study is conducted which assesses how many households would be affected by setting MIR at different rates.
6.3 Setting the MIR for individuals and couples (A5)

Many items, including state benefits, annuity rates and expenses, currently vary between individuals and couples and we do not see why the MIR should be treated any differently. For annuity purchase we suggest that any spouse/partner benefits are purchased at a rate of 50%, which is in line with State and most occupational benefits. However, there is a risk that a surviving spouse/partner may also require state support in the event of requiring care.

6.4 Reviewing the level of MIR (A6)

We would suggest that the level of the MIR is reviewed annually based on an index created by the Government. It would be consistent for the level of the MIR to increase each year in line with earnings as opposed to prices. For simplicity, the MIR should be set at outset for individuals wishing to take advantage of this new flexibility. A relatively high level of the MIR and indexation requirements should remove the necessity for the MIR to be reviewed on an annual basis for individuals.

6.5 Limiting the burden of assessing the MIR (A7)

The potential inclusion of multiple sources of income could make the process of checking the MIR very complex with a heavy administrative burden and high associated costs. Individual industry providers do not have access to data outside their own book of business, so cannot verify claimed income from other sources. However, many individuals with a retirement income high enough to meet the MIR are likely to have a financial adviser who will be charging their clients’ fees for the services they supply. For simplicity and subject to the existence of straightforward guidelines, we would suggest that a financial adviser or other financially qualified professional should certify that their client has enough secure income to meet the MIR as financial advisers also have a more holistic view of a client’s financial circumstances.

7 Legislative and regulatory barriers (A8)

Implementation of the policy ideas outlined in this consultation presents an opportunity to review, and where possible simplify, regulation around the connected issues of small pots, commutation and crystallisation.

We would also welcome the removal of the age 75 limit for value protection. The annuity value protection option is designed to pay a lump sum (less income payments made and tax) on the death of the annuitant prior to age 75. The benefit of value protection is that individuals are at less risk of losing their annuity ‘pot’ should they die prior to age 75. However, with improving life expectancy, a lot more people should live beyond age 75 and so the benefit of the option is seen as limited. Therefore, the removal of the age 75 limit on the value protection option of an annuity should make this benefit more attractive and as a result some consumers will see annuities as a more attractive option.

We believe that annuities could play an important part in the provision of financial support prior to death and that the payment of the value protection lump sum could also be valuable.
in situations of terminal illness or where care is required and life expectancy is deemed to be short, say less than two years. In these circumstances, a lump sum may be of more benefit than a regular income for the provision of nursing home costs/palliative care and may prevent people from having to sell their home. Furthermore, value protection could be used by consumers to pay some, or all, of any insurance premium that the Government may decide to implement for the provision of Care.

The annuity market is as an important insurance mechanism. It has the potential to be developed further: at one level, pricing can become more competitive and inclusive as a result of more granularity and better underwriting. But the product can also be developed so that it becomes more flexible, to better reflect the way people spend money in retirement, potentially even how they cope with the risk of large very late-stage expenditure –typically in the last year or two of life - as a result of going into residential care. If the individual is forced to take on greater levels of responsibility in deciding upon their financial future, then the industry and government must work in tandem to provide products that allow them to do so effectively.

Our research indicates that there is demand for annuity incomes that vary over time in a pre-determined way in order to match consumer-spending requirements in retirement (U-shaped annuities). We also believe that a small tax-free lump sum death benefit that is payable on death to match average funeral expenses would be an attractive option.

8 Unintended consequences of removing the age 75 requirement

The Government should be careful not to weaken unintentionally the pension annuity marketplace with changes that will potentially benefit only a small section of society. These changes need to be communicated effectively, especially to ensure that the requirement for the MIR is understood. Consumers could be exposed to a wider range of options, which they may find difficult to understand, with a consequent need for a higher level of advice for a greater number of individuals. The potential impact of the Retail Distribution Review (RDR) is that there will be fewer advisers available to give this advice and an alternative source of information may need to be provided by Government.

Some of these proposals could lead to extra costs being incurred by providers and they may have to adjust systems at outset and undertake ongoing additional monitoring and reporting. Costs must be recovered and this may increase charges on products, potentially reducing the level of income received by annuitants.

Should the new rules lead to a large take-up of index-linked annuities, there is a risk that providers will not have access to sufficient index-linked assets in which to invest. A requirement to hedge against inflation risk could add to costs for consumers.

In implementing these proposals, the Government will need to have in mind the need to avoid incentivising transfers from DB to DC schemes which are driven by easier access to drawdown. Detailed regulations will also be required to minimise the risk of inadvertently creating tax avoidance opportunities.

We would also urge caution and consideration as to the implications for situations where Power of Attorney is an issue.
Age 75 consultation
Pension and Pensioners Team
Room 2/S2
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Sirs,

Removing the requirement to annuitise by age 75

On behalf of LV= I am submitting the following comments to assist with the above consultation.

As the UK's largest friendly society we're here to help our customers make the best choices when it comes to their money. We have a range of savings, investments and insurance products that are both good value and award-winning.

We pride ourselves on being a provider of SIPPs, third way, with-profit and enhanced annuities and feel it’s in the interest of our existing members and customers to respond on this consultation.

As a specialist in the at and post retirement market – a position that was enhanced in 2008 by our acquisition of the Tomorrow (formerly GE Life / National Mutual business) – we also believe we are very strongly placed to comment on the specific proposals in this consultation. As National Mutual our business was a leading innovator in the drawdown (unsecured pension market) and the GE Life acquisition also gave us a leading position in the enhanced annuity market.

Before providing our replies to the specific points raised in the consultation we believe that it is useful for us to set out our thoughts on the general principles to be followed.

We have used the following key principles when formulating our response:
- Simplicity
- Consumer understanding
- Fairness

We also want to see joined up thinking that will avoid unintended consequences.

In the context of this consultation we note that the removal of the requirement to annuitise has been supplemented by proposals for more wholesale reform of unsecured pensions. Although some of the ideas put forward are innovative and worthy of further examination we would counsel against making wider changes than is absolutely necessary at this point.
On a wider scale we would support a more joined up approach in Government thinking designed to ensure a brighter future in retirement for all, as well as being affordable for the Government. This needs a wider review of individual measures currently being examined. For example how the proposals resulting from the discussion paper looking at an alternative approach to restricting tax relief will interact with those coming from this consultation. There is also the need to consider other potential future Government policies. For example, the Pensions Minister Steve Webb said back in July 2010 that he is considering allowing people early access to their private pensions in cases of dire financial need.

While we appreciate that the Government does not want people falling back on the state any safeguards need to be proportionate. We believe that a simpler system that may in rare circumstances allow someone to fall back on the state is much better than one that removes all such possibilities but at the price of undue complexity. We feel that in the simpler regime people will be much more likely to build up savings and so in fact reduce the risk overall of them depending on the state.

Responses to the questions in the discussion documents are on the next page. We would be happy to discuss these in more detail if required.

In summary are proposals are:

- Maximum Capped Drawdown should remain at 120% of GAD up to age 75.
- After age 75 we suggest a small sliding reduction to the maximum Capped Drawdown
- The flat rate tax charge on lump sum death benefit should be 40% not 55%.
- Lump sum death benefits (except death in service and pension term assurance) from uncrystallisation funds should be subject to a tax charge.
- Remaining pension funds on the death can be passed onto a family member of an individual to be invested in their pension. This would be subject to a reduced tax charge.
- In view of the complexity (for example issues around the MIR) consideration should be given to delaying the introduction of Flexible Drawdown
- Consider withdrawals from Flexible Drawdown being subject to a flat rate tax and not taxed at the individual’s marginal rate of income tax.

Yours faithfully

Vince Flanagan
01202 542130
Vince.Flanagan@lv.com
Questions

Developing a new tax framework for retirement (Chapter 2)

A.1 The Government welcomes views on the level of an appropriate annual drawdown limit for capped drawdown. [Question page 9]

In our experience most people do not choose income drawdown at the maximum permitted level – analysis of our existing book suggests less than 15% took maximum income in the past 12 months. Since income drawdown has been available we have also only seen a handful of cases where customers have exhausted their pension fund.

When a person goes into income drawdown normally a financial adviser will be involved. Where the maximum drawdown amount each year is being recommended they would have to justify why this would be in their client’s best interests. We believe that by having a higher capped limit the amount taken in any year can be adjusted to meet the client’s changing needs.

While we appreciate that the Government does not want people falling back on the State any safeguards need to be proportionate. We believe that a simpler system that may in rare circumstances allow someone to fall back on the state is much better than one that removes all such possibilities but at the price of undue complexity. We feel that in the simpler regime people will be much more likely to build up savings and encourage personal ownership which will reduce the risk overall of them depending on the state.

As a result we suggest that up to age 75 the yearly drawdown limit should be retained at 120% of GAD. We feel that this approach also meets the need for the capped income to be seen as transparent and fair. The continuity of retaining the current limit for these individuals should also help with the transition to the new regime from 6 April 2011. We have considered alternative means of setting the limit (for example based upon the average of annuity rates available in the market) but feel that they would be harder to track and administer.

We accept that the risk of pension funds being exhausted increases with age. So from age 75 we can see the case for a reduction in the yearly drawdown limit.

Currently there are no GAD tables for ages over 75 so it is hard to judge the impact on income and so the appropriate percentage of GAD that should be used. There is also the increasing possibility that people in this older age group will require long term care. If the income drawdown income that can be taken by people over age 75 is too restricted they may have to fall on the state or alternatively be forced to buy an annuity – this is the outcome that this consultation expressly is designed to avoid.

Ideally we would recommend that final rules are delayed until the picture is clearer (for example when firm proposals are established to cover the cost of long term care).

In the meantime we would suggest that any decrease for individuals over age 75 should be minimal.
For example decrease the GAD thresholds in say three bands.

- 120% up to 75
- 100% from 75 to 85
- 80% from 85 or above

We did consider if there should be a requirement to take a minimum level of income drawdown each year as currently is the case from age 75. Our conclusion was that this was not necessary. If evidence comes to light that the lack of such a requirement is causing abuse then we would suggest that inheritance tax could be used to deter such behaviour.

Consideration needs to be given to how often the capped income drawdown needs to be calculated under the new regime. We would favour retaining the current automatic review cycles of every five years up to age 75 and beyond, although would accept a more frequent review after 75 if the Government felt this was necessary to ensure withdrawals were sustainable. It should be remembered that individuals would usually review arrangements on at least a yearly basis with their advisers and also have the opportunity to request a formal review of income limits on a yearly basis from the product provider.

With regards to the change to the new rules for calculating the maximum drawdown we recommend that the approach taken at A-day should be followed – that is the scheme administrator should be allowed to choose when to make the change.

**A.2 The Government welcomes views on its intended approach to reforming the pensions tax framework, in line with its commitment to end the effective requirement to purchase an annuity at age 75. [Question page 12]**

In answer to this question we have looked at how the proposed regime could be made simpler and so get more engagement from consumers.

To do this we explained

a) why we believe that an automatic check at age 75 against the lifetime allowance (LTA) should no longer be required and

b) how lump sum death benefits should be taxed.

c) We have also commented on the proposals for a new Flexible Drawdown arrangement to be introduced.

