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ABI Submission to HM Treasury's consultation

"Removing the requirement to annuitise by age 75"

About the ABI

1. The ABI is the voice of the UK's insurance, investment and long-term savings industry. It has over 300 members, which together account for around 90% of premiums in the UK domestic market.

2. The UK insurance industry is the third largest in the world and the largest in Europe, helping individuals and businesses protect themselves against the everyday risks they face. It pays out over £230 million per day in pension and life insurance benefits and over £50 million per day in general insurance claims. The industry is an important contributor to the UK's economy: it manages investments of £1.5 trillion, over 20% of the UK's total net worth; employs more than 300,000 people in the UK alone; is the fourth highest contributor of corporation tax; and is a major exporter, with one-fifth of its net premium income coming from overseas business.

Key points

3. The ABI welcomes this consultation and supports the Government's intention to remove the requirement to annuitise at age 75. We agree that these reforms will give people greater flexibility over their pension savings and will allow for greater market innovation in retirement products. We also welcome the Government's recognition of the continuing value annuities provide by guaranteeing an income throughout the whole of a person's retirement.

4. The ABI therefore supports the Government's intention to end compulsory annuitisation and roll out the new capped drawdown arrangements in April 2011 so that pensioners can enjoy the benefits of this new flexibility as soon as possible. However, it will be a challenge for providers to ensure that their literature and systems are updated to allow for capped drawdown beyond age 75 in just seven months. The FSA will therefore need to be fully engaged to ensure that providers can meet any requirements about the impact on customers.

5. It is extremely unlikely that any provider will be able to develop and market products allowing for flexible drawdown in this time, given the complexities of the regime and the many questions about the detail that still remain to be answered. The proposed reforms are radical and will require complex administration and system changes. Many of the questions around the detail of the new regime will not be decided for several months, making it impossible for the industry to complete the necessary changes in time.

6. The Government must make sure that people are not misled about the speed at which these reforms can be rolled out, and the number of people who are likely to be able to take advantage of flexible drawdown. Although auto-enrolment and the increasing number of DC pension schemes mean that pension pots will be larger in future, flexible drawdown will only be appropriate for a limited number of people retiring today.

7. The ABI would therefore recommend that the Government allows more time for fuller consideration of flexible drawdown and the Minimum Income Requirement, with a view to implementing the reforms in April 2012. This period of development will allow for proper analysis of the many variables, and a sufficient amount of time to ensure the relevant pieces of legislation and regulation, and the necessary guidance, is accurate, consistent and properly understood by both the industry and the people hoping to take advantage of the policy.

8. On a wider note, the ABI is also concerned about the cumulative impact on the industry of the numerous different reforms, directly or indirectly impacting on the pension sector, being implemented over the next few years. Some of these reviews, such as the Royal Commission's investigation into the funding of Long Term Care, are likely to affect people's decisions about how best to draw down their retirement income Many others, such as the Retail Distribution Review, will also require the industry to make significant changes to their systems and literature and yet others, such as Solvency II, will impact on the annuity market. If these reforms are not properly co-ordinated, it will be extremely difficult and expensive for the industry to remain up-to-date and compliant throughout this period of change.

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Developing a new tax framework for retirement

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

9. The ABI welcomes the decision to allow capped drawdown beyond age 75. We also agree with the Government that the maximum GAD limit should not encourage inappropriate withdrawal of retirement funds or the exhaustion of pension pots.

10. Although we acknowledge that the current limits were set in the context of compulsory annuitisation at age 75 and that the risk of running out of funds during drawdown increases with age, there is no evidence to suggest that people are currently withdrawing inappropriate amounts of their savings. The majority of our members therefore do not consider lowering the upper limit necessary for those above age 75. Allowing people to continue to enjoy the short term flexibility to draw down a higher income beyond age 75 will allow people to plan for expenses, such as making their home elderly-friendly, which are likely to fall towards the end of retirement.

11. Some of our members feel, however, that an upper limit of 120% is too high for later retirement ages and that the Government should consider lowering the limit beyond age 75. It is very important that people are given clear warnings about the consequences of drawing down more than 100% of the GAD limit and have accurate information about the current value of their funds. We would therefore recommend that annual reviews are required beyond age 75.

A.2 – The reform of the pensions tax framework

12. We are very pleased that the Government has decided to reconsider the existing pension tax regime and welcome their decision to lower the tax charge on funds remaining at death. However, setting the recovery charge at 55% will provide an incentive for people to seek to avoid tax by withdrawing the maximum amount from a pension pot as early as possible in order to ensure that no funds remain at death.

13. A 55% recovery charge will also impose a punitive level of taxation on pensioners who have only received the basic level of tax relief throughout their life. The charge is particularly regressive because anyone who meets the Minimum Income Requirement will be able to withdraw their surplus funds in the most tax efficient way, avoiding the recovery charge completely. The charge will therefore fall predominantly on those who do not qualify for flexible drawdown and are more likely to have only received the basic level of tax relief throughout their life.

14. We would therefore consider 40% a more appropriate level for this charge. Alternatively, any remaining funds could be taxed at the marginal rate applied in the pensioner's final full-year tax assessment to prevent basic rate tax payers being unduly penalised.

The Minimum Income Requirement

15. As noted above, the ABI is deeply concerned about the speed at which the Government is hoping to roll out flexible drawdown.

16. From April 2011, the extension of capped drawdown to those over age 75 will give pensioners considerably increased flexibility over how to draw down their pension savings. All pensioners will be able to avoid any irrevocable decisions whilst proper consideration is given to the final shape of the flexible drawdown regime and appropriate products are developed and marketed by the industry. There is a danger that, if decisions on the technical detail of flexible drawdown are made based on incomplete and uncertain evidence, the final regime will lead to both customer detriment and unnecessary cost to the Government. People will be left with insufficient income towards the end of their retirement, and might fall back onto benefits. Unintentional loopholes might also be created allowing increased tax avoidance.

17. Unintended consequences such as these could lead to serious reputational damage to the pensions industry, as well as financial damage to people and the Government, and would risk the success of other critical Government reforms, such as auto-enrolment.

18. Allowing an extra year for the flexible drawdown regime to be developed will also allow for people to be properly educated and advised about the new possibilities. Providers will be sending out the first wake-up pack for people planning to retire soon after April 2010 in a matter of weeks and it will be impossible to give an accurate picture of what options are available to them at this time. Rolling out flexible drawdown in 2012 will ensure that people will be more able to make informed and appropriate decisions about their retirement income, and will be able to maximise their benefit from these reforms.

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

19. Although we understand the Government’s concern that a pensioner might fall into poverty if their ‘secure’ income can be eroded by inflation, it would be much simpler to set the MIR at a sufficiently high level at the point of qualification to allow level annuities to be considered ‘secure’, instead of trying to select the appropriate level of escalation. Given the different indices used by DB schemes to escalate a person’s income over time, the changing escalation of the state pension, and the relative unpopularity of escalating annuities, it will be extremely difficult for people to understand what income can be considered or not.

20. Given the speed at which the Government is currently planning to implement these reforms, we agree that only pension income currently in payment and guaranteed for life should be considered ‘secure’. However, we think there is a case for other sources of income, such as third-way annuities and purchased life annuities to be considered for inclusion. Similarly, the possibility of allowing the MIR to be met by means of retaining a sufficiently large lump sum in a pension fund could also be considered. We would recommend that the Government allows a further review of these alternative sources of income in the future.

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

21. The ABI would recommend that the MIR is set at a high level to ensure that people enjoy a sufficient level of income throughout their retirement. We would hope that flexible drawdown will only be considered by people with considerable levels of pension saving, with the majority of people continuing to annuitise their savings or enjoying the increased flexibility of capped drawdown. We would also note that if the MIR is set too low at the start and has to be raised, it will be too late for the people who have already withdrawn their pension savings and have no way of rebuilding their pension pots.

22. We would suggest that the MIR is set at the value of average earnings at that point in time. This would make it unlikely that inflation would erode the value of the secure income enough to drop the pensioner over the poverty threshold of 60% of average earnings in the later years of their retirement.

23. Since it will be cheaper for an older pensioner to purchase an annuity that meets the MIR, we do not feel that the level needs to be adjusted by age.

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

24. Although setting an appropriate MIR for couples would be logical, particularly in view of the important benefits that a joint annuity can offer a couple, there are many questions that would need to answered first. For example, what would be an appropriate level, what sort of income would be considered 'secure' and what would happen if a couple's circumstances were to change. We would therefore recommend the possibility of a joint MIR should also be considered in a later review of these arrangements.

A.6 – How often the MIR should be reviewed

25. We would recommend that the level of the MIR is up-rated annually in line with average earnings, as will be the case with the basic state pension. This will ensure that the proportion a state pension contributes to the MIR will not grow over time, reducing the incentive to save.

26. We would also recommend that the entire flexible drawdown regime is comprehensively reviewed five years after it is implemented in order to assess whether the level of the MIR and the types of income considered secure are appropriate.

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

27. We are extremely concerned at the possibility that a pension provider will be expected to assess whether a person meets the MIR or not, beyond checking the income received by them from their own books. Given the number of people who will receive their pension income from a variety of sources, including the Government, different providers and complex trustee schemes, no provider will be able to verify the accuracy of a person's claim to meet the MIR. If the Government were to require the industry to bear the liability for inaccurately assessing whether a person meets the requirements, it is unlikely that any provider would be able to afford to offer a product allowing flexible drawdown.

28. We would therefore recommend that the assessment of the MIR rests on a system of self-certification, with a provider responsible for verifying only the income that they write themselves.

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

Small pots

29. As previous ABI submissions have highlighted, there is a continuing disparity between commutation rules for trust-based and contract-based defined contribution schemes. Although pension rules allow those in a trust-based scheme to commute pots of less than £2,000, regardless of other pension assets, this flexibility is not extended to contract-based schemes. Where the claimant has failed to meet the 12 month deadline for trivial commutation, this restriction can leave the assets stranded.

30. We appreciate that the Government is concerned that allowing self-certification for the purposes of commutation would increase the possibility that a person might deliberately fragment their pension savings in order to qualify. However, we consider that any such innovation could easily be prevented by requiring each provider to certify that the commutation is not from a fragmentation scheme set up to exploit these rules.

31. There would remain a very small risk that a person could deliberately fragment their pension pot across multiple providers, but given the very small amount of benefit that would accrue from such a step, we think it very unlikely indeed that anyone would consider such a step worthwhile.

Crystallisation regulations

32. Current crystallisation regulations restrict a claimant's ability to amalgamate their pension savings after benefits have been taken. Allowing both crystallised and un-crystallised assets to be combined into a single arrangement would allow a person to simplify their pension arrangements and potentially reduce the ongoing management costs whilst costing the Government nothing in terms of revenue.

Trivial commutation limits and the lifetime allowance

33. The ABI is concerned that recent Government proposals to lower the lifetime allowance to £1.5 million might lead to the automatic adjustment of the trivial commutation limits. Given the complexity of the triviality rules, we feel that any adjustment of the current levels will lead to further confusion amongst consumers and would recommend that any revision of the lifetime allowance is not passed on to the trivial commutation limits and that the same £2,000 de minimis level applies across all pension arrangements.

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

The value of annuities

34. For people to gain the greatest amount of benefit from the increased flexibility proposed in these reforms they must be sufficiently aware of their options to make informed choices about their retirement income.

35. Although these reforms allow people to avoid annuitisation completely if they wish, annuities will remain the most appropriate retirement product for the majority of people as they provide a guaranteed income for the whole of a person's retirement. We are concerned that the perception that annuities offer poor value for money will lead people to avoid annuitisation and leave themselves exposed to the risk of outliving their pension funds, or losing their pension savings in inappropriately risky investments. As more low-income earners start to save for a pension through NEST and auto-enrolment, the Government must take care that the value of annuities are properly appreciated buy people.

36. The Government must ensure that these reforms are implemented alongside clear and accessible information about the risks of alternative retirement products. We would like to see the Government and advice bodies encourage people to consult a professional adviser before considering either flexible or capped drawdown. Getting professional regulated advice is an important and valuable service for people seeking to purchase a retirement product suitable for their circumstances.

The industry's ongoing work on OMO

37. ABI research shows that 96% of people are aware of the Open Market Option and the right to shop around and 67% of people shopped around before buying their annuity. However, our research also shows that more needs to be done to improve people's understanding of the different types of annuity available to them to ensure they are able to make informed decisions about their retirement income.

38. To this end, the industry is continuing to build upon the improvements we have already made to the wake-up packs sent out to people as they approach retirement. The ABI is working with providers to update its guidance on the wake-up packs, including the development and inclusion of a decision tree to help people understand the different types of annuity available to them and to decide which is the most appropriate for their circumstances.

39. The ABI also recognises that people can experience difficulty in comparing the income they would receive from different providers, particularly if they are unable to afford professional advice. We are therefore working with the Consumer Financial Education Body (CFEB) to update their comparison tables to allow for real-time quotations for all types of annuity.

40. We are also continuing our work with the FSA to develop simplified advice services to help the large and growing number of people unable to access existing full advice. Simplified advice will particularly help people with smaller pension pots receive an appropriate recommendation about which financial product meets their needs and particular circumstances at an affordable cost.

A.10 – Unintended consequences on the annuity market

Index-linked assets

41. If the MIR can only be met by index-linked income there will be a considerably increased demand for similarly linked assets to support the appropriate type of annuity. This increased demand might not easily be met by the market, leading to a fall in the rate that can be offered for this type of annuity and an increase in the perception that annuities offer bad value for money.

Defined benefit transfers

42. We are concerned about the possibility that these reforms will lead to an increase in demand by those in a final salary pension scheme for the opportunity to transfer into a DC scheme in order to take advantage of the flexibility offered by capped and flexible drawdown. If the effect of the abolition of contracting-out for DC schemes is that transfers out of a DB scheme will no longer be possible, these reforms could lead to a rush to transfer before April 2012.

Tax avoidance

43. The ABI is concerned about the cost that is likely to fall upon the industry if the Government seeks to prevent tax avoidance by means of onerous and complex regulation. When drawing up the details of these reforms, the Government needs to consider the possibility of their use for tax avoidance from the start and not rely on imposing new restrictions and requirements after implementation.

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10 September 2010

Private & Confidential
Age 75 Consultation
Pensions and Pensioners Team
Room 2/SE
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Sirs

Removing the requirement to annuitise by age 75

I am writing on behalf of the Association of Consulting Actuaries to respond to your consultation.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and actuarial advice is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

The ACA is the representative body for consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

We understand that the government's intention is to remove the requirement to annuitise at age 75 and to make it easier to use draw down arrangements. In our view, this requires use of a simple approach which will allow individuals to do their own calculation of the minimum income requirement.

We have suggested a small expansion to the list of items that can count for the Minimum Income Requirement, to make the system available for those with little or no defined benefit or state pensions, such as the self-employed.

We also believe that it will be appropriate to make sure that standard information is available to those that are considering draw down, particularly in relation to the absence of longevity insurance if no income is provided by an annuity.

Our responses to the consultation questions are set out in the appendix to this letter. If you have any queries about what we are suggesting please do not hesitate to contact me on 020 7082 6228 or charles.young@hymans.co.uk .

Yours faithfully

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Appendix – response to consultation questions

ACA Response to: Removing the requirement to annuitise by age 75

In this response, we have assumed that the Minimum Income Requirement (MIR) would normally be tested once only, when an individual first wanted to draw down more than would be permitted under the capped drawdown arrangements. After this point, the individual would be permitted to draw down any or all funds outside those needed for the MIR, as and when the individual wished. This approach would be cost-effective to implement.

If more frequent testing for an individual is proposed by HMT, this may affect some of the responses below, and we would like to have the opportunity to comment.

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

We suggest retaining the current level of 120% of an equivalent annuity.

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 that the intended approach is consistent with ending the requirement to purchase an annuity. We understand from the initial briefing when the consultation document was launched that HMT is comfortable with the possibility that an individual could draw down the whole of his or her pension fund in excess of that required for MIR, as a single lump sum. The structure should be made available to all pensioners, not just those who have reached age 75. We think this is implied in paragraph 2.16 of the consultation paper.

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.

To tie these requirements in with existing legislation, we suggest that the reference to defined benefit pensions and annuities cross-refers to the existing tax legislation, as summarised in HMRC's Registered Pension Scheme Manual. In particular, "Secured pension" (as defined in the Glossary RPSM20000000) appears to be the relevant item. In addition, we would like to suggest a further item that can be recognized as providing secured income, as follows.

As the proposals stand, the requirement to have a pension or annuity that is actually providing the MIR seems onerous, particularly for people who have no defined benefit pension (DB) and/or no state pension (eg the self-employed). As things stand, someone who has no DB provision has to buy an annuity with part of his funds in order to be allowed to avoid buying an annuity with the rest! We therefore suggest a small extension to the items allowed to count as secure for the MIR. If this is not permitted, a significant and vocal group of those approaching age 75 will complain about the fact that they still have to buy an annuity.

We also suggest the terms on which non-increasing secured pensions ought to be allowed to count.

We suggest that the rules should permit the following items to be added up to get a notional income equivalent to compare with the MIR.

- "Secured pension" (i.e. DB pensions and/or annuities) that carry "Limited Pension Indexation" increases in line with inflation capped at 2.5% per annum or more (Note: this item should include all Guaranteed Minimum Pensions (GMPs). While it is common for occupational pension schemes not to index-link GMPs that were earned for service between 1978 and 1988, this is because they are index-linked by the state as an addition to the individual's normal state pension.)
- 75% of "Secured pensions" (DB pensions and/or annuities) that do not increase, or increase at less than the 2.5% rate.
- 50% of the "annuity equivalent" of any pension funds that the member agrees will be 'ring fenced', so that they will not be drawn down as cash unless and until the member asks for a further MIR assessment. (This would require policing by the fund provider to ensure that the funds are not withdrawn.) The member should however be allowed to use some or all of the ring-fenced funds to buy an annuity at any time.

The non-increasing multiplier of 75% means that inflation will have to rise by a third before the MIR is threatened by the absence of indexation. The final piece with a 50% multiplier is intended to provide quite a lot of safety margin, so that even if markets fall and annuities become more expensive, the remaining assets are likely to be large enough to support a pension over the MIR.

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

The MIR should be set at the minimum level required to keep a pensioner out of state means-tested benefits, plus a margin to allow for the possibility of this minimum rising somewhat faster than the income that covers the MIR.

We would suggest £200 per week. This provides a significant safety margin above the Guarantee Credit, where the individual would receive state support. It also compares reasonably with an individual's expenditure needs, based on the figure during the "normal" part of a pensioner's life. We do not believe that there is a need to ensure that there is more income shortly after retirement: while typical expenditure is higher at that age, the pensioner will typically have their retirement tax-free cash sum to finance this, so this level of expenditure does not need protecting.

We also noticed that £200 per week is around the 20^{th} percentile of UK earnings[1] – we do not believe that it would be appropriate to require more than this.

We do not believe that there should be a higher figure towards what might be the end of life: there is no compulsion for anyone else in the UK to save towards increased healthcare costs at the end of life.

Having a constant sum across all ages will simplify arrangements, and there does not seem to be adequate justification to do anything more complex.

[1] Source: Office for National Statistics: 2009 Annual Survey of Hours and Earnings: Weekly pay – Gross (£) – for all employee jobs – United Kingdom. The 20^{th} percentile was £207 pw

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

We believe that the same MIR should apply to individuals and couples. It is entirely possible that the spouse has their own income, so it seems unnecessarily restrictive for a married member to be required to guarantee income up to a higher level.

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

The £200 figure should be increased annually in line with state pension increases generally.

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

Using the simple structure outlined above will keep burdens to a minimum. Each provider of a pension that is being relied on to cover the MIR would have to give details of the person's pension, showing the part that is increased by at least LPI 2.5% and the part that is not. There would need to be a table of annuity equivalent factors and the person's age and sex. The calculations are easy enough that the individual ought to be able to self-certify.

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.

No

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.

Currently, income drawdown is quite closely monitored, in that pension providers typically require the individual taking drawdown to take independent financial advice. This is one of the reasons why drawdown is usually only recommended for individuals with large pension funds.

If HMT wishes to make drawdown more widely used, financial advice is likely to be less thorough for those with smaller funds. The industry will need to find some way of providing information that will help individuals assess the pros and cons of drawdown, and in particular the lack of longevity insurance. We also strongly suggest that information for individuals makes clear that drawing down all money up to the maximum permitted may not leave the member with what he or she regards as a reasonable income for the remainder of their life.

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.

None.

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10 September 2010

The Actuarial Profession

making financial sense of the future

Consultation response

HM Treasury: Removing the requirement to annuitise by age 75

September 2010

About the Actuarial Profession

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Actuarial Profession
making financial sense of the future

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15 September 2010

Dear Sir/Madam

Removing the requirement to annuitise at age 75

The Actuarial Profession is pleased to respond to HM Treasury on its consultation paper dated July 2010 in relation to its proposals to remove the requirement to annuitise by age 75.

Summary of key points

In summary, the Profession has concerns, outlined below, about some of the proposals. We would welcome the opportunity to discuss these concerns further with the Government.

We recognise that the decisions people have to make at and in retirement are complex and may involve significant risk of financial loss. We are concerned that the removal of the requirement to annuitise at 75 will be presented to the public, or may be interpreted, as an endorsement that annuities are less valuable than they really are.

Pension provision is complex and many people place more emphasis on cash today rather than long term guarantees. It is important that each person secures appropriate advice, suitable for their individual circumstances, to enable them to make the best decision for their financial future.

While removing restrictions and thereby increase people's options might have superficial attractions there is always a danger that individuals may make ill-informed or bad choices with that given freedom. It should be noted that an earlier decision, in 1988, to remove the ability for employers to make occupational pension scheme membership a condition of employment alongside the creation of personal pensions may have contributed to some of the issues around mis-selling.

We suspect that the "capped drawdown" requirements might not always meet the stated policy purpose of avoiding people having to rely on state support. Any individual who lives longer than assumed by the drawdown cap will see a gradually reducing drawdown amount that could push them into reliance on state support. We consider that annuity purchase offers an insurance, which is not provided by "capped drawdown", against living longer than average. In our view the impact assessment does not address the possible implications to the state of people opting for “capped drawdown”, and subsequently finding themselves having to fall back on state support.

We consider there is a structural weakness in the regulation of trust-based occupational defined contribution pension schemes. Because the sale of the scheme to the employer is considered to be business to business it falls outside the protections afforded to the individual consumer. Many employees work for small businesses and if their employer “buys” a trust-based pension scheme option for them there is no formally regulated body held responsible for the product sale or advice. Employees would have to take up independent advice when it came to their retirement options.

We suggest the Government could consider a range of changes to the way in which defined contribution pensions are regulated at retirement. These changes include:

1. To make information provided to people at point of retirement simpler to understand.

2. Capped drawdown could only be permitted beyond age 75, where the fund size exceeds, say £150,000 to limit the risk of future reliance upon state benefits. Flexible (i.e. uncapped) drawdown means that the provider is relying upon other sources of income – including from the state and elsewhere – and may therefore be unable to give this guarantee.

3. To seek to achieve a balance between consumer protection and flexibility. There is an important role for the Consumer Financial Education Body (CFEB) and other regulators to ensure that there is appropriate information provided as a matter of course to anyone who attempts to apply for a drawdown product so that the risks and their alternatives are clear. Mandatory information provided pre-sale and at periodic reviews should illustrate the effect of variation in future income from the product due to scenario changes in asset values, long-term interest rates as well as allowing for the impact of mortality drag and the level of income drawn from the plan.

4. To require pension providers to adhere to strict service standards in allowing pension monies to be moved between providers at retirement.

<u>Consultation questions</u>

A1: What is the appropriate level for capped drawdown?

We suggest the Government could consider the possibility that many people who currently annuitise may be tempted into capped drawdown.

Drawdown will facilitate taking more income than an annuity provides in the early years of retirement as well as preserving funds in the event of early death. Many people may be attracted to this.

The downsides are that the expenses of running a drawdown policy are usually higher than running an annuity. The investment and longevity risks are higher, which may lead to a wide distribution of potential outcomes. For these reasons, drawdown is not usually regarded as suitable unless overall private savings are in excess of £100,000. However, the average drawdown policy size has historically been smaller, 90% of people have pots of less than £50,000.

The challenge will be setting a level of capped drawdown that will achieve the policy aim of preventing people relying on state support. The existence of means tested state benefits could justify advice to take drawdown policies. More money may be drawndown in the early years, while people maintain their pre-retirement standard of living. In later years, they may accept a lower level of income.

We would therefore suggest that a capped drawdown could be linked to the size of an individual's fund to manage the risk of people relying on state support.

A2: Reform of framework

We consider the proposals to reform the framework are appropriate.

A3: Definition of secure income

We broadly support this proposal and have one suggested change. The proposal is that pensions that are not indexed should have nil value. However, most people have historically purchased nil escalating pensions, which are worth more than nil.

We suggest taking these in at 75%, and including life annuity income. It is important here not to distort demand for index linked annuities over fixed annuities.

A4: Appropriate amount for MIR

It should be taken as the single person's pension guarantee level, i.e. £132 per week at present. There is then a clear link between the requirement and the policy intent. Having a different figure for different ages seems unnecessarily complex. Government may wish to consider in addition to exclude eligibility to means tested income benefits from anyone who has taken flexible drawdown.

A5: Different levels for single or couples?

Since pension policies are in individual names, the limit should be by individual.

A6: Review levels of MIR

The MIR level should mirror the means tested benefit it is pegged to. It is suggested that the average earnings number is revised annually and the proportion reviewed, say, every five years in light of experience and/or changes in the welfare state.

A7: Minimise burden

We agree that the provider should police the release of funds. We suggest the Government may need to consider what form proof of pension level is to be provided and how readily available it is. Where pensions are paid net of tax, it may be harder to demonstrate the gross income equivalent.

Paragraphs 19, 20 and 27 of Appendix C of the Consultation Paper appear to indicate that the Government is expecting about 4,600 organisations to be testing about 8,000 cases per year. We are concerned at the inefficiencies which this process would entail and the disincentive to volunteer to provide flexible drawdown, particularly since the consumer is free to take their entire fund in exchange for an income tax charge, which would be of no benefit to the service provider. This could be further exacerbated if guidance on how to perform the MIR became more complex.

We would suggest that the HMRC administer the MIR test. Individuals could apply to HMRC for a MIR certificate at a fee, to keep this cost neutral to the taxpayer, with a “re-test” fee where the individual did not wish to re-apply). HMRC would have the advantage of being easily able to check on the level of basic state and additional pension payable, check that no means tested benefits were currently being paid (with the support of the DWP), check that other sources of income were consistent with the individual’s tax records, spot any attempts to defraud the system and ensure the MIR test is kept up to date and consistently applied (since someone processing one case every year or two would struggle to be up to speed on all of the intricacies and potential abuses).

A8: Legislative or regulatory barriers

Allowing annuities to be bought with longer protection periods than 10 years will place annuities on a level playing field with drawdown. We suggest increasing it to 20 years to be consistent with the maximum period allowable under drawdown.

Regulation requires a huge amount of information to be provided at the point of sale of a retirement product to the consumer. The volume and complexity of information can be off-putting, hamper understanding and can be a major factor in people making poor choices at retirement. We suggest consumers would benefit from reform to the provision and presentation of appropriate information at point of retirement.

A9: Other changes

<u>Regulatory challenges</u>

Contract based DC schemes set up by employers over the last 20 years are now producing an increasing number of retirements. In contrast with trust based schemes, the contract is between the employee and the pension company and there is no governance protection for the employee. It is the pension company which benefits from poor choices made by the employee. Employers who make advice available find that inertia and ignorance often means that very few people actually take up the advice.

Trust based pension schemes are not covered by FSA regulation. There is little protection for members where trustees do not put in place arrangements to support members making appropriate choices.

We suggest the Government could consider the merits of removing the ability of a provider to sell a pension annuity or drawdown policy on an ‘execution-only’ basis. A duty of care responsibility (on the provider, trustee, employer or adviser) could help ensure the member is able to make an informed and appropriate choice.

At present there is poor provision of advice for people with modest savings. There is though sufficient capability to advise people. Government may consider the barriers to taking advice at retirement are similar to the barriers for starting to save for a pension. If regulations were to change such that advice at retirement became more accessible then the market can and will supply the advice.

We suggest that CFEB could provide impartial, clear, expert information on request which will encourage people to seek advice on the choices they have to make at retirement.

A10: Unintended consequences

Without appropriate safeguards, the new rules will reduce the amount of annuity business written. Experience from the defined benefit pension buy-out market indicates that a lack of competition led to poorer value for the consumer.

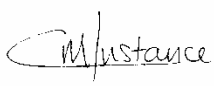
It is vital that these rules, which will benefit a small minority of relatively wealthy savers, do not undermine a competitive annuity industry, particularly when millions of average savers could be affected if they do not have access to appropriate advice about alternative products.

The total exclusion of non-index linked annuities from the MIR could skew demand towards index linked annuities and result in customer detriment.

We would observe that, if it is the intention for a flexible drawdown policy to attract tax-exempt investment roll-up even where there are no restrictions on withdrawing the money, this would seem rather generous. We wonder what restrictions there would be on people using their Annual Allowance as an extension to their ISA (i.e. by contributing funds into a pension arrangement and then using their MIR certificate to convert it to a flexible drawdown pot which gets tax-free roll-up). It could be argued that a flexible drawdown pot is not tax exempt on the roll-up (or there is some kind of capital charge similar to the Irish 3% mentioned in paragraph B6 of the Consultation Paper), and that once an individual exercises a right to convert a pension to a flexible drawdown pot, then they are prohibited from any further tax-advantaged pension saving.

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Audrey Cosens, Administration Manager, Professional Community Support Division on 020 7632 2118 or via audrey.cosens@actuaries.org.uk

Yours sincerely



Caroline Instance
Chief Executive

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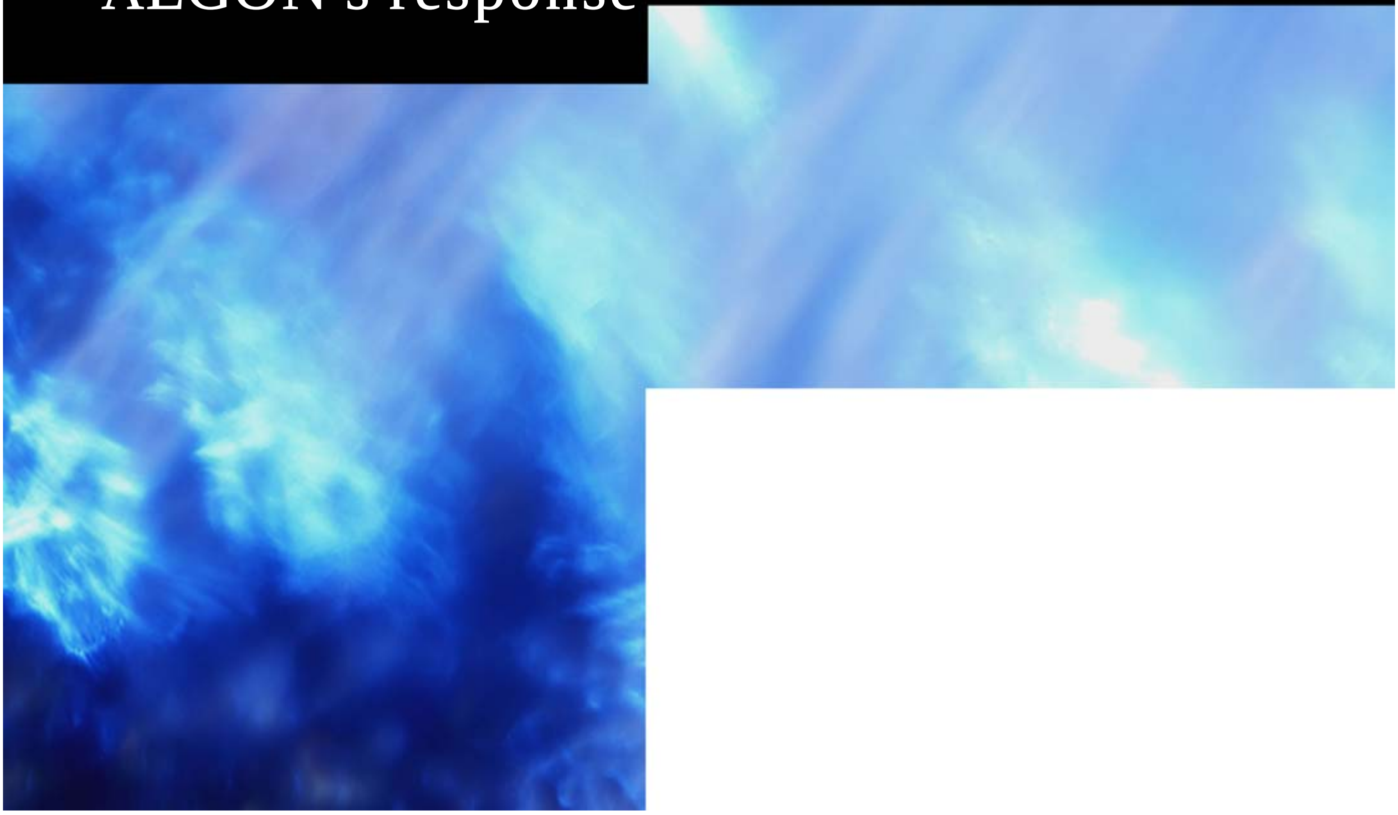
Removing the requirement to annuitise by age 75

AEGON's response



Prepared by:
Mark Stockwell

Friday 10 September 2010

BRITISH TENNIS LTA LEAD PARTNER

Removing the requirement to annuitise by age 75

AEGON's response

Introduction

AEGON UK is part of the AEGON Group, one of the largest life insurance and pension companies in the world. In the UK we have pensions, life insurance, asset management and advice businesses. AEGON UK has assets under management of £51.7 billion, including revenue generating investments and employs around 4,000 staff. The AEGON Group has assets of around Euro 409bn (£334 billion).

AEGON welcomes the emphasis in the consultation on allowing people greater flexibility in how they access their assets in retirement. We have long argued that the legal and tax framework around retirement needs to be re-examined and brought into line with increasing longevity and changing lifestyles, so that it more closely reflects the way people approach their retirement and the financial decisions they face.

The concept of a fixed retirement point is gradually becoming obsolete with people increasingly likely to move from full-time work into a 'pre-tirement' stage where they either reduce their hours or change role, or even start a new career. These changes are likely to be accelerated by the Government's decision to accelerate the rise in the State Pension Age and to abolish the Default Retirement Age.

People are also more likely to have a mixture of different assets and income streams in retirement. They will increasingly have defined contribution pensions instead of defined benefit, and may also be able to draw on equity in property as well as other investments they may hold. The new world requires people to juggle taking income from these different assets at different times to meet their needs and to protect against the various risks they face (longevity, morbidity, inflation).

The current environment – legislation, taxation, public services and often also the financial services market and the products it offers – tends to support the more traditional view of retirement as a fixed point, matched by a single conversion from pension to annuity. With people living longer, it makes sense to revisit this approach, especially in light of the sustained shift to defined contribution schemes in recent years.

These changes will have major implications for product providers, advisers and most importantly for consumers themselves. For that reason, we think they require very careful consideration. We raise specific points in the following sections. We also have a number of wider concerns:

- **Timescale**

We believe the Government should delay implementation for a further 12 months to April 2012. We do not think it is sensible or realistic to seek to deliver the full range of changes the Government proposes in time for an April 2011 implementation and, in light of the transitional arrangements in place, find it hard to understand why the Government feels it necessary to do so. In particular, the Government needs to give much further consideration to the flexible drawdown regime and the Minimum Income Requirement.

We propose the Government should give itself and the industry more time to work through the issues raised and to allow the market to effect an orderly transition, including relaying information and advice to consumers who may be affected by the changes, and where necessary designing and marketing new products to meet the demand.

Ideally, we would like to see the Government take a step back and institute a thorough-going review of incentives to save and the changing face of retirement. The piecemeal approach taken by successive UK governments is in danger of being perpetuated, to the detriment of both consumer and investor confidence in the long-term savings market.

- **Cost of implementation**

The proposals will require substantial changes to systems and communications. **We fear the Impact Assessment in the consultation paper dramatically understates the scale and cost of this task**, as we set out in detail in our section on the Impact Assessment.

- **Cumulative regulatory change**

Cost issues are exacerbated by the level of change already in the pipeline. These proposals come against the backdrop of radical changes affecting both the accumulation and decumulation spheres.

April 2011 will see, for example:

- The new pensions tax regime (i.e. the proposed reductions to annual allowance and possibly also the lifetime allowance)
- CPI replacing RPI as the 'standard' for indexation
- The abolition of the default retirement age

2012 will feature even more sweeping change:

- The roll-out of automatic enrolment will begin
- The Retail Distribution Review will be implemented
- DC contracting out will end and protected rights will be abolished
- Solvency II will come into effect

The Government is also consulting on increasing the State Pension Age to 66 sooner than originally planned, and has commissioned a report into the future funding of long-term care, due to report in late 2012.

Many of these have a direct and important bearing on how people plan for their retirement. They also have significant resource implications for product providers and advisers.

We question whether it makes sense to consider all these issues separately. There is a danger that policy in one area will conflict with or undermine attempts to resolve other issues. The outcome of the long-term care review, for example, could have major repercussions for the calculation of a robust Minimum Income Requirement, given the Government's stated aim of avoiding future recourse to means-tested benefits.

- **Advice**

The introduction of greater choice and flexibility inevitably creates a more complex environment for people to plan for their financial needs in retirement. At the same time, scrapping the age-75 rule removes a powerful 'nudge' to encourage people to deal with the financial issues they face in retirement. We are concerned that many consumers will lack access to the advice and guidance they will need to navigate this environment, particularly in a post-RDR world.

- **Communication**

The timescale also impacts on this 'advice gap'. Given the April 2011 implementation date, advisers would ideally already be communicating with their existing clients about these changes. Without knowing (for example) the level of the MIR, what income will count towards it, or the level of the capped drawdown limits, it is impossible for them to do so. We would question whether regulations passed this autumn will allow sufficient time both for advisers to familiarise themselves with the details and to communicate the changes to their clients.

The Government is also pushing for further changes to retirement 'wake-up' packs which would apply regardless of whether providers wished to offer capped or flexible drawdown options.

Tax framework

We believe that the proposed 55% tax on unused funds at death is unfair, especially to basic-rate taxpayers.

A fairer solution – one which seems to us to be most consistent with the 'EET' framework to which the consultation paper refers – is for the individual's marginal tax rate at the date of death to apply to unused funds.

We appreciate, however, that this introduces a considerable degree of complexity. A simpler alternative – although one which would remain unfair to basic-rate taxpayers, especially those whose contributions have attracted relief at a lower rate – would be to tax all unused funds on death at 40%.

In general, we believe responsible behaviour should be rewarded and there should be some attempt to encourage people to keep their pension funds within a savings environment. For this reason we would favour allowing transfer of funds on death to relatives' pension pots, at a lower tax charge of, say, 20%. This would help ensure that future generations are also able to build up sufficient retirement savings so that they are not reliant on the state in the future.

The consultation paper states that "inheritance tax will not ordinarily apply to unused pension funds … in addition to the recovery charge". We would welcome greater clarity on the status of unused funds where death occurs prior to age 75, where the Government is proposing that no recovery charge should apply. Our understanding of the Government's intention is that IHT will not apply in this instance but the wording of the CP is ambiguous.

Capped drawdown

We see significant benefits to allowing the flexibility offered by current unsecured pensions (USP) to be extended beyond age 75.

There has already been considerable innovation in the market in recent years with new 'third way' products such as AEGON's 'Income for Life' and 'Secure Lifetime Income' coming on the market, which offer a guaranteed income as well as allowing customers to benefit from investment gains. The increased flexibility of capped drawdown will enable the industry to build on these innovations and develop a wide range of products to suit customers' different circumstances.

Although growing numbers of people are taking advantage of arrangements of this nature, for many people, a conventional annuity will continue to represent the best way of securing an income in retirement. We are pleased that the Government has explicitly acknowledged the good value offered by annuities in insuring against exhaustion of funds.

As the consultation paper notes, this risk increases as people get older. We believe the new rules should recognise this by reducing the annual USP limit to 100% of an equivalent annuity from age 75, while retaining the existing 120% limit before that age. This may also act as a 'nudge' to encourage people to consider purchasing an annuity where that is an appropriate course of action.

In order further to mitigate the risk of consumers exhausting their funds, we believe there should be annual reviews from age 75 to determine the level of income that may be taken from a fund within the capped drawdown rules. We recognise this adds more volatility of pension income but believe this is a worthwhile trade-off to encourage customers to take a realistic view of sustainable income levels.

The consultation presents an opportunity for the Government to address a specific issue relating to 'third way' products of the type described above. Some customers entering these arrangements can subsequently find themselves in a situation where their guaranteed income under the terms of the product, exceeds the GAD maximum for their remaining fund. Since the guaranteed income cannot subsequently fall, it is by definition a sustainable level of income. We believe the government should use the opportunity to clarify that customers in this position should be able to draw down the higher of the GAD limit and the guarantee.

Flexible drawdown

We have serious concerns about the operation of flexible drawdown. At the very least, the issues raised require far more detailed consideration than an 8-week consultation permits and **we would strongly urge the Government to reconsider its intention to introduce flexible drawdown from April 2011**.

The level at which the Minimum Income Requirement (MIR) is set will have a major impact on the profile of those who might be eligible for flexible drawdown. In turn, the profile of the eligible population may be relevant to other conditions and regulations such as the need for and access to advice.

We agree that the MIR should be set at a level which makes it unlikely that an individual who opts for flexible drawdown will at any future point fall back on the state. In other words, the individual should have sufficient secured income to make it likely that their income will be above that which would generate entitlement to means-tested benefits in retirement.

To the extent that means-tested benefits are linked to marital or civil partnership status, to be consistent with the Government's aims, the MIR should also be assessed on a 'couples' basis. This adds considerable complexity.

We have attempted some preliminary calculations to show the range of possible outcomes depending on how the MIR is assessed. These are presented in the Appendix.

As we note there, many means-tested benefits are subject to uprating in line with earnings rather than inflation. This suggests it will be necessary to take into account how future earnings growth may affect entitlements. The simplest way to do this is to set the MIR at a sufficiently high level to allow for earnings growth over the average lifespan. Our initial view is **the MIR would need to be around the level of average earnings** – although much more consideration needs to be given to this, not least to establish how best to take into account the age (and therefore likely lifespan) of an individual entering flexible drawdown.

As we explain in the Appendix, we propose that **flexible drawdown should not be available until after state pension age has been reached.**

Overall, our view is that the level of uncertainty around the calculation of the MIR makes it inadvisable to proceed with plans for flexible drawdown on the timescale envisaged by the Government. Given the transitional arrangements already in place, we do not see any need for haste in implementing these proposals and we would ask the Government to push back the start date until at least April 2012, pending further consultation with the industry and other interested parties.

As indicated above, we would prefer for this to take place as part of a wider review of the long-term savings market.

Impact assessment

Under-estimation of costs

Our key concern with the Impact Assessment is that these preliminary estimates significantly understate the costs of implementing the proposals. **We believe the likely actual costs and preparatory effort make it extremely unlikely that the industry will be able to make all the necessary changes to customer documents and service support in time for 5 April 2011**.

There are at least 3 main aspects to our belief that the current cost estimates are too low:

- **There are more "affected groups"** than in the initial assessment. We identify the following:
    - Personal pension and annuity providers (life companies)
    - Trustees and administrators of occupational pension schemes. It might be worth distinguishing between those who offer a "scheme pension" and those who buy external annuities for their members. (It is not clear how the assessment has measured these populations, for example in table 1 of the assessment)
    - Financial advisers and benefit consultants (time to serve clients will rise, there will be training and process costs)
    - Consumers (for instance, the assessment notes the transaction and compliance costs associated with the MIR. We have demonstrated elsewhere that in theory anyone with full BSP and S2P entitlement could be eligible for flexible drawdown, and indicated the level of savings an individual without such entitlement would need)
    - Government (HMRC costs are the only ones included. There will be costs to FSA, tPR and possibly DWP – via TPAS and the Pensions Service too)

  - CFEB – the Government might like to consult with CFEB about the cost of making amendments reflecting these reforms to its existing public materials, including the scripts and training for Money Guides and the printed Retirement Guide. CFEB might well conclude that merely updating existing material is insufficient to meet the public comprehension challenge that the Government proposes to set it, especially within the time frame proposed. In this case the impact assessment needs to include the cost of additional new activity. It's worth noting that CFEB costs are paid for by the financial services industry through a levy.

- **There are costs to providers regardless of whether they choose to offer new products following the reforms**. Clearly product development costs, including marketing, staff training, service development and compliant literature depend on firms' decisions about whether to offer new products. Irrespective of this, though, providers will need to adjust documentation, and change customer service operations (call centre scripts, staff knowledge etc.) to make sure that information given to customers about their retirement options is accurate and complete. We are obliged to do this under FSA's requirement to Treat Customers Fairly. This suggests the statement at paragraph 20 of the impact assessment is wrong. Moreover, these considerations apply to providers of all sizes, which might significantly alter the assessment of the impact on smaller providers in paragraphs 69 and 73 of the assessment.

  It is likely that pension schemes not administered by insurance companies would also feel obliged to inform their members of changes to their retirement options. This might affect the estimates for costs to employers and schemes, including small schemes and SMEs.

- **The costs of making these non-discretionary changes are many orders of magnitude higher than the estimates in the initial assessment.** The Government's proposals are not detailed enough for us to work out exactly what we would need to change. To some degree this would depend on whether and how tPR, FSA and other regulators reflect the policy change in their rules and guidance. However, it is possible to offer some indicative estimates based on AEGON's experience of other recent regulatory changes.

  The cost of any change depends on a number of factors:

  - how many different documents need amending (which relates partly to how many products a firm offers)
  - customer numbers
  - whether the amendments require us to re-programme calculation engines that generate personalised figurework for customers, or simply change text or alter generic figurework
  - more generally, how prescriptive the change is, versus how much discretion we have over presentation

- timescales: the period to the intended April 2011 implementation needs to allow for drafting, consulting on and finalising the legislation as well as making the relevant changes to systems and communications.

Based on the information in the consultation paper, our highly preliminary view is that the required changes to pre-retirement information for existing customers would be of the same order as the wake-up pack changes. It's hard to give a more precise estimate, though the extremely short implementation timescale envisaged by the Government creates a risk the resource implications will increase.

In fact the requirement to annuitise is built into a much wider range of communications. Point of sale investment illustrations and annual statements calculate potential retirement income on the basis of buying an annuity. That might well remain a sensible approach, but we and the FSA might want to think about whether we need to change this, or at least to change the language in our material to reflect the new options. These further changes have the potential to multiply the costs of changing pre-retirement materials many times.

It is also clearly more efficient to combine several changes to the same document into a single project. It is worth noting that further revisions to retirement communications are highly likely in the coming months (Ministers are pressing the industry to make further changes to wake-up packs beyond those already in train). Extending the implementation period might provide opportunities to combine this work with other projects and reduce costs.

Other comments on the impact assessment

- The Government appears to have captured the nature of the benefits of the proposed policy change, and we agree these are very difficult to quantify.
- The Government offers no evidence that the obligation to annuitise is a barrier to saving. We are in the course of some research which might help illuminate this point, and would be happy to share the results in due course.
- Although the Government has excluded from the impact assessment the voluntary costs of product development for providers, the benefits of the policy depend on these costs being incurred.
- We have estimated elsewhere the amounts of saving required to qualify people for flexible drawdown. Hopefully this allows a clearer estimate of likely take-up (para 31 of the assessment.)
- The picture of annuity provision in Chart 1 is very out of date.

Responses to the consultation questions

What is an appropriate level for the capped drawdown limit?

We understand the Government's main concern is to give individuals greater flexibility in how they access their funds, while also seeking to ensure people do not use up their funds prematurely and have recourse to income-related benefits later in life.

As indicated above, we believe the government should retain the 120% cap until age 75 but thereafter a limit of 100% should apply. We believe this would mitigate the risk of fund exhaustion and also provide consumers with a 'nudge' to encourage them to give further thought to their financial arrangements.

Views on the Government's approach to reforming the tax framework

The consultation implies that a 55 per cent tax charge will apply on death in USP from April 2011, regardless of the member's age. This compares with 35 per cent at present for those under 75. We would argue that this is unfair, especially to those who are basic rate taxpayers. See above for further details.

What income should be considered 'secure'?

As noted above, people often have a wider range of assets than they might have done in the past. To reflect this, we believe the Government should permit some non-pension assets to be counted towards the calculation of secure income.

In particular, there has been significant product innovation in the market in recent years, with the development of 'variable' or 'third way' annuities which provide a guaranteed income but also allow customers to benefit from investment returns. It would be paradoxical if in trying to provide greater flexibility, the Government did not recognise where innovation has already taken place.

What is an appropriate level for the MIR? How should this be adjusted for age?

The MIR should be set at a level commensurate with the Government's stated aim of avoiding future recourse to state support. We go into considerable detail on this issue in the appendix.

Should a different MIR be set for individuals and couples?

Again, we have tackled this question in our section on flexible drawdown.

How often should the MIR be reviewed?

Our understanding is that once an individual is deemed to have met the MIR, they will not have to continue to meet further tests. On this basis, we are taking the question to relate to prospective new entrants to flexible drawdown, rather than applying a new, potentially higher MIR to customers who have already taken flexible drawdown and who may no longer have sufficient funds to make up the difference.

On this basis, our view is that the MIR should be subject to annual review to allow for changes in the level of benefits driven by Government policy.

How can unnecessary burdens on individuals and industry be avoided in the assessment of the MIR?

The 'cleanest' method is for an advised customer to self-certify that (s)he has secured the requisite level of income. However, as our analysis suggests, there could be a wide range of variables to assess making the task extremely complex. Setting a higher level for all would reduce that complexity.

The consultation paper seems to suggest the Government is intending to place the onus on product providers. This would be a significant burden on providers and may act as a deterrent to supply.

Are there other legislative or regulatory barriers the removal of which would enable industry to provide more attractive products without incurring fiscal or avoidance risks?

- It is of vital importance to the annuity market that a pragmatic outcome to Solvency II is reached.
- As indicated above, we believe the Government should take the opportunity of implementing capped drawdown to ensure that customers of 'third way' products are able to take the full value of their guaranteed income, where it is higher than the GAD limit.
- As part of the abolition of protected rights, the Government is suggesting transfers from contracted-out DB schemes to DC will not be allowed. We would challenge this conclusion, in part because it will limit flexibility in retirement.

How can the industry, Government and advice bodies such as CFEB work to ensure individuals make appropriate choices in the absence of the requirement to purchase an annuity by age 75?

AEGON believes the issue of access to the right mix of information, guidance and advice is of critical importance to the success of the Government's proposals. The advent of capped and flexible drawdown introduces considerable complexity and this in turn creates an 'advice gap'.

We have serious concerns about the ability of the current advice and guidance infrastructure to ensure people do not enter into arrangements which are not suited to their individual circumstances.

A further consideration, as indicated above, is the interaction with funding of future care needs.

What unintended consequences could the proposed reforms have that may affect the market's ability to supply annuities at attractive rates or prevent the market meeting demand?

As indicated above, we are concerned that people will lack access to the advice they need in order to make the best choices in the new, more complex, environment in which they will find themselves. In the absence of such advice, and with the removal of the annuitisation 'nudge', it may be much more difficult to persuade consumers to act in their own interests.

Appendix – Minimum Income Requirement

We have explored below a range of different approaches to setting an appropriate level for the MIR. Entitlement to means-tested benefits is highly complex and the analysis below has made a number of assumptions. We hope, however, it paints a picture of the possible range of outcomes.

We have based our calculations on the following figures:

Basic state pension

Single person qualifying for full BSP - £97 per week

Married couple (based on one individual's NI records) - £155 per week

SERPS / S2P

Maximum possible entitlement in 2010/11 for an individual (including ongoing to spouse on death) - £157 per week

Guaranteed minimum income

Single person with full BSP - £132 per week

Couple - £202 per week

Savings credit

Income at which all entitlement to pension credit/savings credit ceases:

Single person - £184 per week

Couple - £270 per week

Other significant means-tested benefits

Analysis carried out for AEGON UK in early 2009 highlighted that Council Tax Benefit and Housing Benefit could represent further significant means-tested benefits in retirement. Homeowners are not entitled to HB and because of its significance, the MIR could be set at different levels. However, some consideration would need to be made of the possibility that homeowners could in theory sell their house after having entered flexible drawdown and subsequently have recourse to HB having depleted their funds.

In broad terms, a single person can still be entitled to Council Tax Benefit until income is £50 above the cut-off for savings credit and (for non-homeowners) to Housing Benefit until income is £70 above that cut-off.

For an individual who is not a homeowner, the income required before entitlement to all of these means tested benefits stops is around £254 per week.

Only one partner can claim these benefits. We have assumed the equivalent income for a couple at which all entitlement ceases is £340 per week.

Note that we have not made any attempt to assess eligibility for any benefits associated with long-term care.

Possible levels of MIR

- No allowance for single / couple status:

  (a) The minimum MIR we believe could be introduced would be that required to exceed entitlement to Pensions and Savings Credit for a single person – i.e. £184 per week.

  (b) Another possible level would be that required to exceed entitlement to Housing or Council Tax Benefit for a single person – i.e. £254 per week.

- Allowance for couple status:

Couples could opt to be assessed as individuals – i.e. both partners might be able to demonstrate independent qualification for flexible drawdown. Alternatively, one individual might seek to qualify by taking into account secure income from their partner's pension arrangements. If the latter approach were followed, it seems reasonable to set a higher MIR.

(c) Minimum MIR where a couple combine secure income to meet eligibility test – to exceed Pension and Savings Credit level for couple - £270 per week

(d) As with (c) but set to exceed Housing/Council Tax Benefit threshold - £340 per week

It also seems reasonable to allow the couple's secure income to reduce on the death of the 'lead' partner. The following figures allow for a reduction in additional secure income by one third.

Inflation

The CP implies that secure income would be expected to increase by inflation subject to a 2.5% cap. If inflation does exceed 2.5% for any future period and means-tested entitlement levels increase at that higher rate, then individuals deemed to have sufficient secure income to qualify for flexible drawdown could still become entitled to means tested benefits in future. This suggests the MIR might be set at higher levels than those implied above.

Moreover, many means-tested benefits are uprated in line with earnings rather than inflation. On the assumption that earnings will generally outstrip prices, 'mere' inflation indexing will be insufficient to meet the Government's aim of ensuring people in flexible drawdown do not have future recourse to such benefits.

The paper suggests to qualify for flexible drawdown, the individual would need a minimum level of secure income that increased by 2.5% per annum. If an individual was just above entitlement to means-tested benefits, then any excess over inflation in means-tested benefit entitlement levels above 2.5% would mean they would once again qualify for means-tested benefits. Over a 20-year period, to protect against the potential for means-tested entitlements to increase at 1% more than 2.5%, the starting secure income would have to be set 21% higher. To protect against a 2% excess, the starting secure income would have to be 47% higher.

It would be logical to set a greater margin the lower the age at which flexible drawdown is selected, to allow for the greater uncertainty over a longer period in 'retirement'. Note that we have **not** made any such adjustment in our figures below.

Observations

An individual with full BSP and maximum SERPS/S2P will have an income of £254 per week which takes him/her out of eligibility for any of the means-tested benefits considered above. Therefore, **all such individuals may in theory be entitled to opt for flexible drawdown and withdraw their private pension pot in full**. We would question whether this is the Government's intention.

If one partner in a couple has full entitlements as above and the other partner no entitlements, they would have a combined state pension of £312, which is above level (c) but below level (d).

Many individuals will have little or no SERPS/S2P – the self-employed have no such entitlement and those who have been contracted out will have little or no SERPS/S2P (although will have built up a broadly-comparable protected rights pot or GMP). **The following figures provide an indication of the size of private pension fund such individuals might need to have to meet various levels of MIR**.

State pension benefits are payable from state pension age. Below that age, the individual may be entitled to a number of other means-tested benefits. This complicates the approach to setting the MIR, or the likely pension fund required to top-up to MIR, for those below State Pension Age. To avoid complicating matters further, we have ignored this in our figures below and have assumed the additional secure income required nets off full Basic State Pension. This understates the fund required to be safely above means testing for those who opt for flexible drawdown at ages below state pension age. **We therefore seriously question whether flexible drawdown should be available below state pension age.**

Private pension funds required to reach MIR

The following figures use AEGON current annuity rates as at 1 September 2010. All assume 2.5% fixed escalation, are paid monthly in advance and have no guaranteed period. Joint life annuities continue to the spouse at two thirds the starting level.

Option	Additional secure income		Minimum fund £000
(a) Single, £184 per week including BSP	£87 per week, £4524 pa	Male aged 55	137
		Female aged 55	152
		Male aged 60	122
		Female aged 60	136
		Male aged 65	106
		Female aged 65	119
		Male aged 70	89
		Female aged 70	102
		Male aged 75	72
		Female aged 75	84
(b) Single, £254 per week including BSP	£157 per week, £8164 pa	Male aged 55	248
		Female aged 55	274
		Male aged 60	220
		Female aged 60	246
		Male aged 65	191
		Female aged 65	216
		Male aged 70	160
		Female aged 70	184
		Male aged 75	131
		Female aged 75	152
(c) Couple, £270 per week including couple's BSP	£115 per week, £5980 pa	Male 55, Female 52	213
		Male 60, Female 57	194
		Male 65, Female 62	172
		Male 70, Female 67	149
		Male 75, Female 72	125

(d) Couple, £340 per week including couple's BSP	£185 per week, £9620 pa	Male 55, Female 52	344
		Male 60, Female 57	312
		Male 65, Female 62	276
		Male 70, Female 67	239
		Male 75, Female 72	202

The table above shows the huge variability in the private pension pot an individual or couple **without** S2P/SERPS would require before being eligible for flexible drawdown. The funds determined on this basis also vary significantly between males and females. Couples require a larger pot than a single individual, but less than would be required if both individuals within the couple wished to qualify in their own right. As would be expected, in all scenarios, the required fund reduces as age increased.

As mentioned earlier, an individual with full S2P/SERPS entitlement would qualify for flexible drawdown whatever level of private pension fund they had.

This means there is a very varied population that might qualify for flexible drawdown. This in turn makes it more difficult to draw lessons from the population when considering what additional guidance/advice they might need.

Allowing for level income

Clearly, the best way of protecting against falling back on means-tested benefits is to have a secure income which will increase each year (at least as fast as means-tested benefit limits). In practice, many individuals may have secure income which is level as opposed to increasing. It would seem reasonable to give such individuals 'partial credit' for their level income.

The level annuity starts higher than the escalating annuity, but there comes a point in time when the escalating annuity will increase above the level amount – assuming the individual lives to that age.

One approach to allowing for secure level income would be to set the partial credit as the ratio of the escalating annuity which could have been secured to the level annuity which could have been secured with the same fund. For males, the ratios (based on AEGON annuity rates as at 1 September 2010) would be as follows. The cross-over ages are also shown.

Age	Partial credit (%)	Cross-over age
55	67%	72
60	70%	75
65	73%	78
70	76%	82
75	79%	85

There are various alternatives to this approach including requiring a minimum cross-over age or a minimum term over which the level income top-up keeps the individual above the MIR (assuming a fixed rate of escalation of MIR). Allowing partial credits for level income significantly increases the complexity of self-certification.

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Age 75 Consultations
Removing the requirement to annuitize by age 75
and related matters

Submission by Two Experienced USP SIPP investors

We have been investing entirely for ourselves since 2002, using electronic trading platforms, and our two funds are jointly worth over £500,000.
We presume that most submissions to this enquiry will come from financial industry sources, and we are keen that the voice of private investors should also be heard

The current USP rules

(1) Flexible choice of income withdrawal from zero to 120% of the typical annuity you could otherwise purchase for your age, sex, etc – as determined by GAD tables;

(2) Compulsorily reviewable at least every five years;

(3) More or less compulsory annuity purchase by age 75 (the ASP deal is so blatantly bad, even an index-linked annuity would be preferable).

The proposed new rules

(1) Flexible choice as before, though the 120% capping factor could be revised;

(2) The compulsory review period would appear to remain the same;

(3) ASPs will be abolished, so that the USP option is now a lifetime option;

(4) Flexibility to make income drawings above the cap – provided MIR criteria can be met from sources other than the USP fund itself.

(5) The balance of any USP fund to be taxed at 55% if it is taken as cash by beneficiaries on the death of the USP holder.

Simple changes to these rules that would offer greater flexibility

(1) The 120% capping factor presumably exists on the assumption that annuity funds are conservatively invested largely or even entirely in gilts (the yield on which is combined with actuarial data to calculate annuity rates), whereas USP funds are usually invested for a potentially higher return with equities, corporate bonds, etc. As well as gilts. Unless investment conditions have changed irrevocably downwards, there seems no reason to reduce the 120%. Rather, there is a good case for increasing it slightly (say to 130%[1]). This would give all USP holders a degree of flexibility, not simply those who meet MIR from other sources. Coupling this with annual rather than 5-yearly reviews (see below) would provide not only flexibility but immediate control.

(2) Currently, the USP cap for each holder is reviewed at least every 5 years, though annual reviews are possible. We propose that annual review becomes the norm, particularly for anyone who seeks to draw an income based on any capping factor above 120% (or whatever new standard level is set).

(3) The abolition of ASPs or any compulsion to take out annuities is welcome, and simple enough in intention to need no further change.

(4) The criteria for MIR require more fundamental thinking (see below).

[1] Currently, gilt yields, to which annuities are geared, are close to an all-time low, with the consequence that income related to them is also very low.

(5) We entirely concur with the principle that USP funds exist to provide pension income rather than to provide tax-advantageous inheritance opportunities. Indeed, it could be said that USP holders who exhaust their funds entirely prior to death, provided they avoid being a burden on the state, fulfil this principle entirely. Where there is a residue on death, which is passed on in the form of cash, it will be taxed at 55% (calculated to repay the balance of taxation that was deferred when the pension fund was built up). Our only suggestion here is that 50% has a greater ring of fairness, whatever the mathematics may say.

Circumstances under which a USP holder could call on the state for assistance

Under current rules, assuming (as is likely) that the unsecured pension holder has a state pension, he or she could only call on the state for additional assistance if he or she required long-term care, in particular when needing residential care. As was the case with one of our mothers, the state will subsidise such care only once the claimants' other capital has been exhausted. For most people, their largest single asset is not their pension fund, but their property. Selling or mortgaging property is therefore a necessary resort for those going into residential care, and the state would not offer assistance until all proceeds from property had been exhausted. In addition, the USP holder can, on going into care, seek an impaired life or an immediate care annuity.

To avoid or minimise risk to the state in paying for long-term care, USP holders need to demonstrate sufficient equity in their property, USP fund or a combination of both to meet the costs of an impaired life or immediate care annuity. If the capital alone can satisfy this requirement, then there need be no earmarking of the USP fund. If owning property prevents the USP holder from seeking state assistance for long-term care, that property should be taken into account when assessing what may be taken from the USP fund as income. Otherwise the state appears to have it both ways.

For certainty, all that would be required would be an undertaking with the USP provider that the USP holder would supplement his USP fund from any profit from the sale of his or her property, with sufficient to purchase an impaired-life or care annuity.

Meeting basic living expenses

Living expenses are living expenses, and can hardly be avoided. Therefore, it is sensible for the state to ensure that USP holders requiring additional drawdown flexibility at least have the means to meet everyday living costs. A MIR of £10,000 or thereabouts, based on Family Expenditure Data, makes sense, but for the reasons outlined above, it need not be higher (except in the unusual circumstance of the USP holder owning no property). Here, too, we believe property or other asset values should be taken into account, as well as income.

In addition, we believe that the MIR calculation should not be confined to income outside the USP. Where a USP is sufficiently large, it too should contribute to the MIR calculation. That is, any surplus in the fund over and above an annually review-able minimum would qualify for flexible drawdown. We suggest for the purpose of discussion, as well as simplicity, that the minimum should be 150% of that required to generate today's MIR.

Index-linked annuities are a bad deal and ought not to be encouraged

An annuity is really a bet: each annuitant is betting that he or she will live longer than the insurance company actuary is predicting. Those who exceed the actuarial average win the bet at the expense of those who die early. Indexing the payback makes it harder to win the bet, since more of the payback is earmarked for later life. Anyone who dies early (at least half the cohort, depending on mortality distribution) will almost certainly have got less of his or her fund back in the form of income than if he or she had taken out a flat-rate annuity. For example, a man of 68 investing £100,000 in a 3% indexed annuity must live until he is 89 to get back more than if he had bought a flat-rate annuity. For most 68 year-old men that is an actuarial long-shot.

USP holders must, almost by definition, be wary of annuities. Therefore any proposal that seems to encourage poorer-value, index-linked annuities will not go down well.

For this reason, as much as for any other, we believe that flexible drawdown should not be over-reliant on USP holders investing in index-linked annuities.

Age UK is the new force combining AGE Concern and HELP THE AGED WE WILL

Consultation response

Ref: 2510

Removing the requirement to annuitise by age 75

10 September 2010

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Currently, tax legislation limits the ways in which pension savings accumulated through a registered defined contribution pension scheme can be used to provide an income in retirement. The rules create an effective obligation to purchase an annuity by age 75. In the June 2010 Budget the Government announced its intention to remove this obligation and this consultation requests views on how this should be achieved. It proposes:

1. Extending beyond age 75 the existing option of 'income drawdown' direct from the pension fund, subject to a cap on the amount drawn down each year ('capped drawdown').
2. Introducing a new 'flexible drawdown' model, which would allow individuals to draw down unlimited amounts from their pension pot, provided that they can demonstrate that they can meet a 'minimum income requirement', by securing enough guaranteed and inflation-protected income from other sources to prevent them from exhausting their savings prematurely.

Key points and recommendations

1. The proposal to remove the age 75 rule is attractive in principle and will benefit a particular segment of the population with relatively high wealth. However, we are concerned that it will also bring significant costs and risks, some of which may affect people with more modest wealth. These risks include the mis-selling of complex and expensive alternative products, damage to the annuity market and hardship for some pensioners in future.

2. In the light of the risks, we urge the Government not to introduce flexible drawdown until the necessary modelling has been carried out, even if means a delay. We do not know the outcome of the current review of care funding, which will affect the level of any Minimum Income Requirement (MIR). There may also be very severe unintended consequences on the rest of the decumulation market.

3. In the meantime, we recommend that a high-level review is set up by HM Treasury to look at the problems in the round. This should include ensuring that people who do annuitise get best value and that the annuity market is competitive, looking at the desirability of introducing a default open market option, and behavioural issues around securing a retirement income.

4. Immediate action is needed to ensure that people with pension funds that are too small to annuitise can draw their savings in cash without penalty.

5. We agree that the level of the cap for capped drawdown should be reviewed.

6. We agree that only pension income should be considered for the purposes of the MIR, that 'secure income' should mean pensions in payment and guaranteed for life. The MIR should rise in line with earnings.

7. The MIR should be set taking into account the availability of all means-tested benefits, the possibility of care needs later in life, and the possibility of greater life expectancy/expenditure among those who are most likely to take up drawdown. There should also be a considerable margin for error.

8. We would not support a lower MIR for couples. Many surviving partners face hardship because they lose all or part of the private pensions received by the partner who has died. We recommend that the MIR should be calculated on the basis of the retirement income available to the lowest-income partner after the first death.

9. Regulators and the Government should ensure that the market for drawdown products is tightly regulated so that they are only sold on an advised basis by advisers who are qualified to do so. They should also consider whether a system of kite-marking 'simple' or 'high-risk' products would be necessary.

10. There is a considerable risk that the annuity market will be damaged. Government and regulators should promote public understanding of annuities and all providers should be required to publish benchmark rates.

1. Introduction

The market for decumulation products such as annuities and drawdown has a significant and growing impact on the lives of people in retirement. Already, around half a million pension annuities are bought each year. Age UK, through its local information and advice services, hears from consumers on modest incomes and with small savings who still face extremely complex decisions about how to draw down their savings on retirement.

Many will welcome the Government's proposals for liberalising the legislation governing the drawdown of pension savings. We are aware that some people find the (effective) requirement to annuitise by age 75 constraining, and the removal of the age limit is superficially attractive.

However, we are concerned that while this reform will benefit a small number of people with higher retirement incomes or savings, there are no proposals to deal with the difficulties faced by people with more modest amounts of pension saving. We understand that, currently, less than 5 per cent of people reach 75 without annuitising, and the impact assessment suggests that only 3,000 to 8,000 people a year will benefit from the reform.

We also have concerns about the impact on the existing annuity market, and about the risk of complexity, the increase in the need for advice, and the risk of mis-selling.

2. The need for a holistic approach to retirement income products

It is vital that the Government approaches the reform of the age 75 rule as the first step in improving the retirement income market, not the last. There is much more that should be done to ensure that people get best value from their pension savings. Issues that should be addressed are:

- Ensuring that people who do annuitise get best value, by improving the open market option.
- Legislative complexity around small pension funds, that can mean that some people are left with savings that are too small to annuitise but that cannot be drawn in cash without suffering penal rates of tax.
- Challenges to annuity market funding in general – we are concerned that strict capital requirements are reducing providers' ability to compete and provide the best possible value.
- Behavioural issues around securing a retirement income, and whether complex terminology (such as 'annuity') is a barrier to understanding.

Our detailed response on these issues is given under question A8 to A10 below.

We also urge the Government to ensure that its reforms do not damage the existing annuity market. In spite of current low annuity rates, annuities offer very valuable guarantees against the longevity risk that consumers rarely appreciate. Once purchased, there is little or no need for advice, and they are simple for consumers to manage as they age. We are concerned that, as a result of the reform, the public and some sectors of the financial services industry may turn away from this unique product to consumers' detriment. For example, purchased life annuities offer the same valuable guarantees as pension annuities, together with favourable tax treatment (the 'capital' element of the payment is tax-free), yet fewer 1,000 of these products were sold in 2008[i]. The Government, industry and regulators should promote a better understanding of annuities and ensure that after the reforms there is a clear message that while it may not be essential to buy an annuity any more this is still the best option for most people.

A further concern is that these proposals will introduce a major change over a very short timescale, and that the detail of the proposals is not yet fleshed out. The change presents a number of risks, and in particular the risk of hardship in old age, if flexible drawdown is used inappropriately and savings are exhausted prematurely. It is not just the risk to the public purse. Often people are reluctant to claim means-tested benefits and suffer hardship as a result. Currently, around a third of pensioners do not claim pension credit to which they are entitled, either because they are not aware of their rights or through a reluctance to claim. There is also a risk of financial abuse, if individuals are persuaded to draw down savings and pass them on to other people.

The Government must guard against the risk that complex alternative products are developed, probably with high charges and constraints on switching provider. Even if the market does develop in an orderly fashion, more choice tends to make decisions harder. We note that the consumer-focused American publication, *Annuities for dummies* (which covers a range of decumulation products) is 360 pages long.

There are also significant risks of mis-selling, as the FSA acknowledged in its *Financial Risk Outlook 2010:*

Those consumers close to retirement…… are also vulnerable to mis-sales of decumulation products, such as drawdown, which may generate higher income for distributors than sales of annuities, and mis-sales of asset classes which are higher risk than the consumer's agreed risk appetite ……. The shift from defined benefit pension schemes to defined contributions (where the investment and longevity risks reside with the individual) will further increase demand for decumulation products and thus the potential scale and impact of any mis-selling problems that do arise.

We urge the Government to take a cautious approach. Liberalisation should be introduced in a staged manner, and in particular flexible drawdown should not be introduced until a robust Minimum Income Requirement (MIR) is in place and tested.

In the meantime, we recommend that a high-level working group is set up by HM Treasury to look at the problems in the round. This could take on, extend and refresh the role of the OMO working group currently convened by DWP (but which was initially a joint Treasury/DWP working group). The OMO working group has produced useful outcomes, such as the ABI Options scheme, but it needs a higher profile and more stretching brief.

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

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

We are not in a position to suggest an alternative figure, but by definition the current rule allowing people to withdraw 120 per cent of the annuity rate will entail a risk of running out of income. Drawing too much is particularly dangerous in the early years, because even if investment returns recover, there is too little left in the 'pot' ever to generate enough returns to remedy the loss. Given that income drawdown is usually sold as an advised product, so that a customer should have someone to explain the issue, we think that it would be reasonable to consider an age-related limit, with a lower limit at older ages.

However, the decision on how much to withdraw cannot sensibly be made, in practice, without considering other sources of retirement income. In practice, depending on the level at which the MIR Is set, many people for whom capped drawdown is suitable will also be eligible for flexible drawdown option. For this reason, it is essential that the interaction of the two routes is considered.

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.

The recovery charge should be set in order not to distort decision-making and in order to reflect the perceived fairness of the tax treatment between different forms of saving. The availability of tax relief on pension contributions, particularly at the higher rate, is a very valuable benefit. Given that by definition, only the better-off are likely to be able to take advantage of flexible drawdown, it is important that the tax recovery charge is seen to recover the benefit of the tax relief, particularly since, unlike property, unused pension funds passed to beneficiaries are not usually subject to inheritance tax.

We welcome the proposal to remove the age 75 limit on value protection lump sums, pension commencement lump sums and trivial commutation lump sums. However, we question whether the age 75 limit should remain for pension contributions. While we understand the desire to avoid people funding their pensions from other assets as part of an inheritance tax planning scheme, it is increasingly likely that there will be some people working into their 70s who wish to carry on funding a pension. We suggest that above age 75 contributions should be allowed if the individual continues to have earnings.

3. 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.

We agree that, initially at least, only pension income should be considered for the purposes of the MIR. Although some people may be able to meet their income needs out of non-pension savings, this will depend greatly on the type of saving, and the market conditions. For example, we know from our postbag at the time of the economic crisis that many people who were previously relying on savings to top up income experienced difficulty following the cut in interest rates and are now experiencing a negative real rate of return. In addition, comparing the value of different non-pension assets (such as equities and cash) for the purposes of providing income will be difficult and could have unintended consequences if it encouraged people to invest in a particular way simply to meet the MIR. The development of the home income plan market offers a salutary lesson – initially home income plans used a mortgage loan to buy an annuity and provided a safe if low return. But in the late 1980s many firms sold loans invested in investment bonds, the value of which fell sharply following the 1987 crash, leaving many people in negative equity.

For this reason, we would argue strongly for a cautious approach to flexible drawdown.

We also agree that 'secure' income should be currently in payment, guaranteed for life and take into account the effect of inflation. A strict interpretation should be applied, initially at least, until the impact of the reform is clear:

- Currently in payment – we are aware that some may argue for deferred income to be taken into account, for example for people who want to bridge the gap between early retirement and receiving a state pension. However, we think that early retirement for people in the 'drawdown' market could be catered for through the pension commencement lump sum.
- Guaranteed for life – this should be interpreted strictly as a 'guarantee' rather than a structured product with limited protection.
- Inflation protection – there are particular difficulties in this area as different measures of inflation apply to different types of pension. Over the 10 years up to 2009 a pension linked to the RPI would have increased by about 30 per cent compare to just 20 per cent for a pension linked to the CPI. Relying on CPI alone runs the risk of leaving older people seriously short of income later on retirement, just at the point when costs may start to rise because of care needs, for example. For this reason, we recommend below that a generous safety margin should be built into the MIR, for example by calculating the required amount in relation to increases in earnings. However, given the limited number of providers offering escalating annuities, and the lower 'money's worth' they present, we suggest that a level annuity should be permitted at a sufficiently high level to generate equivalent index-linking.[ii]

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

There are very considerable difficulties in setting the level of the MIR. However we agree that the aim should be to set this at a level that protects the Exchequer from an individual falling back on the state. In order to do this it should take into account

- the availability of *all* means-tested benefits, including pension credit (guarantee and savings credit), council tax benefit and housing benefit, additional payments with benefits such as the severe disability premium. It should include a notional amount for other benefits received on a 'passported' basis because someone is receiving the guarantee credit. It also needs to allow for expected increases of these benefits over time
- the possibility of care needs later on in life. It is unclear how much will need to be set aside for this eventuality, because the current care commission will not report until 2011.
- the position of surviving partners (see below)
- the uncertainty about individual life expectancies. For example, people with the level of wealth required for drawdown may be expected to have rather better than average life expectancies.
- the likelihood that people taking advantage of flexible drawdown may have higher expectations of expenditure (and indeed higher outgoings in the form of housing maintenance costs). Research by the University of Birmingham for Age UK[iii] found a sub-set of people who are determined to enjoy life in early retirement and who may not be aware of the impact on their finances.

We acknowledge that needs such as housing costs and care needs vary and the system would not be able to predict individual future benefit entitlement precisely. However the factors above should be taken into account in establishing average income needs at different ages to avoid reliance on the state in the future.

Even after taking all the criteria above into account, the figure chosen should allow considerable 'head-room'. We believe that it is better to be cautious, and perhaps set the bar too high initially, than to run the risk of people running out. Modelling should be carried out to test the robustness of the MIR in a number of potential economic, political contexts, including a period of high inflation and changes to the state pension system, and in relation to individual circumstances, such as high spending early on retirement or high care needs later on in retirement.

In the light of the complexity, we urge the Government not to introduce flexible drawdown until the necessary modelling has been carried out, even if means a delay. If the level is set too low, it will be several years before problems emerge. We do not know the outcome of the current review of care funding. There may also be very severe unintended consequences on the rest of the decumulation market. Removing the age 75 limit for capped drawdown in the meantime will help those people who do not want to buy an annuity.

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

We would not support a lower MIR for couples. Instead, to avoid the risk of surviving partners becoming dependent on state benefits, we recommend that the MIR should be calculated on the basis of the retirement income available to the lowest-income partner after the first death.

Although couples may need less income per person than single people, the MIR must take into account the position of a surviving partner after the first death.

Retirement assets are often very unevenly distributed between partners: research by the Fawcett Society[iv] reveals the extent of the pensions gap between men and women, and the latest date from Scottish Widows finds that while 60 per cent of men over the age of 50 are adequately preparing for retirement, only 38 per cent of women are doing so[v]. Many surviving partners experience hardship on the death of the first partner, as private pensions often fall by more than essential expenditure. In the transition from defined benefit to defined contribution pensions, many surviving partners will risk poverty because people with small pension pots rarely buy joint life annuities because of the extra cost.

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

Once the methodology for the MIR is established, the MIR level should be reviewed on an annual basis, using a number of key indicators. The MIR for the following year could be published in the Pre-Budget report, allowing people a bit of time to plan.

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

We agree that individuals wishing to use flexible drawdown should be required to provide evidence of their secured income. This will inevitably incur cost for the individual and the provider. However, given the pressure on public spending, we do not think it would be acceptable to require an agency such as the DWP or HMRC to take on this role. There will also be a knock-on cost for HMRC in terms of handling reporting requirements that should be taken into account in the impact assessment.

4. 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.

We are concerned that legislative constraints are penalising people with very small pension pots in the following ways:

- they may run the risk of a ‘stranded pot’
- tax administration means that they may pay 40 per cent tax on the fund even if they are only basic-rate taxpayers.

Stranded pots
This may apply to people with small funds for whom annuitisation is not an option. We are aware of only one annuity provider who is prepared to annuitise funds under £5,000 because of the cost of doing so. Someone with a small fund may be able to amalgamate it with another personal pension fund or, if their total pension savings are under £18,000 in 2010-11, take it all as cash under the ‘trivial commutation’ rules. However, trivial commutation is not always possible, either because someone also has a small defined benefit pension that takes them over the limit, or because it requires encashment of all pension savings within a 12 month period. If so, it is possible to end up with a small fund that cannot be annuitised but that cannot be drawn as cash without significant penalty. The Pensions Advisory Service brought the following case to our attention:

Mr X had a pension pot of £618 which he could not trivially commute because he had an occupational pension which took him over the £18,000 limit. The pension company told him that it was too small to annuitise. He was given the options of:

- *drawing 25 per cent as tax-free cash and forfeiting the balance*
- *transferring his savings to another pension fund with a different company – but he had no other pot to combine it with*
- *pay in more to bring his savings above the provider's minimum to annuitise – which he was not prepared to consider.*

HMRC would have allowed the whole amount to be paid in cash, but this would have been taxed as an unauthorised pension payment at 55 per cent.

In another case, the pension provider was not prepared to make an unauthorised payment, and the customer was only given the option of drawing the 25 per cent tax-free lump sump and forfeiting the rest.

This is an injustice. To remedy it, we recommend that:

- the Government should permit the withdrawal of very small personal pension pots in cash, in addition to trivial commutation. Amounts under £2,000 held in occupational pension schemes can already be drawn in cash, but the previous government did not introduce this for personal pension plans because of fears of avoidance. We believe that the risk of avoidance could be dealt with by allowing only one or two such 'small withdrawals' per person, perhaps with a reporting requirement to HMRC (this is likely to be considerably less onerous than the reporting requirement for flexible drawdown). Alternatively, to avoid the risk of providers marketing 'cluster' schemes, such schemes could be notifiable under the 'Disclosure of tax avoidance schemes' rules.
- The Government should waive the rule that requires all trivial commutation to take place within 12 months in certain circumstances. This rule is not widely known, and we think there is a real risk that people may overlook a small fund such as one arising from contracting-out through a rebate-only scheme. As historic fund valuations should be easily available, the rule should be waived if it can be shown that, using the valuation that applied when the main pension was taken, trivial commutation would have been permitted.
- The Government should break the link between the amount that can be trivially commuted and the lifetime allowance – currently the trivial commutation limit is 1 per cent of the lifetime allowance. As the lifetime allowance has been frozen, we do not think it is appropriate to freeze the trivial commutation limit too.
- Even with these reforms, there will still be a problem for people with pension funds of between £2,000 and £5,000 who are not able to trivially commute for some reason. As a matter of justice, pension savers should always be able to get an annuity or cash sum from their pension fund. The Government should review the £2,000 limit regularly as well as the trivial commutation limit.

Tax administration

Trivial commutation lump sums are taxable as income, apart from 25 per cent which is tax-free (equivalent to the pension commencement lump sum). We are concerned that, because of the way in which PAYE is applied on such payments, providers often deduct 40 per cent tax, even for basic-rate taxpayers, who are then left to reclaim the excess (assuming they are aware they can do this). In addition, some people who are normally basic-rate taxpayers may be pushed into the higher-rate tax band by receiving a one-off lump sum. We understand that the charity Tax Help for Older People (TOP) has dealt with over 2,000 such cases relating to trivial commutation.

We recommend that the administration of tax on trivial commutation lump sums is reformed so that:

- Only 20 per cent tax is deducted as a matter of course. By definition, most people taking advantage of trivial commutation are unlikely to be wealthy.
- The taxable portion of a trivial commutation lump sums is treated in the same way as a deferred state pension lump sum. The recipient of a deferred state pension lump sum can choose to have it taxed in following year and at their normal marginal rate. Although a quarter of a trivial commutation lump sum is tax-free (i.e. up to £4,500), we would point out that someone receiving the maximum lifetime allowance would benefit from a tax-free lump sum of up to £45,000.

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.

The absence of the age 75 rule will greatly increase the complexity of decision-making. Initially at least, regulators should require drawdown products to be sold on an advised basis by advisers who are qualified to do so. If a special qualification is required, it should be in place before the regime is liberalized. We also suggest that the Government and regulators consider whether a system of kite-marking ‘simple’ or ‘high-risk’ products or would be necessary or helpful for decumulation products.

In addition, regulators and industry must redouble their efforts to make it easy to buy a good-value annuity. In particular:

- The OMO working group should be charged with taking evidence on the desirability of a default open market option and making recommendations on whether this should be set as a default.
- All providers should be required to publish benchmark rates (or, where possible ‘real time’ rates), including providers who sell on the open market and those who sell postcode-rated annuities.
- The Government should consider some form of kite-marking scheme for annuities. For example, a kite-mark could be given to annuity providers who keep their rates within a certain margin of the top rates in the market.

We are extremely concerned that the liberalisation of drawdown will damage the image of annuities still further. Any liberalisation should be accompanied by work to promote public understanding of annuitisation. Steps that could be considered might include:

- ‘rebranding’ annuities by calling them something that is comprensible to the general public

- Requiring the 'warm-up letter' sent out before a pension plan matures to include both average life expectancy and the percentage of people who survive beyond the average.

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.

There is a risk that the reforms could have a knock-on effect on advisers' costs. Even if an annuity is manifestly suitable for a client, the adviser may feel the need to explore and explain the drawdown route, on a precautionary basis.

A further issue, not directly related to the reforms, is the pressure on annuity rates caused by increasing longevity and the Solvency II Directive. We would support a review of annuity funding to examine whether longevity bonds, for example, could provide a sustainable source of funding in an ageing society. We would also welcome discussion of other possible innovations for the annuity market, such as the commutation of annuities if someone needs care.

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[i] *Time to annuitise?,* Jackie Wells, International Longevity Centre UK, October 2009
[ii] *Survey of annuity pricing,* Cannon and Tonks, DWP, 2006
[iii] *Housing and finance in retirement,* Louise Overton, University of Birmingham, Age UK 2010
[iv] *Women's financial assets and debts,* Fawcett Society, November 2007
[v] *Scottish Widows Pensions Report 2010,* Scottish Widows, 2010

AIFA is the trade association that represents UK regulated independent financial advisers (IFAs). Membership of AIFA is voluntary and on a corporate basis. AIFA currently represents over 80% of IFA firms in the UK.

IFA firms are the leading distribution channel for retail financial products in the UK. Last year they generated 73% of business by monetary value and are the major sector advising and arranging retail life and investment products in the UK. As such, IFAs represent an important element in the maintenance of a competitive and dynamic retail financial services market.

AIFA welcomes the recognition of the importance of retirement planning and specifically the proposal to remove the requirement to annuitise by age 75. These proposals will not affect all consumers as many will choose to annuitise before age 75 but as people are living and working longer, changes to the rules for retirement planning are key to encourage pension savings. The proposals will give consumers greater choice and increased flexibility which is particularly relevant given the current negative perception of annuities.