**No need for a test against the LTA at age 75**

We agree with the broad thrust of the approach but feel that it does not go far enough. While the need to purchase an annuity or go into ASP at age 75 has been removed the requirement to check against the lifetime allowance (LTA) at age 75 has been retained. In our response to the HM Treasury discussion document on the alternative approach to restrict tax relief we propose that in a lot of instances the need for checks against the LTA could be abolished.

If our proposal is rejected we would recommend that the test against the LTA only takes place when pension benefits are taken. We believe that doing away with a mandatory benefit crystallisation event (BCE) at age 75 will save time and money for pension schemes and HMRC. For example, a client does not want to take any pension benefits until their 80th birthday so it will be then that the BCEs (taking a pension commencement lump sum and going into USP) will occur. At that point the...
member is engaged and the pension scheme administrator has to do the work to crystallise the pension benefits.

**Taxation of lump sum death benefits**
We welcome the removal of the old complex rules around the taxation of death benefits after age 75. However, while we agree with having a flat tax charge payable for all people with unused unsecured pension we feel that the proposed rate of 55% is too high.

Having a rate as high as 55% will in our view push people into other savings vehicle and encourage people to burn up their pension funds. So it appears to us that the proposal goes against the very things that you are endeavouring to promote.

Most people in USP will not have sufficient secure income to take advantage of the new Flexible Drawdown. However, people who do can strip out their pension funds as income paying at the most 50% tax and more likely 40%. So when they die in unsecured pension there will be little, if any, of the fund subject to the 55% tax charge. This is unlike the vast majority of people who will not have this option and their unsecured pension funds on death will be subject to the 55% tax charge.

Where people are in Flexible Drawdown a fairer way may be to tax any income drawdown at the flat rate (55% proposed) rather then at their marginal rate of tax. This would result in the same tax rate being deducted with the only issue being in the timing.

While, if adopted, this would introduce some fairness we would still have concerns and would favour the flat tax rate being reduced. We would recommend a rate of 40%. We can see that a case could be made for a slightly higher rate, but higher then 45% does not seem appropriate.

We appreciate the need to generate the same tax revenue but we believe that a fairer way would be to tax lump sum death benefits from uncrystallised funds. This would also in our view be fairer as the current regime means a different outcome for an individual that dies just before or after a crystallisation event.

Our proposal is that 25% of the uncrystallised fund is paid out tax free and the remaining 75% is taxed at the new flat rate for unsecured pensions. For example if a member died with a pension fund of £100,000 and the new flat rate is 40% as we recommend any lump sum death benefit would be subject to tax charge of £30,000. We believe that this measure would generate sufficient income to allow you to reduce the flat rate tax charge to 40%.

We would propose this for the majority of pension arrangements where the main purpose is to provide the member an income in retirement. Such pension arrangements would also have the infrastructure to provide a dependant’s pension benefits (for example dependant’s income drawdown) where required as an alternative to lump sum death benefits. An example would be where a member died and left a young family.

However, there would not be the tax charge for arrangements that were solely taken out with the view to provide a lump sum death benefit (pension term assurance or death in service benefits). Unlike most pension arrangements with these from the start the expectation from all parties would be that either the member lived to the
date when the cover ceased (for example scheme retirement date) or they died and a tax-free lump sum was paid out.

To support the message that building up pensions is important and to be encouraged we believe that another option should also be considered. This would be to allow the remaining pension fund of a deceased individual to be passed onto a family member as an addition to their pension fund. While the family member’s increased pension fund will in due course be subject to tax (for example when they start to take an income) we appreciate that there will be a delay before the tax relief provided is recovered. In view of this we would recommend a lower flat rate tax charge (for example 20%) is deducted from the pension funds transferred to the family member.

As a further point of context here, we note that the proposals on restrictions of tax relief suggest a cap of 40% on the amount of relief that can be claimed. If this is introduced we feel this reduction will appear more significant if accompanied by a sizeable increase in the tax on pension death benefits. The unintended consequence here is that the media seize on this and pensions are seen as poorer value, further damaging the environment for saving for retirement that we are trying to encourage.

Flexible Drawdown
We welcome the innovative suggestions around Flexible Drawdown designed to afford greater flexibility in retirement – which in turn should provide a boost to pension saving where individuals feel that the system will provide sufficiently flexibility in later life to fit their specific needs at that time.

However, we do have reservations around the specific proposal, primarily for the following reasons:

- Complexity associated with the Minimum Income Requirement (MIR) – see our responses to questions A3 to A7 provided below
- The likelihood that this option will only work for those with relatively large funds who in any case are less likely to fall on the state – making it difficult to justify costs associated with the introduction versus likely benefits
- The need to look at retirement issues more holistically – for example if someone has prefunded long term care, could this mean that the requirement for MIR should be lowering?

As a result our view is that further consultation is required on the potential for Flexible Drawdown to work effectively and that this proposal should be deferred pending this discussion rather than introduced in April 2011 (with the inherent risk that the detailed rules are then rushed and will require significant rework).

Minimum Income Requirement (Chapter 3)

A.3 The Government welcomes views on what income should be considered ‘secure’ for the purposes of the MIR and whether proposals for the life annuity income that can be considered for the MIR are practical and appropriate.

[Question page 14]

We have answered these questions in the spirit that the consultation suggests, however, we would point out that we have distinct reservations regarding the introduction of Flexible Drawdown which we covered in our answer to A2.
As explained below we believe that there is no need for secure income to increase in payment to be considered for the MIR. In fact we argue that such a proposal is counterproductive and acts against a lot of people’s best interests.

We believe that the level of secured income that would be required to meet the MIR would make Flexible Drawdown a niche product that would be irrelevant to most people. In our opinion it is also important that the requirement to meet the MIR operates fairly and does not drive undesirable behaviour.

With the MIR we agree that to be classed as secure such income must be guaranteed for life. However, we would question that to count as secured income it must increase each year by the lesser of the increase in prices or 2.5% - that is at least by LPI.

These reforms are intended to provide a more flexible future but the requirement for secured income to increase by at least LPI appear to be looking back at a past when a lot more people had access to a good quality defined benefit (DB) pension scheme. In the private sector there has been a movement over a number of years towards defined contribution (DC) pension provision. This is not currently the case for the public sector but the whole future of public service DB pensions is currently under review.

Where people in DC pension schemes have a choice the overwhelming experience is that they choose a level and not an increasing annuity (for example by LPI or a fixed percentage). This appears entirely logical as increasing annuities for a lot of people represent poor value for money and do not match their needs. As is noted in the paper (section 3.14) a person typically needs the highest level of income in their early years of retirement. This would favour a level annuity where the starting income is significantly higher than an annuity that increase by LPI. For most people with the same pension pot it would take the best part of twenty years for the LPI annuity to overtake a level annuity and start to break even.

While people are now living longer the trend that the Government want to support is for them to work longer if they wish.

As we explained in our answer to question one, we believe that a simpler system that may in rare circumstances allow someone to fall back on the state is much better than one that removes all such possibilities but at the price of undue complexity.

There is also the lack of suitable investments to back LPI linked annuities. Unless the Government makes suitable gilts available this problem will only get worse with the move from RPI to CPI. The lack of suitable investments means that these assets are expensive and thus not good long term value for the consumer.

We do accept the risk of inflation but believes that a better approach is to allow level annuities but have a cushion by setting a higher starting level for the MIR. There is also the fact that the Bank of England in line with its directions from the Government is working to retain a low inflationary environment.

As we mentioned in our answer to A3, payments made out of Flexible Drawdown could be taxed at a flat rate rather than via PAYE at the client’s marginal tax rate. As well as the question of fairness that we mentioned earlier this should generate extra income for the Government and could help stop tax avoidance.
From the notes (note 13) we see that at a later date technical provisions will be issued with more details. Given that the MIR is to be measured at a single point in time, the subject of pensions sharing on divorce should be covered in the technical paper.

**A.4 The Government welcomes views on what an appropriate level for the MIR should be and how the MIR should be adjusted for different ages. [Question page 15]**

We explained in our answer to question three why we believe that level annuities should be included in the MIR. The MIR should decrease with age (the shorter the life expectancy the less of an issue inflation is likely to be) and include a cushion.

People, pension schemes and the Government will all benefit if the MIR requirements can be keep as simple as possible.

Our proposal for the level of MIR would be as follows:

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<thead>
<tr>
<th>Age</th>
<th>Percentage of MIR</th>
<th>Amount</th>
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<tbody>
<tr>
<td>55 to 60</td>
<td>100%</td>
<td>£40,000</td>
</tr>
<tr>
<td>60 to 65</td>
<td>90%</td>
<td>£36,000</td>
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<tr>
<td>65 to 70</td>
<td>80%</td>
<td>£32,000</td>
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<tr>
<td>70 to 75</td>
<td>70%</td>
<td>£28,000</td>
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<tr>
<td>75 to 80</td>
<td>60%</td>
<td>£24,000</td>
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<tr>
<td>80 or above</td>
<td>50%</td>
<td>£20,000</td>
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Alternatively to decrease the likelihood of people running out of funds Flexible Drawdown could only be available from an older age (for example at age 65 or the state retirement age).

**A.5 The Government welcomes views on whether a different MIR should be set for individuals and couples. [Question page 15]**

While the idea has some attraction we believe that the complexity introduced by having a different MIR for couples would outweigh the benefits.

- While the MIR is checked at a single point in time a couples circumstances can change significantly over time – for example get divorced, partner die.
- It is not practical for providers to be expected to keep a check on status.

**A.6 The Government welcomes views on how often the MIR level should be reviewed. [Question page 15]**

We believe that, as with various other limits, the MIR should be reviewed each year, with the new figure announced in September for implementation in the following April. This should give sufficient time for providers to update literature.

**A.7 The Government welcomes views on how to minimise unnecessary burdens for individuals and industry in the assessment of the MIR.**
We have concerns that if the industry needs to police the MIR it will be complex, costly and time consuming. The need to collect and vet the paperwork would inevitably result in queries and disagreements as a result of these checks.

In line with a number of existing requirements (for example tax relief at source) we believe that the pension scheme should be able to take as proof a declaration from the individual in question.

If pension schemes are forced to police the MIR requirement there should be clear guidance from HMRC as to what would be considered acceptable evidence. This should also be material currently sent out by pension schemes/annuity providers (for example P60 or annual statements) to avoid extra costs. We would also want good warning of any information requirements as they would likely involve IT changes (for example to the information captured on the Event Report).

The UK annuity market (Chapter 4)

A.8 The Government welcomes views on whether other legislative or regulatory barriers remain whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance risks. [Question page 18]

We believe that further clarification of how inheritance tax would operate under the new regime would be useful.

Until we see more of the detail of how the proposals will operate it is hard to see if there are other issues that need to be addressed.

Although technically not a legislative or regulatory barrier as such, we would recommend further action from the Government to improve awareness of the open market option at retirement. In our role as founder members of the Pension Income Choice Association (PICA) we would welcome any action to reinforce the proposals put forward by PICA to improve consumer outcomes in this area.

A.9 The Government welcomes views on how the industry, Government and advice bodies such as CFEB can work to ensure that individuals make appropriate choices about what to do with their retirement savings in the absence of the requirement to purchase an annuity by age 75. [Question page 18]

To address the issue stated in the paper (section 4.20) it is important that a clear message is given by all parties that annuities are the right product for a lot of people.