It is crucial that, in order to make informed choices tailored to their needs both in the accumulation and decumulation stages, access to high-quality financial advice is available to consumers.

Whilst encouraging flexibility, we recognise the need for appropriate safeguards to ensure that people do not fall back on the state but it is important that the design of the Minimum Income Requirement (MIR) is not unduly complex. As well as the assessment of the MIR there are some other important design issues (e.g. withdrawal rate for capped drawdown, recovery tax charge for past relief) which will determine the success of the policy, and we look forward to hearing HM Treasury's conclusions on these matters soon.

The proposed implementation date of April 2011 – given that a significant amount of the detail is still to be determined – will present significant challenges for advisers and, very likely, for product providers too. Whilst we appreciate that it may be necessary to make changes to the rules in the future, we encourage HM Treasury to only implement the proposals once it is certain that there can be a substantial period without further amendment. Consumers find it difficult to trust a regime that is constantly changing and want certainty in retirement planning.

In AIFA's June 2009 report "Financial Planning Through Retirement" we called for fresh thinking, recognising that the decisions consumers need to make around the time of retirement was developing into a market in its own right. The proposals in this Consultation Paper form part of the solution but it is important that a holistic view is taken so that we:

- develop a joined-up public policy and regulatory approach

- ensure consumers have access to the advice they need, and the industry can provide that advice

AIFA is currently in the research phase of an important benchmark study of the decumulation market which will develop our thinking further. This study will include analysis of the range of propositions and current advice models together with consumer research on how consumers want to access advice and the scope of advice that they're seeking. We look forward to sharing our findings with HM Treasury in due course.

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Age 75 consultation
Pensions and Pensioners Team
Room 2/SE
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10th September 2010

Dear Sirs

Removing the requirement to annuitise by age 75

A J Bell is the largest privately owned provider of self administered pensions and stockbroking services in the UK dealing with in excess of 47,000 SIPP and SSAS clients.

Our consultation response is focussed on three key areas:

- The tax rate charged on lump sum death benefits paid from pension schemes;
- The appropriate level for the Minimum Income Requirement; and
- The appropriate annual drawdown limit for capped drawdown.

We appreciate that the rate of tax applied to lump sum death benefits is not one of the areas upon which the Government has invited views. However, this is a key concern for pension savers. Based on research carried out with clients and advisers, we believe that the Government must look at these tax charges again in order to achieve a solution that is fair and simple for the widest range of pension savers.

Lump sum death benefit tax charges

The Government has recognised that the 82% tax charge on lump sum death benefits paid from alternatively secured pensions effectively forces almost all individuals to annuitise at age 75. This cliff edge was clearly unfair and we welcome the Government's intention to remove it.

However, we believe that increasing the tax charge applied to lump sum death benefits paid from income drawdown arrangements from 35% to 55% will simply create a new cliff edge. The drop may look less dramatic, but many more individuals will be pushed towards it and may feel forced to annuitise at the point they decide to draw benefits.

We believe that the 55% tax charge will significantly reduce the number of individuals who are able to make use of the flexibility offered by income drawdown and that this will reduce overall tax receipts from lump sum death benefits paid from income drawdown funds.

Given that the Government is innovating with proposals such as flexible drawdown we do not believe that there is any intention in this consultation to make pensions less flexible. We also doubt that the Government would welcome any change that reduces tax receipts. On that basis we would recommend that the 55% tax charge is looked at again.

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The two alternatives we would ask the Government to consider are:

1. 25% tax on all pension funds i.e. uncrystallised funds and income drawdown funds; and
2. 0% tax on uncrystallised funds, 35% tax on income drawdown funds before age 75, and 55% tax on income drawdown funds from age 75.

We put these two suggestions, as well as the Government's proposal of 0% tax on uncrystallised funds and 55% tax on all income drawdown funds, to a range of clients and their advisers asking them to consider which option was fairest. We received almost 900 responses, 580 from clients, and believe that this demonstrates the level of importance that clients place on this issue and gives our proposals a unique level of legitimacy. The results of the surveys were:

Client Survey

Proposal	Number	Percentage
0% tax on uncrystallised funds and 55% tax on all income drawdown funds	53	9.5%
25% tax on all uncrystallised and income drawdown funds	319	57.3%
0% tax on uncrystallised funds, 35% tax on income drawdown funds before age 75, 55% tax on income drawdown funds from age 75	199	35.7%

Adviser Survey

Proposal	Number	Percentage
0% tax on uncrystallised funds and 55% tax on all income drawdown funds	31	11.5%
25% tax on all uncrystallised and income drawdown funds	49	18.2%
0% tax on uncrystallised funds, 35% tax on income drawdown funds before age 75, 55% tax on income drawdown funds from age 75	189	70.3%

The key points to draw from this information are:

1. The Government's current proposal is viewed as the fairest option by a small percentage of respondents to both surveys;
2. A majority of pension savers believe that applying a single rate of tax to all lump sum death benefits is the fairest option.
3. A clear majority of advisers, perhaps because they are approaching this from an informed position in terms of the existing 0%/35%/82% framework, view the 0%/35%/55% proposal as the fairest option.

The Government acknowledges that fairness and simplicity must be at the heart of the pensions tax framework. The uniform application of a 55% tax charge on lump sum death benefits paid from income drawdown funds is clearly not viewed as fair by pension savers or their advisers. The reasons for this are:

1. The cliff-edge imposition of such a significant rate of tax may force savers to purchase an annuity i.e. the opposite of what this consultation is trying to achieve; or delay taking their pension, which may cause individuals to take inappropriate choices regarding the point at which they access their retirement income.
2. The tax rate is disproportionate for those who have received basic rate tax relief on all, or the majority of their pension savings. This will be relevant to the majority of pension savers.

...../continued

3. The tax charge is disproportionate when compared to inheritance tax. It is disproportionate both in terms of the rate applied, the fact that the charge is made regardless of whether the lump sum pushes the amount being passed on over a threshold, and the fact that there is no exemption if the lump sum is paid to a spouse.
4. The 55% tax charge is sufficiently high that it will encourage evasion via inappropriate use of vehicles such as QROPS, scheme pension and EFRBS. Use of these vehicles is typically only affordable by the wealthiest savers.

Level of the Minimum Income Requirement (MIR)

We welcome the innovation demonstrated by the Government in proposing flexible drawdown and believe that, provided it sits within a pensions system that is transparent, fair and simple, it will go a long way towards improving the general public's view of pensions.

We also support the MIR and understand the need for the Government to ensure that pension savings are not diminished to the extent that savers need to rely on the state for financial support. We are in a position to confirm that this view is supported by the majority of clients and advisers with over 70% of respondents to our surveys believing that the MIR is a sensible suggestion.

In terms of an appropriate level for the MIR we offered three suggestions to clients and advisers - £7,000, £15,000 or £22,000 per annum. The results are set out in the table below:

Proposal	Number	Percentage
MIR of £7,000 per annum	154	21%
MIR of £15,000 per annum	507	69%
MIR of £22,000 per annum	72	10%

The figures above clearly demonstrate support for the MIR being set at a realistic level to support the idea that there should be little risk of the individual falling back onto the state for support.

Annual drawdown limit for capped drawdown

The consultation raises one other question of particular interest to our client base, the maximum limit for capped drawdown.

The Government is clearly concerned that clients in income drawdown are at risk of running out of funds, particularly as they get older. As a major SIPP and SSAS provider, we are able to provide an informed analysis of client behaviour and fund performance relating to over 9,800 clients in drawdown, some of whom have been in drawdown for 12 or more years. During that period we have not come across a single client who has entirely depleted their pension fund.

We would not suggest that the annual income drawdown should be increased. At the same time, we are aware of no evidence supporting a need to reduce the limit, particularly for the risk related reasons suggested by the Government.

Yours faithfully

pp **Andy Bell BSc FIA**
Chief Executive

ALLIANCEBERNSTEIN
Defined Contribution Investments

Mark Hoban Esq.,
Financial Secretary to the Treasury,
Age 75 Consultation,
Pensions and Pensioners Team,
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H.M. Treasury,
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Dear Mr. Hoban,

We are delighted to have been given the opportunity to respond to this consultation and are broadly supportive of the Government's aim of increasing flexibility and promoting saving by removing the effective requirement to annuitise by the age of 75. We believe this will ensure the system continues to support the social policy objectives for which it was established by encouraging saving while safeguarding the provision of a sustainable retirement income.

We have recently conducted consumer research which demonstrates that the current system is failing the majority of savers in DC arrangements at or around retirement. What we discovered is that most savers are ill-prepared for the financially significant decisions that are being forced upon them at this stage in their lives. Furthermore, the irreversible nature of many of these decisions, as a result of both the tax regime and current product design, means that the system is unlikely to ever serve savers well in its current guise.

Hence we believe, where possible, any changes made to the system which aim to increase flexibility should remove the need for savers to make such critical decisions in the first place.

Our key recommendations in respect of this consultation are:

1. The principle behind the new capped drawdown should be "sustainable drawdown". By this we mean that limits on drawdown should reduce with age, thereby encouraging, but not enforcing, annuitisation. We believe the industry will shortly be able to deliver products which meet this requirement.
2. The new flexible drawdown should not be an additional option to be selected only at retirement, but rather an option available to all retirement savers of any age who can demonstrate a minimum level of savings within their account in excess of the new minimum income requirement (MIR).
3. Access to flexible drawdown should not require savers to make amendments to their current savings. Hence all pension savings should be eligible for inclusion in the calculation in whatever form they may take (including those in DC accounts). For this to be the case, the MIR should also be expressible as a capital sum or minimum savings amount.

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4. The administrative burden for those wishing to withdraw savings in excess of the MIR should fall upon providers who wish to offer this facility. It should place no additional burden on existing providers who do not wish to offer the facility.
5. The Government should take further action to remove the discriminatory nature of the taxation of remaining funds at the point of death.

In a nutshell, the aim should be to ensure a saver only needs to meet one simple rule to allow them access to their savings under flexible drawdown: "Do I have savings in excess of the MIR? If so, I can take those excess savings out." No other decisions should need to be made by the saver, such as whether to buy an annuity etc.

We believe the whole concept of retirement is increasingly becoming less well defined. Our proposals will not only increase the flexibility of the system, but also increase awareness and promote the use of this flexibility by making the system simpler to understand, less complex and cheaper to use. At the same time, by reducing the significance of whether a saver is in retirement or not, the system should be able to adapt more easily to the changing nature of retirement.

Given our proposals, we recommend the Government urgently reviews other arbitrary features of the system which have a significant impact on financial outcomes for savers. Most importantly, a review should be undertaken into the rules concerning the taxation of remaining funds at death, which differ enormously depending on status and age. This is widely perceived to be an unfair feature of the system which needs to be rectified if the Government is to meet its aim of encouraging retirement saving.

We attach herewith our detailed replies to the consultation document *Removing the requirement to annuitise by age 75.* We would also be more than happy to meet the Government to discuss our response in detail, the findings of our latest research and our thoughts on how we see the post- retirement landscape developing.

Yours sincerely,

David Hutchins,
Head of DC Investment Research & Design,
AllianceBernstein.

/B

Replies from AllianceBernstein to questions in Treasury consultation on *Removing the requirement to annuitise by age 75*, July 2010

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

In line with the social policy objectives mentioned in our covering letter, we think it is important that the limit should look to encourage drawdown at a sustainable long-term level. Hence we believe "capped drawdown" would be better termed "sustainable drawdown", which more positively describes the objective.

For "sustainable drawdown" to be encouraged by the system, the limit should be reduced with age to reflect:

- the fact that, as individuals age, the greatest risk they face is outliving their assets, thus mortality drag becomes significant as savers get beyond 80 years;
- that savers' ability to pursue higher returns, via allocations to more risky assets such as equities, diminishes with age as their investment horizon shortens.

One approach may be to develop a precise table which reflects the combined impact of mortality drag and falling investment horizon with age. However, in the interest of simplicity, the following generalised bands might be more appropriate:

Under age 70	120%
70 – 80	110%
Over Age 80	100%

Whilst not enforcing annuitisation, this approach will encourage good risk management by both individuals and their advisers as savers age.

Clearly, where "sustainable drawdown" products guaranteeing a minimum level of income for life in excess of the limit become available, then the rules should be flexible enough to allow the limits to be increased.

Note

We believe ***sustainable drawdown*** will be an income-paying investment product that will become the norm for most retirement savers in the early phase of retirement (up to the age of 80). The principles behind it will be similar to those underlying default investment strategies already used by the majority of DC savers saving for retirement. Thus, the product would combine an investment objective aligned with savers' needs, low fees (less than 0.6% per annum) and flexibility (no initial or exit charges). Unlike existing annuity products, we believe a new product with these features would meet the key requirements of the majority of savers who do not take an active decision about their savings and tend to end up in default funds. This is a group we refer to as "accidental investors".

AB

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 welcome the intention to remove the current effective requirement for annuitisation by age 75. But, whilst the proposed reforms may add to the attractiveness of the system, our research suggests the sort of flexibility they will introduce is rarely properly understood or used by the majority of savers.

We recently completed a survey of savers who have just retired or are about to retire. This clearly identified a worrying lack of understanding of the process that savers have either been through or were about to go though and of the products they had or were about to purchase – most commonly, an annuity. One area clearly highlighted by our research was that savers dislike immensely the feeling that they are being rushed into irreversible decisions they do not understand.

With that in mind, we believe that the reforms in their proposed form could simply increase the complexity and costs of an already complicated system, potentially leading to their inappropriate use and a subsequent reduction in confidence. In particular, we do not like the proposal that "flexible drawdown" becomes just another irreversible option at retirement alongside "capped/sustainable drawdown" and annuity purchase. Rather, we believe the option should exist from time to time for any saver who can demonstrate that their savings meet the minimum income requirement, whether they are in retirement or not, subject to appropriate taxation.

This approach would:

- further enhance the flexibility and attractiveness of the system, whilst ensuring the social policy goals continue to be met;
- avoid the need for savers wishing to use this flexibility to make other complex and difficult financial decisions which they are likely to regret in the future (thereby reducing the risk of misselling);
- be more in line with a society moving towards a more flexible concept of retirement ("future proofing").

We would also welcome an extension of this approach by reforming, where possible, other arbitrary rules which make the system complex and unnecessarily inflexible, namely:

- The restriction on access to pension savings before retirement. (A saver who can demonstrate the MIR has been met should be able to access excess savings at any age.)
- The unfairly divergent tax treatment of savers who take assets out of a retirement fund, which depends on their status – retired or not-retired – and age – under or over 75. (It would seem reasonable that a lump sum paid from the remaining assets be treated as income received the day before death.)

AB

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

We agree with the principle that access should only be allowed to savings in excess of a minimum savings threshold. However, we do not believe the life annuity should be the only method of calculating whether the MIR is met. We suggest a more practical, flexible and cost efficient approach would be to allow a saver to use *any* tax privileged retirement provision to demonstrate they could meet the threshold for access to flexible drawdown.

Hence a saver would be able to demonstrate that the MIR is met by one of or a combination of the following:

- a secure life annuity income in excess of the MIR;
- savings in excess of a certain capital sum representing a prudent value equivalent of the MIR

With respect to the secure life annuity, all annuities should be eligible to meet the requirements of the MIR, subject to adjustment where the rate of increase of the annuity is less than the rate required by the MIR or the age of commencement of the annuity is after state pension age. This will

- improve annuity choice;
- increase annuity market competition;
- avoid the need for costly re-alignment of existing pensions; and finally
- avoid inadvertent misselling of limited price indexation (LPI) pensions, which we believe are inappropriate for the majority of savers.

The adjustments to different annuities could be calculated by, for example, assuming:

- a prudent average age of death (say 95) when calculating pension increase adjustments;
- a prudent annual reduction of 5% a year for pensions commencing after state pension age;
- the proposed 2.5% LPI cap.

Thus a saver currently aged 60 with a state pension age of 66 who had access to the following pensions would achieve the following MIR credits:

- £3,000 per annum pension from age 65 (level in deferment and payment)
  $= 3000/1.025^{35} = £1,264$ credit
- £3,000 per annum pension from age 65 (rpi in deferment, level in payment)
  $= 3000/1.025^{30} = £1,430$ credit
- £3,000 per annum pension from age 66 (rpi in deferment, 2% fixed in payment)
  $= 3000 \times (1.02/1.025)^{29} = £2,603$ credit
- £3,000 per annum pension from age 62 (5% fixed in deferment, level in payment)
  $= 3000 / 1.025^{33} = £1,328$ credit
- £3,000 per annum pension from age 66 (5% fixed in deferment and payment
  = £3000 credit
- £3,000 per annum pension from age 68 (rpi in deferment, level in payment)
  $= 3000 / 1.025^{27} \times (1 - .05 \times 2) = £1,386$ credit

AB

For non-annuitised savings, a capital threshold will be required. We suggest a suitable level would be 20 times the current MIR, which would be consistent with how annuity benefits are valued for the purposes of checking compliance with the lifetime allowance at retirement. However, the Government may want to use a more prudent number in order to allow for market volatility and encourage, if not enforce, annuitisation before allowing access to excess savings at later ages.

We believe the approach proposed here is both practical and appropriate to meet the Government's aims since it:

- promotes greater flexibility – allowing access both before and after retirement to flexible drawdown – making the system more attractive;
- ensures that access is only provided to savers who meet a minimum savings threshold;
- promotes good risk management as it encourages annuitisation as the saver ages (which is a more efficient way of meeting the MIR due to the use of a fixed factor for capitalising the MIR when comparing it against DC savings);
- avoids the need for the costly realignment of existing benefits before savers can gain access to the proposed new flexible arrangements;
- avoids the need for savers to make difficult choices and therefore require costly advice.

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

There are many complex approaches that could be taken here, but there can never be a correct answer. We therefore recommend a simple approach is likely to be the most beneficial, both to aid savers' understanding and to ensure any level can be defended by the Government in the future. The level should therefore be fixed for all ages (subject to future indexation).

Based on the evidence presented, we suggest an MIR of c£75-100 per week would be a good starting point. This would reflect the approximate income which, in combination with the basic state pension, would take a saver to a level prudently in excess of the minimum income standard. To achieve this income using our proposed alternative test of a minimum savings amount, a saver would need to have amassed personal retirement savings of between £78,000 and £104,000.

We do not believe that the MIR should be age-adjusted because any advantage it might give is likely to be heavily outweighed by the complexity it will introduce into the system. Individual savers are likely to find it hard to understand, thereby reducing their willingness to save and increasing their need for costly advice.

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

We see no justifiable reason within the current savings system to differentiate, which would merely add to the complexity of the system. The MIR should be assessed at the individual saver level for both single people and couples as is consistent with the existing legislation covering the lifetime allowance and contribution rules.

AB

A.6 How often the MIR level should be reviewed

Given the need for the MIR to keep up with the cost of living, we believe it should be reviewed annually with other cost of living benefits. To provide clarity and consistency within the system, and to avoid further administrative burden, we would suggest the MIR should be uprated in line with the basic state pension if this is to be maintained as the foundation for a secure retirement income.

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

The Government should avoid any additional administrative burden falling on the providers of pensions. Hence we would propose a process as follows:

- All providers should give savers sufficient information for their savers to calculate how much of the MIR is being met. This would not require any additional burden in comparison with the current system.
- Providers should register whether or not they are prepared to make payments on a flexible drawdown basis. (They may elect not to.)
- Providers who are willing to make flexible drawdown payments should be responsible for certifying that the MIR is being met and for completing a return to HMRC for the payment, along with the initial tax deduction.
- Providers wishing to offer a flexible payment service should give the option free of charge at least once every three years (to ensure access is widely available), but should be allowed to make a charge at their discretion for more regular provision.
- Where a saver can clearly show they have met the requirement with a proportion of existing savings arrangements, the flexible payment provider should only need to demonstrate that the MIR is being met, rather than making a complete disclosure.

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

As we stated earlier, we have recently carried out some in-depth consumer research covering savers who are either approaching retirement or who have recently retired and their attitudes to retirement income and annuities. It highlights the fundamental failings of the current system beyond the relatively easy-to-identify issues surrounding the open market option and impaired life annuities. We would be more than happy to share this research in a meeting with the Government.

One area we would recommend the Government looks at is the treatment of the remaining assets in a saver's account after death. The current system is unnecessarily complicated and discriminates significantly from a tax perspective in two areas:

- whether death occurs before or after the saver has started to draw their pension, which is not consistent with the need to make the system simple, fair and future-proof;
- whether the saver is under or over the age of 75, which is inconsistent with the current proposed changes.

We believe that any rules that refer to the age or status of the saver should be removed to reduce complexity and unnecessary discrimination. Such a reform would also reduce the need for savers to seek expensive advice in an area which our research tells us many see as extremely important.

A.9 How the industry, Government and advice bodies such as the 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.

Our consumer research suggests that few savers, even those at or approaching retirement, engage properly with the decision-making process. They are often befuddled by the complex variations of annuities they believe they must purchase, as well as the rules and the advice they receive. Based on our research we would suggest that the most cost effective and successful approach to overcoming this confusion would be for providers of un-advised pension savings vehicles, such as workplace pensions, to provide a well managed default. This should apply not only in the accumulation stage but also in the payment, or decumulation, stage.

Well managed defaults in our opinion should incorporate the following broad concepts:

An appropriate investment and (where necessary) payout objective	Maximising returns, subject to an acceptable degree of risk given the need to achieve a sustainable retirement income.
Be age-appropriate	Recognising the decreasing ability of savers to take risk as their investment horizon reduces.
Be flexible	Imposing no upfront charges or penalties for savers choosing to move away from the default.
Build-in independent oversight with the ability to make changes on behalf of savers.	Ensuring management is in keeping with the savings objectives outlined to overcome the high costs suffered by many savers as a result of their inertia and low level of engagement with financial affairs.

We believe "sustainable drawdown" approached in this way is likely to be a more suitable default than an annuity. Savers would then be encouraged, rather than forced, to annuitise as they get older and the limit on sustainable drawdown income starts to bite.

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

We believe the "at retirement" annuity market has peaked and is likely to decline as better-value and less risky options are developed. It is not clear whether these latest proposals will have any significant impact on this market.

We believe the future will consist of the majority of savers going through the following phases:

- Accumulation – the savings phase (ages 20- 70)
- Decumulation – sustainable drawdown (ages 55 – 80)
- Decumulation – annuity (age 75+)

alltrust

Response to Age 75 Consultation

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1. **Introduction**. I welcome the Treasury's consultation on this matter and even more so the nature of the proposals contained therein.
   1.1. I am an actuary by profession and have over 30 years' experience in the pensions industry. Of these, the last 19 years have been in the self invested pensions market and have been managing my own SIPP and SSAS business now for over five years.
   1.2. The comments made are formulated from my own experience of operating in this market at all levels and from my understanding and thinking in the matter.
   1.3. I also believe that huge progress though the starting point is, this is an opportunity to look at the matter in a more fundamental manner and set in place principles which will stand the test of time.

2. **Removing Age 75 limit**. This is a most welcome proposal and brings the regulation in line with the improving longevity of the population. I appreciate that there are other considerations and I discuss these below.
   2.1. The current limits on drawdown seem arbitrary in the sense the from 120% pre age 75 they drop to a maximum of 90% from age 75. What makes one think that the income requirements for an individual fall at this age is anybody's guess. The five yearly review process has the effect of bringing the amount drawn in line with the assets available but given the vagaries of the financial markets, this is too long a time span.
   2.2. Then there is the matter of trying to arrive at the appropriate annuity rates using tables published by the Government Actuary's Department (GAD) but then increase this potentially accurate assessment of a "true" annuity rate by 20% for maximum income calculation. Why not adjust the basis so that the maximum is the 100%? Once this is adopted, then the 90% post 75 limit seems more reasonable.
   2.3. The need to address the concerns of individuals falling back prematurely on the state may be partly addressed by having triennial reviews rather than quinquennial. Yes it will increase the costs marginally but offer better protection. Ideally, the annual review process by a financial adviser should cover this but there are many people who do not have an adviser for various reasons.
   2.4. If the concerns are that at around age 75 the danger of disproportionately reduced pots is greater, then the review process should perhaps be reduced to three years from age 75. This, combined with the 90% limit should be capable of providing adequate protection.

3. **Pensions Taxation**. I welcome the Government's intention of maintaining the 25% tax-free lump sum (TFLS) and continuing to tax pensions on the EET system. The implications of removing the annuitisation by age 75 in this context needs to be considered a bit further.
   3.1. Most holders of personal pensions / money purchase schemes are basic rate tax payers and consequently have lower pension pots. Thus applying a 55% tax limit across the board would be penal in a majority of the cases. It is appreciated that the greater amount of relief is enjoyed by higher rate tax payers but it appears inequitable and against the Government's intention of helping those on lower incomes.
   3.2. With the 25% TFLS the Treasury would recover 10% tax for an individual who is on a pension of twice the annual personal allowance creating a shortfall of 10%. I appreciate that the action of higher personal allowances from age 65 complicates matters further in that the recovery rate is reduced again. For simplicity, I follow this example. Thus the Treasury needs to recover 30% on death for a neutral outcome.
   3.3. A rate of tax of 35% upon the death funds being paid out as lump sum would thus more than adequately compensate the Treasury for the deferment and any lower recovery due to the interaction of income and higher allowances post age 65.
   3.4. For a higher rate tax payer a recovery rate of 50%is likely to create a neutral position and increasing this to 55% thus allows for any variations and deferment of tax.
   3.5. It is to be recognised that not all those paying basic rate tax on their pensions would have been paying the same rate in employment. They might as well have been higher rate payers but unable to accrue sufficient pension rights.
   3.6. For the sake of simplicity I have ignored employer contributions and the different rate of relief that the Treasury allows. These would complicate the situation further when approaching this matter from the tax rate payable by an individual.
   3.7. The intention to limit contributions for tax relief purposes also reduces the Treasury's exposure and thus lowers the exit tax rate for recovery making the proposed rates above more than adequate.
   3.8. I have two proposals for recovery whilst recognising the tax position of the individual:
      3.8.1. The tax to be charged is calculated on the tax position of the individual at the time of death so that a basic rate payer's fund is charges 35% and higher rate 55%. This obviously has advantage of simplicity but also drawbacks in that the fund in question might have enjoyed relief at the rate of 40%.
      3.8.2. The tax is based on the maximum pension for the age of the deceased that was possible to be drawn on the remaining fund which is being paid out as a lump sum. Thus if the pension falls in the higher rate bracket then 55% is levied otherwise 35%. This again has the advantage of simplicity but a drawback in that the fund may have been small but the individual was a current higher rate tax payer.
      3.8.3. As a refinement a combination of the two may be applied in the case of higher rate. Where an individual is a higher rate tax payer but the fund does not generate an income sufficient for higher rate purposes then the 55% tax is levied.
   3.9. I believe that there has to be a distinction between the recoveries made for the two types of tax payer in order to achieve the objectives in 3.1.

4. **A Different Approach**. I do believe, however, that we are missing a trick here. All the regulation and thinking appears to concentrate on the contributing member and the dependents. We should explore the actions which might help materially towards lowering the risk of individuals prematurely falling back on the State by considering generations to come rather than just current member.
   4.1. Increasingly there is falling provision by employers for the pensions of their employees due to various reasons which are not for discussion here. It is not easy to convince the public that it needs to take on a greater responsibility for this provision as taxation in retirement and upon death is a worry that crops up all the time. Thus in order to address this worry we need to think like the public.
   4.2. Pension pots accrued by personal or own business contributions are always considered as "my money". The more frequently asked questions are:
      4.2.1. "What happens to my money when I die?"
      4.2.2. "Can I pass it on to the next generation?"
      4.2.3. "Can I make provision for my grandchildren?" and so on.
   4.3. There are already genuine and justifiable concerns regarding the limitation of contributions for tax relief purposes. More often than not the ability to make contributions at a high level comes at higher ages; sometimes after 60 and even 65. Thus the term over which a reasonable retirement fund can be accrued is being shrunk. The ability to make one-off large relievable contributions has already been withdrawn and unless provision is made to be able to benefit from unused allowances, this ability is further eroded.
   4.4. Yet there is a genuine concern amongst Ministers regarding the "prematurely falling back on the State". These aspects are not consistent with each other.
   4.5. My proposal is:
      4.5.1. Allow fund balances after death of member or dependents, whichever is later, to be transferred to the dependents' or the next generation, or the ones after as a pension fund asset with no tax charge. This can either happen within a scheme if a multi-member scheme or a separate individual scheme.
      4.5.2. It gives a head start to the individual and reduces their likelihood of prematurely falling back on the State (PFBOTS).
      4.5.3. Allows the individual a reasonable opportunity to build sufficient assets in order to avoid PFBOTS.
      4.5.4. Increases pension provision for the population by creating an interest not only amongst those making their own arrangements but establishes this interest early in the future generations.
      4.5.5. As this permeates in the society over time, it will generate interest in this subject even amongst those who are not yet making a provision, or are not in a position to but will consider it seriously, which will impact on their descendents.
      4.5.6. The whole scenario will continually reduce the risk of PFBOTS and address one of the most serious funding issues for the present and future governments.
      4.5.7. In addition, it will reduce the liability for provision of tax relief over time and the future generations are unlikely to be fully utilising their allowances given that they already have funds in a pot to start off with.
      4.5.8. Efficiency and cost savings will be made by reducing the processing of collection of taxes upon death and allowing reliefs in the future, a matter very close to heart for all governments.

4.5.9. It will make for a better provision for retirement in the UK and represent increasing prosperity for the nation thus further reducing the risk of PFBOTS.

4.5.10. Yes, initially there will be a loss to the Treasury in that collections will fall but these will be offset by lowers reliefs with the passage of time and highly likely to be very close to neutral if not wholly neutral. There will also be higher collection from members drawing higher amounts from these funds than would have been possible and savings made due to reduced risk of PFBOTS.

4.5.11. The funds that would have been used for pension contributions will either be spent thus adding to Treasury revenues or used for investment thus generating GDP and higher revenues again with all the other attendant benefits as well.

4.5.12. Any Government pension schemes will be positively affected and thus more attention and funds can be directed towards those who are genuinely less well off. Another one of the objectives of the Government.

4.5.13. I will be delighted to discuss this concept in more detail if so desired.

5. **Minimum Income Requirement**. This again is a very welcome proposal and addresses one of the requirements of flexible retirement.

5.1. Given the Government's intentions to completely overhaul the benefits system, it is perhaps best at this stage to deal with this topic on a principles approach.

5.2. Following the final outcome of the benefits review, it is likely that a more reliable figure for benefits and minimum income can be arrived at which is not too affected by the changing circumstances of the individual unless I have completely misunderstood the thrust of the proposals.

5.3. **What is a secure income?** In this context any income which has some form of a guarantee from a recognised institution such as a life office or an employer's pension scheme are the obvious ones to consider.

5.4. Then there are incomes from trust funds and other similar instruments which can be taken into account as long as there is reasonable certainty that it will continue for life. An individual may have a fund under management which provide a regular income but is subject to the desires of that individual.

5.5. This brings into play the concept of attaching a risk factor to the nature of the income and starts introducing complexities.

5.6. If, however, there are individuals who have sources of income as in 5.4, then it is unlikely that they are the type of person who will require a huge variation of income from their pension fund. If my proposals in section 4 are adopted then such individuals are the ones to pass their funds on to the future generations.

5.7. Thus secure income may be limited to that in 5.3.

5.8. The next question is that of indexation. This depends upon the level of secure income and to what extent this is over and above the MIR. It may not be necessary to insist on indexation if the secure income is above the MIR by a certain level. Thus flexibility is required when considering establishing MIR.

5.9. The levels should be set excluding persons who are on disability and other similar benefits for whom a different formula should be used.

5.10. **The Level of MIR**. Given the Government's concerns about PFBOTS, MIR levels should be set on conservative assumptions. Perhaps second quartile figures should be used instead of averages.

5.10.1. Costs of living vary from region to region and from element to element within and amongst regions. Averages will tend to favour some areas and individuals over others.

5.10.2. It is also very difficult to regionalise because various means can be adopted to demonstrate residence in a different region and leads to unnecessary expense and complexity.

5.10.3. Undoubtedly the more well off regions will have a better outcome than others. Thus setting a figure is fraught with difficulties on the basis, moral and political levels.

5.10.4. May be consideration should be given to a %age of potential income from all sources subject to minima and maxima.

5.10.5. Same considerations apply to **age related MIR** but again the data already available should be analysed in greater detail and levels should be set conservatively. It may well be that initial level is set for 2 and then 3 years from age 55 and then set for every 5 years depending on the outcome of the data analysis.

5.10.6. Again data analysis is critical as it appears (and is also logical) that income requirements are **different for couples than for individuals**. Thus separate levels of MIR should be set. In which case the secure income levels of both partners should be taken into account when testing this. I am not sure how much data is available but is the age difference between partners material in this regard?

5.10.7. I believe that this is a matter which requires more research and further in-depth consultation before a decision is made.

5.11. **Review of MIR**. I believe that once the methodology has been established, an annual review should be conducted and ready for the next year commencing 5 April.

6. **Conclusion.**

6.1. I am unable to comment on the annuity market as I have no expertise in this area.

6.2. I do believe that the Government needs to take note on the industry's concerns as mentioned in this note and summarised below:

6.2.1. Set a level of annual allowance for relievable contributions no less than £50,000 with a facility to avail unused allowances.

6.2.2. Differentiate in the recovery tax rates applicable upon death.

6.2.3. Adopt the "Different Approach" outlined in section 4.

6.2.4. Carry out further research and consultation for MIR whether via a working party or delegated to the industry.

6.3. I shall be delighted to be of any further assistance if required.

Hamid Nawaz-Khan

Thursday, 09 September 2010

Age 75 Annuities Consultation

Response from Dr. Ros Altmann 12th September 2010

Executive Summary of my response:

These proposals are grossly unfair. 55% tax relief recovery charge is penal for those who only received basic rate tax relief on their pension savings. This rate will see the middle classes subsidising pensions for the wealthiest:

55% tax relief recovery charge is great for the wealthiest, with ASP rates coming down from 82% to 55%, but it is a big increase from current 35% tax on drawdown funds passed on by those who die before age 75

Current pension taxation policy is illogical - the regime of death benefit taxation does not fit with the stated objectives and rationale. This is a chance to rethink the application of taxation rules more fundamentally and make the system fairer, rather than less fair. Whether or not an income has been taken, surely some kind of tax relief recovery charge should apply.

Wealthiest pension savers can already escape paying tax on their pensions, with no tax relief recovery charge being levied on QROPS.

Treasury still failing to address problems of OMO - I first called for a radical overhaul of annuity selling in 2002 - it has still not happened: Having been closely and personally involved in the 2002 consultation by the previous Government - 'Modernising Annuities', it is deeply disappointing that there is still a massive failure of regulation when it comes to the annuity sales process.

These proposals are a classic example of the problems faced by the silent majority, who have inadequate representation. The wealthiest pension savers have advisers and industry lobbies but less well-off middle classes will suffer a potential tax increase if they die young and have already entered drawdown.

To ensure they do not 'fall back on the state' people will need to annuitise around £300,000 - £500,000 worth of pension savings (or have income from defined benefit schemes of an equivalent value) - this is only the top 1.5% of pension savers.

Beware: There is a serious risk that these proposals will cause annuity rates to worsen

Money back guarantees beyond age 75 is a good idea - I called for it in 2002 and it is long overdue.

Need more long-term thinking - long-term care is the next crisis. Government should consider incentivising long-term care provision, before the crisis hits us

Proper reform of state pensions would obviate the need for concern about annuitisation

Alternative proposals:

Tax relief recovery charge of 55% is too high - should not be levied on those who received only basic rate tax relief

Tax relief recovery charge should be levied on pension fund capital on either death or withdrawal, also on funds moved abroad

Retirees should not be offered a default annuity - annuity sales process must be urgently reformed to ensure OMO works in customer's interest not provider's

Pension tax regime should incentivise long-term care

People should not be required to annuitise to secure the MIR - allow a capital sum

Government should issue longevity gilts to alleviate worsening rates

The Government has issued a consultation on its proposals to reform the Age 75 rules for mandatory annuity purchase from pension savings and this document contains my response.

The cost of pensions tax relief is around £37billion a year. Such huge sums represent an enormous benefit for top rate taxpayers in particular and the current tax regime already helps the wealthiest pension savers far more than ordinary workers. The proposals contained in this Consultation will improve the tax regime even further for the very wealthiest, but at the expense of those lower down the income or wealth scale. The proposals will not help those who need it most and far more is required to address the inadequacies of the annuitisation process for most of the nearly half a million people who buy an annuity every year.

What is the aim of this consultation and its proposals?

The Government states that it wants to reinvigorate pension saving and that the current pension rules are unnecessarily restrictive. Unfortunately, although the aim of reviving a savings culture and reducing restrictions is sound, the proposed measures will only address problems faced by a tiny minority of pension savers, while potentially worsening the position of millions of others.

The Government says the current rules are unnecessarily restrictive, but this is really only the case for the very wealthiest few percent of pension savers. For most people, the problem is very different and the proposals will not help the majority of pension savers. Indeed, for many, the proposals will result in worse outcomes, as they will increase the tax rates on those who cannot afford to leave their pension funds untouched until age 75 and die in drawdown, as well as risking worsening annuity rates if more people try to annuitise to secure their MIR at younger ages.

The principles of the Government's current pension tax policy are confused. For example, if the purpose of tax relieved pension savings is to provide income in retirement, why is the recovery charge only levied on those who do take some income, while those who can afford not to take income pay no tax at all on their pension fund on death? This tax free pension is offering free life assurance to the wealthiest but what about everyone else?

The current proposals benefit the wealthiest pension savers, but what about everyone else? On the figures in the consultation document, the reduction of tax on ASP and introduction of flexible drawdown with only income tax rates being paid on withdrawals above MIR, will benefit 8,000 people a year, which is just 1.5% of those buying annuities.

The pensions crisis and annuitisation problems affect mostly the middle classes, not the wealthiest and it is these people for whom policy should be ensuring pensions work better. The current proposals do not address the most significant failures of the existing system.

These proposals will not do anything to help people in the new NEST scheme or those auto-enrolled into pensions

Specific responses to consultation questions

A2 - Government's intended approach to reforming pensions tax framework is grossly unfair. It is inevitable that mandatory annuitisation will need to change, due to volume pressures in the annuity market, but the proposed tax changes represent a huge improvement for the very wealthiest pension savers, at the expense of those lower down the income scale. This is unfair.

A3 - 'Secure' income should include a capital sum, perhaps invested in index linked or other gilts, that is sufficient to annuitise up to the MIR level

A4 - An appropriate level for MIR would be that which takes people above means-testing limits and the capital sum needed would vary according to age

A5 - There should not be a different rate for individuals or couples, since single pensioners could marry in later life and there would be no safeguard against the surviving spouse falling back on the state

A6 - The MIR should be reviewed annually

A8 - There are huge regulatory barriers for all those outside the very wealthiest. Those who do not have access to an adviser are stuck with a wholly deficient regulatory sales process which urgently needs to be reformed. Consumers should not be offered a default single life level annuity - they should be forced to choose. At the moment, the industry has a captive at retirement customer base, too many of whom end up in the wrong product at a poor rate, partly because they do not understand, they only annuitise once in their life and their provider often makes it easiest for them to simply take the standard annuity offered in order to start getting their pension as quickly as possible. The FSA is at fault here and, despite numerous consultations and initiatives, the OMO is still not working in the interests of consumers. It is in the interests of providers, especially those who offer poor rates and take commission of 1-2% out of people's pension funds, even when they receive no advice. No other financial product is so poorly regulated - in fact there is virtually no proper regulation of annuity sales. All the customer has to do is sign a form and send it back, to get the wrong annuity at a poor rate. No risk disclosure, no advice, nobody ensuring they know what they are doing in this

irreversible process. This failure often leads to increased poverty among older single female pensioners, whose husbands took single life annuities without realising the consequences until it was too late.

A9 - The CFEB and FSA can ensure individuals make more appropriate choices by forbidding the practice of offering default annuities. This will force people to make a choice and find out the necessary information before they buy an annuity. They will then have to consider the vital questions, such as whether to cover a partner, whether their health would mean an enhanced rate is available, whether to take the tax free lump sum and delay annuitisation, whether to take a ten year or lifelong guarantee instead of just five years, whether to consider inflation protection etc.

A10 These reforms may have the unintended consequence of worsening annuity rates, if people have to annuitise earlier than age 75 in order to be able to access the capital in flexible drawdown and benefit from just income tax rates, instead of the recovery charges or death rate.

Detailed Comments:

These proposals to reform the pensions tax framework are grossly unfair. 55% tax relief recovery charge is penal for those who only received basic rate tax relief on their pension savings. This rate will see the middle classes subsidising pensions for the wealthiest: I have serious concerns about the proposed reforms, although the Government claims that a 55% tax relief recovery charge is 'appropriate' this simply cannot be fair for basic rate taxpayers. It is only 'appropriate' for higher rate taxpayers, who are actually the minority of citizens. Those who receive top rate tax relief get £2 for every £3 they invest in a pension, which is a 66% benefit from tax relief. However, those on basic rate relief get only 20p for every 80p they invest, which is only 25% uplift. Thus a 55% recovery charge is unfair.

55% tax relief recovery charge is great for the wealthiest, with ASP rates coming down from 82% to 55%, but it is a big increase from current 35% tax on drawdown funds passed on by those who die before age 75: The 55% rate will increase death taxes on many middle class pensions of those who die before age 75, while vastly reducing the tax paid by those with the very largest pension funds who will be the wealthiest pension savers. This is a transfer of wealth and tax benefits from the middle to the top of the income distribution, which cannot be considered fair. Removing ASPs will simplify retirement options and tax treatment, but it will penalise all non higher rate taxpayers in the process.

Current pension taxation policy is illogical: The logic of current pension taxation policy is difficult to fathom, with confused objectives and inconsistent rationale. Surely this would be an ideal opportunity to reform pension taxation fairly, rather than merely improving the position of the top echelons of society at the expense, potentially, of those in the middle. Tax policy is supposed to ensure that pension savings are used to provide an income in retirement and that the tax relief is recovered later. The Government also stresses that pensions should not be a means of passing on wealth tax free. However, as long as an income has NOT been taken from the pension fund, it is passed on tax free on death. This means that those who are wealthiest and can afford not to take any income from their pension, can pass on their accumulated pension savings tax free if they die before age75, while those who need to take some income will suffer substantial tax on death. Such a regime does not fit with the stated objectives and rationale. This is a chance to rethink the application of taxation rules more fundamentally and make the system fairer, rather than less fair. Whether or not an income has been taken, surely some kind of tax relief recovery charge should apply.

Wealthiest pension savers can already escape paying tax on their pensions, with no tax relief recovery charge being levied on QROPS. QROPS represent another example of the illogicality and favourable treatment for the wealthiest, by current pension tax policy. Those who can afford to leave the UK are able to take their pensions without any tax relief recovery charge and will not even pay UK tax on the income they receive. They have been able to escape tax almost entirely in many cases and, again, these are the people with the largest pensions.

Treasury still failing to address problems of OMO - I first called for a radical overhaul of annuity selling in 2002 - it has still not happened: Having been closely and personally involved in the 2002 consultation by the previous Government - 'Modernising Annuities', it is deeply disappointing that there is still a massive failure of regulation when it comes to the annuity sales process. Given the numbers of people annuitising each year - which is approaching half a million people - and the ongoing switch from defined benefit to defined contribution pension provision, coupled with the demographic profile which sees a sudden surge in the numbers of 65 year olds over the coming decade, the need for improved pension outcomes is urgent. This consultation and its proposals do not really address the failings of the annuity sales process and the Open Market Option. There is a difference between allowing flexibility and choice and ensuring this. The current system may allow it, but in practice it works against those who have no adviser obtaining the best value for themselves from the irreversible annuity process.

These proposals are a classic example of the problems faced by the silent majority, who have inadequate representation. The wealthiest pension savers have advisers and industry lobbies but less well-off middle classes will suffer a potential tax increase if they die young and have already entered drawdown. Pressure for the wealthiest pension savers has delivered substantial tax reductions already, such as in these proposals to reduce tax rates from 82% to 55% - and even to 50% or 40% for those who pay only income tax rates.

To ensure they do not 'fall back on the state' people will need to annuitise around £300,000 - £500,000 worth of pension savings (or have income from defined benefit schemes of an equivalent value) - this is only the top 1.5% of pension savers! The MIR test, to be reliable, will need to ensure that both single and married people secure at least enough to reliably avoid means-tested benefit levels, including inflation linking. The level of the MIR should be revisited each year and the cost will vary with age, but the aim would be to ensure an index linked income of around £15,000 a year, including state pension. At the moment, a married couple would need around £500,000 at age 60 and perhaps £300,000 at age 70 to be able to buy an index-linked joint life annuity to secure this level of MIR.

Beware: There is a serious risk that these proposals will cause annuity rates to worsen: I also fear that the result of the current proposals will be a worsening of annuity rates, despite the suggestion that the opposite is more likely. Although, in theory, they should mean fewer people over 75 buying annuities with their whole pension fund, in practice, it is likely that more people under age 75 will buy annuities This will mean a rise in demand for annuities in the nearer term. Yes, it is possible that annuity rates may not worsen as much as they would under an unchanged tax regime, however the proposed 'Minimum Income Requirement' is likely to force more people to buy annuities earlier than age 75, in order to secure their 'Minimum Income' and this will place further pressure on the annuity market, which is already suffering from lack of volume at times now. In order to satisfy the MIR it is entirely possible that we will see a sudden rise in demand for annuities of around £300,000 from people in their 50's or 60's with large pension funds. As increasing numbers of workers reach retirement, which is inevitable in the next few years due to demographic pressures, there will be more demand for annuities, while supply is limited. In the nearer term, forcing people to annuitise at least part of their pension savings earlier than age 75 could add demand that would have been delayed for some years into the future.

Money back guarantees beyond age 75 is a good idea: The one sound proposal is that 'money back guarantees' will be permitted for annuity sales in future. Again, this is something that I was championing in 2002, but at that time the Treasury refused to permit anyone to receive the balance of capital if they died after age 75. There was no logical reason for that refusal and it is welcome to see the decision being reversed. However, a 55% tax relief recovery charge is very harsh and, indeed, grossly unfair for those who only received basic rate tax relief on their pension savings.

Need more long-term thinking - long-term care is the next crisis. Government should consider incentivising long-term care provision, before the crisis hits us: Reform of pension taxation and annuity requirements also offers an opportunity to think ahead to the next crisis of old age that is looming for the next twenty or more years. Long-term care will be the crisis to follow our pensions crisis. Not enough is being done to provide funding for future long-term care expenditure. One in five of pensioners will need long-term care, but almost none has made provision for this. If Government wants to plan for the long-term then it needs to ensure that both pension income and long-term care needs are catered for. There is a long way to go on this! Having allowed the pensions crisis to develop, without putting in place appropriate or adequate policies to avert it in time, surely it would be wise to consider how best to use pensions and other savings or insurance to ease the pressure of funding long-term care in future.

Proper reform of state pensions would obviate the need for concern about annuitisation: Finally, if state pensions were properly and radically reformed, to provide a decent basic minimum social welfare payment, without additional mass means-testing, the Government would not need to be so concerned about people falling back on the state and pension savings could be freed to be used more flexibly as individuals wanted or needed.

Detail on Alternative Proposals:

Tax relief recovery charge of 55% is too high - Government should look for ways to raise revenue from pensions elsewhere to allow the rate to come down.

55% tax relief recovery charge should not be levied on those who received only basic rate tax relief. The rate is far too high for such people and should not be more than 35%.

Tax relief recovery charge should be levied on pension fund capital on either death or withdrawal. At the moment, it is illogical and unfair that those who can afford not to take any income out of their pension funds before they die can pass on their whole pension fund, tax free, while those who have needed some income before age 75 (in other words not those who are wealthiest), will have to pay even more tax on death - the rate will increase from 35% to 55%. If the aim of policy is to provide tax relief in order to ensure people have an income in retirement, then surely the tax relief recovery should be made from those who do not actually take an income! At the moment, the tax regime on death for those who have not yet started drawing an income neither provides income nor recovers the tax relief.

Tax relief recovery charge should be levied on funds moved abroad that would otherwise not repay any of the tax relief received. Current QROPS rules allow the very wealthiest often to avoid UK tax altogether. This is another example of how the current pension tax rules benefit the very wealthiest the most. In order to improve fairness and help improve tax revenues, this situation needs to be urgently addressed.

Retirees should not be offered a default annuity -. If not default annuity is offered, then people will have to make a choice that suits their circumstances and engage with the process to consider the vital questions they need to answer before committing to a lifelong annuity. The current annuity sales process is not working in the interests of consumers, it is in the interests overwhelmingly of providers. Since the 'Modernising Annuities' consultation in 2002, I have been trying to help the FSA and Treasury understand that the current OMO process is failing and needs radical reform. So far, this has not happened. People who buy annuities do not understand the issues involved, often receive no help or advice with their annuitisation decision, feel forced into buying the annuity and once bought, it can never be changed. The FSA has failed to understand that annuities are a high risk product for many people. Yes, they can secure a lifelong income, but it may be the wrong level or the wrong type of income. By allowing the default offer from providers to be a single life, level annuity with only a 5-year guarantee, individuals are often annuitising without covering their spouse, which could aggravate the problem of female pensioner poverty in future. In addition, they will have no inflation protection and they may be entitled to an enhanced rate but not receive it. They may also obtain a very poor rate for their annuity from their existing pension provider, but once bought, they cannot change their annuity. They are stuck with it for life.

Pension tax regime should incentivise long-term care. Pension funds should be convertible into long-term care funds or insurance options, with tax incentives. This could help avert the looming care crisis, which will inevitable follow our pensions crisis as the ageing population reaches older ages.

People should not be required to annuitise to secure the MIR - allow a capital sum. If more people under age 75 suddenly have to annuitise to secure their MIR, there could be a negative effect on annuity rates. Therefore, it would make sense to permit a capital sum should be set aside, rather than forcing annuitisation, with the amount determined by index-linked annuity rates. If the Government wants to ensure that this capital sum is secure - as well as perhaps helping the fiscal deficit somewhat - this amount could be required to be invested in index-linked gilts, as an alternative to forcing people to buy annuities.

Government should issue longevity gilts - must take the volume issues seriously. There is a serious risk of annuity rates continuing to worsen. As more employers switch from defined benefit to defined contribution and as a result of Solvency II legislation, as well as the increasing trend of closed defined benefit schemes to buyout or buyin with annuities, the pressure on the annuity markets will increase.

Specific responses to consultation questions

A2 - Government's intended approach to reforming pensions tax framework is grossly unfair. It is inevitable that mandatory annuitisation will need to change, due to volume pressures in the annuity market, but the proposed tax changes represent a huge improvement for the very wealthiest pension savers, at the expense of those lower down the income scale. This is unfair.

A3 - 'Secure' income should include a capital sum, perhaps invested in index linked or other gilts, that is sufficient to annuitise up to the MIR level

A4 - An appropriate level for MIR would be that which takes people above means-testing limits and the capital sum needed would vary according to age

A5 - There should not be a different rate for individuals or couples, since single pensioners could marry in later life and there would be no safeguard against the surviving spouse falling back on the state

A6 - The MIR should be reviewed annually

A8 - There are huge regulatory barriers for all those outside the very wealthiest. Those who do not have access to an adviser are stuck with a wholly deficient regulatory sales process which urgently needs to be reformed. Consumers should not be offered a default single life level annuity - they should be forced to choose. At the moment, the industry has a captive at retirement customer base, too many of whom end up in the wrong product at a poor rate, partly because they do not understand, they only annuitise once in their life and their provider often makes it easiest for them to simply take the standard annuity offered in order to start getting their pension as quickly as possible. The FSA is at fault here and, despite numerous consultations and initiatives, the OMO is still not working in the interests of consumers. It is in the interests of providers, especially those who offer poor rates and take commission of 1-2% out of people's pension funds, even when they receive no advice. No other financial product is so poorly regulated - in fact there is virtually no proper regulation of annuity sales. All the customer has to do is sign a form and send it back, to get the wrong annuity at a poor rate. No risk disclosure, no advice, nobody ensuring they know what they are doing in this irreversible process. This failure often leads to increased poverty among older single female pensioners, whose husbands took single life annuities without realising the consequences until it was too late.

A9 - The CFEB and FSA can ensure individuals make more appropriate choices by forbidding the practice of offering default annuities. This will force people to make a choice and find out the necessary information before they buy an annuity. They will then have to consider the vital questions, such as whether to cover a partner, whether their health would mean an enhanced rate is available, whether to take the tax free lump sum and delay annuitisation, whether to take a ten year

or lifelong guarantee instead of just five years, whether to consider inflation protection etc.

A10 These reforms may have the unintended consequence of worsening annuity rates, if people have to annuitise earlier than age 75 in order to be able to access the capital in flexible drawdown and benefit from just income tax rates, instead of the recovery charges or death rate.

AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

AMPS Response to Treasury paper: "Removing the requirement to annuitise by age 75".

Contents

Introduction

The Association of Member-Directed Pension Schemes (AMPS) welcomes this consultation and the commitment shown to re-design the rules after age 75.

The age 75 issue has probably been the most hotly debated issue of our member firms over the years, and the current rules provide a real cliff-edge for many of our clients, given the rules become so very restrictive after age 75.

The changes in April 2006, and over subsequent Finance Acts, have meant that the Alternatively Secured Pension ('ASP') rules introduced under Pensions Simplification do not present an attractive option to most, and is so restrictive as to effectively rule it out for the majority of people who have chosen income withdrawal over annuities (for whatever reason).

We are therefore delighted that the current Government has heeded the concerns expressed by the pensions industry about the current age 75 rules and is prepared to consider alternative approaches, and we welcome the opportunity to respond, via this paper, to the questions as set out in the Chapters of the consultation document.

We have focussed on the Questions in Chapters 3 and 4.

We very much accept there needs to be a fair balance between annuity business and income withdrawal options, and very much want to see a robust, innovative and flexible annuity market. Anything that can be done legislatively to encourage this is to be welcomed. However, we do not feel we are the best body to respond on the Chapter 5 questions, but would very much be interested in the ideas of the Association of British Insurers and other bodies involved with insurance business.

It is fair to say that we have a number of differing views in our industry on the proposals (and in particular the proposal surrounding the taxation of death benefits). However, the relaxation of the position post age 75 will be universally welcome by our members. It is important, however, that time is taken to ensure the system is fair and workable, and that providers and advisers are prepared for the changes.

We suggest that splitting out the key proposals may be helpful here. The manifesto pledge was to rectify the annuitisation issues at age 75. We believe that there is very strong support for the proposals being made to effectively replace the Alternatively Secured Pension with a continuation of Unsecured Pension rules. Debate around the rate at which income can be drawn from age 75 and frequency of reviews is, relatively speaking, just fine tuning, particularly if existing GAD mechanisms are used. Plus allowing any remaining funds following death after age 75 to be paid out as a lump sum less a tax recovery charge of 55% echoes consultation responses made years earlier in connection with the current Alternative Secured Pension regime proposals. In other words, this aspect of the proposals could be implemented relatively quickly.

The proposals for flexible drawdown, whilst in concept are very much welcomed, are much more radical and are a departure from current pensions practice. We believe more consultation time is needed to explore options and the practical and behavioural impact of introducing such a concept. Development of this concept may be better placed in further consultation around the Government's ideas of introducing greater accessibility to pension funds.

Likewise, we believe raising the tax charge on death benefit lump sums paid from crystallised funds from 35% to 55% is not justified particularly as the policy regarding the taxation of lump sum death benefits appears confused and inconsistent. Whilst we recognise that the primary aim of a pension is to provide income, consumers are concerned about what happens to their pension fund – their deferred, hard earned income – following death and the ability to pass that on to their dependants in a fair and equitable way. We would therefore suggest further consultation is launched into exploring policy objectives regarding pension death benefits so that a fair, simple and consistent approach can be developed. This may require radical change but would hopefully result in a sustainable long term approach to death benefits.

As in our response to the recent Treasury consultation on 'Restriction of pension tax relief: a discussion document on the alternative approach', we accept that the economic situation probably requires a cost neutral position to any changes overall (Para 2.10). That said, it is important that a fair balance is found and that any changes to tax rates are based on strong evidence that the desired neutrality is achieved (rather than achieving an increased tax burden through the back door), and do not tilt the balance between the income withdrawal and annuity markets. Pension provision, and in particular privately financed ones like SIPPs, must not be seen as something that can be squeezed for short term income needs. That would be disastrous for retirement provision of the future, and lead to an unworkable tax system long-term.

As a representative body we are committed to ensuring that any tax framework:

- keeps an 'Exempt, Exempt Taxed' model;
- provide a fair balance between the operation of the income withdrawal and annuity options and markets;
- provides a fair balance between the different members who hold SIPPs and SSASs through our member firms, whether small, medium and large fund holders;
- provides flexibility, where it can; and
- promotes good retirement outcomes (Para 2.9) and the principle that a pension fund should provide an income for life.

We think this very much fits into the principles outlined in Box 2.A on page 8, and fully support these principles.

Directly below is a summary of our main points. We then answer the specific Questions.

AMPS would very much welcome the opportunity to provide further information and participate in ongoing consultation to develop the ideas and suggestions arising from this discussion paper. Whilst we note the very short timescales proposed, we think it vitally important the industry are fully consulted on the more detailed proposals to ensure the new regime is fit for purpose. We do not want a flawed regime because changes are rushed in. You also need to give providers adequate time to bed in the new rules and to ensure the processes involved are workable.

Summary

General:

- *We are not convinced that the 'flexible' drawdown proposals as they stand are particularly needed, or wanted by a significant number of scheme members. We think only those few with higher fund values would be potentially interested (and not in great numbers).*

- *Development of the concept of 'flexible' drawdown should be deferred and explored further under wider consultation regarding accessibility to pension fund money.*

- *We would be concerned if the 'flexible' drawdown proposal is seen as a balance for increasing the tax rates on death, and tighter restrictions on 'capped' drawdown. We very much feel that the rules should be fair across the board to all people in income withdrawal.*

- *The treatment of pension funds remaining on death, whether crystallised or uncrystallised funds, or whether death occurs before or after age 75, needs rationalisation and therefore further consultation is required rather than implement a blanket 55% charge on lump sum death benefits paid from crystallised funds.*

Age 75:

- *We very much welcome the proposed change in the rules past age 75.*

- *We do feel, however, that any changes should not be at the expense of those making use of the income withdrawal rules before age 75.*

- *We have no objection to the retention of the age 75 rule for contribution limits and Lifetime Allowance tests, and welcome the extension of the triviality and value-protection option beyond age 75.*

- *We welcome the extension in the interim rules introduced in Finance Act 2010 to ensure those hitting age 75 without vesting do not lose their Pension Commencement Lump Sum (PCLS) entitlement and that this is something that should be extended to the new rules. We are however unclear on what actually is being proposed with regards removing the age 75 limit for PCLS purposes. We do not think it unreasonable that people are required to take benefits by a certain age.*

Death – tax rate and options:

- *We are not convinced that a flat 55% charge is justifiable and consistent with a cost-neutrality principle, particularly for those with the relatively smaller funds (who are less likely to have benefitted from significant higher rate tax relief on build-up).*

- *Possible alternative suggestions are:*

  - *A tiered rate or marginal rate is used (with a possible surcharge after age 75);*

  - *Using a marginal tax rate;*

  - *Uncrystallised funds are brought within the tax charge (with a 25% exemption), with a corresponding reduction of the overall rate;*

  - *Keeping the tax rate at 35% or a rate lower than 55% before age 75, but counter-balancing this by bringing uncrystallised funds within the tax charge (with a 25% exemption); or*

  - *Taxing any lump sum at IHT rate.*

- *IHT should be taken out of the equation altogether if the taxation method is primarily meant to be through a direct recovery tax.*

- *There is strong support to bring back the option of re-allocating funds on death to a nominated pension fund of a beneficiary, as originally introduced with ASP in Finance Act 2004.*

- *We agree that dependants' pensions should be outside any tax charge scope (other than income tax), and outside IHT.*

- *Any tax rate decided upon should be applied across the board, including value-protected annuities.*

Capped drawdown:

- *The fundamental concern is that the flexibility of varying income year-on-year is maintained (and in particular the ability to take 120% GAD, certainly as you can now up to age 75).*

- *We propose that the current 120% of 'basis amount' annual maximum calculation before age 75 is retained.*

- *We suggest that an appropriate maximum rate after age 75 for 'capped' drawdown would be to retain the flexibility of the 120% of 'basis amount' maximum as before age 75, but with the retention of the ASP rule that the post age 75 'basis amount' is calculated based on an age 75 rate (no matter the age).*

- *We are not in principle against a minimum income requirement after age 75 (or any later age).*

- *We have had a number of suggestions as to what the review structure should be. There is an argument for retaining the current 5 year and annual reviews pre and post age 75, as this means fewer changes to systems / processes. There is also an argument that there should be consistency before and after age 75, for example, 3 year reviews throughout. The concern about excessive fund depletion as the member gets further away from age 75 should be limited if the GAD tables continue to cease at 75. In truth, we think the main issue here is simplicity and costs (to providers, which of course are passed on to members)..*

'Flexible' drawdown:

- *If taken forward, we think the rules should allow the MIR threshold to go into 'flexible' drawdown to be measured against retained pension fund values, as well as secured income (that cannot be touched through 'flexible' drawdown).*

- *If MIR is taken forward as an income rather than fund measure (see above), we agree with the inclusion of basic State Pension and additional State Pension counting towards MIR.*

- *We would suggest consideration be given to including other annuities within the MIR calculation, but subject perhaps to a % reduction. Similarly with 'Scheme pensions' provided through money purchase schemes (see below). .*

- *What the MIR is in specific circumstances and what counts towards it (through tables we would suggest) needs to be clear . Adequate time needs to be given for firms to change systems and processes for the new rules.*

- *Our member firms are used to operating complicated procedures and systems. However, it should not be underestimated the potential work, responsibility and system changes this could entail. We are concerned whether firms can reasonably be expected to be ready by April 2011*

- *Operation of the 'flexible' option should be optional.*

- *It must be made clear what the consequences are if a mistake is made in the MIR calculation (particularly with any 'scheme sanction charge').*

- *Consideration needs to be given as to how those members of money purchase schemes who are receiving their pension as a 'scheme pension' will be catered for under the new regime. This could be on a pro-rata basis (as suggested above for non-indexed annuities) or at face value where the funds backing the annual rate are above a prescribed multiple.*

Timescales and further consultation:

- *Whilst we note the very short timescales proposed, we think it vitally important the industry are fully consulted on the more detailed proposals to ensure the new regime is fit for purpose. We do not want a flawed regime because changes are rushed in. You also need to give providers adequate time to bed in the new rules and to ensure the processes involved are workable*.

- *Transition issues need to be considered*.

Responses to Chapter 2: Developing a new tax framework for retirement

A1 (Para 2.17): "The Government welcomes views on the level of appropriate annual drawdown limit for capped drawdown".

AMPS comments:

We have had differing suggestions from our membership on the proposed limits of capped drawdown. Our preferred suggestion is below, but in truth the fundamental concern is that the flexibility of varying income year-on-year is maintained (and in particular the ability to take 120% GAD, certainly as you can now up to age 75).

Before Age 75:

We would propose that the current flexibility of being able to take 120% of the 'basis amount' (being the broad annuity purchasing power of the funds) is retained. We think the flexibility offered by the current rules to vary income over time is a crucial benefit of the income withdrawal rules, and part of that is being able to take slightly more one year due to a member's financial needs and circumstances (and to balance out earlier years where low income is taken).

We have no evidence that the current 120% rule is abused by members. If the Government wishes to add fund depletion protection by reverting to three year reviews before age 75 as a balance to retain this flexibility then we would accept that (although ideally we would not want a change here). But this must be weighted against the cost of administrators changing processes and systems. On balance, we therefore suggest the current 5 year review basis is retained.

If the 100% 'basis amount' calculations used in the current GAD Tables are out of kilter with current annuity rates we accept that an adjustment should be made, provided this is evidence based and an open and transparent exercise consulted upon.

After Age 75:

We would propose that an appropriate rate after age 75 for 'capped' drawdown would be:

- Ø to retain the flexibility of the 120% of 'basis amount' maximum as before age 75, but

- with the retention of the ASP rule that the 'basis amount' is calculated based on an age 75 rate (no matter the rate).

Whilst clearly you will want to base any revisions on actuarial work and guidance, our initial view based on informal actuarial input is that 120% of the current age 75 GAD rate is broadly equivalent to 100% of an extrapolated age 80 GAD rate. This therefore fits with concerns about old people running out of fund as from age 80 onwards the annual cap will start to be restrictive (and even more restrictive if funds are performing more than underlying GAD yields).

This also has advantage of consistency with current regimes and so systems will not need adapting too much. It also means the GAD tables will not need to be extended.

Minimum income requirement:

We are not in principle against a minimum income requirement after age 75 (or any later age), although clearly it adds complexity and administrative work. We do not think it unreasonable that an income must be taken, given the purpose behind tax relief on pensions.

In many ways, if the tax rate on death (before and after age 75) is set at the right level, and a fair level, this will be reflected in the behaviour of the individual. Set the tax rate too high, and people are more likely to want to draw off income as quickly as possible to ensure they get best value. Set too low, and people are more likely to leave funds to roll-up. If a fair rate is set, people are more likely to draw income subject to their needs, but to manage the funds to ensure the funds cover their lifetime.

Review of maximum:

Again, we have mixed views here. In principle it is not unreasonable for the maximum to be reviewed more regularly the older the recipient gets, given the increased risk of fund depletion.

There is an argument to keep annual reviews (as under current ASP rules), and this will mean changes to systems and processes are minimised. Or perhaps less frequent reviews to start, with more regular reviews once certain age thresholds are reached.

However, we think there is also merit in keeping the rules simple, and maybe reverting to a standard 3 year review, before and after age 75. Whilst this would mean system changes, it would get away from the age 75 differing regimes (which is simpler) and we feel the threat of fund depletion as the member gets older is minimal if the GAD tables continue to stop at 75.

Transition:

If the maximum and review mechanism are significantly changed, consideration needs to be given to transition issues (particularly given the suggested start date is less than a year away).

A2 (Para 2.25): "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".

AMPS comments:

'Flexible drawdown model':

We are not convinced this is an option that is particularly needed, or wanted by a significant number of scheme members.

We do not feel that the proposal to introduce a mechanism for members to take all of the excess funds in one go and only pay income tax at their marginal rate necessarily sits with the stated Government policy that the purpose behind a pension scheme is to provide an income in retirement. Whilst we are all for flexibility, we do not think that this will really be an option considered by many, except for those with very large funds, and we wonder if the potential for tax avoidance opportunities has been considered (given the suggestion that tax rates on returned funds on death will be increased).

Generally people in drawdown have chosen not to buy an annuity for a reason. They are unlikely therefore to want to buy an annuity with part of their fund to access the residue, particularly a very specific indexed and inflexible annuity, unless it represents a relatively small amount of their funds.

Looking at quotes on the FSA comparative tables (www.moneymadeclear.org.uk/tables/bespoke/Annuities), it is clear that even taking the lowest suggested MIR in the consultation document of £132.60 a week for a single person under Guarantee Credit, it would take a sizeable fund to secure (after tax-free cash) an indexed annuity to meet that MIR. The comparative tables do not provide for annuity quotes where indexed by LPI, but the nearest equivalent of 3% per annum show that a 60 year old man would need a gross fund of over £200,000 to secure an indexed annuity of around £6,900 per annum. We accept that, at a later age, when state benefits kick in, the funds needed to secure a sufficient indexed annuity will fall significantly, but this is only the funds required to secure the lowest MIR figure quoted.

We think it reasonable to say that people would need to have combined fund values of at least £300,000 to seriously make the 'flexible' drawdown option a consideration. To be attractive, there needs to be a critical mass of 'excess' funds to drawdown upon.

The Impact Assessment quotes 7 million people with personal pension or stakeholders schemes (Para 28). We think it reasonable to say that the majority of people possessing sufficiently sized pension funds to consider this option will be members of Self Invested Personal Pensions (SIPP) or Small Self Administered Schemes (SSAS). The Impact Assessment (Para 27) estimates that providers in total will have to carry out tests against the MIR for 8,000 people a year. We think it highly unlikely that number of people will take up the option.

- We estimate that there are around 440,000 SIPPs in existence (conservatively), based on the June 2010 Pensions Management SIPP Survey. The figures provided here by SIPP Providers give an estimated £49.8bn under management within these SIPPs. This equates to an average SIPP value of around £110,000.

- The full survey can be accessed from the PM website: http://www.pensions-management.co.uk/cp/19/Sippsurvey_0609_online.pdf

- Only some SIPP Providers provided a breakdown of the spread of their SIPP values, but we have figures for about 2/3rds of the number (see Table 5). From the figures provided, only 9.34% of SIPPs had values between £250,000 and £500,000, with 6.15% of SIPPs having values of over £500,000. Extrapolating the figures to the 440,000 figure, we get around 68,000 SIPPs over £250,000 in value, with roughly 27,000 being worth over £500,000.

- Clearly SSAS members need to be added into the figures, and they are likely to have larger funds than the SIPP average, and even within the SIPP figures, there will be people with multiple SIPPs, but even so we do not think the figure of 8,000 a year is realistic based on these figures. We think the likely numbers (after any surge due to initial interest) would be well below this figure. The assumption seems to be that all those with sufficient pension funds to make the option viable will use the option.

Ireland has a similar option to personal pension holders as proposed, and our understanding (from anecdotal evidence) is that this option is not generally used by holders. It might be nice to think you've got the option, but in reality would many people take up the option?

Whilst there is in many ways not a real issue with introducing such a relaxation (apart from the issue of a further move away from simplification), even if not used by many, our concern is that the:

- facility be clear, workable and as simple to administer as possible; and
- introduction of this proposal will be seen as justification for increasing the tax rates on death, and tighter restrictions on 'capped' drawdown.

The rules should be fair across the board to all people in income withdrawal, and not be skewed towards a relative few high fund holders who might, or might not, want to use the option, or as a balance against an option we do not think many will take up anyhow.

We are also concerned that the proposed increase in tax rate on death (55% being suggested) is not justified, and combined with suggestions that 'capped' drawdown maximums will be reduced, will detract from the introduction of more reasonable rules after age 75, which will be welcomed by the majority of people in income withdrawal.

Position past Age 75:

We very much welcome the proposed relaxation of the rules past age 75. We have commented in the answer to the previous question on our suggestions for calculating 'capped' annual maximum after age 75.

We do feel, however, that any changes should not be at the expense of those making use of the income withdrawal rules before age 75, who probably will buy an annuity before then. They currently are the majority of those in income withdrawal.

Tax rate on death:

We recognise there should be a reasonable tax rate to ensure people use their funds in their lifetime to provide them with a pension income.

We are, however, unclear as to why a flat 55% charge is being suggested as necessary, when the object is cost-neutrality. We would suggest this is too high and a blunt rate for those with relatively smaller pension funds (who have not had the benefit of significant higher rate tax relief on build-up). As shown by the 2010 Pension Management survey referred to above, only around 15% of SIPPs are over £250,000 in value.

Whatever tax rate or system is decided upon, it must be fair to all. We also doubt whether a flat 55% tax rate across the board is consistent with the cost-neutrality principle stated in Paragraph 2.10. . This would in effect be a 57% increase for those under age 75 in drawdown, who are currently the majority.

Psychologically, the prospect of losing more than half of your pension fund in tax on death makes income withdrawal very unattractive at outset, even if in reality most funds at outset will hopefully be used to provide an income over life either by drawdown payments or through securing an income via an annuity.

It seems very unfair that a basic rate taxpayer dying with a £100,000 fund pays tax at 55%, the same rate as a high net worth individual with a much larger fund.

A 55% rate could also encourage the use of the proposed flexible drawdown model within tax planning schemes, as the tax take through income tax would always be less (assuming the scheme manages to avoid extra IHT liabilities).

We have had a number of suggestions within our membership. These include:

- Using a tiered rate (with a possible surcharge after age 75);
- Using a marginal tax rate;
- Keeping the tax rate at 35% or a rate lower than 55% before age 75, but counter-balancing this by bringing uncrystallised funds within the tax charge (with a 25% exemption); and
- Taxing any lump sum at IHT rate.

We can see merits to each suggestion, although there are clearly complications to consider with some.

One suggestion which we have had strong support for is that consideration is given to bringing back the option of re-allocating funds on death to a nominated pension fund of a beneficiary, as originally introduced with ASP in Finance Act 2004.

We also would welcome full clarity over pensions and IHT; we suggest that if lump sums are going to continue to be taxed direct that pensions are taken entirely out of IHT (no matter the circumstances). Currently the position is unclear and complicated.

These suggestions and some of the issues are explored below.

Tiered rates or marginal tax rates:

We do wonder whether a tiered tax rate could be applied, although we recognise the problem of multiple scheme membership adding complexity.

This could work by bands. For example, 35% tax on first £200,000, 40% on next £200,000 and 45% on anything above. Clearly the thresholds and rates would need to balance with the cost-neutrality objective and a process developed to administer this to cater for multiple schemes. (One way suggested could be for a flat 35% charge to be deducted by the administrator, with HMRC applying a surcharge on any recipient where the thresholds are breached in total, in a similar way as any Lifetime Allowance charge on death is administered currently, in a proportional manner where there are multiple recipients). Or it could possibly be done through the Legal Personal Representative. Clearly there would need to be work done on this option and further consultation. But we add this as an option to consider.

Alternatively, the lump sum could be taxed at the marginal income tax rates of the member at death, or possibly the recipients.

We have discussed whether with this option we would see it as reasonable that a small surcharge is applied after age 75 (say 10%). This is on the basis that those going beyond age 75 are more likely to be the ones benefiting from higher tax reliefs over their lifetime, and to ensure the spread of tax take over the whole spectrum of pension fund holders is fair this may be something that is needed as a balance. However, this has the disadvantage of perpetuating the arbitrary nature of an age cut off point (.i.e. age 75), which many be opposed on the grounds of age discrimination. This would need to be considered by Government.

Uncrystallised funds:

A number of members have suggested that there is a strong argument for taxing uncrystallised funds paid as a lump sum on death, in a similar manner to crystallised drawdown funds.

Whilst not taxing such lump sums has been a long standing principle of pension tax rules, there is in many ways little to warrant this exemption on policy grounds; it works against the principle that pension funds are there to provide a pension income, as any dependant is strongly encouraged by the tax treatment to take the tax-free death benefit lump sum, rather than secure a lifelong income (that will be taxed), even though their circumstances may better warrant the income route.

We suggest therefore that consideration is given to reducing the overall tax rate on remaining funds on death by including uncrystallised funds in the scope of the tax, but perhaps allowing for a 25% of fund to be paid as a lump sum tax-free (to reflect the fact that the member has not taken a tax-free lump sum in their lifetime from the funds). **But** only on the basis that this counterbalances a lower rate than the 55% proposed, certainly before 55.

Consideration would need to given as to how this impacted with occupational pension scheme provision. Clearly this goes wider than our membership.

A hybrid option would be to only tax where death occurs after minimum pension age.

Inheritance Tax (IHT):

We think this is a good opportunity to take pensions outside of IHT altogether.

A lot of confusion and uncertainty was created by the recent Fryer & Others vs HMRC case, and the existing rules on the interaction of IHT and the ASP rules after age 75 are horrifically penal and complicated.

We think either death lump sum benefits are taxed through (and only by) the IHT system, or not at all, with tax rates within the pensions' framework working instead.

Re-allocation to other members:

We think the Government should look to re-introduce the option of passing on unused funds on death to an arrangement of another scheme member, as nominated by the member, as originally permitted through the ASP rules coming into force in April 2006 (the 'transfer lump sum death benefit' covered in Paragraph 19 of Part 2 of Schedule 29, Finance Act 2004, repealed by Finance Act 2007).

This would be an alternative to payment as a lump sum.

Members choosing ASP generally accepted this option, even though more restrictive than the rules before age 75, and is an option there is genuine support to re-introduce.

We think this has many benefits:

- Ø It helps boost recipient's retirement income without the Government having to give further contribution tax relief.

- It would not count as a contribution for Annual Allowance purposes, so someone with no or low earnings could still receive a significant boost to their pension fund.
- If utilised more people would be less reliant on the state.
- It overcomes the major perceived disincentive to make pension provision for consumers that their pension savings cannot be passed on.

If the Government had concerns about a further 25% being drawn by the recipient from funds received from a deceased crystallised fund then the industry could cope with segmenting the fund in this respect.

This is something our members are used to, as there are a number of occasions where we already have to segregate funds (Protected and Non-Protected Rights, crystallised drawdown funds and uncrystallised funds in phased drawdown, Pre and Post 6th April 2006 drawdown funds etc), and have systems already in place to cope with this. Ultimately of course there is still the Lifetime Allowance to control recipients not getting excessive benefits from inheriting a pension fund.

We see no reason why this should:

- not be possible on death before age 75 also if introduced (with perhaps future credit for 25% tax-free cash if derived from uncrystallised funds); or
- be limited to members of the same pension scheme only (as with the short-lived ‘transfer lump sum death benefit rules’); we do not see why it should not go to any existing money purchase scheme of the nominated beneficiary (provided the scheme is prepared to accept it).

Whilst we do not think this is necessary, if this option was being ruled out purely on lost tax take, we do not think a small tax surcharge being applied after age 75 (say 10%) would be unreasonable..

We think the ability to pay to charity should be retained.

Dependants’ pensions:

We agree that dependants’ pensions should be outside any tax charge scope (other than income tax), and outside IHT (Para 2.22).

Consistency with annuities:

Any tax rate decided upon should be applied across the board, including value-protected annuities.

Age 75 Rule for PCLS and LTA:

We have no objection to the retention of the age 75 rule for contribution limits and Lifetime Allowance tests (Para 2.25).

We welcome the extension of the triviality and value-protection option beyond age 75 (Para 2.25 again). However, it is important that the tax charge on value-protected annuities is consistent with any change to the tax rate on death in drawdown etc, to make the system fair.

We welcome the extension in the interim rules introduced in Finance Act 2010 to ensure those hitting age 75 without vesting (and are automatically put into unsecured pension under the current legislation) do not lose their Pension Commencement Lump Sum (PCLS) entitlement (effectively now having a year to take that entitlement from age 75). We think this is something that should be extended to the new rules, but are not so sure what actually is being proposed in Paragraph 2.25 with the comment about removing the age 75 limit for PCLS purposes?

We do not think it unreasonable that people are required to take benefits by a certain age; pension schemes are all about providing a pension benefit after all. Whilst not everyone's working life will be over by age 75, surely most people's will.

We would not be adverse to an increase to a slightly higher age, but are not convinced an open relaxation is warranted. However, this is not something we feel that strongly about, provided such an extension does not come at the expense of higher tax rates elsewhere (if, for example, it is felt to be a cost, say if this extension is coupled with a requirement not to have to take a minimum – taxed - income from any age).

Scheme pensions:

Consideration needs to be given as to how those members of money purchase schemes who are receiving their pension as a 'scheme pension' (within Paragraphs 2 or 16 of Schedule 28, Finance Act 2004) will be catered for in the new regime.

Specifically whether:

- they can transfer into the new capped (or flexible) drawdown; or
- if not, how they fit into the new death taxation regime.

To sum up, taken as a whole, we welcome the intended proposals. However, we think:

- Further consideration should be given to the tax rate, and the way applied in differing circumstances.
- The flexibility and maximum income levels embedded in the ethos of income withdrawal should not be eroded in the new 'capped' drawdown rules.
- The 'flexible' income withdrawal proposal is likely to be largely irrelevant for the majority; if introduced, the rules need to be clear and fair to those who do not choose this route (or, more likely, do not have the fund size to make this viable). We also think it unlikely the industry will be ready in time for next year.

Responses to Chapter 3: Minimum Income Requirement

Our general comments on the proposed 'flexible' drawdown option have been made previously in relation to the previous Chapter. As mentioned there, we do not think the proposal is really something significant numbers really want or will be used much.

We have therefore kept our comments here to a minimum, with more practical comments / suggestions.

If taken forward, we think the rules should allow the MIR threshold to go into 'flexible' drawdown to be measured as well on the basis of retained pension fund values (that cannot be touched through 'flexible' drawdown). This is something the Irish rules incorporate (as pointed out in Appendix B).

Clearly this would need to be set at a relatively high level to give the protection needed of the member not falling back on the state (as not representative of a guaranteed income that, for example, an indexed annuity would be and that fund clearly could go up and down with investment performance). We would accept whatever level thought prudent and appropriate.

This would have the benefit of opening up flexible drawdown to those with principled objections to annuities, the driver for the ASP reforms in April 2006, and being easier to administer.

There could be different fund levels depending on the member's age.

A.3. (Para 3.9): "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".

AMPS comments:

If MIR is taken forward as an income rather than fund measure (see above), we agree with the inclusion of basic State Pension and additional State Pension counting towards MIR.

We would suggest consideration be given to including other annuities within the MIR calculation, but subject perhaps to a percentage reduction. So allow a percentage of the annual rate of level or with-profits or variable annuities to count (i.e. 70%, or whatever rate is deemed appropriate – clearly again age is a factor, but presumably a table could be drawn up). Requiring a very specific indexed annuity to be secured to qualify for MIR purposes is going to severely limit a member's option in wanting to take up flexible drawdown, and if as successful as you propose, is likely to work against innovation in the annuity market.

Many providers market pension provision to money purchase fund holders through 'scheme pension'. These tend to be taken up by those with the larger pension funds. We think people who have already chosen the scheme pension route (or do so in the future) should be catered for in the MIR calculation. This could be in a similar pro-rata way as discussed above, or be included at full value provided the supporting funds are at least a certain minimum multiple of that annual rate being included (x 20, or whatever is accepted by your actuarial advice and on consultation).

A.4. (Para 3.15): "The Government welcomes views on what an appropriate level for the MIR should be and how the MIR should be adjusted for different ages"

AMPS comments:

We have no strong views on this.

Clearly the higher the MIR level, the less people will be able to make use of the flexibility.

The important issue is that it is clear and the process of checking is not onerous on providers.

A.5. (Para 3.17): "The Government welcomes views on whether a different MIR should be set for individuals and couples".

AMPS comments:

We have no strong views on this. See our answer to the last question.

If a higher MIR was used for couples, it would seem reasonable that the income of the other party be considered too, although clearly that adds complications.

A.6. (Para 3.18): "The Government welcomes views on how often the MIR level should be reviewed".

AMPS comments:

This is not something we feel qualified to give a view on..

This is more of an actuarial consideration.

A.7. (Para 3.20): "The Government welcomes views on how to minimise unnecessary burdens for individuals and industry in the assessment of MIR".

AMPS comments:

What the MIR is and what counts must be clear as must what evidence will be required and who is responsible for certifying MIR has been met..

Our member firms are used to operating complicated procedures and systems. However, it should not be underestimated the potential work, responsibility and system changes this could entail. We are concerned whether firms can reasonably be expected to be ready by April 2011.

The respective balance of responsibility between member and administrator needs to be carefully considered and made clear.

Firms will presumably not be forced to provide the 'flexible' option; it is a business decision for them as to whether they want to go to the expense of changing their procedures and systems to offer it to their members.

What also must be made clear is what the consequences are if a mistake is made in the MIR calculation.

We assume if the MIR had not been secured as thought, that the payment (over and above the 'capped' annual maximum) would be treated as an 'unauthorised member payment'.

If this is the case:

- Presumably any member unauthorised payment charge would be offset by the income tax deducted on the original payment.
- This clearly opens up the scheme administrator to a potential 'scheme sanction charge' (within Section 239, Finance Act 2004) of up to 40% of the excess payment where no funds are retained in the scheme; whilst the 'good faith' provisions of Section 268, Finance Act 2004 will be available where the scheme administrator has made a genuine mistake, this is still a potential big (and expensive) risk to be considered by providers operating the new flexible drawdown option.

It is vital the rules and process are clear and as simple as possible.

AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

About AMPS

The Association is a combination of two former associations from the self administered industry, the Association of Pensioneer Trustees (APT) and the SIPP Providers Group (SPG).

It was agreed to combine the two associations following the introduction of the Simplification and Taxation of Pension Schemes in order for the industry involved in the administration of, provision of and establishers of self administered arrangements to have a single cohesive voice rather than the possible fragmentation of a very professional group of pension specialists.

The Committee is drawn from all walks of the self administered industry and includes pension consultants, actuaries, lawyers and insurance company representatives

AMPS represent approximately 200 member organisations operating or providing services to Small Self Administered Schemes (SSAS) and Self Invested Personal Pensions (SIPP).

It is estimated that in excess of half a million individuals have pension provision in a member-directed pension scheme. SIPP products are suitable for a wide spectrum of the population and the SIPP market continues to experience growth of 20% each year based on data taken from industry publication surveys. Estimates for funds under management in these products are in excess of £50bn.

Employers sponsoring SSAS and SIPP membership are typically family-run businesses, employing up to 100 people, although the membership of these schemes is generally limited to the directors or owners of the businesses and their families.

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Dated:
9th September 2010

Annuity Direct Ltd

Response

To

HM Treasury

August 2010

About Annuity Direct Ltd

Annuity Direct Ltd is one of the oldest firms that has specialised in providing advice for those who wish to generate income from their accumulated pension savings. We are one of less than 300 firms of Chartered Financial Planners and work as independent advisers offering whole of market access to all products available to those who are entering retirement.

We take great care to discuss with clients their attitude to investment risk and the impact which it might have on their income. When discussed in an honest way we find that the vast majority of clients want to ensure that retirement income is guaranteed. There are few who have the risk appetite or funds to be able to face the prospect of a variable income.

We welcome the discussion paper which HM Treasury has produced and the additional flexibility that will be brought to those who are converting retirement funds to income.

There is an aspect of unsecured pension that is not covered in the paper, namely the regulatory requirements for assessing the risk of unsecured pension. The FSA require that what is termed a 'type A critical yield' is calculated. This is defined as the annual return required within the unsecured pension to maintain an annual income equal to that available from an annuity. We regard this as a good way of demonstrating the risk of unsecured pension. However the FSA do need to specify that the annuity rate used is **the best rate available to the client on an open market basis and taking account of any medical condition.** Insurers do not generally do this – preferring to use their own rate which has the impact of severely understating the critical yield and therefore the risk that is posed by drawdown.