A lot of good work has already been done to flag with people their options when they come to take their pension benefits. However, we believe that all parties including the Government need to build and develop this understanding to improve general public awareness and engagement on the issues. A well worded wake up letter is no good if the recipient does not read it and only puts it behind the clock on the mantelpiece. With this in mind, we would reiterate our comments made in our response to question A.8 in terms of the recommendations made by PICA.

A.10 Whether the proposed reforms have unintended consequences that may affect the market’s ability to supply annuities at attractive rates or prevent the
annuity market being able to meet likely demand for annuities. [Question page 18]

As we mentioned in our answer to question three we have concerns that Flexible Drawdown could trigger undesirable behaviour with people with large pension funds burning them up to avoid the flat rate tax charge.

This could be made worse if people go into Flexible Drawdown and then move abroad to avoid having to pay tax on the uncapped income they are taking out of their pension plan.

We are also concerned that the current proposal that secured income for MIR must be provided by a LPI linked annuity will cause issues. In our answer to question three we have gone over why we do not believe that this is in the best interest of the customer in a lot of cases.

There is also the issue about of the lack of suitable investments to back LPI linked annuities. Unless the Government makes suitable gilts available this problem will only get worse with the move from RPI to CPI.

Using level annuities is simple and is what the general public understand and often is the best choice for them. Allowing this option within the simpler regime we recommend will get customers more engaged and likely to build up pension savings. This will help to achieve the Government objective of keeping people off mean tested benefits.
Living Time Ltd
Response to HM Treasury consultation: *Removing the requirement to annuitise by age 75*

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<thead>
<tr>
<th>Consultation Point</th>
<th>Living Time’s Comments</th>
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| Views on the level of an appropriate annual drawdown limit for capped drawdown | It is our view that the maximum income under a capped drawdown remains at a level similar to that available currently. The reasons for this are threefold:  
1. The very reason to use drawdown over annuity is flexibility; in many ways flexibility is drawdown’s *raison d’être*. Living Time would like to propose that this income flexibility up to 120% of a standard lifetime annuity is retained in order to offer consumers choice. If the maximum is reduced then the range of options to many consumers will be reduced, which will not be to the benefit of those in retirement or in generating competition and innovation across the industry. If the Government has concerns about over erosion of funds then the current five year reviews could be reduced to triennially, for example, so new maximums are introduced earlier for poorly performing capped drawdown funds.  
2. The GAD tables merely reflect an expectation by the GAD of what annuity rates would be in normal market conditions; it would be extremely rare for a 100% GAD rate to truly reflect actual annuity rates available in the market. Offering scope for clients to select higher than 100% GAD would allow income to be selected at a level that at least matches that available from an annuity in market conditions where 100% GAD is in fact below the current annuity rate.  
3. Providers have existing controls and measures in place for this income maximum and maintaining this would expedite the transition from unsecured pension to capped drawdown. |
| Views on what income should be considered ‘secure’ for the purposes of the MIR | The consultation refers to income being ‘secure’ when the source is from the State Pension, a defined benefit scheme pension or the purchase of a compulsory purchase annuity with indexation. Whilst Living Time appreciates that the Treasury will need to be comfortable that the MIR sources are ‘secure’, we would encourage the Treasury to broaden the scope for the categories of products to be included. Broadening the scope will drive product innovation both inside and outside of the pension tax environment.  
1. The current definition does not allow product providers to utilise fully pension tax legislation when developing products to help consumers meet MIR. Living Time do not believe this is the Treasury’s intention but we wish to explicitly clarify this to avoid any unintended consequences. Living Time urge the Treasury to allow benefits secured within the Unsecured Pension/capped drawdown environment to be regarded as suitable to meet the MIR on any benefits that provide an income for life with an element of indexation. This will enable consumers to benefit from future product innovations that could potentially allow them to opt out of a lifetime contract and to secure an alternative arrangement (that still conforms to the MIR requirements). Living Time’s experience since launching its innovative Fixed Term Annuities has demonstrated customers value the opportunity to keep their options open to allow them to make changes to their benefit structures for major changes in their life such as the onset of a serious health condition or the death of a partner. We believe the industry should pursue the challenges to meet this need whilst providing reassurance to the Treasury of a guaranteed income. An example of such a contract would be one that provides an income of £6,000 per year of which say £3,000 is guaranteed for life with indexation.  
2. In addition, as the Government’s intention is to ensure minimum income requirements are met, then the exclusion of non-pension income seems inconsistent with that view, as the source of income should not really be relevant. Therefore if a client has secured a guaranteed income via a non-pension asset then as long as the asset cannot be surrendered it should be included in the calculation of MIR. The basis of the non-pension income source should match the requirement the Government make of pension annuities. Living Time believes that including non-pension assets for MIR calculations will have a positive impact on product development improving both choice to the consumer and innovation in the industry. |
Living Time view the MIR equal to that at which state benefits become payable to be sufficient to meet the Government’s goals. If a relatively high figure is set, it may make meeting the MIR too prohibitive in cost that only the wealthy can afford to use the flexibility of flexible drawdown to meet their retirement aspirations. We believe a level of £13 -£15K would be appropriate.

Living Time’s view is that the MIR should be set for individuals due to the fluidity of marriage statuses and the prevalence of non-married/civil partnered relationships. Having a married couple MIR will lead to additional complexity and unintended unfair outcomes to individuals.

Once Government has decided upon the basis of the MIR, authorisation should be given by HMRC to providers of products that are eligible to meet the MIR to issue certificates confirming the %age of MIR that has been met by that particular plan. This authorisation could be extended to non-pension assets should they be permitted to offset MIR as described above. When individuals apply for a flexible drawdown plan, they must submit such certificates along with details of their state pensions in order for providers to ascertain eligibility.

The UK Annuity Market

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<thead>
<tr>
<th>Matter/Concern</th>
<th>Living Time’s Comment</th>
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<tr>
<td>Policy Conflict</td>
<td>Living Time believe the Government’s intention is to introduce healthy competition and additional consumer flexibility and choice into the market to make retirement planning more attractive to consumers and consequently more contributions are made into pensions. Reports that have allegedly come from Ministers during the consultation seem to conflict with this overall aim. Speculation has increased that the Government wish to set the maximum income available from a capped drawdown at a level lower than is currently available from an unsecured pension. Restricting levels of capped drawdown to, for example, one equal to a lifetime annuity is not attractive to the middle-Britain consumer who, (i) doesn’t have the wealth to meet MIR in order to adopt a flexible drawdown and, (ii) has no desire to purchase an inflexible lifetime annuity, especially early in their retirement. This may have two unintended consequences: 1. Inflexibility at and during retirement may work counter to the Government’s desire to promote retirement saving via pension plans. Middle-Britain may turn to other non-pension investments to meet their retirement income needs – the nature of which will not protect the Government from retirees depleting savings to the point of reverting to state benefit support. 2. Where the capped drawdown doesn’t offer an income that matches an annuity (possible with 100% GAD as discussed above), clients may effectively be forced down the annuity route, an outcome we have assumed the Government is looking to avoid, ie there is a product bias / inequity introduced. This may also introduce an issue for capital availability to fund annuity demand if more consumers select against drawdown. It will also put drawdown providers at a significant competitive disadvantage.</td>
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<tr>
<td>Recovery charge of 55% on death with crystallised funds in capped or flexible drawdown</td>
<td>Living Time view this tax rate as punitive, particular in death in early retirement. The existing 35% tax charge was originally deemed as sufficient as a recovery charge and the jump is a large one. It is confusing that the 35% was previously deemed a sufficient recovery charge whereas now this been increased by over 70% to 55%. This will certainly be difficult to professionals to explain to existing retirement savers or those already in drawdown. The extent of the recovery charge will also not help guide investor behaviour to retirement planning via pension plans as the rate is likely to be viewed as high, particularly if individuals compare this rate to Inheritance Tax (ie 40%, and only on wealth over £325,000). Such a comparison may lead individuals to view pension saving as unattractive compared to non-pension options, especially if they include analysis of other restrictions placed on pension savings (eg access and investment restrictions). The 55% is also equal to a combined unauthorised member payment charge and scheme sanction charge and therefore is no more punitive than the recovery charge so will not help encourage behaviour the Treasury desires. IT may also lead to the wealthy exploiting flexible drawdown by taking funds as income and then using Inheritance Tax planning methods to avoid assessment on death. Alternatives that could be considered include: 1. A ‘middle’ rate of recovery charge between today’s 35% and the proposed 55%. The Inheritance Tax rate of 40% could be considered for consistency of rate. 2. Escalating rate of recovery charge based on your age on death. A suggested structure could be: 65 and under – 35% 65-70 – 40% 70-75 – 45% 75-80 – 50% 80+ – 55%</td>
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Living Time appreciates the Government’s efforts to recover the tax benefits given to pension investors but is concerned that over taxation on death may act as an overall disincentive.
| **Transitional arrangements for existing Unsecured Pension funds** | Living Time as a provider of USP plans have concerns about the Government’s proposal on existing USP clients. Should the decision be to reduce the maximum income available from capped drawdown compared to the existing GAD maximums from a USP. We would like to propose that existing USP plans maintain their current GAD maximum figure and the same reference period. A requirement to review in a short period after April will create extreme administrative difficulties and will not benefit the industry or individuals. When the new rules come into force, all existing plans could be regarded as capped drawdowns to help facilitate a seamless transition. |
| **Merger of capped drawdown plans under new legislation** | Existing legislation does not allow the merger of separate USP funds. This creates a situation where individuals may have many separate plans, making their overall retirement income portfolios complex and creating a strategy for meeting their income needs more difficult than they necessarily need be. The change in legislation is an opportunity to create new rules that permit mergers of capped drawdown plans to simplify individual’s retirement arrangements. |
Dear Sirs,

CONSULTATION: “REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75”

I am responding to this consultation document on behalf of the Lloyds Banking Group.

The rationale behind the proposal to remove the requirement is accepted and we welcome the greater flexibility and choice that will be available for individuals, whether they have personal pensions or are members of an occupational scheme.

Nonetheless, we believe that it is important for consideration to be given to establishing safeguards which would potentially protect individuals from leaving themselves financially dependent on state benefits. Here, I have in mind a situation where someone utilises income drawdown and is effectively left with nothing in later years, bearing in mind that people are of course living longer.

If you need any further information in respect of this submission please let me know.

Yours faithfully,

STUART STEPHEN
GROUP PENSIONS DIRECTOR
Removing the requirement to annuitise by age 75

July 2010

response by

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1. Background and reason for response
2. Observations on proposals
3. Alternative suggestions
4. Client feedback
1. Background

I have worked for 35 years in Financial Services as a Building Society manager, Insurance Company Consultant and currently as an Independent Financial Advisor (IFA) since 1997.

My work as an IFA brings me into contact with a wide variety of people all of whom need to plan for their financial future. The majority of my key clients who have not yet bought annuities have pension funds between £50,000 and £250,000. I would not count these clients as wealthy – but prudent savers determined not to be dependent on the state in future.

I am also father of 5 children – planning for my future and theirs! Two work in the Public Sector with guaranteed Final Salary pensions, one is employed and in a Group Personal Pension scheme while the other two are self-employed.

During the last 13 years advising clients, I have seen first hand the decline in savings. In particular pension contributions have reduced to the point where currently the average pension value at retirement is under £50,000. This has been a gradual process with no particular one element causing the damage however some key factors have been:

- Robert Maxwell’s decision to steal from the Daily Mirror pension scheme in 1991
- Gordon Brown’s decision in his first budget in July 1997 to tax dividends for Pensions and ISAs
- The introduction of Pension “Simplification” in April 2006 which added further layers of complexity to pensions
- Employers being required to include Final Salary pension scheme deficits on the balance sheet
- Increasing longevity meaning lower annuity payments as people live longer
- Falling interest rates also resulting in lower annuity payments
- Volatile investment markets since 2000 – which can mean fund values fall just before they retire
- Gordon Brown’s 2007 decision to apply 82% tax on death benefits from a pension after age 75
- The credit crunch etc etc

When I first started advising clients the question was invariably “how much should I pay into my pension?” now it is more likely to be “why should I bother?” Is it any wonder with the constant barrage of seemingly bad news stories that people have lost faith in pensions? Generally however when you explain the potential benefits of pension funds clients can see beyond the headlines.

I agree that we need a fresh approach to pension saving in the UK. I see these proposals very much in keeping with the fundamental proposal that the Government wish to “foster a new culture of saving in the UK” on the basis that “saving has to become more flexible and attractive in order to encourage people to take greater responsibility for their financial future”.

The future for pensions is looking worse than at any time in my lifetime. Subsequent generations will now be saddled with the burden of University debt, high housing costs (if they can buy at all) and the demise of sponsored employer Final Salary Schemes. Pensions must be made more attractive to encourage savings.

As illustrated by my own family circumstances, this country operates a two tier pension system. Those who have final salary guaranteed pensions and that who have not and must depend on building up investment funds themselves. It has always concerned me that the people who currently make the decisions about pensions (politicians Civil Servants) have the benefit of a generous Final Salary Pension scheme. Is it any wonder they are less inclined to propose change. Unlike politicians the rest of the population are not able to benefit from public sector, taxpayer-sponsored fully index-linked pensions.

Whilst I am not acting as part of a trade body, I hope this introduction demonstrates my experience as an advisor to hundreds of clients planning their retirement and as a concerned parent to respond to the document “proposals to remove the requirement to annuitise by age 75”. I welcome the opportunity to become involved in the debate.

To gain further opinions I posted my initial response on the Lowland Financial website and invited comments from clients – so this response is not just one IFA acting in isolation – but a reflection of comments form a cross section of my clients who are either planning ahead of who have had to make decisions about retirement income already but concerned about future generations.
2. Observations on the proposals:

Minimum Income Requirement (MIR)

I am concerned that this will introduce yet another layer of unnecessary complexity and discourage pension saving. This is not giving people choice – on the contrary it is treating them like idiots who cannot manage their own affairs without nanny state interfering.

I appreciate you must “ensure that people do not exhaust their savings prematurely and fall back on the state” (page 8) however in my experience people who save via pensions do so precisely because they want to provide for themselves and not have to rely on the state. In over 13 years as an IFA I have yet to see a client who has ever had to fall back on the state having exhausted their savings - within the current rules. If pensions are made more attractive this situation can only improve.

Part of the drift away from pension investments has been the increasing use of alternatives, such as ISAs, Property and Business Assets. If you must introduce a MIR this should take account of alternative sources of income to pensions as in reality the vast majority of people if left to their own devices tend to do what is best for them – which includes making provision for their retirement.

Having satisfied MIR - take as much as you like from the pension fund

I have serious reservations about this option. Why is it being considered, who benefits from it?

If “the purpose of tax relieved pension saving is to provide an income in retirement” why give people the option to raid their own pension funds rather than use the funds to provide income for themselves (or future generations thereby reducing the potential for having to fall back on help from the state)

Income Levels

Currently we have constantly changing USP and ASP maximum income levels. Clients find this hard to follow and of course at 75 you move from 120% of the equivalent annuity to 90%.

This is complex and needs to be much simpler. I appreciate that investment conditions change and inflation, gilt returns and a host of other factors need to be considered but looking back over the last 15 years of drawdown there must be data to reflect many different conditions so why do we need to constantly keep changing the rate?

Death benefit

The ability to pass investments on to family members is a key factor in financial planning. In my experience as an adviser, most clients list their priorities at retirement as providing a decent income during their lifetimes and having something to pass on to family thereafter. The penal 82% tax from 75 has therefore been a major disincentive for pension savings.

At the completely arbitrary of 75 (which most people can be expected to achieve these days) your pension goes from being an investment capable of generating income and a lump sum on death (albeit less 35% tax) to being a worthless investment for your family.

I (and many of my clients) feel this approach is a major disincentive to pension savings in the UK.
Client responses to the draft response:

“I feel that your response seems a fairly reasonable answer. However as you point out the decisions are made by people who are in a “bomb proof” pension situation”

S. S. - Melrose

“I agree with your points entirely, in particular

- the disparity between public and private sector pensions
- the disincentive that funds will disappear rather than be able to provide for future generations”

S.R. - Galashiels

“Your draft views seem sensible (on a quick read-over) so good luck”

R. L. – Melrose

“I agree with many of your points, in particular when you say that the prospect of the pension fund being heavily taxed on death (a Brownish claw-back one might say) is a serious disincentive. The idea of a transferable pension, with tax reclaimed at a lower level, is a good one.

I think the Government is putting its head in a noose over the MIR; a hostage to fortune! How can a realistic amount be arrived at? An arbitrary MIR will make no allowance for the untold and often unexpected variables that crop up. I could go on but...”

M. W. - Hawick

“I can pass on every other investment I have – so why can’t I leave my pension to my kids when I die?”

J. H. - Kelso

“I like the idea of passing funds to a pension for the family – that way they can’t blow the lot when they are younger – and when they are much older and hopefully more responsible they will appreciate the income a pension can give them!!”

M. H. Jedburgh

“55% seems a big jump from 35% - why 55% on death?”

M. M. – Selkirk
My Proposals:

I want to see a simple, flexible set of options for pensions which encourage saving for this and successive generations. I accept that in the current financially austere times any changes must be achieved at no cost to the exchequer. I believe the following proposals achieve all of these objectives:

1 Scrap the Minimum Income Requirement (MIR)
A much simpler alternative to MIR would be to allow anyone wishing to defer the purchase of an annuity to sign a waiver agreeing that they give up the right to fall back on state help. This would require an emergency contingency fallback (perhaps a form of longer term Government Equity Release Scheme?) and must not be seen as an easy option.

For many the right thing would still be to buy an annuity. However this would encourage a degree of personal responsibility and sensible planning and keep things relatively simple.

2. Simplify Income Drawdown Income Limits
Introduce a flat maximum income percentage which can be adapted to the changing investment conditions.

You could set the parameters to take account of any anticipated circumstances so for example it could be stated that the maximum income level will be between 6% and 10% per annum giving people a simple means of identifying how much fund they would need to get the income they need.

For example if you set a current maximum limit of say 7% of the fund today and your target income was £14,000pa from the pension it would be easy to work out that you would need a fund of at least £200,000. Knowing the figure cannot be less than say 6% would help plan for most eventualities.

In reality 7%pa is a lot to expect from your pension every year so the fund would need to be higher, however it would be relatively easy for people to plan ahead with a simple system as opposed to the one we have at present.

3. Bequeath Pension Funds to other pension funds on death:
If I could have one wish for pensions it would be to change the rules for pension payments on death.

In 2007 there was a proposal to allow death benefits to be paid into a pension fund for nominated individuals (generally children). This would have encouraged pension investments but for some reason this was scrapped and people effectively forced to buy annuities after the age of 75 with the introduction of an 82% potential tax charge at age 75 compared to 35% prior to age 75. This was well received among clients.

I would like to see this looked at again as it could help achieve every objective of the review:

<table>
<thead>
<tr>
<th>Tax on crystallised benefits:</th>
<th>Pre age 75</th>
<th>Post age 75</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current arrangements</td>
<td>35%</td>
<td>82%</td>
</tr>
<tr>
<td>Consultation paper proposals</td>
<td>55%</td>
<td></td>
</tr>
<tr>
<td>My proposal – reduced tax on death if fund paid to a pension</td>
<td>25%</td>
<td></td>
</tr>
</tbody>
</table>

Whilst the proposal of a 55% tax would be an improvement for over 75’s it is a backward step for under 75’s. I would therefore propose that you retain the 55% tax charge on death if funds are passed on as a lump sum but introduce an alternative option on death with a lower tax charge say 25% - but where the money must be paid into a nominated pension fund (or funds).

- Clients would be inclined to save more money in pensions if they knew the money in their pension fund would not disappear when they die
- More Tax would be raised on the funds every generation as pension funds are passed on through the generations
- Children could not “blow the lot” but would need to wait till 55 to get access (something many parents want to encourage)
- Future generations would be far less likely to have to fall back on the state for support as a result of having inherited pension funds from parents
- And they in turn would be inclined to save more to pass on to the next generation etc etc. if they knew the money would not disappear when they die and so on.
10 September 2010

Age 75 consultation
Pensions and Pensioners Team
Room 2/SE, HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Email: age75@hmtreasury.gsi.gov.uk

Dear Sirs,

Removing the requirement to annuitise by age 75

I am writing as Chairman of the Taxation Committee of the London Society of Chartered Accountants (LSCA). This response also includes input from our colleagues on the LSCA’s Personal Financial Planning Committee; further details about the LSCA and the Committees are given at the end of this letter. Both Committees welcome the opportunity to comment on the current consultation about the best way for the Government to implement its commitment to allow people more choice over the use of their pension savings, a commitment that we commend.

On this occasion, rather than addressing all of the specific questions in the document, we have restricted ourselves to some general comments and answering those questions on which we feel particularly strongly.

A. GENERAL COMMENTS

A1. In general terms we welcome the objective of this consultation and the potential increased flexibility which it proposes. We believe that, providing that the limits are reasonable, the removal of the requirement to buy an annuity or enter into alternatively secured pension arrangements by age 75, coupled with the proposals for flexible drawdown, will remove what has been a major disincentive to saving for retirement via a pension scheme.

A2. We also welcome the commitment that the tax-free commencement lump sum will continue and trust that this will remain at least at the current level of 25% of the fund.

A3. However, we do have a number of concerns, the most pressing of which is the suggested recovery charge at death of 55% (see under section B below).

A4. Those most adversely affected by the current rules are generally those with more sizeable pension pots which have been created by extensive contribution over a protracted period. Typically such contributors are those with a strong savings mentality and it is vital to continue to encourage such attitudes.

A5. We have seen the representation submitted by ICAEW’s Tax Faculty and would like to endorse their comments.
B. OUR MAIN CONCERN

As mentioned above, our most serious concern is the suggested recovery charge of 55%. While there may be some logic behind this proposal and it is better than the current potential 82% under ASP past 75, including an unauthorised withdrawal charge of 55% and IHT, our concern is that it will represent a continued negative element in the fight to encourage proper pension provision. Those of our members who have arranged drawdown policies report that the main driver is the almost paranoid feeling among policyholders that annuity purchase is tantamount to the insurance company stealing their money. We are of course aware of the arguments about a guaranteed income for life, etc., but the fact is that one can put the money in a good income fund or investment trust, get about the same as an annuity and at the end of 5 years or 10 years one still has the capital.

We believe that this is a good set of proposals and is meant to encourage flexibility in pension provision, but feel that the 55% recovery charge is an unwelcome sting in the tail which may prevent the proposals achieving their aim.