Annuity Direct is so concerned that consumers are being misled by drawdown quotes that it has launched a campaign www.fairusp .co.uk. This has been supported by a number of providers and advisers who regard this as a critical issue in giving greater flexibility at retirement.

We encourage HMT to require the FSA to update their guidance on critical yield calculation in order to remove any risk of a mis- selling scandal as a result of the increased flexibility outlined in the consultation paper.

Response to HMT Questions

Developing a new tax framework for retirement

A.1 We consider that the current maximum limit of 120% of GAD rate is not appropriate given the Government's desire to ensure that a client who elects to take drawdown does not fall upon the State. It is also a very arbitrary tool in that it does not take into account any reduction in life expectancy as a result of medical or lifestyle history which will increase the annuity that is available.

There is now a mature market for annuities that are bespoke to a client's life expectancy. We wonder therefore if the maximum should be related in some way to the annuity which the client can purchase at outset and at regular reviews. If this were on an open market basis it would automatically adjust for both the general level of interest rates and also a client's actual life expectancy. We should suggest that scheme administrators should be required to seek an open market annuity quote at outset and at regular reviews and this would mean that the income is based on a client's **actual** circumstances and that this is updated following review. We would suggest that reviews should be annually.

We have no view as to what percentage of the annuity should be imposed as a maximum although we would suggest this should be substantially below 100% in order to take account of the additional investment risk. We are certain that by adopting this approach an actuary could easily produce a risk based model to assess the likelihood of a client running out of funds.

We believe that there is an additional advantage in adopting this route in that it would mean that drawdown providers would have an open market rate with which to calculate the type A critical yield making it an easy matter for the FSA to update its guidance and remove a significant risk of mis-selling.

A.2 The paper suggests that all funds remaining on death will be taxed at 55%. We are concerned that if this applies to annual payments applying to guarantee periods consumers will be disadvantaged as they will be paying a penal rate of tax following death when in the vast majority of cases their premiums will have been relieved at basic rates of tax.

We think that the position of capital protection also needs some consideration. Whilst it is easy to draw the comparison with funds returned from a drawdown fund the majority of people buying annuities have small funds where contributions will have been relieved at basic rate. In these circumstances a rate of 55% seems to be penal.

We wonder if a scaled charge should be imposed on capital protected annuities – basic rate tax up to a certain level and then 55% for larger funds where contributions will have been relieved at higher rates of tax over the years.

Minimum Income Requirement

A.3 In answering this question we have placed a significant emphasis on the word secure. We would therefore suggest that the definitions might be as follows:

1. State pension income from whatever source.

2. Annuity income providing that it has requirement to be increased by the Government's preferred method of inflation for pensions – CPI. In setting the amount the Government might take account of worst case scenario if an annuity provider falls into the compensation scheme – currently 90% of the benefit.

3. The majority of people who purchase an annuity do not include any inflation protection. This is because their pension fund is insufficiently large and as a result they cannot afford to take the income reduction in the early years – which is also when they will be most active. By only allowing an inflation protected annuity a large number of people will have their level annuity excluded. Would HMT consider allowing a percentage of a level annuity to be included which could increase with age?

4. For a final salary scheme the Government would require inflation protection. It might also consider the financial security of the scheme although it is difficult to see how this might be achieved other than through a published list of acceptable schemes.

A.4 We have no strong views in relation to this question.

A.5 We have no strong views in relation to this question.

A.6 We have no strong views in relation to this question.

A.7 We have no strong views in relation to this question.

The UK Annuity Market

A.8 We do not understand why the FSA and the Treasury has failed over many years to require life companies to make the open market option the default option. This results in pensioners losing money and the Exchequer losing tax revenue both from tax on the additional income and also from earlier payment of State benefits.

The FSA have stringent rules if a pension is switched before retirement. It is far from clear that these same rules apply when a fund is switched to generate income. There are a number of issues that should be looked at before an annuity is bought including the availability of guaranteed annuity rates, higher tax free cash, dates on which penalties are removed or bonuses added. Best practice would indicate that these factors are always looked at but we are aware of a number of providers and practitioners who do not look adequately at the ceding scheme. We believe the Treasury should require the FSA to make it clear that it expects switching rules to be applied in all cases where a pension fund is being used to generate income by whatever means.

Introduction

As the leading supplier of pension administration software solutions in the UK, *aquilaheywood* welcome the opportunity to contribute to the informal consultation document on removing the need to annuitise by the age of 75 issued by HM Treasury (HMT) in July.

Details of our response are set out in the following sections. To put our response in context, we have provided the following details about *aquilaheywood* and our clients.

aquilaheywood, the Group comprising *aquila* and *heywood*, is the leading supplier of pensions administration software solutions in the UK. The pension schemes for nearly ten million members in more than 200 major organisations are run using the Group's administration software solutions. These solutions cover the whole range of available schemes including DB, DC, hybrid, career average, cash balance and stakeholder, as well as group and individual products such as group and individual personal pensions including SIPPs, Wraps, income drawdown, flexible retirement and annuity payments.

The Group provides solutions to the Financial Services, Third Party Administration, Corporate and Public Sector pension scheme markets in the UK, Ireland and the rest of Europe. Its clients include Prudential, Aviva, BBC, Asda, BP, Diageo, the European Central Bank, Aon Consulting, Hewitt Associates and most local authority schemes. We also provide software and services in to Central Government, including for the administration of the Scottish Teachers Pension Scheme and the Scottish NHS Pension Scheme.

Executive Summary

The timeframe for introduction does not give schemes and pension providers much scope for communication to members, amending scheme rules or testing systems and procedures.

The removal of the requirement to purchase an annuity or vest benefits at 75 provides individuals with more flexibility but, with the current proposals, this is at the cost of more complexity and an increased administrative burden on schemes and pension providers.

More Detailed Responses

Given our focus on pension administration, we have concentrated most of our comments below on the impact of the proposals on occupational pension schemes and personal pension providers. We will leave others to comment in more detail on the levels of income, how these could vary and what constitutes a secure income.

We support the thinking behind the proposals and feel that removing the need to purchase an annuity at the age of 75 provides individuals with more flexibility around their retirement planning. We also feel that the EET model should be preserved and that tax relief on pension contributions should only be made available to the age of 75.

Our main concerns are around

- the timescales for implementing the changes
- the interaction between performing the test against the lifetime allowance (LTA) and crystallising benefits, and
- the policing of the Minimum Income Requirements.

Implementation Timescales

Pension schemes will have a number of changes to be implemented during the next 18 months, with the restriction of tax relief and workplace pension reforms being required over the same period. In addition many schemes may be required to change the revaluation and indexation basis from RPI to CPI.

With this in mind we support the proposed changes and timeframe, but with the proviso that the impact on pension schemes be minimised. If changes are required to pension schemes then we would prefer a longer timeframe to allow for the implementation of these changes.

To reduce the impact on pension schemes and to allow for the timeframes proposed in the requirement HMT could consider removing the age 75 restrictions in legislation but provide pension schemes with the flexibility to decide whether and when to remove such restrictions. This would allow schemes to phase in the introduction of the removal, allow them to communicate the change to members in more appropriate timeframes and ensure the appropriate systems and procedures are in place for members retiring after the age of 75.

Benefit Crystallisation and Lifetime Allowance Tests

We are concerned about the removal of the interaction between performing the test against the lifetime allowance (LTA) and crystallising benefits. The proposals state the LTA test must be conducted at the age of 75, but pension commencement lump sums (PCLS) and other benefits do not need to be taken until later.

Calculating the maximum PCLS allowed can be complex. Where the member has protection, or there are scheme-specific lump sums, it can depend upon the LTA at the time the benefits crystallise. If the LTA test is carried out at 75 but the PCLS can be taken later, there will need to be clarity around how the maximum PCLS is calculated. Is it calculated at 75, based on the LTA at that point, or calculated at the point it is taken? The same issue would apply to determining trivial commutation limits.

In addition, any value of pension benefits over and above the available LTA is subject to a tax charge which depends on whether the benefits are taken as a lump sum or as income. Allowing the PCLS to be paid after 75 would mean that someone could breach the LTA, but it would not be possible to determine and pay the tax charge until later, as it would not be clear whether the funds were being used for income or for a lump sum.

Additional complexity would be introduced to the process of crystallising benefits after 75. If the value of a pension fund is tested against the LTA at 75 but is not yet crystallised, this means that subsequent crystallisation events will not be tested against the LTA, which means that these processes will need to be different depending on whether the individual is over the age of 74 or not.

We feel that resolving these issues would require the introduction of rules that would be unnecessarily complex. We feel that principle 3, of giving individuals the flexibility to decide how best to take their retirement benefits, can be met more simply by removing the need to conduct the LTA test until the member crystallises their benefits – even over the age of 75. Should the member die over the age of 75 without crystallising their benefits then they should be treated as if they crystallised all of their benefits on the day before they died. Conducting the LTA test at the time of crystallisation keeps the existing link between paying a PCLS and testing against the LTA. This removes any complexities that could be introduced by breaking the link and would allow schemes to retain existing systems and processes and simply remove any age restrictions that may be in place.

Minimum Income Requirement (MIR)

As we indicated earlier, we feel that other commentators are better informed to respond to:

- what constitutes 'secure income'
- at what age the MIR can be met, and
- the level of the MIR.

We do have views on how the MIR should be assessed as this will impact on pension schemes and their members. The process for demonstrating qualification for flexible drawdown should be as simple as possible.

Clarity will be required on how the arrangements being used to provide the MIR will be policed. Will the provider of an arrangement being used to provide the MIR need to know that is the case and ensure that the payments continue to meet the required level? For example, if guaranteed drawdown arrangements ('third-way' annuities) are allowed, would the provider be responsible for ensuring the funds are not transferred to a different provider where guarantees are not in place? This would add to the burden on providers.

I had hoped that we were entering an age that the state would within good sense allow people to do with their pension funds what they wanted.

The changes I have seen proposed so far are very little different from what went before.

Why not allow unused pension funds to cascade through generations on the basis that only income can be taken on funds passed down?

No need for any additional tax charge plus IHT solely IHT where due.

Upon receipt of a pension fund the receiver may be more inclined to invest more, they will in any case have some income thus reducing further liabilities for the state if any top-up pension or benefits would otherwise be required.

Where an individual has a pension fund they should be obliged to take the maximum income allowed before any state benefits are paid to them even if this means initially allowing a very high payment via drawdown rather than a lower payment from the purchase of an annuity.

Like it or not people do not save in pensions fro a number of reasons but I find the main one is the money saved is perceived as being kept by the annuity provider, hence the increase in the use of drawdown.

I appreciate that annuity providers are a main purchaser of Government Bonds and it may simply be that the reality of being in government has come home and that you cannot allow people the freedom they desire in their pension planning. I am also aware you are too afraid to admit the truth hence all the equivalent of moving the deck-chairs yet again in another smoke and mirrors exercise.

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REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75

Executive Summary

The ATT welcomes the proposals within this consultative document.

The availability of capped Unsecured drawdown throughout retirement, without an artificial break at age 75 (or any higher age) will enable greater flexibility in the delivery of pension benefits, with individuals able to match their options more closely to their needs.

Flexible drawdown, the ability to access a greater proportion of the pension pot than permitted by capped drawdown, subject to a minimum income requirement, would enhance the flexibility within the system while retaining safeguards to ensure individuals could not overdraw and become burdens on the state.

Rather than reduce the upper limits for capped USP, in order to guard against excessive fund depletion, our preference would be for reduction in the interval between fund revaluations.

The proposal that all tax charges should be framed in terms of income tax, and that these tax relief recovery charges should do no more nor less than recoup income tax reliefs previously granted, is a sound one. The removal (in all but cases of serious abuse) of Inheritance Tax from all pension death benefits is a much needed reform.

We support the introduction of a single tax relief recovery charge on lump sum death benefits, regardless of age, and agree that this should be set at 55% based upon existing rates of initial tax relief. There will be winners and losers compared to the existing regime, but overall we see the move as beneficial.

Depending upon the implementation of the consultation document "Restriction of pensions tax relief: a discussion document on the alternative approach", the 55% rate will, over time, cease to be the appropriate level to reflect the tax reliefs being recovered. The situation will need to be monitored and, as and when necessary, the rate of the tax relief recovery charge, the Lifetime Allowance Charge, and the charges within the unauthorised payment regime will need to be adjusted appropriately – our suggestion would be an ultimate level of 28% after 30 years.

With regard to death leaving uncrystallised benefits (the "death in service" position), we welcome the government's assurance that no IHT, and no tax relief recovery charges (other than the Lifetime Allowance Charge) will be levied.Retaining 75 as a watershed age, to mark the transition from a "working, funding" life-stage to a

"retirement, benefit-taking" stage, appears to us to be sensible. It makes sense, therefore, to retain at 75 the cut-off age for activities which relate to the "funding" phase (including the Lifetime Allowance test). Equally, it is logical that activities which belong in the "benefit" phase should have no such cut-off age.

The Minimum Income Requirement for flexible drawdown should be set at a single level, with no differentiation between individuals and couples. We see no overall advantage in having age-related MIRs. MIR should be reassessed at least once in the life of each five-year parliament, more frequently if the government identifies a need.

A relatively simple system for administering the release of flexible drawdown funds (in excess of the capped limit) should be attainable. This should require minimal disruption to the providers of scheme pensions and annuities, the Department for Work and Pensions, and the scheme administrators offering capped and flexible drawdown.

Introduction

The ATT welcomes the government's desire to provide greater flexibility in retirement benefits, coupled with its commitment to maintain simplicity of operation as a key principle.

There can be no dispute regarding the underlying factors: longevity is increasing, with the result that a far greater proportion of the population fail to see age 75 as any sort of milestone; defined contribution pensions are taking an increasing role in the provision of benefits; annuitisation, while secure, is notoriously inflexible over time.

The government's proposals seem to us to be sensible and well-envisaged in principle. It is not for us to comment on any detailed operational complexities which they may cause to pension providers. Our comments will be confined to the impact which these proposals will have upon pension scheme members and their families.

Developing a New Tax Framework for Retirement

First of all, we welcome the government's principles as set out in box 2.A, and in particular the continued commitment to the EET principle, with lifetime benefits taxed at income tax rates.

We agree that many individuals will continue to choose an annuity as their best option, even when the effective requirement to do so by a given age is removed.

For those not wishing to take an annuity, the existing transition at 75 between unsecured and alternatively secured pension drawdown is an awkward and unnecessary one. The upper and lower limits for ASP[1], with a narrow scope between 55% and 90% of the GAD basis, currently make ASP too inflexible. This lack of flexibility may currently be steering some individuals into reluctant annuitisation.

The government's proposal that unsecured drawdown should be available throughout the individual's retirement, without an artificial transition age, is very welcome.

The proposal for "flexible drawdown" is very welcome. It recognises the fact that retired people can have more complex financial needs than are provided for by a fixed income. The caveat that a suitable level of guaranteed income should be retained is a wise one, but over and above that "minimum income requirement" there seems little merit in imposing too much restriction on how the retirement funds are drawn.

The introduction of flexible drawdown offers in addition the opportunity to reduce the upper limit for USP without unduly restricting individuals' available options. The current limit of 120% of the GAD basis was set so high in order to offer significant flexibility, and could safely be set so high because the mandatory transition to ASP (or annuitisation) at age 75 guaranteed that a pension pot could not readily be drawn down too severely. With an ability to continue in USP for the whole of retirement,

[1] Inserted by FA 2007 Sch 19, alongside provisions taxing undrawn ASP funds on death, as part of a concerted policy to discourage individuals from remaining in drawdown past age 75.

that protection would no longer exist, and so we agree it would be prudent to have a less generous upper limit for capped drawdown.

The limit should not be set too low, however. One attraction of USP is the ability to enjoy an income level comparable with a purchased annuity while still retaining investment control over the scheme assets. A reduction below 100% of the GAD basis may make USP less attractive.

An alternative to reducing the upper limit might be to reduce the length of the period between revaluations[2]. This would diminish the risk that a USP fund could be drawn down to exhaustion by more frequent realignment of the maximum withdrawal to the reduced funds available.

If anything, ASP as originally enacted[3] was over-engineered for safety, having both a modest upper limit and an annual revaluation: it was mathematically impossible for an ASP fund to be depleted to exhaustion, even with no internal fund growth. It would not be necessary for capped drawdown to be quite so crash-proof – either a modest upper limit or a short reference period would suffice.

Of the two, and for reasons discussed above, we are not in favour of an upper limit less than the GAD basis; equally, considerations of simplification would militate against a one-year reference period for all drawdown throughout an individual's retirement. A suitable compromise period might be three years; this was the length of the reference period for pre-A Day drawdown, and is likely therefore to prove acceptable within the pensions industry.

On balance, we would suggest retaining the limit of 120% of the GAD basis, over a three year reference period.

Designing a New Tax Framework for Retirement

Once again, the ATT welcomes the government's principles as set out in this section, in particular the recognition that (since the tax privileges given to pension saving are essentially a deferral of income tax), any tax charges associated with benefit delivery should also be of an income nature.

We see much merit in the suggestion that a single "tax relief recovery charge" (TRRC) should apply to all undrawn crystallised pension funds which, on the death of a member, are not applied to provide dependant's pension income. The current situation, where death benefits in respect of a member aged 74 years 364 days are taxed at 35%[4] yet those in respect of a member aged 75 years and 1 day are taxed at an effective 82%[5], is indefensible.

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[2] The "reference period" per FA 2004 Sch 28 para 10.
[3] Ibid, para 12, 13.
[4] Special lump sum death benefits charge per FA 2004 s.206
[5] Unauthorised payment charge on the transfer lump sum, per FA 2007 Sch 19 para 5 *et seq* , followed by IHT on the residue per FA 2006 Sch 22 para 4 as further amended by FA 2008 Sch 28 para 10.

Since neither of the two outcomes under the existing law is underpinned by a great deal of logic[6], it would be no great loss to sweep both aside in favour of a more rational charge. The basis of such a charge, as recognised in the condoc, should be no more and no less than the recouping of the income tax reliefs originally made available at the time of funding or accrual, and the tax-free internal growth subsequently derived from those initial reliefs.

The government's suggestion of a 55% rate appears, in this context, to be well-judged. It conforms with the charge[7] on lump sum benefits in excess of the Lifetime Allowance, and with the aggregate of the Unauthorised Payment Charge and the Scheme Sanction Charge[8]. These existing charging regimes serve the same purpose, that of withdrawing previously-granted income tax reliefs together with accrued tax privilege on internal fund growth, and have found broad general approval since their introduction.

There may be objections from various quarters to the concept of a single tax relief recovery charge, based upon the fact that, for individuals dying aged below 75, the effective tax rate would increase by some 57%. However, in the move towards a fairer and more consistent overall regime, there will inevitably be winners and losers. As a counterbalance, we imagine there will be great approval from those aged 75 or more, whose effective tax rate would fall by around a third.... Given that a substantial driver for this proposed legislation is the increasing proportion of the population now living beyond age 75, we consider the case to be amply made.

We are pleased to see the government proposes that – in general – Inheritance Tax should not apply to undrawn pension funds.

In most cases, individuals will have managed their funds to provide an appropriate level of income for their retirement, and they will not have been driven by a motive to shelter capital sums outside the scope of IHT. Any lump sum death benefit available to dependants is regarded as a welcome windfall, and not a pre-conceived objective in itself. In such cases, we consider it is appropriate that IHT should not be levied, and that this principle should apply to all, regardless of age[9].

There will potentially be occasions where individuals may seek to "game" the system in order to shelter capital sums from IHT. Having the tax relief recovery charge set at a rate greater than the IHT death rate will no doubt deter many from such an approach (by the stage of the member's death, the original tax reliefs obtained will be long forgotten, and a 55% recovery charge will look like a direct – and less favourable – alternative to IHT!).

In exceptional cases, for example where individuals have built up significant capital within a pension scheme, minimising drawdown income with a direct motive of

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[6] The 35% charge was imported from the pre-A Day legislation to fill a gap; the 82% effective charge arose from a series of arguably ill-considered amendments targeted at making ASP less desirable.
[7] FA 2004 s.215.
[8] Respectively, FA 2004 s.208 and *ibid.* s.239.
[9] The artificial cliff-edge for IHT at age 75 introduced by FA 2006 Sch 22 only makes sense in the context of a forced, or effectively forced, annuitisation at that age.

boosting the IHT-free funds whilst spending the capital within their free estate, we consider that the Exchequer already has sufficient power to intervene.

IHTA 1984 s.3(3) has long been held to have application to cases where income withdrawal has been deliberately minimised in order to maximise IHT-free death benefits. A letter from the Capital Taxes Office to the Association of British Insurers on 5th June 1991set out a reasonable approach to how and in which circumstances these provisions might be implemented:

> "We would consider raising a claim in such cases as remain only where there was prima facie evidence that the policyholder's intention in failing to take up retirement benefits was to increase the estate of somebody else (the beneficiaries of the death benefit) rather than benefit himself or herself.
>
> "To this end, we would look closely at pensions arrangements where the policyholder became aware that he or she was suffering from a terminal illness or was in such poor health that his or her life was uninsurable and at or after that time the policyholder ... assigned on trust the death benefit of an existing policy or ... paid further contributions ... or deferred the date for taking retirement benefits.
>
> "In these circumstances it would be difficult to argue that the actions of the policyholder were intended to make provision for his or her own retirement given the prospect of an early death. Even then we would not pursue the claim where the death benefit was paid to the policyholder's spouse and/or dependents (that is, any individuals financially dependent on the policyholder). In addition, a claim would not normally be pursued where the policyholder survived for two years or more after making any of these arrangements."

These principles were enacted – for individuals dying aged below 75 – by FA 2006 Sch 22 para 2. We would imagine that extending those provisions beyond age 75 would provide suitable safeguards for most "innocent" individuals, whilst leaving HMRC equipped to deal with the most blatant abuses. Experience will reveal whether any more extensive anti-avoidance provisions are due.

We endorse the government's view that there must be a cut-off age (as the condoc expresses it, a "proxy for the end of an individual's working life") beyond which tax relief on contributions is inappropriate, and we agree that 75 remains reasonable for this purpose. It is possible that demographics may, in the future, suggest a higher age, but at this stage there appears to be little rationale for disturbing the contribution limit.

By similar logic, it makes sense to retain at age 75 the point at which benefits must be crystallised – the LTA test, and with it the lifetime allowance excess lump sum. There are sound reasons for aligning this with the age at which contributions must cease, and so enshrining that age as the watershed between the "pension funding" and the "pension benefits" stages of the individual's life. Similar arguments apply to the short service refund lump sum and the refund of excess contributions lump sum – as both belong within the "funding" stage, it is right that they should not extend beyond the watershed age.

Equally, we acknowledge the sense in removing the age 75 limit from the pension protection lump sum death benefit and annuity protection lump sum death benefit, the pension commencement lump sum and the lump sums associated with trivial commutation. Since all of these relate to the "benefits" phase of the individual's lifetime, it is appropriate that they should become fully flexible in line with the removal of the age 75 limit for annuitisation.

Finally, we welcome the confirmation (in paragraph 2.22) that death benefits where the individual dies aged below 75 without having accessed their pension savings will remain free of tax relief recovery charges. This tax-free "death in service" benefit is a much-valued component of the pension regime.

While this is not explicitly stated in the condoc, we would envisage the potential application of IHTA 1984 s.3(3) to individuals who died aged 55 or more with uncrystallised funds no less than to those who had already taken the pension commencement lump sum. For the avoidance of doubt, we assume the government agrees that s.3(3) could not ever apply where the individual died below the age at which benefits could be crystallised.

Interaction with Other Current Consultation

The comments in the above section are predicated on the regime for tax relief on pension contributions and accrual remaining at its current state (which is to say without the proposals in FA 2010 Sch 2 coming into force).

The position will, however, be different should the proposals in the consultation "Restriction of pensions tax relief: a discussion document on the alternative approach" be enacted.

The rationale for a tax relief recovery charge set at 55% derives from a regime where tax reliefs are available at marginal rates of up to 40%. The same rationale applies to the Lifetime Allowance Charge (LTAC), and to the aggregate of the Unauthorised Payment Charge (UPC) and Scheme Sanction Charge (SSC). As all of these mechanisms are designed to recover tax relief previously enjoyed on contribution or accrual, and on subsequent internal tax-free growth derived from that tax relief, it is important that the rate of the recovery charge is appropriate to the rate of the tax reliefs.

In its response to that consultative document, the ATT proposed an alternative approach which would result in *all* tax relief (regardless of the individual's marginal tax rate) being at the equivalent of the 20% basic rate of income tax.

While we would urge the government to adopt our proposal, we acknowledge that the more likely outcome of that consultation will be a system where some contributions/accrual will enjoy 40% tax relief and others will be denied all tax relief.

Of course, we cannot rule out the possibility that the FA 2010 Sch 2 provisions (with all their flaws) will, *faute de mieux*, be permitted to come into force. Under these provisions, some contributions/accruals will enjoy tax relief at 40% while others enjoy relief at only 20%.

Whichever of the three approaches has sway from 6th April 2011, it is clear that the overall average rate at which contributions and accruals are relieved will fall. The precise mix is unknowable, but it would not be unreasonable to predict that the average rate of tax relief will approach 20%.

On that basis, it is clear that a TRRC which "recovers" that tax relief at a rate of 55% is excessive and penal. If a 40% relief regime implies a TRRC of 55%, logic suggests that an effective 20% relief regime would call for a TRRC in the order of 28%.

Matters, however, are not quite that simple.

For an individual whose entire accrual of pension rights is post-2011, the lower rate of TRRC would be appropriate; for an individual whose entire accrual was pre-2011, the 55% TRRC would continue to be appropriate. But what of an individual with pre-2011 accrual who continues to accrue benefits post-2011? Over time, the average tax relief inherent in that individual's pension pot will gradually decline, moving asymptotically towards 20%.

Dealing with this process poses, as so often in pensions tax, a conflict between precision and simplicity. In that conflict, the ATT's sympathies lie with simplification.

One possible route would be for pre- and post- 2011 accrual to be kept separate, and for a separate rate of TRRC to apply to each. That would, we suggest, not be the ideal approach: pension schemes are already required, for DWP purposes, to keep separate records for pre-1987 and post-1997 accruals; to add a further segregation category would be excessive.

Neither would it make sense to adopt a reduced TRRC rate immediately on 6th April 2011, when the reduced rates of tax relief became available. That would have the effect of sparing all pre-2011 accrual from the full economic rate of recovery, and would therefore represent a significant and avoidable cost to the Exchequer.

In our opinion, the lesser evil would be to maintain the current level of TRRC (along with LTAC, UPC and SSC), at least for the immediate future. This would mean that individuals with no pre-2011 accrual would be suffering recovery of tax relief at a (significantly) higher level than the relief had actually been received. This might at first blush seem to be inequitable.

However, the simple fact is that most individuals do not see the receipt of tax relief on contributions (and certainly not the tax relief on accrual) as being directly related to the tax charges which arise on death, or on crystallisation of benefits above the LTA, or on unauthorised payments.

In addition, the instances in which the TRRC and other charges are levied are relatively few. In blunt terms it is likely, in the first few years after 2011, that the individuals dying (and so being exposed to the TRRC) will in the main not be those with only post-2011 accrual. The actual incidence of unfairness will, in practice, be very limited in the early years.

Maintaining the 55% level initially would, therefore, represent a relatively "painless" saving to the Exchequer.

After some years have elapsed, it will be appropriate to rebalance the TRRC etc, to match more closely the effective level of reliefs which are being recovered. As time passes this will become a more pressing need, as the proportion of individuals subject to a TRRC but having only post-2011 accrual will increase.

How precisely this should be done (for example by an immediate one-off reduction or by a progressive series of steps) is a question for future discussion, but we urge the government to keep the matter under review and, at the appropriate stage, to reduce the TRRC to 28%.

One possible approach might be to have 28% as an aspiration for, say, 30 years from now – it is not unreasonable to assume that, by that stage, the vast majority of scheme members will have little or no pre-2011 accrual. The transition between the two rates could be managed by reducing the rate by 9% every ten years, a rate of change which would approximate to the change in the overall mix of accrual within the population.

<u>Minimum Income Requirement</u>

First of all, the concept behind MIR appears to us to be sound and laudable. Individuals who can demonstrate that they will not be able to exhaust their pension savings prematurely and subsequently fall back on the state should be able to access those savings in a more flexible manner than via an arbitrary upper limit.

This is especially pertinent in the context of the EET model – since any withdrawals will be taxed as income (and, when spent, will presumably incur VAT), the Exchequer has no interest in forbidding them, above and beyond the preservation of a secure minimum income going forward.

<u>Secure Income</u>

The proposal that the definition of secure income should be limited to pension income is not unreasonable. Some individuals might argue that, if they can demonstrate sufficient other income to prevent their becoming a burden on the state, there should be nothing to prevent their withdrawing all of their pension funds. We can see why the government rejects this reasoning – there is no guarantee that the other income would continue. Equally, we can see why the definition should only include income actually in payment, guaranteed for life and subject to reasonable index-linking.

Based on the above, the proposed list of acceptable secure income appears reasonable. In particular, we welcome the indication (footnote 13) that the government will look into how flat-rate annuities and pensions might subsequently be considered for inclusion within the secure income regime. Until such consideration has been given, the basic requirement for escalation/indexation at a rate of at least LPI certainly looks to provide the required certainty.

As regards setting a level for the MIR, we do not feel able to offer any suggestions, other than to comment that the research included in the condoc appears to be a sound basis on which to proceed.

We do not believe that it would be appropriate for the MIR applicable to an individual wishing to release funds from a pension pot to be computed on separate "individuals" and "couples" scales. The MIR for a couple would appear, from the sample data provided in the condoc, to be anything from 10% to 33% greater than that for an individual. It might at first blush appear prudent for a married pensioner to compute his MIR based upon this higher level. However, as noted in paragraph 3.17, income is secured once and irrevocably, and the marital status of the pensioner is not similarly set in stone, so why should it not be equally prudent for a currently unmarried pensioner to compute his MIR on the higher level?

Provided the level of MIR is set properly *ab initio*, there should be no need for separate individual/couples scales. The income set aside, even if only one secured pension is being drawn on, should be enough to maintain the individual, whether in marriage or not.

Adjusting the MIR for different ages is potentially a complexity too far. We can see the superficial attractiveness of having a sliding scale, perhaps calculated actuarially and running in the opposite direction to the GAD basis scale, so that an individual entering flexible drawdown at age 60 would need to secure less income than one entering at age 70.

However, maintaining such a scale would be a far more onerous and complex task than maintaining the GAD tables, where the only variable is long-term gilt yield in 0.25% increments. Either the MIR table would need to be massively complex, showing age-related figures for each of a wide range of potential baseline MIRs, or a less complex table would need to be recomputed each time the MIR was changed. We doubt whether the modicum of additional "precision" which such an exercise might add to the process would be worth the loss of simplicity.

On the whole, our preference would be for a single MIR to be set, sufficient to meet the minimum income need of a 55-year-old. While individuals adopting flexible drawdown at higher ages might well be securing more income than they strictly need, this is at least a structural simplification which errs in the right direction.

How frequently MIR needs to be reviewed will depend to a large degree on the behaviour of the economy. If living costs rise suddenly and sharply, the MIR could move out of step with the economic realities which it is designed to reflect; in such circumstances, it might be prudent to review as frequently as annually. That would be for the government to decide. It would, however, be prudent to ensure that MIR was reviewed no less frequently than once in the life of each parliament, and to provide for that mandatory review in the legislation.

How the MIR Should be Assessed

The role of administering flexible drawdown will fall upon the scheme administrator of a pension scheme providing capped drawdown. The administrator would have a duty to satisfy himself that adequate secured income was in place to meet the MIR. We do not see that this would necessarily prove burdensome.

The Department for Work and Pensions currently provides individuals with details of their entitlement to the basic state pension and state second pension. It may prove necessary for the format in which that information is supplied to be redesigned in order to provide a clear and straightforward "certificate" which can be lodged with the scheme administrator.

Similarly, annuity providers could be required to produce a certificate verifying the level of the annuity and the terms under which it is either escalated or index-linked. This would only need to be produced once, either at the time of issuing the annuity or – for annuities already in payment – on demand. The same considerations would apply to pension schemes paying out an indexed or escalating scheme pension.

The individual should then be in a position to provide his scheme administrator with sufficient certificates to vouch the necessary level of secured income. From the scheme administrator's viewpoint, the process of paying out flexible drawdown sums in excess of the capped limit should be binary – either sufficient certificates have been produced, in which case the funds are released, or they have not, in which case no funds are released.

HMRC should operate a "light touch" on pension providers in this regard. As long as the scheme administrator has taken reasonable steps to satisfy himself of the existence of sufficient secured income, there should be no sanctions against the administrator for releasing the flexible drawdown funds.

Conclusion

This consultation represents a welcome move towards simplification, flexibility, and the unification of pension benefit rules across the whole of an individual's retirement.

The proposed measures appear likely to offer individuals an increased freedom to plan how they take income in retirement.

The measures include sufficient inbuilt safeguards to ensure that individuals will not, through excessive drawdown, risk becoming a burden on the state.

The balance between fairness and precision on the one hand, and simplicity on the other, seems to be appropriately set.

The practicalities of implementing these provisions do not appear likely to impose a significant additional burden on pension scheme members or administrators.

The concurrent consultation on restricting tax relief will have an effect on these provisions; while the impact will not be immediate, the government will need to keep the matter under review.

The interaction between this consultation and that on "restriction of pensions tax relief" will need to be considered, as the level of charges to claw back tax reliefs will, over time, become out of proportion to the level of the reliefs actually given.

Note

Founded in 1989, the Association of Taxation Technicians (ATT) is the leading professional body for those providing tax compliance services and related activities in the UK. Our members are qualified by examination and practical experience to assist individuals and businesses in complying with their tax obligations.

The primary objective of the Association is to provide an appropriate qualification for individuals who undertake tax compliance work. Those who meet the membership requirements have their qualification recognised by use of the title of 'Taxation Technician' and the designatory letters 'ATT'.

The Association now has over 10,900 members, affiliates and registered students.

Aviva's response to HM Treasury consultation:
"Removing the requirement to annuitise by age 75"

Introduction

Aviva provides peace of mind for more than 50 million people across the world, protecting their families and possessions and looking after more than £380billion to help our customers save for the future.

More than 20 million customers rely on us in the UK – one in three of the population – and we are one of the leading providers of long term savings in Europe, providing annuities and drawdown in the UK to help our customers manage their income in retirement. Our 54,000 employees are committed to understanding our customers' needs and responding to them, and we have one of the largest programmes of customer research and engagement in the industry.

We support the Government's initiatives to offer savers more freedom to use their savings and assets in retirement to best match their income needs. Aviva's first Real Retirement Report (published May 2010) shows that individuals increasingly view retirement as a process rather than an event.

Historically, retirement has been perceived as a definite point in life when a person gives up work permanently, but just 35% of all UK adults (aged 16 and over) still hold this view. For the majority it means many other things; for 20% it is the day you give up your main career even if you are moving into part-tirement, and for 14% it is when you start to wind-down and think about giving up work. 11% think it is the day you give up all work, paid and unpaid.

Today's retirees experience different working patterns and income needs throughout their later years than previous generations. Offering people freedom to use their assets when they need to will therefore ensure the retirement income framework reflects the realities facing future generations of retirees.

Our customers indicate a strong preference for guarantees and a secure index linked income for life (similar to those supplied more commonly in the past by final salary pensions). However, these can appear less affordable to customers looking for a higher initial return and so many customers choose income drawdown and take on more investment risk in an attempt to secure a higher income.

However, for the majority of pension savers, an annuity is likely to remain the most appropriate use of their fund to secure an income, and the introduction of the Minimum Income Requirement seems a pragmatic way to ensure customers are able to maintain a suitable income level throughout retirement while offering greater flexibility to those who have sufficient assets.

Developing a new tax framework for retirement (Chapter 2)

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

The consultation paper rightly recognises that the risk of running our of funds during drawdown increases with advancing age. Aviva agrees that, as capped drawdown will be available both pre- and post-75 after April 2011, the existing cap of 120% of the value of an equivalent annuity should be reviewed.

We believe a more conservative limit should be applied, to help ensure customers' retirement savings are never entirely exhausted. To ensure a competitive market between annuities, other retirement income products and capped drawdown, an annual drawdown limit for capped drawdown should be broadly similar to the amount the retirement fund could buy on the open annuity market. In practice, for customers with larger pension funds, a portfolio of all these products is likely to be suitable.

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.

The proposed changes do not seem to fundamentally overhaul the tax position of savers at retirement – they will continue to get tax relief on contributions and investment growth and pay tax on pension income, however that is provided. However, some of the changes do pose questions about the new tax levels for some retirees.

The tax charge on death lump sum payment before age 75 will increase for those who have started to take benefits, from 35% to 55%. This higher tax rate may be balanced by the reduction in the tax charge on death lump sum payment after age 75 from [potentially] 82% to 55%, by creating a standard tax rate at all ages. The new rates seem a good compromise for higher rate tax payers but may be less reasonable for those who received tax relief at basic rate throughout their working life.

Value/capital protected annuities were developed to provide some protection for customers who wished to offset the risk of dying soon after taking out an annuity and so failing to realise much benefit from a lifetime of pension savings. These products had a limit of age 75, and while we would assume this limit is also scrapped, there is no reference to these products specifically within the consultation and we would welcome and explicit statement on their future.

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.

Individuals increasingly enter and move through retirement with a broad range of savings, investments and assets, not relying solely on state, occupational or individual pensions. Aviva's third Real Retirement Report (published September 2010) looks at the variety of sources of income in retirement. The largest source is state pension and benefits (24%), followed in order of importance by employer pensions (16%), personal pensions and annuities (15%), wages/earned income (13%) and investments/savings (12%).

The range of income types that should be considered 'secure' for the purposes of the MIR should therefore be as broad as possible. This should include state pension, any other occupational pensions, annuities, any other guaranteed investment income, and guaranteed incomes from court settlements or trusts

We have considered whether it would be suitable to include salary, particularly to allow customers under state pension age to access flexible drawdown by including salary towards the MIR, before the salary is replaced by the state pension when they meet state pension age. However, it seems incredibly difficult to verify the stability of earnings when checking MIR, and there may be cases where someone in work on a salary over the MIR takes all their flexible drawdown benefits, then leaves the workforce with no salary, and no pension pot to purchase an income.

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

Aviva agrees that the Minimum Income Requirement should be set at a level that protects individuals from poverty should they use all their other assets (either for consumption or meeting the costs of long term care).

Promoting consumer choice and flexibility recognises the changing patterns of retirement, but in reality only 4% of retirees buying an income from Aviva have a pension fund that is large enough to buy them an income greater than the level of Pension Credit. Many savers will therefore fall outside the Minimum Income Requirement regime and we expect annuities to remain the most appropriate retirement income product for many retirees.

Aviva would suggest a panel of actuaries and poverty experts agrees the MIR. The consultation refers to a range of poverty measures, which largely settle on an income of about £150 per week - £200 per week as a suitable basic standard. A scientific, consensus view would be welcome in agreeing a specific MIR that genuinely reflects a level of income which would allow a suitable basic standard of living, but a suggested MIR of twice the Basic State Pension seems a good rule of thumb.

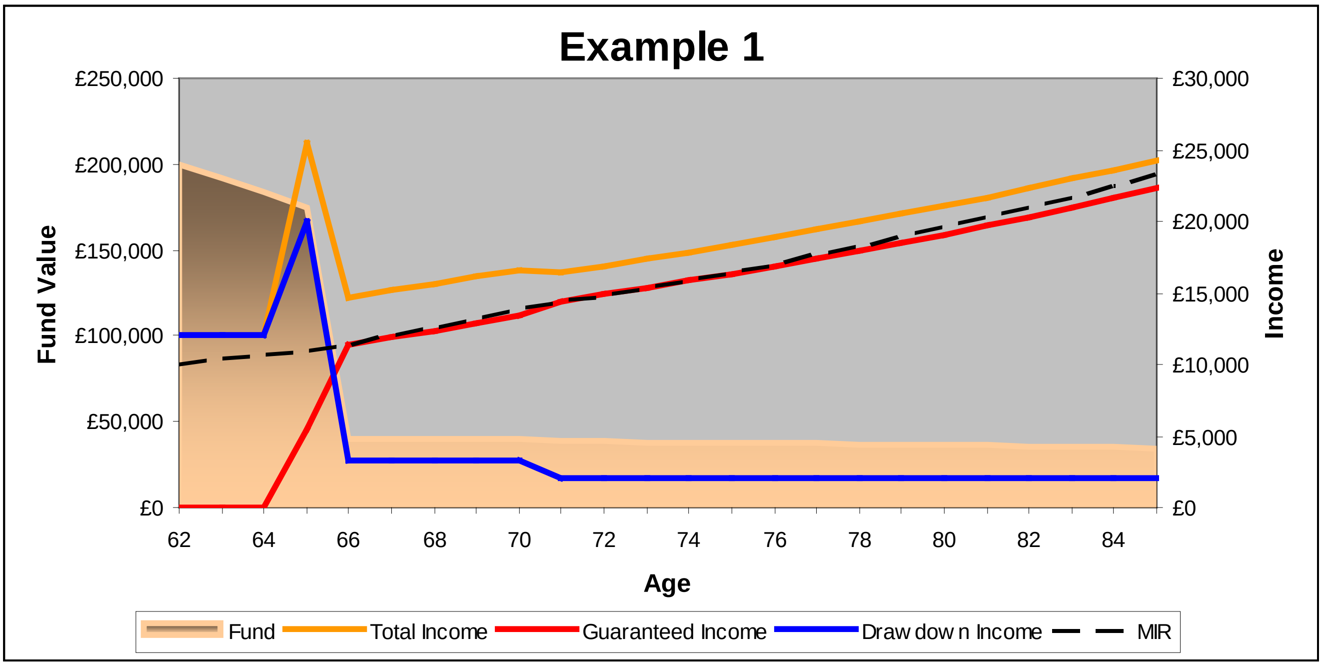
Whatever the level set, the Government may attract criticism for those who have no private savings yet fall under the MIR due to the levels of state support they receive. The MIR should therefore be positioned as a suitable income needed to achieve an active and moderately comfortable lifestyle, with the basic state provision contributing to this by providing a subsistence level safety net. A MIR of perhaps twice the Basic State Pension might therefore seem reasonable to both keep people out of poverty, but also to help people maintain a good living standard through retirement.

Aviva believes a person's compliance with the MIR should be checked whenever they access flexible drawdown benefits. As this could be at any time throughout retirement, we do not believe there is a need to set different MIRs for different ages. Although it is recognised people's income needs tend to dip in mid-retirement, and rise again in late retirement to meet healthcare needs, this will be reflected by smaller or less frequent use of flexible benefits and the MIR should not be complicated by attempting to reflect expected variations in expenditure across such a diverse population.

Alternatively, customers could buy an index linked income (this would cost more at outset than a level escalation of income) but the customer would only need to have his MIR checked at the outset of his flexible drawdown product.