The Government’s argument is that one has had tax relief on the way in, tax-free growth during the life of the policy and so one pays tax on the way out. We do not have any difficulty with this principle – it is the rate of tax (the recovery charge) proposed that is the problem. This is a catch-all rate and, like all catch-all rates, it is going to be unfair to a lot of people. We have to assume that it is supposed to recognise the rate of tax relief given on contributions, whether or not the 25% tax-free lump sum has been taken and whether or not the estate is subject to IHT. If we take the case of a policyholder who has always been a basic rate taxpayer, did not take the lump sum and has no IHT liability, the recovery charge should equitably not exceed 20%.

We suggest that a better alternative to the 55% rate would be just to consider the element of average tax relief on contributions. Indeed, we note that this was what the previous Conservative government did when drawdown was first established and the charge of 35% was applied for those aged under 75 who had made withdrawals, with no IHT liability. This was a sensible, bearable recovery basis which did not act as a disincentive. We recommend that this is what should continue to be applied, both before and after age 75.

We also wonder why it is necessary to have a flat rate and are not entirely clear how the recovery charge on unused funds from any one death has been calculated. It will be helpful to have some further detail as to why the likely recovery charge would be around 55%. In this respect we welcome the statement that further details on the proposed tax charges will be published in draft legislation later in the year and will be interested to see this.

C. ANSWERS TO SPECIFIC QUESTIONS

Developing a new tax framework for retirement (Chapter 2)

A.1 The Government welcomes views on the level of an appropriate annual drawdown limit for capped drawdown.

If the government intends to retain an annual drawdown limit for capped drawdown, it would seem appropriate to retain the existing annual USP limit (120% of the value of an equivalent annuity). Although the USP provisions have only been in force for a few years, there is no evidence that this limit has created difficulties or proved to be over generous.

Where the rule has proved difficult, particularly for those with a bigger fund, is the position after age 75. Hitherto the maximum ASP limit has been 90% of the equivalent annuity for a person age 75. This seems to overlook totally the effects of longevity and/or mortality. It has always seemed wholly unreasonable that, for example, the maximum drawdown for a 90 year old should be restricted to 90% of the equivalent annuity available to a 75 year old.

Since the new proposals would remove ASP and, effectively, continue USP, consideration would need to be given to any annual capping for older scheme members.
If the proposed limit of 120% would seem too generous, or too risky, in the context of over depletion of funds and potential reliance on state benefits, then it would perhaps be appropriate to introduce a sliding scale.

For example, the scale could be reduced from 120% of the value of an equivalent annuity at age 75 down to, say, 100% at age 95 or above. It is worth noting that an individual’s propensity to spend income tends to diminish as they become more elderly, the one big exception being spending on residential care, which of course becomes more likely the older one gets. Nevertheless, on balance it seems unlikely that a somewhat tapering scale for capped drawdown after age 75 would necessarily give rise to any increased degree of risk that the individual’s pension fund would be depleted too quickly during their lifetime.

The system for determining the ASP currently involves a valuation of the ASP fund each ‘ASP year’ (adopting the figure at the beginning of the year or within 60 days before) and then drawing at least 55% and at most 90% of the annuity a 75 year old could buy with that value. Given the need to re-value every year, it would be no more troublesome and perfectly logical to relate the ASP to the current age of the member. The increase in the maximum to 120% will only partly meet that.

The alternative of relating the ASP to leaving sufficient to meet a minimum income requirement should be just that; an alternative the member may choose. The consultation does not address the possibility of poor investment performance resulting in an inadequate fund at the next anniversary.

A.2 The Government welcomes views on its intended approach to reforming the pensions tax framework, in line with its commitment to end the effective requirement to purchase an annuity by age 75.

See our concerns about the proposed 55% rate set out in section B above.

Minimum Income Requirement (Chapter 3)

A.3 The Government welcomes views on what income should be considered ‘secure’ for the purposes of the MIR and whether proposals for the life annuity income that can be considered for the MIR are practical and appropriate.

We note the proposal that life annuity income should be allowed for the purposes of MIR providing it increases annually by at least a limited price indexation defined as the “lesser of the annual increase in prices” or 2.5%. It is unclear whether the annual increase in prices is to be measured by the retail prices index, consumer prices index or some other variant. It would seem desirable for the indexation measure for this purpose to be the same as that applied for the uprating of state pensions. If this switches from RPI to CPI then the same change should apply for the purposes of the minimum income requirement.

A.4 The Government welcomes views on what an appropriate level for the MI R should be and how the MIR should be adjusted for different ages.

We have no comment.

A.5 The Government welcomes views on whether a different MIR should be set for individuals and couples.

In considering how MIR should be set for individuals and couples it should be borne in mind that a couple is often supported by one substantial pension and one much more modest one, particularly in the case of households where one party has been a high earner during working life. We therefore consider that the MIR for a couple should be twice the limit for an individual, but in arriving at this MIR full account should be taken of the “secured” pension income of each party.
A.6 The Government welcomes views on how often the MIR level should be reviewed.

A.7 The Government welcomes views on how to minimise unnecessary burdens for individuals and industry in the assessment of the MIR.

We have no comment on the above two questions.

The UK annuity market (Chapter 4)

A.8 The Government welcomes views on whether other legislative or regulatory barriers remain whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance risks.

A.9 The Government welcomes views on how the industry, Government and advice bodies such as CFEB can work to ensure that individuals make appropriate choices about what to do with their retirement savings in the absence of the requirement to purchase an annuity by age 75.

We have no comment on the above two questions.

A.10 The Government welcomes views on whether the proposed reforms have unintended consequences that may affect the market’s ability to supply annuities at attractive rates or prevent the annuity market being able to meet likely demand for annuities.

We are told that those who die early subsidise the annuities for those who live longer. It seems to us likely that the price of lifting the annuity age limit, i.e. the return of fund less a tax charge, is a lower annuity. However, we will leave it to those in the pensions industry to comment on this as they will no doubt have done the necessary calculations.

If you would like us to expand on any of the points above or wish clarification of our views, please do not hesitate to contact me.

Yours faithfully,

Adrian Mansbridge BA FCA FCCA CTA
Chairman, LSCA Taxation Committee

About the LSCA and its Taxation and Personal Financial Planning Committees

The LSCA is by far the largest of the 22 district societies affiliated to the Institute of Chartered Accountants in England and Wales (ICAEW). It has a membership of over 30,000, representing nearly one quarter of all ICAEW members, and also provides services for other ICAEW members who live or work in London. London members, like those of the Institute as a whole, comprise a mixture of those working in all sizes of practice and those working in businesses both large and small, or otherwise not in practice. They include many members operating at the heart of industry and commerce in the City of London, as well as those working in the largest accountancy firms, with a wide range of specialisms and expertise. The LSCA’s Committees reflect this diversity and knowledge. Members give their services on a voluntary basis and in addition to their normal full-time employment.

The Taxation Committee responds to consultation and other papers on taxation matters issued by HM Revenue & Customs, HM Treasury and other bodies. It also makes detailed representations on issues such as the Finance Bill proposals. It provides the opportunity for lively debate and selects certain topics for broader discussion and publication to LSCA members. In addition, the Committee organises an annual Breakfast event on the morning after the Budget to review the Chancellor’s main proposals, as well as regularly holding other events on topics of current interest and importance.

The Personal Financial Planning Committee (PFFC) is fully committed to championing financial planning services as a practice opportunity for members. It sees its objectives as representing the needs of members in practice and associated firms that either currently provide financial planning services or who would benefit from so doing. It responds to relevant consultation and other papers issued by the FSA, HM Treasury and others, concentrating on issues particularly affecting professional firms. It also liaises with other bodies whose work may impact LSCA members.
Age 75 Consultation  
Pensions and Pensioners Team  
Room 2/SE  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ  

11 August 2010

Dear Sirs,

I write in response to the Consultation Paper of 15 July 2010.

My suggestion would be to allow pension funds to be left by Will. By all means subject them to the standard rate of IHT. But then they should stay as pension funds for the next generation which would, if you think about it, go a long way to achieve the government’s aim of taking people off state dependency.

As a practising accountant and financial adviser my experience is that very few people are now making adequate provision for pensions, and particularly the younger generation. It’s a growing problem, mainly, in my view, because we don’t have the sort of inflation that allowed people of my age group (I am 67) to build up considerable pension funds over a thirty five year period.

Allowing pension funds to be liquidated, so to speak, with a tax charge of 55% is pointless. Once resources are placed in the pensions arena, why not offer an incentive to have them stay there for the benefit of future generations?

I hope that this helps.

Yours faithfully,

John Malthouse  
john@malthouse.com

Directors: John Malthouse F.C.A. • Mark Herbert F.C.A.  
Stephen Beckwith M.A.A.T. • Catherine French F.C.A.

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www.malthouse.com
24 August 2010

Pensions Tax Relief
Room 2/E2
H M Treasury
1 Horseguards Road
London
SW1A 2HQ

By email & 1st class post: age75@hmtreasury.gsi.gov.uk

Dear Sirs

RESPONSE TO CONSULTATION – REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75

We wholeheartedly welcome these proposals, and believe this to be the most positive Governmental initiative on individual pensions for many years. The inflexibility, severe restrictions and penal tax rates surrounding annuity purchase and alternatively secured pension (ASP) have proved to be massive disincentives in pension funding. We have a number of comments concerning the specific invitation for response, which are more fully set out below. However, we believe there is one major omission which would make this initiative even more powerful in encouraging pension provision throughout the UK, and which may also provide a solution to an unintended consequence.

Inheritance

We fully understand and empathise with the Government’s concern that tax relief and exempted investment through an approved scheme should not become a vehicle for inheritance planning. However, we would draw a distinction between the inheritance of the residue of an approved scheme, and ‘inheriting’ the pension fund itself.

Inheriting the residue of an approved scheme in cash is clearly taking money out of the pension environment. However, inheriting a pension scheme ensures the residue is retained within an approved scheme, the only difference being that different members (typically the member’s children) would become the beneficiaries after the original members’ deaths.

This is in fact no different to what happens in both annuity funds and defined benefit schemes, since in both instances, at the death of a particular member assets are retained in the scheme to fund benefits for other members. Our proposal is that this principle is extended to individual defined contribution schemes.
Taxation implications

Inheritability of the pension fund could most easily be achieved through the member’s preferred beneficiaries (usually adult children) becoming members of the scheme. At the member and spouse’s death the residue could simply be reallocated to the new members in accordance with the members’ wishes. Whilst this would give rise to a loss of the recovery charge, there would be no need for a recovery charge because the assets would remain within the pension environment. Indeed, it is most likely that the new beneficiaries would have less need to make contributions of their own and so there would be a tax saving, since the Government would suffer less tax relief on potentially reduced contributions in the future.

Without such a provision, we believe there would be an unfortunate unintended consequence in a large number of cases: the distribution of a residue on the death of the member and spouse less the recovery charge, could be used by the recipient to fund a contribution to the recipient’s own pension scheme. The value of such reinvestment back into a pension will be affected by the recipient’s own income tax rate, assuming the receipt of the residue to finance the tax relieved cost of making a grossed-up contribution, as the following table demonstrates:

<table>
<thead>
<tr>
<th>Gift net of recovery charge</th>
<th>Value of gift reinvested in approved scheme:</th>
<th>Value of gift reinvested in approved scheme:</th>
<th>Value of gift reinvested in approved scheme:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Nil rate taxpayer</td>
<td>20% taxpayer</td>
<td>40% taxpayer</td>
</tr>
<tr>
<td>Per £10,000</td>
<td>£10,000</td>
<td>£12,500</td>
<td>£16,666</td>
</tr>
</tbody>
</table>

By reinvesting the receipt of a pension scheme residue and grossing this up to allow for the tax relief, the higher rate taxpayer can receive a very much more substantial benefit than the lower or nil rate taxpayers. Permitting the option for such family beneficiaries to become members of the scheme to which funds could be reallocated at the original member’s death, would achieve the Government’s objective of ensuring funds remained in the pensions arena and would ultimately be used for pension purposes, and create a level playing field irrespective of the beneficiary’s tax rate.

We believe that allowing the passing on of pension funds in this way would be extremely popular, and do much to encourage pension provision.

Yours sincerely

R. WOODS
Executive Chairman
10 September 2010

Jonathan Deakin
Age 75 consultation
Pensions and Pensioners Team
Room 2/5E
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

By email to: e-mail to age75@hmtreasury.gsi.gov.uk

Dear Mr Deakin,

MetLife Response to HM Treasury Consultation ‘Removing the requirement to annuitise by age 75’, July 2010

I am pleased to set out MetLife’s response to this consultation. We support wholeheartedly the government’s attempt to make the choices at retirement more flexible and simple. We believe that a simpler and clearly fairer system to convert funds to income will encourage pension savings more generally. MetLife therefore believes that the current post 75 regime for all savers – both annuity buyers and drawdown – should be simplified. Changing the rules on annuitisation in this respect would have a positive impact on pension savings generally as many consumers find them complex and inflexible and may be dissuaded from saving into a pension because of this perception.

As more people save for retirement into DC schemes, there will be an increasing number of people with larger pension funds over the next few decades who will be seeking a greater choice on how they use their retirement savings to secure income in retirement. Changing working patterns and longer life spans as well as the eventuality that people may be required to fund long term care towards the end of their lives are all contributory factors to the need to look again at rules on effective compulsory annuitisation at age 75.

We recognise the benefits that annuities bring and therefore support a system which ensures a lifetime income for consumers, but with greater flexibility and wider choice for consumers on how they achieve this. We take the view that the proposals should focus on encouraging those with pension funds to buy a sustainable lifetime income. This lifetime income could be in the form of a conventional lifetime annuity or could be chosen from innovative ‘third way’ annuity/drawdown products which have become available over the past few years.

The most important areas of policy which are likely to affect the greatest number of people are conventional annuitisation and capped drawdown. These are the two areas which the vast majority of people with pension funds are going to use for the foreseeable future.

We think the proposals for capped drawdown can be usefully improved upon by encouraging the provision of lifetime income and also by reducing the incentives for individuals to use their pension fund as a means of tax favoured inheritance planning.
We believe that an improved form of capped drawdown where individuals are encouraged to buy sustainable income is the best and simplest means of improving on the current system together with more favourable treatment of annuity lump sum death benefits.

Summary of MetLife’s recommendations

- **Annuitisation**, by definition, provides an income for life and is likely to be used by the mass market who have only received basic rate relief on their pension contributions.

- As an alternative to annuitisation, **capped drawdown** could be used as a means of achieving an income for life using one of the new innovative products which have become available over recent years. We propose a tax incentive to encourage people to **secure an income for life** as part of the capped drawdown option.

- A lower rate of tax on unused funds on death of 35% should be offered to those who annuitise or buy a capped drawdown product which includes an income for life guarantee.

- Those who choose not to go with either annuitisation or capped drawdown with an income guarantee would be taxed at 55% for unused funds on death.

- Flexible drawdown (with a Minimum Income Requirement, MIR) will only be an option for people with very large pension funds. The MIR should be set high enough to ensure people do not fall back on the State during periods of high inflation (as most MIR income will be fixed escalation or LPI which does not fully protect against high inflation). We suggest 2/3rds National Average Earnings, although this could go as high as 100%.

- The tax system should also discourage the 'gaming of the system' for flexible drawdown. Individuals could move abroad for short periods to reduce the tax paid on the fund or reduce other income in order to part surrender their pension fund at lower income tax rates. In our view, a flat rate tax on flexible drawdown withdrawals should be introduced which removes this possibility.

- Further work should be done by the Treasury in consultation with industry to look at options for changing the tax rules to allow greater up-take of **longevity insurance** which enables people to ensure that they do not run out of money if they live longer than expected.

I would be happy to discuss any of these points in more detail with the Treasury. I may be contacted at dgrinstead@metlife.com if you would like further information.

Yours faithfully,

Dominic Grinstead  
Managing Director - UK  
MetLife Europe Ltd

*MetLife Response to HM Treasury Consultation ‘Removing the requirement to annuitise by age 75’, September 2010*
About MetLife

The MetLife group (MetLife, Inc. and its affiliates) is a worldwide provider of insurance and financial services and has been helping people with their finances since 1888. In the UK MetLife Europe Limited (trading as MetLife) is authorised by the Irish Financial Regulator and subject to limited regulation by the Financial Services Authority.

In 2007, MetLife Europe Limited introduced our unique range of unit-linked guarantee products to the European market including the UK. We offer a variety of guarantees to enable people to retire well. These are as follows:

**Capital Guarantee** – this is designed for those who are minded to buy an annuity when they get to retirement. It allows them to guarantee their initial investment and lock-in growth along the way. When they reach the end of their guaranteed term, they will know exactly the amount of capital they will have to buy their annuity. This avoids the situation of having to deal with large stock market falls near to retirement.

**Deferred Income Guarantee** – those people who have pension funds large enough to use unsecured pension may well choose our deferred income guarantee. It is designed as a pre-retirement product and guarantees a certain level of income in the future. By selecting this guarantee before retirement, an investor can be certain of their income in the future when they decide to take it. In addition their income can increase by investment lock-ins during the deferment period.

**Immediate Income Guarantee** – for those who want to use income drawdown but want the security of a guaranteed income for life. The guaranteed income is related to the size of the pension fund and the age of the investor when they start to draw income. The income is guaranteed for life and any unused funds can be made available to beneficiaries (after tax). Like all MetLife guarantees, the guaranteed income can increase if fund performance is sufficient.

**Death Benefit Guarantee** – in addition to the guarantees above, all MetLife guarantees carry a minimum death benefit which is generally the greater of the fund value or the guaranteed amount. The guaranteed amount is usually the amount invested less any income taken.

**MetLife responses to consultation questions**

**Developing a new tax framework for retirement (Chapter 2)**

**Question A.1 The level of an appropriate annual drawdown limit for capped drawdown**

1.1 An underlying assumption of the consultation document is that individuals should strive to have an income that is sustainable for life. We agree with this aim. The GAD tables are also based on the underlying assumption of a sustainable income for life based on the annuity principle. They take account of both interest rates and mortality to give a rate which is generally comparable with commercial annuities.

1.2 On this basis the current GAD basis would seem a good place to start, however, a maximum of 100% of GAD would seem more sensible to avoid fund and therefore income...
depletion. It may also be worth reviewing the frequency of GAD reviews as the current five year limit can mean funds being depleted if fund performance is poor over a number of years.

1.3 It is also important that the GAD tables keep pace with changes in mortality as it is now 5 years since these were reviewed and mortality assumptions have moved on since then.

Question A.2 Its intended approach to reforming the pensions tax framework, in line with its commitment to end the effective requirement to purchase an annuity at age 75.

2.1 We believe that what has been published is a step in the right direction but could usefully be improved. The principle purpose of pension tax relief is to encourage income for life and this should be at the heart of these proposals. It is for this reason that we believe capped drawdown and lifetime annuity purchase should be enhanced to give such encouragement. An individual should be able to choose the shape of the income they purchase, as for many, a level income will be more appropriate than an increasing income as income needs are higher in early retirement than later one.

2.2 This would be done for lifetime annuities by reducing the tax charge on the annuity lump sum to 35% from the proposed 55%. For capped drawdown we believe that the tax charge on death should be set at two rates. There should be a lower rate for unused funds where the individual has used their fund to secure a sustainable life time income. This rate should be the same as the current rate of 35%. For those who choose a non-guaranteed income or choose to take no income at all, their funds on death should be taxed at a higher rate of 55%.

2.3 Flexible drawdown is an interesting concept and we do not oppose its introduction, although we do see some complexity in its application. The MIR that is the gateway to unlock the pension fund needs to be set at an appropriate level – too high and this option will only be available to the wealthiest pensioners, too low and those who have secured the MIR risk falling back on the state in periods of higher inflation. Our view is that greater flexibility for wealthier pensioners should not come at the expense of middle income pensioners. In particular, the current proposals for flexible drawdown suggest that excess withdrawals are taxed as income. It is possible for individuals to manipulate their income in a number of ways (moving abroad for short periods, reducing income from other sources) which could reduce the tax charge on these excess withdrawals and creating a situation where the pension fund was effectively a tax preferred inheritance vehicle. We believe that to avoid this, a special tax charge should apply to flexible drawdown withdrawals at an appreciate rate, probably somewhere between 40% and 50%.

We have provided more detail on how this could work in Annex A

2.4 Whether they choose capped drawdown or flexible drawdown, people will be paying tax on the income they are receiving. Ensuring that they have a sustainable income in retirement will mean that they will continue to pay tax on this income and will not run out of income and become dependent on the state. This will benefit the Exchequer and reduce the risk of people requiring welfare payments. This simple regime of differentiated tax rates would encourage responsible behaviour by favouring choices which give a sustainable income in retirement and reduce dependence on welfare payments – which is the whole purpose of the pensions tax regime.

Minimum Income Requirement (Chapter 3)
Question A.3 What income should be considered ‘secure’ for the purposes of the MIR and whether proposals for the life annuity income that can be considered for the MIR are practical and appropriate.

3.1 We believe that the proposals for a MIR would be complex to administer effectively. As has been mentioned in the consultation, the MIR would vary not only with age but relationship status as well. It would need to be updated on an annual basis and where clients were transferring from one provider to another, further complication could ensue.

3.2 Our belief is that policy should encourage savers to secure income which is sustainable for their lifetime at whatever level is feasible for their pension funds. And, also that income should be on a basis chosen by the individual (level or increasing, single or joint life) as we believe it is individuals who are best placed to choose the income shape most appropriate for them.

3.3 Income patterns in retirement are often complex. For example, many people have high income retirements when they first retire as they are still active and want to enjoy their leisure time. However, at older ages, life becomes less active and expenditures reduce. It can be argued that for many a level income matches needs better than increasing income where the initial income is severely reduced.

3.4 Although long term care can increase income needs in later life, neither level or escalating income annuities are able to cater for the amounts which would be required.

Question A.4 What an appropriate level for the MIR should be and how the MIR should be adjusted for different ages.

4.1 Choosing the level of the MIR will be important particularly from a presentational perspective. If the level is set so high that only the wealthiest pensioners are able to use it, many may say they are being treated specially at a time when, due to financial stringency, others are suffering from budget cuts.

4.2 If the level is set too low, although access will be improved, it would increase the likelihood of those people relying on State benefits in later life if inflation picked up. This is because commercial providers are unlikely to be able to provide index-linked annuities which offer good value due to the short supply of backing assets. Inevitably they will offer fixed or LPI pensions which would mean that the income provided would fall relative to an MIR level which would inevitably be fully inflation-linked.