Note – the graph overleaf shows a hypothetical customer journey through retirement, illustrating how the customer can combine guaranteed income and flexible drawdown, and the impact on the fund. We have used this to help our considerations regarding how the MIR may increase and be reviewed throughout a customer's retirement. We have explored many different scenarios including those for couples and customers suffering ill health. The details of these examples are included in the appendix, and we would be happy to discuss these in greater detail with the Treasury.

The graph refers to Example One in the appendix, based on a man aged 62 with a personal pension fund of £265,000. He has taken tax free cash of £65,000 leaving £200,000 which he has placed into an income drawdown contract.



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

Although the state pension system differentiates between single and couple households, Aviva would suggest that the MIR should be set for individuals. This would largely be for practical reasons, to ensure couples maintain adequate income levels despite changes in circumstance particularly separation or bereavement, where one partner has not assured income for the other partner.

If a ‘Couple MIR’ was set, and a couple secured this level of income and went on to draw down all spare funds and then separate, it would not be possible to then use this income and a top up to meet the value of two ‘Individual MIRs’. Admittedly this may be a rare occurrence as largely it would seem that those accessing flexible drawdown would be expected to be the relatively well off, but this context should be considered.

We would note that not reflecting the state pensions recognition of single / couple households may undermine the case for linking the MIR to multiples of the basic state pension.

Aviva would also suggest the couples be allowed, but not obliged, to share their MIR requirement. Realistically members of most couples will retire at different times and this allows maximum flexibility.

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

It would seem sensible to review the MIR annually to ensure it reflects rises in the cost of living drawn from a range of measures (for example, inflation, RPI, and CPI.) This would support Aviva’s conviction that it is appropriate to check whether a person has met the MIR whenever they take flexible drawdown to ensure the relevant level is maintained.

If the MIR is linked to the Basic State Pension, it would automatically update in line with changes to the Basic State Pension. The relative value of the Basic State Pension as a proportion of expected minimnum income required to achieve a comfortable living may decline over time. In this case, the MIR should be reviewed and the multiple of the Basic State Pension it represents should be increased by an appropriate factor.

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

To access benefits at any time, the customer should be able to provide to the drawdown provider some form of certificate stating the level of income they receive. We believe the most efficient way of producing this would be to draw on HMRC data to produce a combined certificate showing the various sources of income the customer receives (including state pension, annuity income, investment income and other payments from occupational schemes or other settlements). Drawdown providers would check this against current MIR levels, and keep a copy for their records.

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.

Customers under state pension age wishing to access flexible drawdown may have to purchase an income for life. This would put them well over the MIR once they start receiving state pensions are paid, as it is not permitted for lifetime annuities to reduce except in very limited circumstances, or stop at all.

Altering short term annuities to allow the period payable to run from purchase up to state pension age (removing the 5 year rule), or allowing something similar to a ‘bridging pension’ on scheme pensions which stop when state benefits become payable would introduce greater flexibility for these customers. Alternatively a reducing lifetime annuity could provide the minimum income required immediately, reducing when added to state pension payable from a future point.

Additionally, Aviva would make two suggestions to increase flexibility around the use of residual annuity pots on death. The consultation focuses on making the payment and taxation of death benefits more consistent no matter what point the customer dies, in particular, removing the age 75 limit for Annuity Protection lump sums (and presumably Pension Protection lump sums and Defined Benefit Lump Sum Death Benefit although these are not specifically mentioned).

This would be an improvement over the current ‘cease at 75’ option as the value of having a lump sum option is eroded if it gets removed at an imposed date. There are two related aspects to this:

1. *Tax free lump sum on death after annuity purchase, as long as the value is used to provide a dependants pension.*

Although this has always been part of USP rules, it does not currently form part of post annuitisation rules and is not mentioned in the consultation document. However to provide a more even playing field between the surety of an annuity and the flexibility of USP, allowing the same options for lump sums available on death as well as the same taxation treatment would be beneficial. It would also go some way to making capital protected pension annuities more attractive, as it would be an alternative to buying a spouse’s pension up front where some of the fund is remaining.

2. *Bring back commutation of guaranteed periods and add the dependant's lifetime annuity purchase as an option here too*

Currently, if an annuity customer dies, providers can only pay any remaining protected payments as a lump sum if death occurs before 75. Allowing guaranteed periods of up to 10 years to be commuted, subject to equivalent charges on the lump sum paid, at any age would be fiscally neutral to HMRC and allow customers more flexibility. Alternatively, the rules could allow the use of the 'commuted' fund to purchase a dependant's annuity (a smaller annuity for life rather than a larger annuity just for the guaranteed period). Ideally, if the rules were changed, we could at any point provide the choice of:

- Lump sum taxed at an appropriate rate
- Continuation of pension for remaining guaranteed period subject to PAYE
- Lump sum tax free applied to purchase a dependants lifetime annuity

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.

Most of Aviva's annuity customers purchase their annuity long before the age of 75. In 2009, over 50% of our new annuity customers purchased at 60 or below, nearly 40% between 60 and 65, and only 4% at age 70 or above. It is likely that the removal of the age 75 trigger in itself should have little impact on those buying an annuity. Rather, it will be removing the ability of advisers and providers to use the 'default' option of annuity purchase as a trigger that may mean savers do not make an active choice about using their retirement savings.

Aviva has invested much effort in improving the information and support customers receive as they approach retirement. We provide clear and simple information to customers approaching retirement including a clear headline message flagging the customer's option to shop around for an annuity, a clear reference to assistance from the Pensions Advisory service, and a clear indication of what happens next, what the policyholder needs to do and where they can get help if they need it.

We have also invested a significant sum in promoting the benefits of shopping around for an annuity. This focus on improving customers 'at retirement' options will continue after the requirement to purchase an annuity by age 75 is removed in April 2011.

However, the challenge of encouraging people to take appropriate decisions about their finance at any lifestage remains. An increasing number of people approaching retirement or at pension maturity have no IFA, so many pension and annuity providers offer telephone based help and guidance, or regulated advice teams to help customers approaching and at the point of retirement. Customers can also access help and guidance about their options online, using tools to help illustrate the different annuity options, explain what they are and the different effects on the expected level of income.

Aviva believes bodies such as CFEB will play a crucial role in helping people understand their options. However, information alone is not enough and we are keen to work with government and regulators to explore ways that the industry can help provide simple advised and non-advised services in a commercial setting to help customers move from understanding to action.

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.

Over the next ten to fifteen years, we would expect the annuity market to grow as more people enter retirement, and there will be a greater proportion of retirees having defined contribution pensions. Combined with greater capital requirements, it may prove harder to obtain the appropriate assets to back annuity business to provide competitive levels of income. Allowing a broad range of income sources to count towards the MIR would therefore ensure annuities are available to those who most need the financial security annuities can provide.

The proposals may dramatically increase the volume of index linked annuities being purchased, From a regulatory point of view, the assets required to back these sort of those products are scarce, and a significant increase in demand could cause them to become more expensive and reduce the annuity rates that customers receive.

For more information or to discuss any of the points raised in this response, please contact Katy Litt on 01904 452548 or katy.litt@aviva.com

Removing Requirement to Annuitise by Age 75 – Minimum Income requirement Examples

Example 1

James Williams is aged 62 and is a recently retired Accountant. He is single. He had built up a personal pension fund of £265,000. He took tax free cash of £65,000 leaving £200,000 which he placed into an income drawdown contract.

The current Minimum Income Requirement (MIR) is £10,000. For a 62 year old male the current cap on income drawdown is 7.2% of the fund i.e. for James it will be £14,400 p.a. However he only intends to take an income of £12,000 p.a. which is below the cap and so the MIR does not bite.

By the time James reaches age 65 his drawdown pot is now only worth £175,000. The current cap is now £14,000, still above the £12,000 a year he has been taking. However, James decides that he wants to take out £20,000 in income over the next year, as he wants to fund some repairs to his house. This is above the cap and so the MIR needs to be checked.

The MIR is now £11,000. James is now receiving the Basic State Pension of £5,500 p.a. and so only needs to secure an additional income of £5,500 increasing at 3% p.a. The cost of purchasing an annuity for £5,500 increasing at 3% p.a. is currently £114,500.

The cost of purchasing the annuity plus the income taken from his drawdown policy leaves him with £40,500. The cap is now £3,250. James takes the maximum amount from his drawdown policy subject to the cap. His total income is therefore £14,250 p.a. (£3,250 from income drawdown, £5,500 from his annuity and £5,500 from the State Pension).

By the time James reaches age 70 his drawdown pot is now only worth £40,000. The current cap is now £3,700, still above the £3,250 a year he has been taking. However, James decides that he wants to take £7,500 in income over the next year. This is above the cap and so a further MIR check is required.

The MIR is now £14,000. James guaranteed income is now £13,375 (£6,375 from the annuity and £7,000 from the state pension). So only needs to secure an additional income of £625 increasing at 3% p.a. The cost of purchasing an additional annuity for this amount is currently £11,000.

The cost of purchasing the annuity plus the income taken from his drawdown policy leaves him with £21,500. The cap is now £2,000. James takes the maximum amount from his drawdown policy subject to the cap. His total income is therefore £16,000 p.a. (£2,000 from income drawdown, £7,000 from his two annuity policies and £7,000 from the State Pension).

Example 2

George Smith is aged 65 and is a recently retired self employed Architect. He is married to Sarah, who aged 58 and still working. Sarah is the member of her company's Final Salary scheme and is due to retire at age 60. George has built up a personal pension fund of £200,000. He took maximum tax free cash of £50,000 leaving £150,000 which he placed into an income drawdown contract.

The current Minimum Income Requirement (MIR) is £10,000. For a 65 year old male the current cap on income drawdown is 8.0% of the fund i.e. for George it will be £12,000 p.a. However he only intends to take an income of £10,000 p.a. which is below the cap and so the MIR does not bite.

George is also in receipt of the Basic State Pension of £5,000 p.a.

By the time George reaches age 67 his drawdown pot is now only worth £120,000. The current cap is now £10,200, still above the £10,000 a year he has been taking. However, James decides that he wants to take out £30,000 in income over the next year, as he wants to fund a cruise for Sarah and himself. This is above the cap and so the MIR needs to be checked.

As George's only guaranteed source of income is the Basic State pension, which is now worth £53,000 p.a. the MIR would bite. However, Sarah has now Retired and her total pension is £15,800 p.a. (f£10,500 for her Final Salary scheme and £5,300 for the Basic State Pension).

As a couple their total guaranteed income is £21,100, which is above their combined MIR of £20,400. Therefore, George will be able to take an income above the cap without having to purchase an additional annuity.

The impact of taking this level of income from his drawdown policy leaves George with £90,000. The cap is now £7,700. George takes an income of £7,500 from his drawdown policy which is less than the cap.

As a couple their total combined income is now

George's Income from Drawdown	£ 7,500
Sarah's Final Salary Pension	£10,500
George's State pension	£ 5,300
Sarah's State pension	£ 5,300
Total	£19,150

Unfortunately by the time George is aged 68 he has got divorced from Sarah. His drawdown pot is now only worth £82,000. The current cap, for an individual, is now £7,200, which is less than the £7,500 a year he has been taking. The MIR, for an individual is £10,800. His basic State pension is £5,400 and so he needs to secure an additional income of £5,400 p.a. if he wishes to take an income above the cap. The cost of purchasing an annuity for £5,400 increasing at 3% p.a. is currently £110,000.

Therefore, George has the choice of reducing the level of withdrawal from his drawdown contact or annuitising.

Example 3

Jane Smith is aged 62 and is retired. She is divorced. She has a drawdown fund currently worth £125,000. She also receives a State pension of £4,000 p.a.

The current Minimum Income Requirement (MIR) is £10,000. For a 62 year old female the current cap on income drawdown is 7.0% of the fund i.e. for Jane it will be £8,700 p.a. However she only intends to take an income of £8,000 p.a. which is below the cap and so the MIR does not bite.

At age 64, unfortunately Jane is diagnosed with cancer. It's not terminal and although serious the expectation is that she will recover. The upheaval cause by the treatment means that she wishes to taken £20,000 in income. Her drawdown fund is currently worth £110,000 and the current cap £8,000.

The MIR is £10,800 and her state pension is £4,400. The MIR bites and she needs to secure an income of £6,400 escalating at 3% p.a. in order to take the higher level of income. Due to her medical condition she does qualify for an enhanced annuity. The cost of the annuity is only £67,500.

The cost of purchasing the annuity plus the income taken from his drawdown policy leaves her with £22,500. The cap is now £1,600. Jane takes the maximum amount from her drawdown policy subject to the cap. Her total income is therefore £12,400 p.a. (£1,600 from income drawdown, £6,400 from her annuity and £4,400 from the State Pension

Example 4

Daniel Jones 62 has retired early and sold his business. He had built up a personal pension fund of £330,000. He has taken tax free cash of £80,000 leaving £250,000 which he has placed into an income drawdown contract.

The current Minimum Income Requirement (MIR) is £10,000. For a 62 year old male the current cap on income drawdown is 7.1% of the fund i.e. for Daniel it will be £17,700 p.a. However he only intends to take an income of £15,000 p.a. which is below the cap and so the MIR does not bite.

Daniel does not have any other source of income and is not due to start receiving his State pension for another 5 years.

When Daniel reaches 64 his drawdown pot is worth £225,000. The current cap is now £17,600, still above the £15,000 a year he has been taking. However, James decides that he wants to take out £30,000 in income over the next year so as to purchase a car. This is above the cap and so the MIR needs to be checked.

The MIR is now £10,400. James has no guaranteed income and so he has to purchase an income for £10,400 escalating at 3%. However, as his state pension will start in 3 years he will only have to fund part of this income for life the remaining will only be for a temporary period of one year. The Basic State Pension is currently £5,200, so effectively he needs to purchase an annuity of £5,200 for live and also provide a guaranteed income of £5,200 for a.
The cost of doing this is £113,000 (£108,000 for a lifetime annuity escalating at 3% and £5,000 for a one year temporary annuity).

The cost of purchasing the annuities plus the income taken from his drawdown policy leaves him with £82,000 in his pot. The cap is now £6,400. Daniel takes the maximum amount from his drawdown policy subject to the cap. His total income is therefore £16,800 p.a. (£6,400 from income drawdown, £5,200 from his life time annuity and £5,200 his temporary annuity).

At age 65 his State Pension starts.

By the time Daniel reaches age 70 his drawdown pot is now only worth £70,000. The current cap is now £6,500, still above the £6,400 a year he has been taking. However, Daniel decides that he wants to take £20,000 in income over the next year. This is above significantly above the cap and so a further MIR check is required.

The MIR is now £14,000. Daniel guaranteed income is now £13,375 (£6,375 from the annuity and £7,000 from the state pension). So only needs to secure an additional income of £625 increasing at 3% p.a. The cost of purchasing an additional annuity for this amount is currently £17,000.

The cost of purchasing the annuity plus the income taken from his drawdown policy leaves him with £33,000. The cap is now £3,000. James takes the maximum amount from his drawdown policy subject to the cap. His total income is therefore £17,000 p.a. (£3,000 from income drawdown, £7,000 from his two annuity policies and £7,000 from the State Pension).

“Removing the requirement to annuitise by age 75”

General Comments

The proposals in this document may encourage individuals to look at pensions more favourably for savings because of the removal of one inflexibility in the pension system i.e. the min income at age 75 but for most the proposals will make little difference as they are likely to not be eligible for flexible drawdown or have to secure an income prior to age 75. In fact introduction of the MIR and capped and flexible drawdown is likely to just add another layer of confusion for most people

The ability to take TFC lump sum at any time is attractive but it would be more so if it was not linked to taking other benefits. To allow TFC at any time (or even allow them to phase their TFC so it doesn’t need to all be taken in one hit) without taking pension income benefits would introduce another element of flexibility for all and potentially make savings into pensions more attractive.

The proposed flexible drawdown will not encourage people to use their pension savings as retirement income although the removal of min income at age 75 will help, as would flexibility of TFC payments as suggested above. The majority of people will still need to secure an income pre 75 and so the introduction of two types of drawdown is unlikely to have any major benefit for the majority and just adds another complication into the pension regime. Those individuals most likely to fall back on the state are those with smaller pots and so arguably being in capped drawdown (where no MIR exists) is higher risk for individuals and the state but is where most people will end up. Those people that opt for flex drawdown are least likely to need help from the state and so the MIR serves little benefit in this regard.

Comments on Consultation questions

A1 What is the appropriate limit for capped drawdown (currently 120%)?

Whilst it is clear that a limit of 120% of GAD is not going to be sustainable post 75 in the capped drawdown environment it is difficult to put actual figures onto the problem.

We would not like to see erosion of the position pre 75 with a view to having one flat factor that is sustainable and as a result are happy to see the merits of a sliding scale for the cap from age 75 onwards.

Such a sliding scale could be tied into the reviews of USP required post 75 and we see no problem for such reviews to be more frequent than the current 5 year basis. Having said that an annual review and change of basis as per ASP would be both expensive to administer and complicated to keep track off for the client. A minimum of 3 years before review post age 75 would therefore be more attractive in this area.

It would also be beneficial to consider bringing the review period for USP into line with the tax year to avoid the potential confusion of having different USP drawdowns on different rates due to their review date. This could also be used to simply the consolidation of USP arrangements which at present is prevented by legislation requirement to maintain individual arrangement review data upon transfer.

A2 Views welcomed on intended approach to reforming tax framework in line with commitment to end effective annuity purchase at 75.

In the main the proposals to extend USP beyond age 75 are welcome as are the accompanying proposals :

- to limit tax relief to pre 75 contributions
- test against lifetime allowance at 75
- extend beyond 75 PCLS, triviality and annuity/pension protection lump sums

The one area of concern though is the proposal for a significant increase in tax on death in USP (at all ages) from 35% to 55%. We can see and understand why an increase to 40% to tie in with IHT would be desirable but an increase to 55% to recover all tax relief given seems punitative given that many will have only benefited from 20%-22% tax relief on the way in. Those who have benefited from 40% relief are the ones more likely to meet MIR requirements and so will be able to organise their remaining USP funds to minimise the impact of the tax charge through the flexible drawdown.

If such an increase is to come in it should at least be structured around the age 75 change so that the charge remains 35% before 75 but increases after age 75? Otherwise there is a significant incentive not to take any benefits before age 75 as benefits on death would be tax free (lifetime allowance permitting).

A3 What income should be considered secure for purposes of MIR?

In addition to State pension provision both Lifetime Annuity and Scheme Pension are referred to in RPSM as Secured Income and we would therefore expect both these to count so long as they were secured with the required annual increase of at least 2.5%. For the record we have no issue with the proposed increase requirement of 2.5% representing cost of living increases.

The proposal to only accept Scheme Pension from Occupational schemes creates an unnecessary complication to the process. The purpose of simplification was to smooth over differences not to create them.

In addition to pension savings, non pension savings with guaranteed income should also be considered as part of the MIR for example purchased life annuities.

It would also seem unnecessary for those people with large savings pots (whether pension or non pension savings) to have to meet the MIR. For example if someone with total savings of £2 million wanted to take retirement benefits from their pension at age 55 and wanted to take advantage of Flexible Drawdown they may be forced to purchase a lifetime annuity with some of the assets just to satisfy the MIR (which may not be a sensible purchase at such a time) but in reality given their total savings they are unlikely to run out of money and fall back on state benefits. So another consideration is having a big enough pot of money (in pension or non pension savings) to demonstrate you could meet the MIR if you needed to rather than having to actually meet it. Compare this with someone going into capped drawdown with a smaller pot of money where the chances of running out of money (or at least providing enough income for all of retirement) are far higher.

A4 What is an appropriate level for MIR and how should it be adjusted for different ages?

Whilst it is not possible to calculate an appropriate limit we do feel that the MIR should be set at a level that allows an individual to enjoy living and not at such a level that is considered the minimum to get by. To low a limit may lead to situation where standard of living is compromised in favour of passing on funds to next generation.

We do not feel that the MIR should be adjusted for different ages as this will again just over complicate the process and create potential for confusion. One flat rate that applies whenever pension income is taken after 55 would be preferred and easiest to administer and explain.

A5 Different MIR for individuals and couples?

The MIR should be per individual and not per couple. Private pensions are geared towards the individual and the complication of factoring in other income and provision would overly complicate matters for little reward.

A6 How often should MIR be reviewed?

Too frequent a review would again create confusion. The USP reviews are every 5 years and a review of the MIR at the same interval would not prove too onerous or difficult to administer at that time.

A7. How to minimise unnecessary burdens for individuals and industry of MIR.

The big question for MIR is how is it policed? Is it going to be the responsibility of the provider to verify MIR or can the client simply confirm they meet MIR without having to provide details?

We do not see the advantage in the provider having to obtain details of state pensions payable as well as details of other private pensions to be able to determine what offer they can make to the client. This would be a return to the pre simplification days of retained benefits which were often seen as reason for delays in payment.

As with lifetime allowance the MIR should be a declaration by the client which is why we favour the flat rate MIR and one MIR per individual to minimise complications and the chance of misunderstanding.

A8, Are there other barriers besides age 75 whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance risks?

The establishment of a tax regime for both income in payment and return of capital needs to strike the balance between avoiding incentivising the deferral of income in favour of capital transfer, whilst at the same time ensuring that the tax regime is seen as both fair and stable enough for the long term to encourage long term saving with flexibility.

It is neither the industry nor the governments interest to create a regime which generates so much revenue if capital is accessed that the flexibility that option creates is not worth paying for. We believe that the more people are encouraged to save with the promise of flexible options on retirement, the more likely it is that the revenue generated from income tax payments in retirement will increase.

A9, How can Government ensure individuals make appropriate choices in absence of age 75 annuity purchase?

The number of people deferring the purchase of income past age 75 will grow over time but initially we believe the vast majority of individuals making these decisions will be receiving advice. We think that the most effective way to ensure that people make the right choices at this age is to ensure they are properly advised and would welcome any government action to encourage people to seek advice about their options from qualified retirement advisers.

Retirement packs from the government made available automatically before individuals retire would also assist. Retirement packs from the government should clearly set out the facts of retiring and how long individuals may be in retirement for. It should also set out in plain English the options that people have for their retirement savings the realities including traditional retirement options i.e. annuities and income drawdown but also newer offers such as variable or flexible annuities. As an industry we often focus on very hard factors such as price etc for contracts but often it is not clear that customers understand all of the choices that are available to them and for clients it can be the 'softer' benefits that are important to them not just the hard factors considered by the industry. More and more other factors are becoming important e.g. provider financial strength, the value customers puts on guarantees, the value customers put in retaining access to their retirement funds and the ability to stay invested for growth etc.

A10 Any unintended consequences that may impact supply of annuities at attractive rates or ability to meet demand for annuities?

The majority of annuities purchased in he open market are established at ages well before age 75. Indeed most annuity purchase takes place at age 65 or earlier in the current market. We would expect the removal of the age 75 restriction to have a minimal impact on the size of the annuity market over the short term but longer term, as more people live longer and seek actively invested alternatives with advice it may impact more. There is no reason that this innovation should impact on the capacity of the market to supply annuities or meet the demand (which is estimated to grow as the baby boomer generation of the 1960s come through into the traditional age 55-65 retirement band.)

Smaller annuities may be purchased just to meet MIR which will increase overheads and reduce margins for the industry. It may also be the case that individuals end up purchasing poor value annuities (e.g. when gilt rates are low) just to meet MIR requirements. However it is recognised that it will be Solvency II that is most likely to have an effect on the annuity rates rather than this proposal

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Removing the requirement to annuitise by age 75
HM Treasury July 2010

Age 75 consultation
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THE GOLD WATCH HOTCH POTCH

- "Individuals should have the flexibility to decide when and how best to turn their pension savings into a retirement income, provided that they have sufficient income to avoid exhausting savings prematurely and fall back on the state."
  (Removing the requirement to annuitise by age 75, para 2.10, box 2.A, p 8).
- "Changes to the existing annuitisation rules provide an opportunity for greater innovation in the market. They also provide an opportunity to focus attention on the value of annuities and the importance of consumers making informed choices tailored to their needs."
  (Removing the requirement to annuitise by age 75, para 4.9, p 18).

How long have I got – innovatively speaking?

Representations by Roland Baker

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I was grateful for the opportunity to attend the consultative meeting on 06 August 2010 about ending the requirement to annuitise accumulated pension funds at age 75. Following the discussion at that meeting, I confirm my representations in writing. These representations follow the order of questions in the consultative document. Unless otherwise stated, all page and paragraph references relate to *"Removing the requirement to annuitise by age 75".*

General introduction

I represented workplace colleagues as part of my trade union work with regard to their pensions affairs for some years. In an article in August 2006 on participation in pension schemes I outlined my experience in PMI News, the Journal of the Pensions Management Institute. Changing the pensions landscape radically has, in the past, led to mis-selling which was not truly to the advantage of customers for the new regime. Please bear in mind that the Equitable Life saga caught not only the unsophisticated. Many qualified professional people were misled and mis-sold. This had to be redressed at considerable expense. That error must not be repeated and the removal of the requirement to annuitise must be restricted to those to whom it is appropriate. This will be the class of pensioners with the largest funds who will be the smallest number of retirement products consumers. They may be able to afford good quality advice but the cost of the advice and the management charges and fees that reflect it will bear on their funds. It is not certain that their net return on free assets would be greater than if the annuity market were properly structured for everyone – including the majority who end up seeking an annuity on a retirement fund averaging £25,000 or less.

Not much has moved on since the HMRC Modernising Annuities Consultation to which I made representations in April 2002. I see that its objectives were:

> "16. In developing policy on annuities, the Government is determined that any action:
>
> • should, where possible, increase the level of retirement income that people can expect to gain through an annuity;
>
> • should ensure that funds saved with the benefit of tax relief are used to provide a secure income in retirement. Pension savings should not become a tax-favoured savings vehicle for non-pension purposes; nor should people be enabled to use their funds other than for retirement income, risking their needing additional support from other taxpayers through the social security system;
>
> • should contribute to the Government's aim of encouraging people to save more for their own retirement. The Government is keen that people should understand annuitisation and the options on offer so that they make the right choices and receive good value.
>
> 17. In particular, this document contains options to increase general understanding of annuities and ways to enable individuals to obtain the information and advice they need to make well-informed and appropriate decisions. It summarises the breadth of coverage of the specific advice required, discussing the role of the Financial Services Authority in educating consumers. And it considers further options to encourage people to get the best value from annuity providers."

It is worth remembering from Modernising Annuities:

> "33. From 1979 small self administered pension schemes (SSASs - most of which are defined contribution schemes like personal pensions) were able to postpone buying an annuity for five years after their members retired. Since 1995, both members of these schemes and retired people with personal pension funds have been able to postpone buying an annuity until the retired person reaches age 75 so long as they take a minimum income from the fund on retirement. Since 1999, (nearly) all defined contribution pension schemes have had the same flexibility."

In 1995 both deferred annuitisation and enhanced ill-health annuities were first permitted. What has happened to annuity rates since? They have collapsed. Loss of mortality cross-subsidy has combined with lower interest rates and increased longevity to squeeze annuitants. Now deferral is to be unlimited and these reforms may diminish annuities further by reducing the market size and increasing proportionate costs.

Developing a new tax framework for retirement (Chapter 2)

Views are sought by the Government on:

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

A limit should depend on the assets available against reasonable life expectancy and be formulated by the Government Actuary's Department (GAD). Where the Minimum Income Requirement (MIR) is met so assets are held out of an annuity after age 75, there will be no limit. The capped drawdown pensioner at age 75 could buy an annuity if MIR cannot be met. The cap is designed to prevent premature exhaustion of the funds and recourse to means-tested state benefits, so there should also be a minimum. If the minimum cannot be met taking into account the yield on the assets, surely an annuity should be purchased? The limits should take account of the responsibilities the pensioner has to meet and be within a 110%-85% cap and collar to age 75 and 120%-80% cap and collar thereafter.

If MIR is met, should the assets be depleted more quickly than remaining life span taking into account the yield they can raise? It is intended that MIR, once met, is a definitive criterion. See also my response to question A6 with regard to how often it should be reviewed. If it is a definitive criterion, it permanently secures, for the purposes of the legislation, that recourse to means-tested state benefits will not be required. However future changes in policy about who should receive state benefits cannot be predicted and taken into account. If the criterion is met at outset, imposing a limit on access to the "free capital" in the event of future policy changes might result in an infringement of the human right to the quiet enjoyment of property contrary to Annex C, para C2, "Other Impacts". Any restriction on access to property must be legitimate and democratically imposed for the purposes of the European Convention on Human Rights. Article I of the 1952 protocol provides at page 15 of the Convention that *"No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law.."*.

http://www.echr.coe.int/NR/rdonlyres/D5CC24A7-DC13-4318-B457-5C9014916D7A/0/ENG_CONV.pdf

It is hard to argue for "democratically imposed" if it has already been established by law that the individual will not have recourse to means-tested state benefits disregarding assets to which it might be proposed to limit access. Might it not be better to provide, in the legislation, for the right to review flexible drawdown at periodic intervals so the consent of Parliament has been obtained and later changes can be justified? Otherwise, a pensioner in capped drawdown would be subject to greater restriction on withdrawal compared with a pensioner in flexible drawdown with similar assets. So it might be argued that there was an interference with the right to the quiet enjoyment of property if it could be shown that capped drawdown would not exhaust the assets even if MIR was not met.

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.

One pensions firm argued that value protection lump sums should be taxed at a lower rate than other surplus assets on death as the sum would be "purchased" with a lower income from the annuity compared to a standard annuity. Value protection effectively buys insurance against death before the annuity payments equal the annuity purchase price. So the value protection lump sum would not, per se, arise from a tax privileged environment.

The value of surplus pension assets on death that can be identified as attributable to tax free accumulation is problematic. Para 2.3 on page 7 is not strictly accurate in saying that *"No tax is charged on investment growth from pension contributions"*.

One of former Prime Minister Gordon Brown's most controversial fiscal reforms was to prevent pension schemes from reclaiming the imputed corporation tax in the dividend tax credit. Dividends form an important part of investment returns as recent concern about risks to the BP dividend after the Gulf of Mexico oil spillage demonstrated.

Dividends are taxed in the pension scheme for basic rate taxpayers just as if received by the members directly. Management charges for running the pension scheme bear additionally on the dividend which is a disadvantage not a privilege. Higher rate taxpayers for 2010/11 do not shelter dividends from additional tax inside pension schemes until their taxable incomes reach £43,875 – getting on for double the average national wage outside London. They then shelter themselves from 25% higher rate tax on the net dividends, 22.5% on the gross, as the imputation credit satisfies 10% of the gross. It is likely that the 50% additional tax rate payers for 2010/11 will benefit significantly from sheltering dividends in pension schemes. Across the board, however, these are a small fraction of total pension scheme investors and their advantages should not be given undue weight in fixing an average claw back of pension scheme tax benefits.

Pension schemes are protected from tax on capital investment profits at rates that have varied from the starting rate of 30% in 1965, via alignment with income tax rates up to 40% and latterly to a flat rate of 18% which will be further adjusted following the Budget on 22 June 2010 to rates of 18% or 28% depending on the individual's income subject to specific exemptions and reliefs. In the three tax years ended on 5 April 2011, individuals are not chargeable to CGT on gains of £9,600 in 2008/09 and £10,100 in both 2009/10 and 2010/11. If their pension funds made smaller capital gains than the individual exempt amounts, they would have gained no capital gains tax advantage from being invested via a pension fund. In the 10 years to date equity prices now show little capital gain. Investors' fiscal gains would have been from income tax relief on the contributions. Their fund growth would have arisen from dividends, on which basic rate taxpayers gained no tax advantage but had to pay management charges, and new contributions. Only on the larger funds in the hands of higher income earners could it fairly be claimed that substantial tax advantages had accrued. Decumulated pension funds often total £25,000 or less on which little or no capital gains tax would be payable if the funds were held individually.

Contribution income tax relief is partly recovered by fully charging the pension annuity to income tax without allowing for any return of capital to the annuitant compared to a purchased life annuity. The main beneficiaries are those who obtained higher rate tax relief on their contributions and pay lower rate income tax on their pensions. This may be amended by the proposed reduction in the annual maximum pension contribution allowance to which some pensions specialists objected at the meeting on 06 August 2010. To contribute to the work of the Office of Tax Simplification, perhaps income tax relief on pension contributions could be limited to a fixed rate of 25% for all taxpayers. This would incentivise smaller contributions that benefit only from basic rate tax relief of 20% and not disproportionately reward the rich who would otherwise get 40% relief. Everyone would pay £75 for every £100 working in their pension fund. Otherwise the rich only pay £60 while the poor pay £80. It would simplify the accurate calculation of a recovery charge on surplus drawdown assets and avoid separate claims to higher rate tax relief as, presently, contributions are paid net of basic rate tax relief in all cases.

Care should be taken to calculate a fair charge on surplus drawdown assets remaining for inheritance and not to deter high earners from making the maximum provision for their own retirement within the UK. An arbitrary charge may face a human rights challenge as per my response to A.1 above. High net worth individuals can make provision in low tax jurisdictions outside the UK where the asset management may not be carried out by UK regulated firms and disclosure may not be complete unless international treaties on withholding taxes are enforced. This seems unlikely in some countries with weak government. The funds are likely to be invested in economies outside the UK. There would be no certainty that HMRC in the UK would be the primary taxing jurisdiction for such pensions and related assets under the OECD double taxation conventions or at all.

It is unlikely that 55% of the accumulated value of the fund relates to the tax privileges alone given that some of the income tax relief on contributions will already have been recovered by the taxation of the income from the fund. It is doubtful whether the proposed recovery charge of 55% on surplus assets is therefore justified. It is more likely that no more than 35-40% of the fund relates to the tax advantages. The USP ("capped drawdown") recovery charge of 35% is mentioned in para 2.7 on pages 7 and 8 and it should be noted that Inheritance Tax does not apply to surplus USP funds.

The tax reliefs are proportionate to the contributions and the investment growth not to the form in which assets are held as between flexible and capped drawdown. It is open to anyone to purchase an annuity to settle the matter, and therefore lose all right to the future use of the capital, but there is no reason why the recovery charge should differ as between the form in which assets are held as opposed to differing on a scale relating to quantum.

If a 20% surplus pension assets charge were made on death and the remaining 80% of the assets were subjected to 40% inheritance tax, the total tax on the surplus assets would be 52% which ought to be sufficient and would eliminate the need to treat a value protection lump sum any differently from any other surplus amount. By far the vast majority of the population will never be affected by these rules so I understand that those who are affected will benefit from sophisticated legal and fiscal advice which could create avoidance. However, it is not possible to assign pension assets, for example, in a personal pension plan. So they cannot be the subject of pre-emptive gifting. It seems reasonable to prevent capped and flexible drawdown assets from being assignable as any surplus in them cannot be identified until someone has actually ended the need for those assets by dying. So opportunities for avoidance ought to be limited and most people who benefit from not annuitising may well leave other estate assets that would create an IHT charge. Otherwise, make the recovery charge on the surplus pension assets at 40% (instead of 55%) and exempt the balance from inheritance tax as proposed at para 13(ii) of Annex C.

Minimum Income Requirement (Chapter 3)
Views are sought by the Government on:

A.3 <u>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</u>.

During the discussion on 06 Aug 2010, the level of security for occupational pension defined benefits in calculating MIR was raised. Depending on the security of the employer's covenant for pensions in payment linked to Limited Price Indexation, an allowance at Pension Protection Fund (PPF) rates was suggested. Some care in communicating any such decision by the government should be taken. In principle it is necessary for the employer to be insolvent before PPF protection can be afforded. Reference to the terms on which the PPF would be able to compensate pension scheme members at this URL may be helpful
http://www.pensionprotectionfund.org.uk/About-Us/eligibility/Pages/Eligibility.aspx

The public might not welcome the implication that the Government felt pensions in payment by defined benefit occupational schemes were at this level of risk. It would be unwise to upset the valuations agreed between the schemes' actuaries, the PPF and the Pensions Regulator. Arousing public concern by failing to allow the full amount of a defined benefit pension in assessing MIR would highlight the funding difficulties of the PPF which has a £1.2 billion deficit. Under-funded schemes are allowed many years to reduce their deficits to avoid being taken into possession by the PPF like Heath Lambert.

http://business.scotsman.com/business/Crisis-looms-for-pensions-safety.6500720.jp

Paragraph 3.6 on page 13 posits that flexible drawdown will only apply to pension assets so only pension income can be considered secure for MIR purposes. That does not seem entirely logical. The object is to prevent recourse to means-tested state benefits. If non-pension income can secure this, there is no reason why it cannot be taken into account. A life income under a trust may not be a pension, but it is a life income. A purchased life annuity may not be a pension but it is a life income. Universal benefits related to disability may not be pensions but they are nonetheless on a par with other retirement age benefits.

The fall back positions, if MIR cannot be met, are capped drawdown or annuity purchase. If MIR were reviewed periodically against the assets remaining in flexible drawdown, a wider range of income could be secure. Otherwise only a narrow range of income likely to maintain its purchasing power can be considered. It will already be difficult for most people to meet MIR on pension income alone. Flexible drawdown will require advice and ongoing investment management the costs of which will bear on the fund. It is likely that only the largest funds will be viable in this regard and the MIR test further restricts the availability of flexible drawdown to a very small number of the wealthiest pensioners.

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

The GAD can calculate an appropriate level of adjustment by age. If the MIR is to be adjusted for age, it is proposed that the MIR will be higher at younger ages taking into account the factors mentioned with regard to uncertainty, health and care costs in paras 3.12 - 3.15 on pages 14 and 15. Para 3.14 on page 15 makes a footnote number 18 to the assertion that *"…average peak expenditure levels during retirement were around £423 per week for single pensioners, assuming inflation of 2.5%."* This refers to CEBR research carried out for Life Trust whose backers wound it up after 12 months because its longevity insurance business did not succeed. I do not, therefore, regard this analysis as reliable. It should not be used as a basis to set MIR levels. If £423 per week is regarded as a proxy for a pensioner's income, that is nearly the average national wage outside London and not a true reflection. Few pensioners would be in flexible drawdown as their incomes would be insufficient and the costs of administering it will be disproportionate to the benefit gained.

The Office for National Statistics (ONS) last published a wealth survey including an analysis of pensions wealth for the period 2006-2008. It is available from this website:

http://www.statistics.gov.uk/StatBase/Product.asp?vlnk=15074&Pos=1&ColRank=1&Rank=208

On that page the report is at the link headed *"Report: Wealth in Great Britain"* at this URL: http://www.statistics.gov.uk/downloads/theme_economy/wealth-assets-2006-2008/Wealth_in_GB_2006_2008.pdf

Chapter 6 analyses pension wealth. In Chapter 4, formal financial assets appear not to include pensions which seems anomalous. Page 32 of the ONS report suggests that the mean value of ex-pension wealth is around £40,000 which implies that few people would meet the minimum income requirement on those assets alone. Chapter 2 shows all wealth including pension wealth. Table 2.7 on page 12 of the ONS report is in two parts. One part shows wealth including pension wealth and the other part shows assets excluding pension wealth. The difference between the two shows, as posited in the consultative paper on annuitisation, that wealth peaks between ages 55-64 and declines between ages 65-85. However, the pension wealth derived by subtracting wealth without pension assets from wealth with pension assets suggests that few people would be able to support themselves completely on pension wealth alone. Therefore removing the requirement to annuitise by age 75 is a low-priority policy initiative. Between ages 75-84 mean pension wealth is about £125,000 and therefore below the level posited by pensions professionals at the 06 August meeting at which flexible drawdown would be best advice.

If a fixed quantum test is preferred on the grounds of simplicity, why not limit the availability of flexible drawdown to funds over £175,000 and capped drawdown to funds over £100,000? If a weekly income of £300 plus housing costs can be demonstrated, MIR should be met. The onus of proof should fall squarely on an applicant for flexible or capped drawdown to show lifestyle maintenance for amounts below these figures and this should be easily identifiable at the advice stage before HMRC need be troubled to adjudicate.

Carrying out “lifestyle maintenance” tests, as opposed to fixed quantum tests, imposes administrative complexity for the sake of fairness. In this regard the working families’ tax credit should be a lesson to us all. However, “lifestyle maintenance” is already used to validate exempt “out of income” gifts for inheritance tax purposes so it is tried and tested. The minimum income required in retirement is subject to the crucial test of whether housing costs need to be met. Is the mortgage paid off? That leaves outstanding only property maintenance and insurance. If it is not paid off, its cost should be added to any assumption in the order of £300 per week, with capital likely to remain above £10,000, to secure more than the equivalent of the guaranteed minimum income or pensioners’ credit without recourse to the state. The assumption should be related to any additional financial responsibilities. If property is rented, that eliminates the structural repairs for the landlord’s account but the rent should be added to the assumed income.

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

Opposition was expressed during the meeting to setting different MIR levels for single people and couples but MIR should reflect any responsibility for dependents as this would be an important factor in setting state benefit levels. I respect the fiscal independence of partners in marriage and civil partnership. Taxation is levied independently for example. Less formal “common law” arrangements are hazardous as they do not confer the same legal protection as marriage and civil partnership. Where an assessment of MIR is carried out and clearly partners are financially independent of each other, they should have their MIR assessed independently. Where one party depends on the other’s income, non means-tested benefits such as attendance allowance should be taken into account in the assessment but the MIR should require consideration of the living and maintenance costs of both parties - not just one.

A.6 How often the Minimum Income Requirement (MIR) level should be reviewed.

The intention, as described by Treasury officials at the meeting on 06 August 2010, is that an individual has to demonstrate MIR compliance once only at outset and then enters flexible drawdown – not being required to annuitise funds. Later changes in MIR levels will not affect pre-existing flexible drawdown pensioners. This makes it difficult to bring existing flexible drawdown pensioners within future policy changes. If experience shows that MIR needs to be tightened, for example to cope with higher than anticipated inflation, existing flexible drawdown pensioners may be at risk of depleting assets too quickly.

I argued for a triennial review to make sure that MIR is taken into account, along with the pensioner’s assets in flexible drawdown, to confirm that future reliance on means-tested state benefits can reasonably be ruled out. A quinquennial review would be satisfactory if inflation could be contained to the Limited Price Indexation (LPI) cap of 2.5%. The secure income to be taken into account, per question A3, could include sources that increase in line with LPI which will maintain their real value if inflation does not exceed LPI. At present, RPI inflation is well above LPI which is slightly behind CPI. So the MIR will not be keeping up with inflation. The starting income on purchased annuities linked to RPI is very low. On fixed escalation the future risk is easier to assess. There is a cross-over period of up to 23 years for a male life aged sixty on normal terms before the total payments on an annuity escalating at 3% fixed would equal the payments of a level annuity.

Is it clear what the Government's policy is on means testing? Means tested benefits per the budget on 22 June 2010 will rise in future by reference to the Consumer Price Index (CPI). Flat rate National Insurance Retirement Pension (NIRP) will rise by a "triple lock". *"The Coalition, our programme for government"*, p26, section 23, (May 2010, Cabinet Office, Ref: 401238 / 0510), aims to increase NIRP by the greater of prices, earnings or 2.5%. The triple lock on the NIRP, which is not means-tested, must be a shift towards a higher flat rate NIRP to reduce complexity.

Presumably the more generous regime for NIRP increases will reduce means-tested benefits such as pensioners' savings credit and guaranteed minimum income.The MIR can include benefits that are not means-tested (ie contribution-based) such as the NIRP. These benefits are specifically available regardless of other assets. The level of the MIR is therefore to ensure that means-tested benefits do not become available as a result of excessive asset depletion arising from deliberate action or unexpected longevity. If means testing is to be reduced, the MIR will have to be reduced. If it is not subject to review during flexible drawdown, policy changes like this will be difficult to implement for existing flexible drawdown pensioners. On the triple lock, it is likely that flat-rate contribution-based, non means-tested, NIRP will rise faster than MIR will need to rise if linked to LPI only.

A.7 <u>How to minimise unnecessary burdens for individuals and industry in the assessment of the MIR</u>.

The difficulty of establishing income for MIR purposes is no greater than proving income for mortgage lending. Obtaining proof will largely be undertaken by the individual. A DWP notice of the state pension payable with a letter from a company pension scheme showing the retirement benefits will cover most cases and it should only be necessary for the flexible drawdown provider to keep copies on file. It should be a requirement of any FSMA 2000 regulations that such proof is kept in the same way as for mortgage loans.

The UK annuity market (Chapter 4)
Views are sought by the Government on:

A.8 <u>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</u>.

Providing annuities was traditionally the preserve of insurance companies, within the aegis of the Insurance Companies Act 1982. This has now been repealed and replaced by the prudential and conduct of business regulations set by the Financial Services Authority (FSA) – the N2 regulator that consolidated N1 regulation by professional bodies for insurers, investment managers and intermediaries under the Financial Services and Markets Act 2000 (FSMA 2000). Annuities contain guarantees, for which reserves are made by actuaries who provide their expertise to insurers who specialise in risk management and investment.

Some mutual insurers set up banks to carry on savings and mortgage business in competition with building societies in the early1990s. This was problematic in law as there was a general pre-supposition against the ownership of banks by insurers and the mutuals had to provide comfort from the assets of the whole firm to support the liabilities of the bank. Much of the contention has been resolved by subsequent demutualisation and the development of corporate structures within publicly quoted companies held by shares.

In my representations on the FSA consultation *DP09/03, October 2009,"Mortgage Market" Review* I argued that future overheating in the housing market could be avoided if liquidity requirements could be reduced.

The term over which savings are invested should match more closely the longer terms over which money is lent to borrowers. Returns should be adjusted not only with regard to conventional interest rates but should include elements related to indices of inflation, earnings, property prices and the performance of the economy at large. Banks and building societies could provide long-term fixed mortgages on which interest related at least partly to other factors than market interest rates. They could then attract investment from pension funds seeking exposure to a wider variety of instruments in order to meet the demand for annuities. It is possible that legislation affecting the operation of building societies would have to be reviewed to permit this.

Both building societies and joint stock banks would need to convince the prudential regulators that risks could be controlled but there should be no reason why undue risk should be posed. In particular, margins on mortgage business have widened considerably from 1-2% since they were at the commodity end of the trade to 4% and above at current market rates. Within these margins, there should be scope for adjusting to a different way of charging for mortgages which could reduce demand on government index-linked debt, the price of which has become extortionate because the government does not wish to issue any and all the pension schemes scramble for it to meet LPI on annuities and other forms of liability driven investment.

Solvency II (see A.10 for further remarks on QIS 5) will require substantial capital to be held on annuity business and may be a barrier to new entrants to annuity business. One of the mutual insurers that set up a bank did place funds obtained as an annuity purchase price in its bank to supply funds for mortgage lending on a long-term basis. In principle there is no reason why this could not be encouraged more widely provided that the mortgages in which the funds are invested are "prime prime" with low loan-to-value ratios and low income multiples at fixed rates of interest over a long term.

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.

At the consultative meeting on 06 Aug 2010, one of the participants that specialises in the provision of impaired life annuities suggested that advice on managing investments at age 75, if no annuity purchase is required, should only be given by the highest grade of chartered financial planner. This will be very expensive for consumers.

The Pensions Advisory Service (TPAS) could play a greater role. TPAS is represented at: http://www.pensionsadvisoryservice.org.uk/about-us.aspx. It already facilitates intermediation in pensions complaints prior to involvement of the Ombudsman. Some argue that it would not be qualified and there would be a fine line between regulated advice and the provision of information or education. The pensions firms have made a generous living from providing actuarial services, administration and asset management guidance to pension schemes. They could second staff to TPAS to improve skills and inform pensioners likely to be most vulnerable to mis-selling about the options and the need to insure against outliving their savings. Among additional sources of funding to enable TPAS to carry out an informative role I suggest passing the hat round at the TUC and the professional bodies representing actuaries, accountants, pensions solicitors that have their own association within the Law Society and investment managers. I am a member of UNITE but I criticise the TUC's failure to campaign through its affiliated unions for members' pensions and to ensure adequate arrangements for independence among member nominated trustees. It failed to set up industry-wide pension schemes that could have mitigated some of the problems now facing pensions provision through poor investment returns and the longevity squeeze on annuities.

TPAS is a pensions specialist. It could replace the pensions work of the residual FSA consumer protection body. I recommend that the comparative annuity rates should be withdrawn from the FSA website. It would be much easier for TPAS to give rule of thumb expectations and guide consumers to advice.

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.

At the consultative meeting on 06 Aug 2010 key themes discussed were impaired life annuities, value protection, loss of capital to the annuity market from flexible drawdown, QIS5 for Solvency II and businesses that have Small Self Administered Schemes (SSAS).

Page 17, para 4.7 refers to a market for annuities enhanced for ill health that has existed since 1995 and has doubled in size between 2001 and 2010. Anyone retiring at 65 in 2010 was born in 1945 and will have worked entirely in the post-war economy after 1960 when the statutory school leaving age was 15. I agree that those subject to occupational health risks should be looked after and receive special consideration. Coal and other mining activity has caused, for example, emphysema or pneumoconiosis. Construction industry work with asbestos has led to mesothelioma. Other disabilities may arise from industrial injury at a time when health and safety did not meet today's standards.

Many pensioners in this category rely largely on state benefits or defined benefit pensions. Enhanced annuity considerations may not apply to the pensioner as the benefits are calculated by a formula related to earnings. The employer and not the pensioner bears the risk. Such pensioners are a diminishing number given the advances in occupational health over the last 20 years and the closure of DB schemes.

Separating enhanced annuitants from normal annuitants who are not in ill health poses moral hazard as the underwriting questions include offering enhanced money-purchase annuities to smokers, whose smoking is within their own control. Value protection is most common in providing impaired life annuities. The annuitant receives a higher annuity against the prospect of shorter life expectancy and further protection because the balance of the fund will be refunded on death if the annuity payments total less than the purchase price. It was posited by specialists in impaired life annuities represented at the meeting that the ill, poor and deprived have subsidized the healthy and wealthy for far too long and it is time it stopped. I do not entirely agree.

Type II diabetes, largely regarded as arising from an epidemic of obesity, also qualifies an annuitant for a better pension. If that includes value protection, there is no mortality cross subsidy from those who are responsible for their own ill health towards those who have looked after their health. There is no provision to impose different taxation on an enhanced annuity from a normal annuity to reflect the cost to the NHS of treating people whose demand on it is within their own control. The result is exceptionally poor annuity rates to those who have acted according to public policy and looked after their health, thus reducing the charge on the NHS and a reward to those who have not.

I queried whether the loss of cash to the annuity market if large pension fund holders decided not to annuitise would prejudice the returns available to annuitants with smaller funds. One of the specialists in impaired life annuity provision stated that this was unlikely.

Large fund holders would be expected to have lighter mortality (ie live longer) and be less likely to contribute mortality cross-subsidy to other annuitants in the pool. However, as they are likely to have the larger purchase prices, they will disproportionately diminish the funds under management in an annuity pool. The substantial guarantees inherent in an annuity must be conservatively managed but aggregate management charges on a larger fund bear less heavily on individual policyholders than in a smaller fund.

Smaller funds find it more difficult to spread investments due to the reduced flow of new money. Referring to the Modernising Annuities consultation mentioned in the introduction to these representations, I point out that annuity rates collapsed when rules were relaxed from immediate annuitisation on retirement to deferring annuitisation to age 75 in 1995.

On the other hand, there is considerable pressure on gilt-edged stock prices as the pensions market has an appetite for them beyond the ability of the government to supply. This is particularly acute with index linked stocks as these are required to underpin pension benefits that are required to increase by reference to LPI. If demand in this area could be alleviated that might weigh in favour of reducing the high cost of index linked stock which might favour annuitants. However, since MIR is likely to require income linked to LPI, it is hard to see how this can be achieved. It was hoped in Modernising Annuities that introducing temporary annuities for pensioners would ease the strain on demand in the gilt edged market as long ago as 2002 and therefore support gilt yields to improve annuities in the general market. There is no evidence that this happened as annuity rates have continued to collapse. In particular, whilst National Savings & Investments has now withdrawn the only low cost inflation linked investment available to modest and medium sized savings funds, you should check whether the re-organisation of the Government bond market through quantitative easing has resulted in the issue of any index-linked stock by the Debt Management Office.

Solvency II is the EU directive that is being formulated on the capital that insurers are expected to hold to cover their risks. The fifth Quantitative Impact Survey of late 2009 (QIS5) is the latest series of formulae for calculating solvency for the purposes of the directive. It is based on an aggregated average of the insurance industry as a whole and therefore not an accurate measure of any individual company's ability to meet its liabilities. In particular, QIS5 may permit insurers to capitalise their annuity risks with derivative instruments instead of cash or equivalent securities such as AAA Government Bonds

Some UK providers who have sub-contracted (re-insured) their annuity risk to non EU insurers may not be required to hold as much capital against UK annuities as those insurers who write annuity business in the EU. This will not stop them from writing annuities for UK pensioners whose underlying security might not be as great, or subject to the same regulatory recourse, as for UK pensioners who have taken annuities from EU insurers. This has potential for adverse consequences. For example will a non-EU annuity provider, holding less capital than an EU provider, offer better annuity rates to pensioners to reflect the reduced cost of holding the capital? If so, how will that affect competition? To whom will a pensioner with a non-EU reinsurer look for recourse if margins were held too thin and the annuity cannot be continued for solvency reasons? Should we not regulate all providers even-handedly by reference to the annuities they provide to UK residents?

The press has speculated that derivative instruments, such as longevity swaps, may count as security towards solvency. I questioned QIS5 and the role of shareholders in providing capital to meet risks, for example by a rights issue, at the 2010 AGM of one UK quoted insurer where I hold shares. The Chairman said that QIS5 had moved the capital holding requirement further in the direction of insurers so less actual cash would be necessary for Solvency II. The insurer has appointed a Solvency II committee with responsibility for this issue in a directorate of the finance department. Solvency II responsibility is one which Directors cannot delegate although they can take advice on the decisions they have to make. What constitutes adequate capital is likely to mirror the core Tier 1 requirement, such as equity, in banks and building societies compared to money market instruments. During the meeting on 06 August 2010, one of the specialists in impaired life annuity provision said that there was nothing wrong with using derivatives to secure annuities as long as they were properly collateralised. Overtones of residential mortgage backed securities collateralised by debt obligations and credit default swaps sprang to mind.

The discussion on SSAS reflected the risks to liquidity in a pension scheme that arise when the sponsoring employer's business premises are owned by the scheme. At some point, those premises are required to provide the pensions of the scheme members. It is a useful tax advantage to have the property in the scheme where its increase in value is accumulated without capital gains tax, the rent received from the business is accumulated in the pension scheme without income tax and is also deducted in calculating the profits chargeable to tax in the hands of the business by which the rent is paid. It was right to point out that a recovery charge, if the SSAS goes into flexible drawdown, may produce an insufficiency of liquid assets to pay the recovery charge. However, this would be the fault of the trustees' investment policy and should not be given special consideration. The object of the scheme is to pay pensions.

Contrary to Annex B, Small firms impact test, it was argued at the consultative meeting that the recovery charge would impact on SSASs many of which are held by firms, often with fewer than 20 employees. On this point, does paragraph B.1 intend that members of pension schemes at smaller firms will be denied the right to the proposed reforms as schemes will not be obliged to change their rules to permit the flexibility? Please see the remarks on human rights in answer to A1 above if differential treatment of individuals in similar circumstances is envisaged. Changing the rules of a small scheme with fewer than 20 members is not a marathon legal exercise. Doing so should not have a disproportionate impact on smaller firms but not doing so might have a disproportionate effect on equalities if, eg, women are highly represented in the workforce of smaller firms.

The impact assessments at Annex C from page 25

Paragraphs 1-13 re-state the purpose of the consultation. Paragraph 15 refers to removing the requirement to trigger a check at age 75 that an annuity has been purchased as a deregulatory removal of a monitoring requirement. That is not correct. If an annuity is not purchased, the state of investment of the assets will have to be monitored for each individual for tactical and strategic asset allocation instead of once across a pool of risk.

This deregulates a financial institution but imposes a customer-facing conduct of business obligation to ensure that not purchasing an annuity at age 75 is best advice. If a pensioner is to rely on assets that have not been annuitised for lifetime maintenance, strategic and tactical asset allocation will be subject to ongoing monitoring for appropriateness. This is classic liability driven investment not monitored once at the macro prudential level in the dealings between a financial institution and the regulator, but with regard to liability to many individuals for best advice. In practice the monitoring requirement is likely to move from annuity providers to financial advisers. The latter are more fragmented and have been notorious for commission driven mis-selling in the past. To remedy this, the Retail Distribution Review (RDR) of the FSA will soon force advisers to charge by fees and not take commission. If the monitoring of invested assets passes to advisers, they will have to justify this to the pensioners who may be deterred by the cost from seeking the advice.

Product innovation mentioned in paragraph 17 may include the use of derivative instruments. Care must be taken, as one of the impaired life annuity specialists mentioned at the meeting on 06 August 2010, to ensure that inventive solutions are properly collateralised, especially if portfolio efficiencies for pensioners in capped or flexible drawdown include guaranteed stock market investments secured by a bank guarantee. The underlying product structure (ie the guarantee) failed at Key Data and Lehman Brothers. The index performance was not met. On recourse to the guarantee, funds were not available as the counterparties could not pay. The Government will not look good if it introduces the flexibility of not purchasing an annuity, only to ask the FSCS to pay out on doubtful judgments by the banks. The FSCS is not a victimless crime. It is an open moral hazard financed by prudent savers and bears just as harshly on them as any tax.

Paragraphs 19 and 22 raise the legality of trusteeship powers if schemes do not alter their rules but allow flexible drawdown case by case. Institutions must comply with Principles of Business (PRIN) macro prudential rules (INSPRU and BIPRU) and Conduct of Business Rules (COBs). Principles 6 and 8 within PRIN are the rules for Treating Customers Fairly known as TCF6 and TCF8. The former requires that, where discretion exists, providers have to publish how it will be exercised. TCF8 requires that conflicts of interest between owners and customers and between customers (eg conflicts between those who annuitise and those who do not) have to be managed fairly.

http://fsahandbook.info/FSA/html/handbook Full FSA Handbook
http://fsahandbook.info/FSA/html/handbook/PRIN/2/1 FSA Principles of Business

A case by case approach would be fraught with the possibility of multiple cases before the Financial Ombudsman Service (FOS).

Concerning paragraphs 19 and 22, paragraph 28 under-estimates the likely costs and mentions only the costs borne by institutions. Changing scheme rules and trustees' powers is done by specialists whose portals could barely be graced for £1,000. If some schemes and providers decide not to offer the new flexibility, pensioners who are with them will have to move to a firm that does if they wish to take advantage of it. Costs will be incurred by pensioners in making the transfers, in addition to any costs for additional flexibility per paragraph 36, and inure for the benefit of the provider's shareholders. A 1% annual management charge on assets worth £150,000 is £1,500. A bid-offer spread on assets realised for transfer could be up to 3% unless the pensioner is invested in one-price funds. Transferring the assets may not be best advice. It may incur penalties that cannot be recovered by any additional return from the new investment and may erode wealth as much as purchasing an annuity. This is not adequately covered in paragraphs 36-38 and is glossed over in paragraphs 30-35 where no quantum is placed on the benefits.

The impact assessment makes no reference to deregulation of tax compliance that may arise from the work of the Office of Tax Simplification. If life offices and investment managers gain from simplification of the complex tax regimes that affect their products, they will have cost-saving benefits which can be deployed to the advantage of any withdrawal of the requirement to annuitise at age 75.

General Conclusions

This policy initiative has been prioritised incorrectly at a time of national economic stress as it will benefit only a few people. It is designed to benefit wealthy supporters of the Coalition Government. The consequences for the less fortunate have not been considered.

The deferral of annuitisation in 1995 from the date of retirement to age 75 and implementing drawdown did not reduce demand on gilt stocks. So it did not increase their yield and did not improve annuity rates for the smaller pension funds. There is no reason to suppose that the current proposal will have any different effect. Nor was this objective met when, in 2002, Modernising Annuities introduced temporary pension annuities. Trying to improve annuity income in the light of falling rates has proved to be intractable.

In 2002, Modernising Annuities set out, at paragraph 17, repeated on page 1 of these representations, to increase education about annuities. That objective has not been met. Nor has the objective of the FSA to educate consumers generally to prevent them from falling victim to mis-selling. Annuities remain unpopular because the rates are low. If people live longer, allowing them to opt out of an annuity compounds the problem as the rates fall even lower. They are unlikely to buy an annuity if there is no requirement that they should and the market is then not big enough and not balanced. An annuity for a male aged 60 at current rates implies a 16 year payback to equal the purchase price on a level income and 23 years with escalation at 3% fixed. People do not find this attractive.

There is risk to the security of annuities for poorer pensioners from Solvency II and QIS5 if it permits insurers to secure annuities with derivative instruments instead of cash. It is a higher policy priority to address this before removing the requirement to annuitise. Parallels with the collapse of the banking system at the time of Lehman Brothers are clear.

Pensioners in drawdown with no fixed date of annuitisation are at risk of mis-selling. That risk can be mitigated by insisting on highly qualified professional advice. However, the cost of that advice will bear on a pensioner's assets. Pensioners may have to move funds to another provider to take advantage of flexible drawdown, pay transfer charges, possibly incur penalties on realising assets and pay charges for the additional flexibility at the new provider. Every time a new charge is imposed it raises the minimum viable fund size and reduces the market size. Paragraph 70 of Annex C estimates ongoing industry-wide costs of £2 million per annum which, ultimately, can only fall on consumers.

Recent restrictions on pension tax relief imply that the proportion of any surplus funds at the end of a pensioner's life attributable to tax privileges may be less than the consultation paper suggests. Care should be taken in assessing recovery charges in these circumstances. The wealthy have no prescriptive right to assistance from the taxpayer to make retirement provision that they should be able to afford themselves. However, it would be easy for them to make that provision offshore thus possibly holding assets outwith the purview of HMRC, both managing and investing them with no benefit to the UK economy.

Before the requirement to annuitise is abandoned, steps should be taken to standardise quoted rates and simplify the choices. For most annuitants who decumulate funds up to £100,000 on retirement, options for annuities payable in arrears without proportion should be abandoned and all quotations should be for a term certain paid monthly in advance. As people are living longer the term certain costs an insurer less for the risk so a standard offer monthly in advance for 10 years certain should be the norm with only exceptional cases altered for more complex provisions. For a single life this is all that is required. For a pensioner with a married or civil partner who may be the last survivor, a residual pension should also be provided. In fact a 30% survivor's pension might be adequate in many cases which would enhance the life annuity initially payable by reducing the charge for the risk of future provision. This would remove layers of administration in the advice process, reduce the cost of advice and institutional compliance and further contribute to better understanding and more competitive terms. Once this has been done, it may be possible to release pensioners from the requirement to annuitise.

Finally, I am grateful to the Treasury for allowing me to attend the consultative meeting on 06 August which was informative. I caution both the Treasury and the DWP that the only body capable of amortising annuity risk fairly across the whole population is the Government by bringing all annuitants into one cross-subsidised pool under the aegis of the GAD. Breaking up that pool into private insurance companies with individual actuarial experience merely fragments the market and incurs additional costs as shareholders have to receive a dividend on the business. The Government would not, I posit, abandon the requirement to annuitise if it had all the risk. So it should not do so because that risk is kept off its balance sheet and spread among insurance companies.

Barnett Waddingham

HM Treasury Consultation: Removing the requirement to annuitise by age 75

Response by Barnett Waddingham LLP

Andrew Roberts
Barnett Waddingham LLP

6 September 2010

Summary

About Barnett Waddingham

Barnett Waddingham LLP is an independent firm of actuaries and consultants with seven offices in the UK. Its senior partner, Adrian Waddingham, is a strong supporter of self-administered pensions and is a previous chairman of the Association of Pensioneer Trustees. Andrew Roberts, the co-ordinator of this submission is the current Honorary Secretary of the Association of Member-Directed Pension Schemes.

The following represents the views of many, but not necessarily all of the actuaries and consultants working at Barnett Waddingham LLP. Please note that whilst we are very happy to be listed as a respondent, we do not wish this response to made publically available given that it might not represent the views of individual partners of the firm.

The firm manages around 1,700 SSASs and has 2,000 SIPP clients, meaning that it looks after in excess of £2.5bn of funds in member-directed pension schemes for about 5,500 individuals. This includes many “high income individuals” and those who currently use Alternatively Secured Pension as a means of securing pension income beyond age 75. We estimate that 2% of all ASP pensioners are clients of ours and that currently 50 or so of our clients attain age 75 each year, though not all will move into ASP. We expect that most of those that do would annuitise soon after the death of the member or their spouse under the current rules.

We welcome very much the long overdue review of the pension rules effectively forcing annuitisation at age 75 and are pleased with the Government’s proposals to introduce further flexibility to the pension rules. An outline of our response is set out below:

Capped Drawdown

- The capped drawdown maximum should be set at 120% of GAD throughout life. We view this level of flexibility within capped drawdown as being more important and fair for the population as a whole than the introduction of flexible drawdown.
- GAD tables should continue to be maintained to age 75 only. Our analysis suggests that 120% of the age 75 rate is equivalent to 100% of an age 80 rate. A 120% uplift combined with an age 75 table limit brings simplicity whilst addressing concerns about funds running out later in life as, from age 80 onwards, the drawdown limit would be restrictive compared to the life expectancy.
- Compulsory reviews should be set every three years throughout capped drawdown. Our analysis shows that there is little difference between annual and three-yearly reviews other than in times of serious market depreciation but three-yearly reviews are administratively easier and help consumers plan their financial affairs.
- Individuals or scheme administrators should be able to alter the pension review date. This can yield cost-savings to the consumer if a more suitable date is selected. Using the crystallization date or birthday as is currently the case is not usually administratively sensible.
- To further address concerns regarding individuals depleting their pension funds, the Consumer Financial Education Body should continue to play an active role in educating those using income drawdown.

Lump Sum Death Benefits

- The proposal of a single tax calculation for lump sum death benefits paid from crystallised funds out in the consultation document is welcome simplification.

- We are concerned though that the rate of 55% unfairly prejudices those with lower levels of wealth. This would discourage future pension saving and encourage higher levels of income withdrawals. This behaviour is contrary to the principle that private pension funds should help reduce reliance on the State. However, we accept that a low rate of tax may enable pension funds to be used by the wealthy for Inheritance Tax planning most notably at older ages.

- We therefore suggest instead that crystallised lump sum death benefits should be taxed at 35% on death prior to age 75 and 55% thereafter. This would represent a fair tax rate prior to age 75 to encourage pension saving and a sufficient rate post age 75 to discourage Inheritance Tax planning.

- Transfer lump sum death benefits should be available under capped drawdown and flexible drawdown, less a recovery charge if need be. In our view this facility would be an essential part of the new rules if a tax on death of 55% is introduced. The recovery charge would compensate the Exchequer bearing in mind that when the beneficiary crystallises their benefits, the majority of their fund would be subject to income tax.

- Charity lump sum death benefits should be available under both forms of drawdown at all ages, with no tax charge.

- The second lifetime allowance test, usually triggered on annuity purchase or attaining age 75, encourages maximum income drawdown withdrawals and so we expect has not and will not generate significant tax receipts for the Exchequer. Its presence in legislation, though, causes unnecessary complication for advisers, providers and consumers and so should be removed. Furthermore, as those in flexible drawdown would be able to manage to avoid a potential lifetime allowance charge on the test much more easily than those in capped drawdown, we can see no place for it in the new system. Funds should be tested at the point of crystallisation only.

- We accept that there should be a final age by which benefits should be crystallized and are happy that this is kept at age 75.

Flexible Drawdown

- We see limited use of the flexible drawdown regime but this will depend on the level of the MIR, which we suggest is set at £423 per week per individual and not age-related.

- The definition of Secure Income should be limited to

    - Lifetime annuities in payment
    - State pensions in payment
    - Defined benefit pensions in payment

- Qualification for flexible drawdown should be via a certificate from HMRC which would remain valid for the individual's lifetime.

- To ward against tax avoidance, once an individual has established a flexible drawdown arrangement, no further tax-free lump sums should be payable.

Andrew Roberts
Partner, Barnett Waddingham LLP

Our response in detail

We welcome very much the long overdue review of the pension rules affecting people at age 75. Although April 2006 saw the introduction of a pension regime with useful new income drawdown rules, the rules introduced in the following years have created a layer of “complication” that has significantly reduced confidence in the pensions market.

A survey was conducted at the 2010 AMPS Conference organised by the Association of Member-Directed Pension Schemes (AMPS) which showed 76% of those surveyed thought that pensions had become harder to administer post A-Day. This figure jumps to 90% of those involved in technical support.

More complicated rules cost the Government more in providing support services to the taxpayer too. At the same conference, 55% of those surveyed indicated that HMRC service levels have got worse and 32% thought they were much the same. This suggests that the Government either needs to invest in training / recruiting HMRC staff or simplifying the legislation.

It is therefore vital for all stakeholders that any serious review of the pension rules restores simplicity as well as representing a fair deal for the taxpayer and the Exchequer.

We are acutely aware of the need for fiscal neutrality and our proposals respect this. We believe that we have honoured the principles set out in the consultation paper. Wherever possible we have backed up our comments with analysis.

A.1 What would be an appropriate level of the annual drawdown limit for capped drawdown?

Our view is that capped drawdown should be simple to administer and understand, involve minimal capital outlay for providers to implement and be socially responsible. We therefore recommend that the new capped drawdown regime should mirror the existing unsecured pension regime as closely as possible.

<u>Annual drawdown limit</u>

On this basis, we suggest that the rate for capped drawdown is set at 120% of GAD for the whole of the member’s lifetime, with individuals aged 75 or over using the age 75 GAD rate as is currently the case.

We see no necessity for a minimum drawdown requirement at any age. The minimum requirement was introduced to ward against the use of pension funds as a means of passing on wealth through generations, but the taxation rules now achieve this and will continue to achieve this after the proposed changes.

Our proposal has the advantage of simplicity; it should be acceptable to individuals already utilising unsecured pension, easy for providers to implement and remains socially responsible as it will not force existing pensioners (who might not satisfy the MIR) to lower their pension income at a time when drawdown limits are already being reduced by depressed investment valuations and low gilt yields. Furthermore, the tax receipts for the Exchequer are protected as a higher limit helps maintain existing levels of pension income and, of course, brings more money into the personal taxation regime. Finally, our proposal makes use of the existing GAD tables with no requirement for additional work in extending the tables.

We infer from the consultation paper that a reduction in the limit to 100% GAD rate might be considered as suitable given the introduction of flexible drawdown, if not for all pensioners then for those who perhaps are 75 or older. We do not agree with this as it will cause a sudden interruption to individual financial planning, particularly as we do not believe that flexible drawdown will be widely available (see below).

Our analysis indicates that a sustainable drawdown rate for an 80 year old is currently approximately 20% higher than the sustainable rate for a 75 year old. Therefore, continuing to apply a 120% uplift beyond age 75 but keeping the end age for the GAD table at 75 has the effect of phasing in a more restrictive drawdown rate, which helps address Treasury concerns about funds running out.

The level of drawdown selected within the maximum limits should be the responsibility of the individual or their adviser. We refer our clients to the “Money Made Clear” information provided by the Consumer Financial

Education Body (CFEB) and are extremely pleased with the clarity of the information provided by the CFEB. We are confident that the CFEB will update their literature to provide specific information on capped drawdown.

Drawdown reviews

The aim in scrapping Alternatively Secured Pension should be that there is no major change in the rules governing drawdown at any particular age. We would therefore support a uniform review period. The current system requires five yearly reviews prior to age 75 and annual reviews thereafter.

We propose that the compulsory review period is set at three years throughout capped drawdown. Insisting on annual reviews throughout drawdown would be unnecessarily burdensome and would create additional costs for the consumer. On the other hand, five yearly reviews in later years is too infrequent to manage the risk of funds running out. Our analysis shows that the post age 75 review period can be extended to three years without any material impact on the risk of running out of funds. We can provide details of this analysis if required.

We also advocate individuals being able to adjust their review date as this would help reduce administration costs yielding savings which would again be passed on to the consumer with obvious benefits.

Currently, valuations are required for those in drawdown within a set window determined by the date of initial crystallisation (or birthday in the case of those in ASP). This date might not be appropriate going forward and can cause significant extra costs, particularly in schemes such as SSASs where there are multiple members.

For example, a SSAS might need a 5 April valuation for the annual registered pension scheme return, a 31 August valuation for a pensioner in unsecured pension and a 17 December valuation for a pensioner in ASP. At each stage, valuations of assets are required which is often a manual process given the nature of assets held. Calculations might be needed to allocate the fund correctly between the pensioners. This might cost the SSAS £1,500 plus VAT for all of these calculations. The ability to adjust review dates could save these costs.

We propose that the review date could be extended beyond a year (but under two years) provided that the pension drawn between the two review dates does not exceed a pro-rata amount of the annual maximum. This would allow the ASP member in the example above to extend their pension year so that it ends on 5 April, rather than 17 December. The other member could similarly amend their pension year meaning that only one set of calculations would be needed each year rather than three. This would reduce the costs to the members to say £600 plus VAT.

We would be happy for scheme administrators or individuals to select the review date rather than, say, prescribing 5 April as the review date for all individuals as using one date creates administration bottlenecks.

Switch from USP to capped drawdown

We suggest that those in USP should have to abide by the new capped drawdown rules at their next compulsory review date (which would have been set under the existing regime) or at an earlier voluntary review. Indeed, giving individuals the freedom to choose the date at which they switch to the new regime could also provide an opportunity to amend existing review dates to something more suitable for that individual or pension arrangement.

Switch from ASP to capped drawdown

We suggest that those in ASP should switch to the new capped drawdown rules by their next compulsory review date (which would have been set under the existing regime), which manifestly would be within a year.

We would also support retrospective legislation to enable those members in ASP who die before the new rules are introduced to have lump sum death benefits paid in accordance with the new rules, if the payments are delayed until the new rules are enacted.

Switch from DC Scheme Pension to capped drawdown

We are aware that some SIPP providers (and some money purchase occupational schemes) offer a “scheme pension” direct from the resources of the pension arrangement rather than by the purchase of an annuity. This type of scheme pension should not be considered as “secure” income for the purposes of assessing the MIR and so we would suggest that scheme administrators operating this type of scheme pension are able to offer transfers to capped drawdown plans.

There may be concern that an individual crystallises under scheme pension rules and then transfers an excessive fund to capped drawdown in order to avoid a lifetime allowance charge. To avoid this, we would suggest that a limit of 20 times the member’s scheme pension is placed on the fund that can be transferred to capped drawdown without triggering a further lifetime allowance test. This should be sufficient to avoid tax abuse.

A.2 What are your views on the Government’s 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

Annuitisation by age 75 was encouraged by limiting the maximum pension income to a level below that which an annuity could provide, coupled with penal tax rates on funds left over on death which are not used for dependants’ pensions. The corollary of limiting the income that can be drawn is that there is likely to be a higher fund left on death, which can only be viewed as unfair.

Removing these disincentives should end the effective requirement to purchase an annuity at age 75. We are satisfied that introducing capped drawdown as a means of being able to draw a sensible level of income beyond age 75 deals with the first issue.

It is perhaps more important that the second issue is resolved – that there is an appropriate rate of tax charged on “orphan” funds. At the 2010 AMPS conference the audience was asked what single area of pensions most concerned them. At that time, in May 2010, there was general concern about the attack on the EET principle of pension tax relief. Ignoring those who indicated concern about the EET principle being attached, 73% of respondents indicated that not having a fair level of tax on death benefits was their main concern.

<u>Drawdown Lump Sum Death Benefit</u>

We note the proposal that the lump sum death benefits tax charge for crystallised funds is set at 55% applicable whatever age death occurs where lump sums are paid out as a lump sum from a capped or flexible drawdown arrangement. A flat rate has the advantage of simplicity though we are concerned that it is not a fair rate for the taxpayer and that, in particular, the increase in the rate from 35% to 55% for those pre 75 could have ramifications for those who may be making provision for their families based on the current rate.

A 55% rate is likely to be seen as an unfair deal for the pension saver. Whilst it might achieve the aim to remove the effective requirement to annuitise at age 75, it may introduce the effective requirement to annuitise at retirement and for those that chose to operate capped drawdown, would be an unwelcome incentive for them to draw from their pension funds as fast as possible to minimise the death tax.

Of course, the rate has to be fair to the Exchequer too and there should be no material impact on revenue streams. The current tax rate is 35% below age 75 and 82% (say) above age 75. The rate of 35% is consistent with the current position pre age 75 and therefore can be taken as representing a fair rate between the taxpayer and the Exchequer. Our analysis shows that a reduction in the tax rate on death post age 75 does not have to be funded by any significant increase in the tax rate on death prior to age 75, as it can be funded by the additional income tax receipts expected from an increase in the drawdown limit post age 75.

We are aware of a Freedom of Information Request obtained by A J Bell which was issued to the public by them on 25 November 2009. This indicated that 1,100 – 1,200 people were entering ASP each tax year across a range of fund sizes. Extrapolating this information we estimate that ASP funds total some £1 billion currently, representing about 5,000 pensioners aged presumably 75 to 80. We would (over)estimate the average chance of death during the year to be 5%, representing £50 million worth of ASP funds per year.

These funds might be used to provide a dependant with a pension (assume 50% are married) whereas the balance might be distributed to charity tax-free or taxed as unauthorised payments. Assuming then that £25 million of funds are taxed as unauthorised payments each year and are subject to IHT in full, the tax revenue from this would be approximately £20 million. The estimated loss in tax revenue if this was instead taxed at

55% would be £7 million. If the rate were 40% or even 35%, the loss in tax revenue would be £10 million and £12 million respectively.

We earlier proposed that the maximum drawdown rate is set at 120% of the age 75 GAD table rate – i.e. 11.4% of the fund on current rates. This is equivalent to 2.8% more than is permitted under the ASP rules. This additional 2.8% drawdown rate equates to £28 million of additional drawdown income. If we assume that this will be taxed at 40%, this equates to additional income tax receipts of £11 million, offsetting the potential loss of a reduced death tax rate post age 75.

There are other factors to consider as well. We anticipate that most ASP members may not have annuitised as they are comfortable with the rules whilst their dependant is still alive but would give more consideration to annuitisation on first death. This means that the potential tax take noted above is likely to be overstated and the 5,000 or so pensioners already in ASP should not be seen as support for the existing rules.

We are also aware of non-UK resident pensioners who transfer pension funds abroad mainly in protest of the penal tax rates on death. Otherwise, they are willing to retain pension funds in the UK and hence help the UK pension and investment industry as, for example, double tax treaties mean that there is no impact on their income tax position.

Noting that the profits of annuity companies are taxed at a lower rate than unauthorised payments, both routes reduce the tax revenue for the Exchequer and so it is important that a fair tax rate is set. We believe that it is fair to set a flat rate of 35% as the tax rate for lump sum distributions on death prior to age 75 but increase this to 55% on death at or over age 75. There is some support for a flat rate of 40% applicable at all ages and this would be acceptable if the Treasury agree that a 40% rate meets their principles. Having proposed a 55% rate, we assume that it does not. However, in our view this rate would encourage pension saving generally which long term is a better and more fiscally responsible position as there would be less long term reliance on State benefits.

Charity Lump Sum Death Benefit

We recommend that the charity lump sum death benefit option, currently available whilst in ASP and so presumably under threat with the removal of ASP, remains available as an option following death at any age whilst in capped drawdown or flexible drawdown. We have received requests for charitable payments when members have died whilst in Unsecured Pension and so there is demand for this.

Specifically, we are suggesting that Charity Lump Sum Death Benefits should be allowed on death during capped drawdown and flexible drawdown, and not subject to any tax charge. This is a socially responsible change and could encourage charitable giving at a time when many charities are struggling to survive.

Transfer Lump Sum Death Benefit

We also believe that using funds on death to enhance a beneficiary's pension fund should be seriously considered as this would help that beneficiary from having to rely on the State themselves (bearing in mind that there is currently under provision in pension provision amongst the younger generation). It can also assist pension savers who have invested in illiquid assets such as properties which can be difficult to realise if there is a need to pay 55% tax on death. It is a better social result to allow a family to choose to retain funds (less a sensible tax charge) in a controlled pension environment where beneficiaries will be provided with an income stream than to insist that the funds are taken out of the pension environment where they might be squandered.

We would therefore support the reintroduction of transfer lump sum death benefits but with a sensible tax rate that is acceptable to the Exchequer as being sufficient to ensure that where pension savings are used to pass on wealth within a pension environment, this is not done in a tax-privileged way. This therefore allows the fifth principle to be honoured and is a variation on the old Transfer Lump Sum Death Benefit Rules (which were seen as too generous) and the current Unauthorised Payment rules on such allocations (which are seen as too penal).

We would suggest that the transfer could be kept within the same pension scheme or paid to another or new pension arrangement.

Lifetime Allowance Test

As further simplification, we believe that funds being crystallised should only be tested once against the Lifetime Allowance. That is to say, if funds are placed into capped drawdown then there is no further test against the Lifetime Allowance on subsequent purchase of a lifetime annuity, switch to scheme pension or flexible drawdown, or on reaching age 75. Similar provisions should apply to flexible drawdown.

The second lifetime allowance test that currently applies is complex to explain and to illustrate to pensioners, both for advisers and providers. The easiest way to explain the test is that the pensioner should draw as much pension out of the fund in order to avoid growing their pension pot but this increases the risk of pensioners running out of income at older ages.

It cannot be fair to those who do not meet the MIR that they are exposed to a second lifetime allowance test when those that do meet the MIR can use flexible retirement to avoid it altogether.

We do not know how much tax has been collected under BCE5A but cannot believe that it would be a significant amount as most pensioners would seek to avoid their fund triggering a charge as described above.

In summary, our proposal is for the following lump sum options to be available on death whilst in capped or flexible drawdown (as well as dependants' pension options):

- A (capped or flexible) drawdown lump sum death benefit, less 35% tax if under 75 and 55% tax otherwise
- A charity lump sum death benefit, without a tax charge
- A transfer lump sum death benefit, less a recovery tax charge

We understand that the Treasury generally consider 25% as an appropriate level for the recovery charge.

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.

We are supportive of flexible drawdown but only if it is introduced following a sufficient period of analysis to make sure that there are no adverse consequences.

Whilst it is possible for individuals to have secure income that is not linked to pensions, we agree that the practical way of assessing MIR is to include only secure pension income – limited to:

- Lifetime annuities in payment
- State pensions in payment
- Defined benefit pensions in payment

Such income should only qualify if it incorporates guaranteed increases at least at the rate that the MIR will increase (e.g. LPI). We agree that scheme pensions provided by DC pension schemes should not be included in this definition unless they are secured with an insurance company.

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

Level of MIR

The level of MIR will be key in determining whether flexible drawdown is a worthwhile addition to the pension system. If the MIR is set too high, then flexible drawdown will only be available to the few who are lucky enough to have the right combination of a very large private pension fund, state pensions and final salary pensions: we do not envisage many of those with large pension funds purchasing an annuity to secure a high pension income just so that they can draw more than is permitted under capped drawdown. If the MIR is set too low, then there is the risk that flexible drawdown will be used inappropriately by those who will ultimately have to fall back on the state in some fashion.

We believe that the MIR must exceed the Minimum Income Guarantee and indeed must be high enough to cope with disability etc (or lower but require secure income to factor in larger uplifts if certain conditions are diagnosed or require certain level of critical illness insurance? We consider this to be unworkable in practice).

Our recommendation is that the MIR should be set at a high enough level now to allow it to be maintained at that (index-linked) level for the foreseeable future. The rate of £423 per week quoted in the consultation document (an annual income of £22,000) seems to be a sensible figure.

If the MIR is set too low then we can see that flexible drawdown would be more open to abuse. If the MIR is set too high then flexible drawdown will only be available to a very small proportion of the population and may as well not be introduced.

There is potential concern that the income requirement of an individual will increase significantly if they require long term care. There were proposals put forward by the Conservatives for an insurance premium payable to the State to insure against a home having to be sold to fund long term care. This premium was designed to be voluntary. Any review on introducing this premium could be linked in with flexible drawdown – meaning that perhaps a lower MIR would be possible in exchange for that premium being paid out of a retirement fund (either as a tax-free incentive or taxed when the premium is paid, whichever suits Government social policy on whether to encourage uptake of the insurance).

Age issues

We do not believe that the MIR should be adjusted for different ages, but that it should be set at a high enough level to cater for 55 year olds wishing to put flexible drawdown into place at an early age.

Given that the rules of flexible drawdown mean that it is possible to withdraw the whole of a pension fund in one instalment, we believe that once an individual meets the MIR then there should be no further test – i.e. they can continue in flexible drawdown even if, in some unforeseen circumstance, they no longer met the MIR in the future.

If the definition of Secure Pension Income is restricted to secure income actually in payment then the minimum age at which people can meet the MIR will effectively be 60/65 anyway when most DB and State benefits come into force, and for those few who can afford to secure the MIR at age 55, they will likely have significant additional benefits (e.g. State Pension) kicking in age 60/65.

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

The pension system is designed around individual allowances and the MIR should be set and tested on an individual basis for simplicity and consistency. Introducing a couple's MIR would only serve to cause complication, for example following divorce when flexible drawdown has already been established.

However, many forms of secure pension income will include a dependant's pension, which could be included in the calculation of secure income for a surviving dependant once the pension comes into payment.

A.6 How often the MIR level should be reviewed

We believe that the MIR level should be reviewed annually on 5 April in line with LPI (but there should be no ongoing tests for those already utilising flexible drawdown).

If it is not reviewed annually, then individuals would need progressing less secure income to meet the MIR.

The MIR should be increased by LPI each year, in line with the requirement for the increases to the secured pension that can be counted for testing against the MIR. There should be some comfort that the MIR will be met on an ongoing basis by people who enter flexible drawdown.

However, we recommend that the underlying basis is reviewed each five years to ensure that the MIR is still set at a reasonable level of provide a basic level of income in retirement. A suitable lead-in time should be given for any material change in MIR so that financial plans can be reassessed if need be.

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

Our favoured method would be a self-assessment approach with the individual registering, perhaps with HMRC, for a certificate which they can show to as many pension providers as they wish to demonstrate that they are entitled to establish a flexible drawdown arrangement.