4.3 Although intuitively, the MIR should be age related, it may be that working out how it should change with age could be extremely complex and a simpler solution would be more appropriate. Allowing individuals to make their own decisions within a fairly simple regime may be the best alternative. For example, setting the MIR at a level of 2/3rds average earnings would allow people to choose the age at which they secured the MIR based on current annuity rates and their then age. The table above shows how this would influence the amount needed to secure the MIR.

Question A.5 Whether a different MIR should be set for individuals and couples.

5.1 Clearly if this approach is to be taken, it needs to take account of the relationship status of the individual. If it were on a single life basis only (with the assumption that individuals with a partner had their own pension provision) it would mean that many would have an inadequate level of MIR. If the MIR was set at a sufficient level to cover couples there would need to be a second test to see whether a partner had their own pension provision or the MIR test would be set at too high a level.
5.2 However, as in the case of age related MIR, a simple solution may be best and we would favour an MIR on a single life only basis, particularly in an era when individual pension savings is becoming the norm.

Question A.6 How often the MIR level should be reviewed.

6.1 For the MIR to be at all effective it would need to be reviewed annually. This could create additional administrative burdens for individuals and the Treasury.

Question A.7 How to minimise unnecessary burdens for individuals and industry in the assessment of the MIR.

7.1 We believe an issue with the MIR is that if it is to be simple it would need to be set at a high level and therefore, it will only be available to the very richest pensioners, and if it is to be available to a larger group, by setting a lower level it will be extremely complex, not only to administer but also to understand.

7.2 For example, if the MIR were set at ¾ths of average earnings, this would equate to a level of almost £17,000 (ONS data for 2009). After basic Old Age Pension and S2P, the capital cost of the remaining income would be £169,112 for a 65 year old male, much larger than the average pension pot of £25,000. If it were set at a lower level, this would presumably take account of age and relationship status, but could be eroded by periods of inflation above 2.5%.

7.3 Our favoured position is that the MIR should be set at 2/3rds average earnings on a single life basis with no account of age. It should be reviewed annually for those securing the MIR in any tax year.

The UK annuity market (Chapter 4)

Question A.8 Whether other legislative or regulatory barriers remain whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance risks.

8.1 Managing longevity risk is probably one of the most important aspects of retirement planning. The current rules allow various types of flexible annuity and providers such as MetLife have developed unit-linked guarantees as well. However, other product sets, such as longevity insurance are not easily possible within the current tax framework. This is a product which can be a useful back-stop for retirees and helps them manage their pension funds over a fixed period rather than their lifetime.

8.2 The way this type of product works is to buy a single or regular premium deferred annuity. For example, paying a premium of £5,000 a: age 60, could buy an income for life of £6,000 per annum starting at age 85. In the meantime there would be no death benefit or surrender value. This is true longevity insurance in that the client is paying a premium to guard against an adverse outcome (living too long!).

8.3 Clearly if the client does not survive to age 85, their premium is lost, but this is analogous to the principle of term life insurance. Where a client survives for the term, their premiums have been ‘lost’ to them, but they have had the peace of mind during the period of cover that their dependents will be covered in the event of their premature death. Longevity insurance covers the eventuality that people may live longer than they had expected.

8.4 This type of product allows individuals to manage their DC pension funds over a fixed period of time which reduces the risks around running out of money if they live too long. We
believe that there should be further work by government in conjunction with industry to look at options for increasing the availability of longevity insurance to UK consumers.

Question A.9 How the industry, Government and advice bodies such as CFEB can work to ensure that individuals make appropriate choices about what to do with their retirement savings in the absence of the requirement to purchase an annuity by age 75.

9.1 Our view is that the key to helping individuals make the right choices in their retirement is to keep the options as simple as possible. The key argument against ASP was that it was difficult to understand and explain the reasons for the differences in treatment.

Question A.10 Whether the proposed reforms have unintended consequences that may affect the market’s ability to supply annuities at attractive rates or prevent the annuity market being able to meet likely demand for annuities.

10.1 For most of those with DC pension funds, the additional choices are unlikely to be available as they will be unable to secure the MIR with their pension funds and so will continue to have to use either annuity purchase or capped drawdown, albeit beyond age 75.

10.2 However, both of these options have been made less attractive under the proposed rules as unused funds on death will be taxed at 55% rather than 35%. Bearing in mind that capped drawdown is a more risky option than annuitisation, the likely result of these reforms is that more people will go down the annuitisation route. As pension funds increase in size over time, there could be supply issues in the annuity market for two reasons;

1. A shortage of supply of high quality corporate bond assets to back the annuity income streams, and;

2. A lack of appetite in the insurance industry for longevity risk.

10.3 For these reasons we feel the capped drawdown regime should be made more attractive to ease any pressures on the annuities market and to make the capped drawdown option more mainstream. One means of doing this would be to incentivise the purchase of sustainable lifetime income. Thought would need to be given to how this is defined, with particular reference to mortality and asset growth assumptions. The incentive should be a reduced rate of tax on unused funds on death where such an income had been secured (35% as opposed to 55%). Rules should ensure it could not be used as a mechanism to reduce the tax on death without a ‘real’ income being payable.

10.5 A key element of whether the market for annuities would be upset, is the extent to which the new options are taken up. As we have already said, flexible drawdown is only likely to be available to a few individuals. The question then becomes, how many people will take up the option of capped drawdown instead of annuities. Our view would be that this is likely to be a relatively small number with capped drawdown in the form proposed. However, we feel capped drawdown could be greatly improved if incentives were given for individuals to invest in products which continue to offer investment growth as a hedge against inflation with the underpinning of a guaranteed income for life. MetLife’s own products are examples of such products, and others are also becoming available in the UK marketplace.

10.6 We see annuities and capped drawdown products as co-existing productively in a more flexible marketplace, providing complementary choices to consumers.
Annexe I: Table Showing Capital Requirements for Securing Minimum Income Requirement at Different Ages

The table below gives some examples of the cost of securing the MIR on two bases; the first is the single person's pension credit level with an additional allowance of £100 per week for housing costs. The other is set at 2/3rds of National Average Earnings. The cost of the MIR varies considerably depending on age. We have assumed the individual is in receipt of a full Old Age Pension together with the maximum State Second Pension. All annuities use current commercial rates with escalation on a limited price indexation basis.

<table>
<thead>
<tr>
<th>Level of MIR</th>
<th>55</th>
<th>60</th>
<th>65</th>
<th>70</th>
<th>75</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension credit + £100 per week for housing costs</td>
<td>£79,561</td>
<td>£68,214</td>
<td>£58,690</td>
<td>£47,383</td>
<td>£37,835</td>
</tr>
<tr>
<td>2/3rds National Average Earnings</td>
<td>£229,249</td>
<td>£196,554</td>
<td>£169,112</td>
<td>£136,530</td>
<td>£109,020</td>
</tr>
</tbody>
</table>
Removing the requirement to annuitise by age 75

Background

The requirement to secure an income from pension sources has been in existence since 1976. A 65 year old male would have had a life expectancy in the region of 13 years. This compares to a life expectancy of 21 years for the same 65 year old male in good health today.

The rationale for the removal of compulsory annuitisation rules is that in current times, as longevity increases and people remain within the workforce for longer, the rules do not offer enough flexibility for an increasing number of people. The proposed changes will see more choice over the use of pension savings.

Below are listed some issues that will need to be addressed to ensure that the proposed changes do actually offer the benefits to retirees rather than adding complexity to rules that were aimed at simplifying the pensions landscape.

The options available

The proposed changes suggest that there will be 3 options:

- annuities available at any age;
- “capped” drawdown;
- “flexible” drawdown.

Consumers will need to be educated (or advised) on the differences between the options that are available to them. Annuities have suffered due to a lack of flexibility when purchased, and the perception of poor value. There is also the lack of understanding by consumers. Consumers have a low level of financial literacy and a lack of understanding of longevity risk. This is compounded by behavioural decision making which is can be irrational (eg people not wanting to hand their pension pot over to an insurance company when the benefits of an annuity can mitigate the risks during retirement).

Interestingly the ABI has conducted research on the number of retirees that actually take out the Open Market Option (OMO) which states that two thirds of people do shop around yet only one third of people will actually exercise their OMO, and transfer their pension pot to another insurance company to annuitise.

Legislation could improve the situation by making the OMO the default choice at retirement age. Therefore consumers will be forced to shop around for the most appropriate product that suits their need, as well as ensuring that income is also maximised.

The Pension Income Choice Association (PICA) is carrying out lobbying on behalf of the industry to raise the profile of this issue. MGM is about to embark on a pilot where we will offer our policyholders additional information in their wake-up packs to encourage more people to use their OMO.

As part of the pilot, we will write to a segment of policyholders six weeks prior to their retirement date and include the annuity rates offered by competitor annuity companies in addition to the MGM annuity rate. The aim is to inform the policyholder that they may be better off by taking the annuity benefits with another provider.

The pilot will be run for a period of six months and the results will be shared with the industry.
Fair comparison of options

Education will have to be provided to consumers as to which option is best suited for their circumstances. Mortality cross subsidy and mortality drag will need to be explained to the consumer so that a fair comparison can be made between the 3 options mentioned above.

Comparison of income levels

At present, the income available from flexible annuities ranges between 50% and 120% of the average of the top 3 conventional annuity rates (for that age and quote shape of the consumer).

Under income drawdown, the maximum income available is 120% of the annuity determined on the rate tables provided to HMRC by the GAD. These rates are outdated as they were issued in January 2006 and are outdated in terms of the assumed mortality rates as well as the choice of gilts rather than corporate bond yields.

Enhanced rates are available for flexible annuities yet these are not available under the rate tables used for income drawdown purposes.

Clarity will be needed to be provided on how these two methods of calculating incomes can be standardised so that the consumer is able to make a fair comparison. We are therefore proposing that one method of calculating income levels should be established.

Comparison of lump sum on death versus a spouse’s pension or guarantee period

With regards to evaluating the value of a lump sum in the event of the death of the policyholder, the lump sum will be taxed at 55%. Consideration must be given to ascertain if the value of the lump sum is better than a spouse’s pension under a joint life annuity, or an annuity with a 10 year guarantee, for example.

Minimum Income Requirement (MIR)

A consumer can opt to move from capped drawdown to a flexible (or unlimited) drawdown should they wish to take a greater income than available under capped drawdown. This option will allow the consumer to draw unlimited amounts from their pension funds. These amounts will be taxed as income. This option will only be available to consumers who can demonstrate that they have secured an MIR. This is to prevent consumers from running out of funds and then relying on the state to provide additional retirement benefits.

Although only pension income will be considered, guidance will need to be provided by the Government as the income drawdown provider will be responsible for carrying out the checks.

The MIR will take into account the state pension and pension income must be guaranteed for life, and also take into account the future cost of living. This is where complexity may evolve as methods for calculating inflation will differ (eg CPI, LPI, and RPI etc).

Guidance on the amounts that the Government will be expecting that the MIR should be set at will need to be provided. Whilst the Government will review the MIR periodically, it is important that consideration should be given to joint life cases so that the spouse is taken into account, rather than basing the MIR on a single life basis. The monitoring of the MIR could therefore become very complex and difficult to implement.

PCLS

The new rules will allow PCLS to be taken after age 75. It is unclear as to whether it must be taken along side a relevant pension as current rules stipulate.
Harmonisation of death benefits

MGM fully support the harmonisation of death benefits:

Death pre-retirement will see the total pension fund being paid to the estate as un-crystallised funds. Any lump sum death benefits will be standardised across all product options and will be taxed at 55%. This will be payable regardless of the age of the policyholder.

There will be some situations where the new rules will leave some people disadvantaged. Under current income drawdown rules, the tax charge can be as high as 82%. Many middle income earners will see their tax rate increase as anyone dying before age 75 at present may only pay 35% tax charge on and funds passed onto the estate.

This scenario is compounded by basic rate tax payers receiving tax relief of 20% during the accumulation of their pension, only having to pay 55% on death under the new proposals.

This change in tax treatment must also be considered as there will be advantages for opting for phased drawdown rather than straightforward income drawdown. If someone had selected phased drawdown, there would be no tax liability for un-crystallised funds where they died before 75 and the lump sum from the proportion in income drawdown would attract the 55% tax. This is clearly an advantage over someone who had selected to put their entire pension fund into income drawdown.

Value Protection on annuities

Value protection will be available on annuities past the age of 75. Any lump sum payments on death will also be taxed at 55%. The current situation is that annuities with value protection selected as a death benefit and that are already in force, have been priced to the 75 age limit. Therefore the pricing of future annuities with Value Protection will need to be re-examined to take into account the fact that the age 75 limit is removed.

Advantages of annuities

Although conventional annuities are perceived as poor value, they are indeed a relatively cheap product to administer when compared to income drawdown products. Annuities offer mortality cross subsidy and annuitants can benefit from this. MGM research shows that at age 75, the benefits to the customer are in the region of 1.65% whilst at age 76 it could be 1.83%.

Moral hazard can be described when an individual does not take the full consequences and responsibilities of their actions, and therefore have a tendency to act less carefully than it otherwise would, leaving another party to hold some responsibility for the consequences of those actions. In this context, if annuitisation was no longer compulsory, people may enter income drawdown contracts and may drawdown their income at a relatively high level thus running down the fund, knowing that they would be able to rely on the State for benefits. With annuities, the moral hazard has been eliminated.

Risks for consumers

In general consumers are unaware of longevity risk and investment risk. Conventional annuities provide mitigation for both risks and also curtail the costs associated with managing pension wealth. The risk of poor advice also needs to be addressed as financial education of the consumers must be addressed.

Summary

For many consumers entering retirement, annuities may be the best option available. The proposed changes to the rules are to be welcomed as there will be more choice available to the consumer, but these options must be made aware to them.
ABI statistics indicate that 97% of those annuitising do so well before their 75th birthday. The key driver behind the age at which people take their retirement benefits is the age at which the state pension becomes payable. As this age is currently set at 65 for males and 60 for females, this will also be the age at which the majority of people leave the workforce. Therefore people will be seeking to maximise their income during the retirement years, regardless of whether they opt for an annuity or a drawdown based contract.

Product Innovation will be encouraged as life offices will design products that will offer greater flexibility for the target market and with the demographics of the UK entering a period where the so called “baby boomers” enter retirement; there are great opportunities to offer consumers the products that will satisfy their income requirements.

The main issue that must be addressed is that of the OMO. We believe that increased financial education is required and if the OMO were to be made the default option, consumers would have to be made aware of the various different product options that are available. They would then be able to shop around for the most suitable product and the best level of income that they can expect to last their years in retirement.
Questions posed by the Consultation Paper

Developing a new tax framework for retirement

A.1 The level of an appropriate annual drawdown limit for capped drawdown.

The method of calculating the level of income should be *standardised* in line with the limits that currently exist under the flexible annuity rules. 120% of the best three current conventional annuity rates are the most appropriate, as they will take into account the actual age of the main customer and can also cater for a spouse, if applicable. Using current annuity rates will also allow for people with health conditions to be taken into account, which under the GAD limits is not possible.

The actual age of the customer should be used rather than capping at age 75 and this method of calculating age should be consistent across all product ranges. The maximum level of income that can be taken should be stepped down as customers reach older ages so that funds are not depleted at an increased rate. This will reduce the risk of running out of funds during drawdown which would normally increase with age. It must be highlighted to the consumer that this risk is not applicable with the purchase of an annuity.

Under the flexible annuity limits, consideration should be given to removing the 50% minimum income level. This is because with drawdown products, there is no minimum hence the customer can elect not to take any income at all. If the limit were to be removed for the annuities as well, then the customer would be able to make a fair comparison between the different product offerings on offer.

For flexible annuities, the actual quote shape can also be taken into account (single or joint life, nil, 5 or 10 year guarantee, and payment frequency) and this should be available for all calculation of income limits.

Therefore, standardisation will enable the customer to be able to compare the different product offerings that are available.

A.2 Its intended approach to reforming the pensions tax framework, in line with its commitment to end the effective requirement to purchase an annuity at age 75.

Further guidance from HMRC is required in relation to PCLS. For example, when PCLS would be calculated. Lifetime Allowance (LTA) checks are to be carried out by the life office, but is this to be carried out at age 75 or when the PCLS is actually paid out.

The harmonisation of the tax payable on death between products is welcome. However, the level of 55% is too high. If flexible income withdrawals are taxed under PAYE, people would be encouraged to draw as much as possible so that they will minimise the amount that will attract the 55% tax on death of any remaining fund. The tax charge of 55% will also be perceived as punitive and may act as a deterrent from holding money in drawdown.

This change in tax treatment must also be considered as there will be advantages for opting for phased drawdown rather than straightforward income drawdown. If someone had selected phased drawdown, there would be no tax liability for un-crystallised funds where they died before 75 and the lump sum from the proportion in income drawdown would attract the 55% tax. This is clearly an advantage over someone who had selected to put their entire pension fund into income drawdown.

This scenario is compounded by basic rate tax payers receiving tax relief of 20% during the accumulation of their pension, only having to pay 55% on death under the new proposals. A minority of consumers pay IHT and very few will pay 50% under PAYE from their income in retirement. Hence the 55% will be deemed too high for the majority of consumers.

Therefore the tax rate should be set at 45% on death.
Minimum Income Requirement

A.3 What income should be considered “secure” for the purposes of the MIR and whether proposals for the life annuity income that can be considered for the MIR are practical and appropriate?

Fixed pension income should be taken into account, but consideration should also be given to flexible annuities which have a Minimum Income Guarantee (MIG) built into the product.

Existing annuities that customers have already purchased should be taken into account but it is difficult to compare the value of annuities that may have different benefits attached. For example, customers may have elected to have guarantee periods, escalating annuities or spouse’s benefits or a combination of these. These product options will affect the level of income payable under the contract but may have a higher “value” than a conventional level annuity as they may have benefits to the consumer that cannot be measured on a like for like basis.

Therefore the following should be taken into account:
- Basic state pension
- Additional state pension
- Scheme pensions in payment from an occupational pension that are uprated annually by a minimum of LPI
- Life time annuity income provided that it increases annually by at least LPI.

A.4 What is an appropriate level for the MIR should be and how the MIR should be adjusted for different ages.

The MIR should be set at a relatively high level to stop people exhausting their funds. There are various methods of setting the MIR such as the age allowance income limit (currently £22,900) or a possible level of 67% of average national earnings.

A.5 Whether a different MIR should be set for individuals and couples.

Where there is a spouse, the MIR should be set on a joint life basis, hence taking into account the income for a spouse.

This may not be practical in real terms, as it will become an administrative burden. Couples would have to be married or be in a civil partnership. Common law partners would not be taken into account which will result in discrimination of such relationships.

A.6 How often should the MIR be reviewed

The MIR should be announced each year as with the Lifetime Allowance (LTA). This will mean that consumers will be able to forward plan their retirement income needs for a foreseeable future.

Automatic increases each year linked to inflation rates will not provide enough notice for consumers to change their income in retirement plans. The issue of which measure of inflation to use will also become relevant, as it can be argued that the inflation rate for pensioners is much greater than the indices that are used to calculate general inflation within the economy.
A.7 How to minimise unnecessary burdens for individuals and industry in the assessment of the MIR.

HMRC will need to issue regulations about what information individuals will have to provide to schemes and what information scheme administrators have to report to HMRC.

LTA checks are carried out by providers and MIR checks can be carried out in accordance to the guidelines.

The UK annuity market

A.8 Whether other legislative or regulatory barriers remain whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance risks.

A new legislative process should be introduced as part of the pension maturity process. The Open Market Option available at retirement age should be made compulsory for consumers.

If consumers are forced to look at the various options that are available to them before they enter the decumulation phase of their retirement savings, then they will be more likely to opt for the solution or product that is most suitable to their individual needs at retirement. Financial education of consumers will be required as well as an affordable advice channel.

A.9 How the industry, Government and advice bodies such as CFEB can work to ensure that individuals make appropriate choices about what to do with their retirement savings in the absence of the requirement to purchase an annuity by age 75.

Consumers will need to be educated (or advised) on the differences between the options that are available to them. Annuities have suffered due to a lack of flexibility when purchased, and the perception of poor value. There is also the lack of understanding by consumers. Consumers have a low level of financial literacy and a lack of understanding of longevity risk. This is compounded by behavioural decision making which is can be irrational (eg people not wanting to hand their pension pot over to an insurance company when the benefits of an annuity can mitigate the risks during retirement).

The Pension Income Choice Association (PICA) has suggested a three stage process for retirement planning. The first of these is choosing the most appropriate product. The second is to select the appropriate options under that product that most suit the circumstances of the consumer. And the final stage is to select the insurance company that is to provide the income in retirement.

Legislation could improve the situation by making the OMO the default choice at retirement age. Therefore consumers will be forced to shop around for the most appropriate product that suits their need, as well as ensuring that income is also maximised throughout their retirement.

MGM is about to embark on a pilot where we will offer our policyholders additional information in their wake-up packs to encourage more people to use their OMO. As part of the pilot, we will write to a segment of policyholders six weeks prior to their retirement date and include the annuity rates offered by competitor annuity companies in addition to the MGM annuity rate. The aim is to inform the policyholder that they may be better off by taking the annuity benefits with another provider.

The pilot will be run for a period of six months and the results will be shared with the industry.

The Options that are available at retirement should be highlighted by Government agencies with a national campaign.

Other initiatives could be educating consumers whilst they are still in employment by using various forms of media.
A.10 Whether the proposed reforms have un-intended consequences that may affect the market's ability to support annuities at attractive rates or prevent the annuity market being able to meet likely demand for annuities.

The proposed changes will have an impact on government bonds and long term bond markets as the practises of institutional investment may change as consumers alter the age at which they take their retirement benefits. This will have a knock on effect as the yields available from these markets will in turn affect the annuity rates that life offices will be able to offer.

Proposals for the Government to issue longevity bonds linked to the survival of a cohort of the population should be explored so that a market price will emerge for longevity risk. This will create a market for longevity swaps which could be used to back the investments that underpin annuity pricing.

Directly linked are the effects of Solvency II on annuity rates. This will also have a negative effect on the overall annuity market in the UK. The capacity within the annuity market to meet the future demand for annuities will also be affected. The Government is already in consultation with the industry to ensure that the industry can remain sustainable in the future.