The form should be “self-assessment” with HMRC able to verify details via PAYE records and risk-based audits of individual records. The form could be part of an individual’s tax return if a section is included where the individual notifies how much “secure pension income” was received in that tax year and ticks if they want to receive a certificate, declaring at that time that the pension income meets the annual increase requirements.

Restricting the types of income that can form part of the MIR to insured annuities, defined benefit pensions in payment and state pensions in payment will assist with minimising the burden for individuals and industry. It may be harder if money purchase scheme pensions secured by insured annuities are included.

There are further consequences of introducing flexible drawdown that need to be considered to stop tax avoidance. For example, the Treasury would need to ensure that individuals cannot use flexible drawdown as a means of reducing income tax and National Insurance by paying contributions which are immediately paid out again in the form of a Pension Commencement Lump Sum (PCLS) and a single flexible drawdown payment for the entire remaining amount of the contribution.

A further example is the use of phased flexible drawdown to effectively provide enhanced death benefits for those under age 75.

As with some of the changes made in April 2006, we do not wish flexible drawdown to be introduced only to be followed the next year by a raft of legislation or guidance to stop abuse of this nature, and so issues like this need to be carefully addressed at outset.

Our suggestion would be that once an individual has put in place a flexible drawdown arrangement, they cannot take any further PCLS payments from any pension arrangement and this would stop use of flexible drawdown as a tax avoidance planning scheme. We would not wish there to be a self-assessment regime like there is for PCLS recycling as this puts the onus on providers to explain complicated rules with a residual concern that the individual will not interpret the rules properly.

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

The overall aim should be to encourage each individual to save for their own retirement and this is possible with tax incentives and a simple-to-understand regime. The 2006 pension regime made some headway towards being simple, but could have been simpler, and there have been several years of tweaking of the rules designed to stop relatively minor tax leakage with perhaps the more significant indirect effect that individuals have reduced their use of pensions fearing that the rules will always be changed to disadvantage them. This needs to be addressed and I would propose that a small fiscal cost or minor avoidance risk is worth the price of encouraging a whole new generation of pension savers. As is stated in the Treasury principles, the primary goal is to encourage individuals to have sufficient funds at retirement to not have to rely on the state, and this cannot be expected to be achieved with a system that is constantly in a state of flux.

For example, the overly complex recycling of pension commencement lump sum rules might have reduced an avoidance risk by a very small amount but their introduction must have incurred a fiscal cost (and industry cost) and so would have been a net cost to the Treasury. These are an example of rules that should be scrapped as they serve no useful purpose. There is no indication that high net worth individuals are seeking to re-contribute lump sums (indeed, for some this would cause lifetime allowance issues and the lifetime and annual allowances already limit the extent to which this could be used as an avoidance route) and lower net worth individuals would generally be unaware of the self-policing rules in any event.

A further proposal to consider would be to remove the Lifetime Allowance. The Lifetime Allowance could be deemed an unnecessary complication in future as there are now tight controls on contributions. This is noted in our response to the Government's discussion document on restricting higher rate relief which we submitted on 27 August 2010.

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

The removal of this age barrier should not necessarily be associated with the worry that individuals may stray into the wrong type of retirement product – it is perhaps more likely that with the age restriction there were individuals who should have annuitised earlier who were waiting to reach age 75 before making their decision.

There might be temptation to dictate that the MIR should be secured by age 75 but that stance would continue to offend those with religious objections to the pooling of mortality risks.

The better position, therefore, is to work on a program of educating those at and in retirement. This already forms part of an initiative to make sure that those with insured products are aware of their Open Market Option when it comes to selecting an annuity. We would suggest that scheme administrators are required to give set reminders to those at retirement and in retirement about their options. Scheme administrators would already be providing their pensioners with lifetime allowance information and so there should be no major additional burden if the additional information was of a standard form.

As previously mentioned, concerns about funds running out during drawdown should be the responsibility of the individual or their adviser. The "Money Made Clear" information provided by the Consumer Financial Education Body could be updated to provide specific information on capped drawdown and how to decide how much to draw.

Whilst we accept that the structure of the capped drawdown regime could be set up to reduce the possibility of people inadvertently suffering large reductions in pension, the Treasury will never be able to prevent people from making poor investment decisions, which have a much larger impact on retirement incomes. This has been highlighted recently by the dramatic fall in stock value for two blue chip companies: Royal Bank of Scotland plc and BP plc.

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.

We do not provide annuities and so our comments are based on empirical attitudes of our clients, who generally have the choice to use income drawdown or purchase annuities. Income drawdown is often selected where the client believes that they can exceed the relevant critical yield for the annuity by achieving a high return on their investments or where assets are not sufficiently liquid. In addition, there exists a general distrust of the insurance market. Recent annuity purchases have taken place where there are liquid funds and where it can be shown that value for money can be achieved even if death occurs soon after the annuity purchase.

Our expectation is that whilst there might be a reduced demand for annuities being used to buy out the whole of a member's fund, e.g. at age 75, there will be an increased demand on individual cases if there is a need to secure a minimum income before being able to use the flexible drawdown rules. Because of the aforementioned liquidity issue, we do not necessarily see flexible drawdown being used to exhaust an individual's pension fund but as a means of providing additional flexibility and a lower level of ongoing administration.

The introduction of flexible drawdown might, therefore, see increased demand for annuities up to the MIR but a reduction in annuities to provide more than that. Providers may also see some increased demand for very small annuities, for example if an individual is below the MIR by say £1. Consumers may not be able to find insurers willing to sell annuities for such small premiums and so may need to exceed the MIR by some margin, rather than match it. The Government might wish to consider whether it would offer additional State pension for a premium (with a limit to the additional State pension that can be purchased) to assist people who might only wish to secure a small additional pension.

Open Market Option - Consumer research
An independent research study

Presentation of findings
Just Retirement
July 2009

Key findings

- **Perceptions of Retirement:**
  - Those now retired – generally positive
  - Those approaching retirement – mixed reactions
  - Planning for retirement – majority wished they had done more financial planning
- **Understanding of Annuities**
  - General awareness of the term “annuity”
  - Some confusion about the meaning
  - Preference by all to call an annuity a guaranteed income for life – sounds very positive

different

Key findings

- **Process**
  - Majority have no awareness until they receive a letter a few months before retirement
  - Thought the packs are about the choice on whether to take a tax free lump sum or take it all as pension / spouses pension
  - The base knowledge level is very low, most stayed with the pension provider as they did not understand there was any reason to move
- **Understanding of the Open Market Option**
  - The minority that had moved companies did so “because their adviser got them a good deal”
  - Those without an adviser had no idea

different

3

Key findings

- **Documentation**
  - Provider packs were reviewed
  - General conclusions:
    - Surprise (negative) that they would be sent something like this in the post
    - Too much information
    - There is so much jargon: commutation, another provider, triviality, legal phrases and tight deadlines - very off-putting

B different

Key findings

- **ABI Template**
  - The ABI letter would get read
  - Very clear, feels friendly, aimed at people with no understanding, non scary, choices are laid out clearly, headline “by shopping around” – gave a reason to read and the context of the letter explained the answer (which none of the provider packs had so far done)
  - All the retired group had decided about their annuity; those approaching retirement suddenly became a little more enlightened
  - Suggestion that this should go out 6 months before retirement as a stand-alone document

5

Key findings

- **Prototype Letter**
  - Financial example if you have ill health or smoke
  - NO ONE had any awareness that you could get a better deal by having health issues
  - It was suggested that if it was true include as a leaflet for people to read if it applied to them.

different

Key findings

- **Communicating the choices that need to be made**
  - Pension providers seen as main group who need to inform their customers
  - The majority were annoyed that people do retire today without knowing / understanding these choices
  - There is brand loyalty, there is also inertia, some admit they are not really concerned about moving their pension away. Some were adamant that any increase would encourage them to move
    - Brand loyalty – better the devil you know
    - Inertia – too much bother to fill in all those forms
    - Don't understand what the choices are
    - Perception that it would cost them to move to another provider
    - Adviser might only advise to make commission

different

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Key findings

- **Conclusion**
  - Very little knowledge – choices not clear
  - Too much paperwork, very complex, technical and legal jargon
  - Providers do not seem to want to make it easy for their clients
  - Emphasis to seek the advice of an IFA – no recognition by providers that a number of people arriving at retirement do not know an IFA
  - Our suggestion – ensure information about the choices is gradually drip-fed to consumers in smaller doses, material needs to be rewritten in consumer-friendly language.

8

different

Key research objective

To compare and contrast existing pension packs received 4 months before retiring with an alternative short targeted letter to understand which gives greater clarity to the customer about the choices and the decisions he/she has to make in order to take out the best annuity product on the market for them

different

Background

Two research groups:

- **Retired within last 12 months (7 respondents)**
- **Group retiring within next 12 months (8 respondents)**
- **All had paid into pensions during their working life; mix of healthy/not so healthy, smokers and non smokers and mix of those who used an IFA and those who did not**

Perceptions of retirement

- Those now retired**: generally positive, in control of life, freedom, time for family and friends, time to travel, no deadlines; For some it took a while to accept retirement, mainly missed the buzz of work**
- Those approaching retirement**: mixed reactions, some really looking forward to retirement, have plans, want to travel and have choice and freedom. Others apprehensive worried about filling time, would like to phase into retirement**

Perceptions of retirement

- Planning for retirement **– Range of number of pensions held during working life from 1 to 5. Average is two or three pensions. No one appeared to have consolidated at retirement.**
- **Majority wished with hindsight they had done more financial planning.**
- **Those who took an annuity last year were quite pleased with the income they are now receiving; those approaching retirement are generally concerned about what the illustrations show they will get (less than they thought).**
- **Most had not kept a close eye on their pension benefits statements over the years and had only taken an interest as they approached retirement.**

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Understanding of annuity

- General awareness of the term 'annuity'. Those in retirement understood it was the pension they received each month
- Some approaching retirement had not heard the term and others claimed they had heard the term but couldn't explain the meaning
- Majority have heard the term annuity but were cautious about explaining the product, basic awareness it is the income received in retirement, but most simply called this their pension
- Some confusion about an annuity whether the amount is fixed each month or can go up or down, whether it will last for life or for a fixed term and whether it dies when you die
- Preference by all to call an annuity a guaranteed income for life – sounds very positive

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Annuities - what they said

An annuity is about tying up your money
Approaching retirement

Is it when you put your lump sum in and get a monthly sum out?
Retired

An annuity, you can loose all the money if you die
Approaching retirement

The company went bust I worked for so our pension funds went into an annuity
Retired

You get various options that you can choose from
Approaching retirement

An annuity - you can pick and choose If you want a lump sum or a tax free income
Retired

different

The financial retirement process

Moving from investing in a pension (accumulation) to receiving pension income (decumulation)

- **Majority have no awareness until they receive a letter a few months before retirement that they will need to make decisions/fill in lots of forms about what to do with their pension.**
- **This is a real surprise for most and as they have given no thought to this process when it does happen they are rather overwhelmed and want to take the easiest option to get the pension.**

No one told us that we would have to make choices until the end, it was a bit of a shock and we felt rushed
Retired

different

The financial retirement process

- Some admit to simply handing all the paperwork across to their adviser without reading it, others do not trust an adviser and find it very difficult to know what to do
- Those who remember receiving the packs about their pension thought they gave a few choices which included:
  - whether to take a tax free lump sum,
  - whether to take it all as pension,
  - whether to have a spouses pension.
- The base knowledge level is very low, most stayed with the pension provider, as they did not understand there was any reason to move

They just sent the letter through and I filled in some forms and that was that
Retired

I don't know how I got my annuity, my husband and I filled in some paper work and we had to decide how we would take the annuity
Retired

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The open market option - awareness

- Spontaneously asked whether they had heard the term ‘open market option’ just a couple in the retired group were aware of the term (they had advisers) and they had moved companies ‘because their adviser got them a good deal’ and just one in the approaching retirement group had heard of the term and could explain it
- Those without an adviser had no idea how you could take your pension away from your provider and go to another company. They guessed you could look on the internet but they did not know what they would be looking for or what they would be comparing

You can commute your pension, I think that means you can move your pension
Approaching retirement

You can pick or choose if you want a lump sum or tax-free money
Retired

different

Communicating the choices that need to be made

- The pension providers are seen to be the main group who need to inform their customers about the choices that need to be considered at retirement – two years ago it was thought that the Government should do this, no one thinks this now!
- The majority were annoyed that people do retire today without knowing/understanding these choices and that it is important to take time and really understand the choices to be made.
- There is brand loyalty to the provider they have saved with over the years, there is also inertia and some admit they are not really concerned about moving their pension away when they hit retirement.

different

Communicating the choices that need to be made

- **Some were adamant that any increase in their retirement income would encourage them to move; others suggested if it was more than £500 per year or £1000 plus per year they would definitely consider moving;**

Reasons why some would not rush to move providers include:

- Brand loyalty – better the devil you know
- Inertia – too much bother to fill in all those forms
- Don't understand what the choices are
- Perception that it would cost them to move to another provider
- Adviser might only suggest it to make commission

Conclusion

- Consumers approaching retirement have very little knowledge about the move to purchase an annuity, and the choices they have to make are not clear.
- There is too much paperwork for them to digest and providers are still using very complex, technical and legal jargon.
- The providers do not appear to want to make it easy for their clients.

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different

Conclusion

- There is a strong emphasis in the material for customers to seek the advice of an IFA but there should be recognition that a number of people arriving at retirement do not know an IFA, where to find one and perceive they will cost them a lot of money.
- Our suggestion from this research is to ensure information about the choices is gradually drip feed to consumers in smaller doses – and most material needs to be rewritten in consumer friendly language.

Final thoughts - what they said

I wouldn't know how to begin to approach each company and find out what they would offer
Approaching retirement

We have learnt that we have missed out on a lot of information
Retired

I think the pensions company should tell you all this information well before you retire
Approaching retirement

I thought it would be anti me if they asked if I was on medication, because with other insurance it has always been a negative thing
Retired

Nothing is for nothing I would be worried there would be other costs that are hidden
Approaching retirement

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Age 75 consultation
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Room 2/SE
HM Treasury
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SW1A 2HQ

10 September 2010

Our ref: 0052/DM/Removing compulsory annuitisation response Sept 2010

Direct line: 0121 265 7219
Email: david.morris@bdo.co.uk

Dear Sirs

Our Response to: Removing the requirement to annuitise by age 75 dated July 2010

Following the issue of your consultation document we, BDO Investment Management Limited, would like to take this opportunity to respond. In Annex A, views were welcomed on the following topics:

Developing a new tax framework for retirement (Chapter 2)

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

Our view is that the current annual USP drawdown limits produce appropriate levels of flexibility and sustainable income levels for our clients and do not require amendment.

It may be simpler if the GAD tables are increased by 20% so that the maximum income does not need to be calculated as 120% of the base amount.

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 are broadly in favour of the proposals made.

Removing the age 75 restriction for trivial commutation lump sums after age 75 will particularly assist with the efficient winding up of occupational pension schemes.

We would also welcome the removal of the age 75 restriction for value protection lump sums as this will be important to allow this form of secured pension to remain a valid alternative to capped drawdown in future years. This will allow providers to offer flexibility for each policyholder to choose the age they require, possibly with a maximum age. The providers are likely to come to a conclusion as regards an optimum value protection age.

We would also expect to see value protected lump sums taxed at the same level as the lump sum for capped drawdown funds.

We do not however agree with the proposal to remove the requirement to draw the pension commencement lump sum by age 75. We see this as a valuable rule to ensure that retirement benefits commence by a notional age and consider age 75 to be reasonable.

However, if you continue as proposed, clarification is required on a number of issues.

- Will the BCE at age 75 still be the final test against the LTA?
- If a PCLS is to remain available after age 75, will the maximum be calculated as per the BCE at age 75 or can it be based on 25% of the fund at point of crystallisation?

In addition, if a post 75 PCLS is not guaranteed to be free from the proposed death lump sum tax charge of 55 percent, this will inevitably lead to 'death bed' crystallisations. Consideration should therefore be give allowing this portion of fund to be exempt from the recovery charge on death.

We would also welcome a facility that, within specified 'emergency' criteria, allows a taxable pension commencement lump sum to be available before age 55. This will help to reengage individuals with pension savings and commit monies for the longer term whilst knowing that in an emergency, a proportion of the fund could be called upon.

We also propose the ability to utilise uncapped flexible drawdown should also be open to members of DB schemes who satisfy the MIR. This would open the possibility of allowing members to exchange a potentially large proportion of their pension entitlement for a lump sum, whilst retaining a pension from the scheme sufficient to meet the MIR. Any additional lump sum above the current 25% limit would be taxable as income.

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.

We agree with your definition of 'secure' along with the proposal to include State Pensions within the calculation. We also see no reason why other forms of guaranteed annuity income should not be included - for example, income from Purchased Life Annuities.

It is important that footnote 13 is implemented i.e. income already secured as a flat amount needs to be included in technical provisions. These provisions need to provide age related discount tables to adjust the actual annuity income into an adjusted MIR qualifying income figure.

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

We do not have strong views on the level of the MIR. However, we agree that it is important that anyone exercising flexible drawdown has secured an income which virtually guarantees that they cannot get into a position where they could claim State Benefits in the future. The MIR should include an enhancement above current minimum levels to act as an insurance buffer for the State.

At the risk of stating the obvious, it is important that your decision considers minimum net income requirements but the eventual MIR figure will only be workable if declared as gross figure is quoted.

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

Our view is that the MIR should be set at individual level. This will offer a more simple approach and is likely to lead to the MIR being set somewhere between current minimal expenditure levels for single persons and married couples.

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

If set at an appropriate level with robust indexation (probably in line with the triple lock to be introduced for State Pensions), it should be unlikely that the MIR will need to be subject to frequent review.

We would suggest a minimum of every 5 years and a maximum of every 10 years. However, it will be important for the Government to reserve the right to review the MIR earlier in the event of a significant change to the State Benefit system, for example following a review of UK long term care provision.

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

No comment.

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.

To maintain the capital protected annuity market, the maximum age of 75 should be removed in line with the proposals made in the consultation.

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.

No comment

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.

There may be some concern that these proposals will have a detrimental affect on annuity rates because more people go down the drawdown route (instead of buying and annuity) due to the greater flexibility offered under the uncapped version.

However, any impact could be offset by an increased take up of LPI linked annuities as a form of satisfying the MIR. If the two balance each other out, the annuity pools would be unaffected and annuity rates would be less likely to suffer as a direct result of these proposals.

About BDO Investment Management

BDO Investment Management is an FSA regulated subsidiary of BDO LLP, the UK member firm of BDO International. We have three divisions namely Corporate Pensions and Benefit Services, Private Client Services and Asset Management. Our Private Clients are typically High Net Worth Individuals in the accumulation or the decumulation stage of pension planning whilst our Corporate clients range from small employers with fewer than 100 employees to blue chip organisations with thousands of employees. We advise on and administer both money purchase and defined benefit pension schemes.

Yours faithfully

D. M

David Morris Dip PFS, CFP
Technical Support Director
For and on behalf of BDO Investment Management Ltd

Stephen Bluestone

Bluestone & Co
Solicitors

date: 23rd August 2010
your ref: 10/76256/2010
our ref: SB/MPB

Mr. Jonathan Deakin
HM Treasury
1 Horse Guards Parade
London SW1A 2HQ

Dear Mr. Deakin,

I acknowledge your letter received 20th August in reply to mine of 22nd July addressed to Mr. Mark Hoban and thank you for your detailed reply.

I note you comments concerning drawdown prior to the age of 75 and am pleased of your assurance. Whilst I appreciate that the matter is only presently at consultation stage, and the issues will required to go before committee and possible White Paper and onwards, is there a Government or Treasury ' view' on age of early drawdown? Whilst I appreciate that the 75 year rule is to be withdrawn, is it possible that there will be no lower age limit subject to income requirements?

I'm sure that you can appreciate the situation of one in my position, 57 with Multiple Sclerosis, wishing to attend to my financial position as soon as possible for the benefit of not only myself, but my wife and children. Time is not on my side.

I will indeed contact e-mail age 75 with my views. I have requested my MP, Lynne Featherstone to contact your department on my behalf. Might I be so bold as to ask if you have received communication from her?

Yours sincereiy,

Stephen Bluestone

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Removing the requirement to annuitise by age 75 – consultation response

We are pleased to respond to your consultation on 'Removing the requirement to annuitise by age 75. Whilst in principle we welcome the move towards greater flexibility in the way individuals can take benefits, we do have particular reservations about the flexible drawdown proposal. Our comments on this and the other specific issues on which you invited comments are given below.

Developing a new tax framework for retirement (Chapter 2)

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

Inherent to the concept of drawdown is the possibility that the level of income that can be sustained in the future can be severely eroded by inappropriate or inopportune investment, whatever level of income is currently being drawn. No realistic level of cap will guard against this possibility and it is essential that if the market for this type of product is to be widened, then suitable safeguards must be put in place to minimise the risk of consumers not understanding this concept. By the same token, government must understand that unless very restrictive conditions are to be imposed that would probably make the proposition significantly less attractive to the existing market, the risk of significant reduction in available income will always be a possibility.

Having said that, we accept the need for some limits and we think it is important that the existing method of determining the upper level of withdrawal continues, at least in all major respects, up until age 75. From then on, we would regard it as important there is no sudden discontinuity in level of income that can be drawn and we are, in fact, drawn to the idea of the basis of calculation up to age 75 being continued throughout life – the maximum being based on the GAD rate for the age at date of calculation. This may seem generous but the prudent will want to aim to continue to provide a lifetime income anyway and we are not sure what policy objective is served by being too restrictive.

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 generally welcome the proposal to end the age 75 threshold for all but the limit on tax relieved contributions and the lifetime allowance test. This certainly accords with the push towards encouraging later retirement. The next step will no doubt be to remove the 75 limit entirely but we understand that such a move may be undesirable now in the light of the current fiscal situation.

The one area where we have some concern is the intention to charge tax on all lump sums paid out on death after accessing retirement benefits. To introduce, as part of these proposals, a flat rate tax of around 55% designed to recoup past tax reliefs on all such payments seems somewhat invidious. We say this because drawdown flexibility can be expected, in the main, to be of greatest relevance and benefit to individuals who were higher rate tax payers for a large part of the time they were building up funds. For such individuals, a 55% tax may be appropriate but it would be a significant worsening of the position in respect of such lump sums that are currently available (e.g. value protection lump sums) and would be applied to previously lower paid individuals for whom the tax is likely to represent a far more penal charge.

It is suggested that the tax should be applied across the board in the interest of simplicity but we do not think this is a material consideration. We would propose that the charge only applies to sums payable from residual income drawdown funds or any new annuity products that have taken advantage of the drawdown legislation.

Minimum Income Requirement (Chapter 3)

As indicated in the introduction, this is the area in which we have greatest misgivings. There are a number of reasons, including:

We are not convinced that one can say with certainty that any reasonable level of secure income would guarantee that an individual would never become dependent on the state.

Any realistic MIR might therefore be so high as to only apply to individuals with significant 'secured' income.

This could be unfair to individuals below the threshold who might have significant other wealth or who have a significantly reduced expectation of life.

As it stands, the proposal seems to contradict the principle that pension tax reliefs are given to provide an income for life; but only for the relatively wealthy.

However, we do think that it would be reasonable to allow higher than 'normal' levels of withdrawal to provide for significant expenditure that might otherwise be the responsibility of the state, such as long-term care or the adaptation of an individual's home as a result of disability. We accept that this may place more onerous responsibilities on scheme managers than under the government's proposals but believe that this would result in a policy of more universal relevance and more in keeping with the principles underlying tax-relieved pension policy. We would be happy to contribute to further consultation on this concept.

In the light of our comments above, we have not made any specific comments on the issues you raised below.

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.

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

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

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

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

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.

We have no comment on this issue.

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.

As indicated above, it is essential that if the market for this type of product is to be widened, then suitable safeguards must be put in place to minimise the risk of consumers not understanding the risks involved. This is not, however, the only issue in relation to defined contribution pension arrangements on which consumers must be made aware of the risks involved. In addition, if drawdown is to become more mainstream, then this will impact on investment decisions throughout the pre-retirement period. We believe that all stakeholders must collaborate to research the issues involved and establish agreed standards to which all concerned must conform.

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.

We have no comment to make

For further information, please contact:

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Canada Life's response to the consultation document-

"Removing the requirement to annuitise by age 75"

Developing a new tax framework for retirement (Chapter2)

A1 The level of an appropriate annual drawdown limit for capped drawdown (CD).

Response - We suggest the capped level should be pitched at 100% of GAD (Government Actuaries Department) using the current rules for unsecured pension (USP) withdrawals. Keeping GAD as the measure would seem a pragmatic and simple way of dealing with this issue, particularly as it has been the proven method of dealing with excessive withdrawals to date.
Limiting withdrawals to 100% rather than 120% would be sensible if the CD ends up accepting lower value funds than today's average USP and depletion of funds are to be prevented. By allowing 120% withdrawals, a higher level of income could be available from CD than from a conventional annuity. This could result in individuals opting for CD without considering the added risks associated with USP. A minimum fund level could also be imposed to reduce this risk.

A2 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

Response – The existing framework of "exempt, exempt, taxed (EET)" model is well understood and longstanding. The tax deferred system remains one of the incentives to save for retirement as does the ability to take up to 25% of the pension pot as a tax free lump sum. The vast majority of individuals will elect to take this prior to their 75th birthday, so keeping the status quo would seem appropriate. Pension Income should remain taxed at the marginal rate. Restrictions on higher rate tax relief should be reconsidered or at least simplified. We understand that this is the subject of a separate consultation paper. We are concerned about the number of new reforms and recent legislation that the pensions industry has been expected to consider and implement. The many issues arising as a result of these proposals will need very careful consideration. This is particularly so for flexible drawdown and the MIR, if we are to avoid any unintended consequences. We would therefore like to see a longer consultation period.

Lump Sum Death benefits-
The proposal to apply the same tax rate(s) before and after age 75 to both USP and annuity protection is a positive move and will go some way to addressing the perception that annuities provide poor value. It will also keep the rules consistent and simple. However this positive proposal could be completely undermined if the intended rates of taxation on lump sum death benefits are not amended.
Taxation at 55% would seem punitive and unfair compared to the current rate of 35%. If the current 35% figure is sufficient to recover tax relief provided on the way in, then the increase to 55% appears extreme.
Under these proposals HMRC face a net loss of tax receipts from lump sum death benefits held in an Alternative Secured Pension (ASP) however the amount of ASP members are very few in number.
It would seem fairer to apply any recovery tax rates in line with marginal rates. Leaving the current 35% in place for basic rate tax payers, with a higher amount payable from the rest would be more acceptable.

Minimum Income Requirement (Chapter 3)

A3 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?

Response – Secure income, restricted to pension income will keep the requirements simple, however the Treasury should also consider including purchased life annuities for individuals who have other assets outside a pension arrangement.
A lifetime annuity, scheme pension, (any guaranteed income for life) would be appropriate, however inflation proofing the income from a lifetime annuity is expensive, unpopular and we believe that there are insufficient index-linked securities to meet potential demand as a result of the consultation proposals.
Providing an escalating pension at 2.5% would be less problematic but we believe this would prove equally unpopular as our own experience shows that the vast majority of annuities are purchased on a level basis. We therefore suggest that secure income should be satisfied by using level annuities with the MIR set a higher figure to accommodate this.
The basic state pension, state second pension and any occupational pension that is LPI linked should also qualify as for MIR purposes.

A 4/5. The level of MIR for individuals and couples / adjustment for age

Response- The MIR level should be set sufficiently high as to avoid individuals and couples falling back onto state benefits - the Joseph Rowntree Foundation minimum income is a good basis as long as it includes housing costs.
If couples are not factored in to the MIR calculations then it would prove insufficient and ineffective, so there must be a check to ensure both individuals are covered.
This could be achieved via a joint life annuity, a guaranteed dependant's pension or by the spouse having their own pension to satisfy the MIR, or a combination of all three.
The word "Couples" should be clearly defined and consideration given to include a common law spouse who has no independent secure income.
To ensure that the MIR has a degree of inflation protection our suggestion is that it is based on the age/gender of the individual at the time flexible drawdown commences. For example, and assuming that a 2.5% per annum increase is adopted a 65 year old would have 5 years less indexation increase applied to that of a 60 year old and would therefore have to satisfy a lower MIR.

A6. How often should the MIR be reviewed?

Response- The MIR should be set by the government and revised annually in line with Personal Allowances.

A7 How to minimise unnecessary burdens for individuals and the industry in the assessment of the MIR

Response – We feel the responsibility to check the prescribed MIR is in place, should either rest with the adviser or by a method of self-certification. If the onus were to fall on to the provider it would add an extra layer of administration-a cost that would end up being borne by the provider or passed on to the individual.

The UK annuity market (Chapter4)

A8 Removal of legislative / regulatory barriers to provide more attractive products

Response -The annuity market has seen considerable innovation over the last decade. This has brought greater choice and flexibility for those who have accrued funds large enough to benefit from these new products. The reality is however that these products only suit a small minority. This is mainly due to the lack of retirement provision from a significant proportion of the working population. This is borne out by the average annuity purchase price being approximately £25,000-£30,000 providing income of around £1,500-£2,000 per annum.
As a result, even if certain rules were removed, it would have little or no impact on the main stream annuity market. Whilst innovation does bring greater choice, this in turn adds to the cost of a product which is ultimately passed on to the consumer. With annuity rates at or near an all time low any additional cost could reinforce those views that annuities are seen as poor value.
Greater choice means the decision making is more complex resulting in a greater need for advice. For consumers with annuity pots of less than £50,000 the cost of advice could prove a major issue resulting in a DIY solution with poor decisions being made as a consequence. In the future, if the only way of paying for advice is via their PCLS this scenario will be widespread. The requirements of holding higher levels of capital to comply with “Solvency 2” regulations will only add to the cost of buying an annuity.

Annuity changes that could easily be implemented without any noticeable cost would include

- the requirement to provide proof of financial dependency at purchase rather than at death. This would provide couples with greater certainty from outset.
- greater flexibility, choice and value for when dependant’s annuities are required. An example would be to allow an increasing income for the main annuitant upon the death of the spouse. This might encourage more joint life applications.
- long term health care provision could be eased by allowing annuities to be paid tax free for individuals who require long term health care and are seeking a registered nursing home.

A9 What can industry government and advice bodies do to make sure that individuals make appropriate choices with their retirement savings?

Response – Making consumers aware of the Open Market Option (OMO) is important and more can be done to improve this option being exercised. To make this process compulsory would be unrealistic, costly and make very little difference to the end income derived from the average annuity pot. There are only a few providers competing in the OMO market and most will not accept pension pots below a minimum size which is a problem that requires addressing. We suggest awareness could be improved, if it were compulsory for pension providers to include a simple process map in their benefit pack. This should highlight the steps to using the OMO including an illustration showing in income terms the difference between the best and the worst annuity providers from the pension fund accrued. This would increase the number of OMOs taken up particularly from those consumers who currently might ignore this option due to lack of information. In general the government should do more to promote the benefits of saving for retirement.

A10 Proposed reforms and unintended consequences

Response - Most of the unintended consequences have already been highlighted in the previous responses but to summarise the main issues -

- these proposals coupled with those relating to the banning of commission under RDR could result in some consumers abandoning any form of professional advice particularly for those with small pension pots looking to maximise income from an annuity. By consumers taking a DIY approach it could lead to inappropriate product choice or chasing the highest income available without considering all the risks.
- If the ruling on secure income to meet the MIR is to be inflation proofed the annuity industry would find it difficult to provide index-linked annuities because the supply of quality index-linked securities is limited.
- by setting the death benefit lump sum tax rate at 55% this will do little to enhance the views on annuities. Plus it will further discourage saving for retirement, especially following the recent legislation with restrictions on higher rate tax relief.
- flexible drawdown rules will allow a fund to be depleted as no restrictions will apply to withdrawals. In the event of a pending death the entire fund could be withdrawn resulting in a maximum tax charge of 50% (assuming current income tax rates), while those in a capped drawdown or with annuity protection would be subject to a 55% tax charge. It will only be the better off that can afford flexible drawdown which is not fair or appropriate.

THE VOICE OF BUSINESS

9th September 2010

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

CBI RESPONSE TO HM TREASURY CONSULTATION ON REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75

1. The CBI welcomes this opportunity to respond to the government on its consultation on removing the requirement to annuitise by age 75. The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce.

2. CBI members support the government's intention to give people greater ownership and control over income in retirement. We agree that steps to achieve this should involve a reassessment of the current requirement to annuitise at age 75. We also welcome the government's underlying recognition of the continuing value annuities provide by guaranteeing a stable income throughout the whole of a person's retirement.

3. The proposed reforms are substantial and will require complex administrative and system changes. The consultation document leaves, however, many of the questions around the detail of the new regime unanswered.

4. In particular, CBI members are significantly concerned about the suggestion included in the consultation document that the pension provider might be expected to assess whether a person meets the MIR or not, beyond checking the income received from the provider itself. This

requirement would significantly increase administration costs for providers, a cost that it is likely to drive up administrative charges for both employers and individuals in the future. Where a pension scheme is self-administered, such a cost increase would fall directly onto the employer.

5. CBI members strongly believe that the onus of assessing income against the MIR should fall on the individual. The pension provider should only be required to provide the information related to the income coming from them. In fact, it is only HMRC which can accurately access and assess an individual's total sources of income. On that basis we strongly recommend the government revisits the position on this. Businesses fear that without a clear government guidance document accompanied by an awareness-raising strategy, an expectation of advice would fall on employers.

6. The short timetable proposed by the government is also a concern for CBI members. It allows little time for preparation ahead of the entry into force of the changes in April 2011. Given the additional complexities of the new regime and the many uncertainties around the policy detail CBI members believe that the government should not rush the implementation of these changes. In fact we would encourage the government to revisit its implementation timetable to allow more time to get the detail right on how the flexible drawdown and Minimum Income Requirement (MIR) proposals would work in practice. Furthermore, allowing extra time for the changes to be implemented would give individuals a chance to familiarise themselves with the new choices and providers the ability to develop new products to increase choice for individuals.

7. In conclusion, CBI members support the government's proposed changes. However, the pensions industry will be complying with a number of new regulatory requirements in 2011, including the reduction of pensions tax relief and the introduction of the auto-enrolment regime. Abolishing compulsory annuitisation at age 75 is the right policy, but how this is carried out will be even more crucial for employers, the pensions industry and individuals.

Yours Sincerely

Neil Carberry
Head of Employment and Pensions

Consultation on age 75

Firstly we are financial planners and SIPP trustees and have a great deal of direct contact with members of the public.

The current system is complex and rightly or wrongly the vast majority of the public feel the current regime is penal and is a major disincentive to invest in pensions.

More flexible drawdown

We fully support the idea of moving to a more flexible system. We have been involved with cross border advice with a number of firms in the Republic of Ireland - their adoption of the ARF system is universally praised from both their public and their pensions industry.

Specific questions:

A.1 We strongly believe no limit should be set but standard suggested income level of 80% of GAD be made part of standard disclosures to public as a suggested sustainable income level.

A.2 We agree that the current age 75 rule needs changing - the age is arbitrary and the effect is wholly negative many members of the public who would not be effected directly by the rule see it as an example of how pensions are unfair and inappropriate.

A.3 Secure income should be state pension, occupational pensions, annuities in payment, employment income, self employed income, rental income etc but most importantly they should also be a capital option so members of the public with a reasonable fund whether within a pension or in other investments.

A.4 A minimum income requirement should be around the level of full state pension both basic and second state e.g. £8 - £10,000. For the capital option a fund of £50-75,000.

A.5 A differential rate between singles and couples seems complex to administer - we do not feel this is appropriate.

A.6 A 5 yearly review.

A.7 Once the MIR is passed for an individual it should not be revisited. We do not see why clients cannot be left to determine for themselves whether they can or cannot remain with flexible system. What if someone falls £1 below do they have to closedown their arrangement? Sell a property within it at a fire sale value?

A.8 Open market option annuity should be compulsory with existing provider being able to provide a quotation as well as other providers (in case their rate really is better).

A.9 The majority of people do not need to be told how to run their own finances in retirement and if the need advice it is readily available. The majority who opt for flexible retirement products have a degree of sophistication as well as sufficient financial backing.

A.10 Annuity rates are not good value and will be less so post Solvency II. I do not see why any legislation needs to try to protect annuity providers who set their rates commercially.

Ian Smith BA (Hons), APMI, FPFS, IMC, CFPCM

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10 September 2010

Dear Sir or Madam

Removing the Requirement to Annuitise by Age 75

I am responding on behalf of Co-operative Financial Services (CFS) to the above Consultation Paper.

Background to CFS Pension Business

CFS is a significant provider of individual pensions with over 800,000 in-force policies saving for retirement, primarily through regular monthly premiums. The annual volume of CFS pension customers reaching retirement is growing with over 10,000 customers taking benefits in 2009.

In keeping with our co-operative values and customer promise CFS has recently launched an annuity bureau model for our pension customers reaching retirement. This provides customers with the choice of the most competitive annuity rates in the UK market from a range of annuity providers as well as providing access to enhanced and impaired options. This model ensures that our customers are able to access the full benefits of the Open Market Option as the size of their retirement fund (the vast majority retire with CFS funds less than £20,000) restricts their access to specialist advice on retirement income planning.

Small Pots

An increasing area of customer dissatisfaction for CFS pension customers reaching retirement is the compulsion to annuitise small funds (of less than £2,000) where other pension holdings prevent their ability to take trivial commutation or consolidate funds (as a result of occupational pension schemes not allowing transfers in). This results in a customer with a retirement fund of £1,000 often receiving an annuity income of less than £20 per year.

CFS welcomed the announcement with the 2008 Budget to enable small occupational pension pots to be taken as a lump sum ("small pot commutation"). CFS is keen to ensure that the introduction of flexible drawdown as outlined in the consultation does not result in only those who meet the Minimum Income Requirement being able to effectively take small pot commutation through 100% withdrawal as our understanding is that this would result in equivalent tax treatment. We are also concerned that the removal of age 75 will create a situation where those with small pots are forced to keep their funds invested in the hope that this exceeds a level required to purchase an annuity (a number of providers (other than CFS) already impose minimum fund levels) and a high proportion result in benefits only being paid on death after age 75 (thus incurring the proposed 55% tax).

We believe that there are a number of options which should allow this to be extended to non-occupational pension schemes which prevent manipulation by customers or result in additional costs for HMRC. These are as follows:

a) Only allow small pot commutation if no premiums invested 5 years prior to retirement

A key reason for small pots is that customers cease contributing to a particular pension arrangement as a result of changes to circumstances which may provide access to an employer sponsored alternative. Analysis of the CFS pension business shows that the vast majority of funds less than £2,000 have had no contributions made for a number of years. We believe that imposing this condition would prevent manipulation as investment growth over the 5 year period would increase the 'risk' that a fund would exceed £2,000

b) Only allow small pot commutation if the pension arrangement was taken out 10 years before benefits are taken

The same arguments as a) largely apply but this option would ensure that customers continuing to pay relatively small premiums say £20 per month are not unfairly disadvantaged at retirement

c) Only allow small pot commutation if customers declare that they hold less than 3 non-occupational pension arrangements and the provider paying the lump sum verifies that the total of all pension funds held by the provider is less than £2,000

This option would prevent manipulation through either a customer spreading investments across a number of providers or the segmentation of funds across a number of policies with the same provider.

It is important that any extension of small pot consolidation results in tax equivalence with the proposed new drawdown regimes.

Flexible Drawdown and Minimum Income Requirement (MIR)

CFS welcomes the introduction of flexible drawdown and believes this provides far greater opportunity to reduce consumer perception of pension barriers than the existing unsecured pension arrangement or proposed capped drawdown model.

Whilst very few of the CFS pension customers would be likely to meet the MIR from their CFS pension fund alone we know from our customer research a significant proportion have other pension arrangements which currently prevent them taking trivial commutation. Therefore, we believe that a number of our customers are likely to meet the MIR from other pension arrangements and seek to use the introduction of flexible drawdown to gain access to 100% of their CFS funds.

CFS believes distinction is required between customers who will utilise the new rules to take 100% of pension funds held and those who are seek to withdraw income over time as the risk of having to rely on the state is likely to differ. We believe that for those who are seeking to take 100% of their fund the MIR should be set at National Average Earnings or a relatively high proportion of this amount.

It should also be noted that the majority of pension providers, including CFS, do not currently allow unsecured pension arrangements. Therefore, it is likely that any introduction of capped or flexible drawdown (other than 100%) would largely rely on both greater use of the Open Market Option and existing providers of such arrangements being able to meet the new requirements.

Proposed Changes to Taxation of Death Benefits

CFS supports the continuation of tax-free allowance for death benefits taken before age 75 where pension savings have not been accessed. Beyond age 75 we believe that 55% is too high for those who have only received basic rate tax relief in the accumulation stage. Therefore, we believe that the tax-free death benefits allowance should apply beyond age 75 if the total funds payable by a provider are less than the trivial commutation levels.

CFS welcomes this consultation and supports the Government's willingness to remove barriers to retirement saving. We believe our business model and commitment to meeting our customer' needs provides a unique perspective into this review and we would welcome the opportunity to further engage with HM Treasury in this area.

Yours faithfully

Danny Hurley
Head of Pensions
Co-operative Financial Services

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Jonathan Deakin
Pensions & Pensioners Team
HM Treasury
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09 November 2010

Dear Mr Deakin,

RE: Removing the requirement to annuitise by age 75

We are writing to you in reference to a particular issue, affecting charities, that arises from the above consultation document. While we acknowledge that the formal consultation period has now ended, we have only just become aware of this issue.

By way of background, CFDG is an umbrella charity that supports charities in their finance-related functions, promoting best practice in charity finance, driving efficiency and helping organisations to make the most out of their money. CFDG's circa 1,600 members – all senior financial professionals in the voluntary sector – are responsible for managing around £17.53 billion in charity funding, which represents around half of the sector's income. Our members work at the heart of the strategic development of their organisations, and are at the forefront of delivering a sustainable and efficient charity sector.

We welcome the intended flexibility that the proposals in the above consultation can provide to individuals. However, we would like to stress that these proposals will threaten the future legacy income that charities can receive.

Although there is usually no way to identify those legacies that come from pension funds, we know that they could make up a significant proportion, and are likely to increase in the future. Legacies overall make up large amounts of the income of many of our charity members. This is especially true for charities working in emergency, relief, medical research and animal welfare. Cancer Research UK received £157 million in legacy income last year – over 30 per cent of their total income. Smaller charities also rely on legacies to do their important work. For example, Devon Air Ambulance could not provide their emergency services without the 26 per cent of their income that comes from legacies.

Currently, the pension funds of most individuals who have passed away can be left to charity without paying any tax. The consultation document proposes that pension savings will be taxed on death, even if they are left as a legacy to a charity.

Specifically, the consultation document proposes a recovery charge of 55 per cent on unused funds, for those who pass away after the age of 75. This fee is not charged where funds are used to provide a pension for a dependent. However, the document proposes that the exemption for funds donated to charity should be removed. Those who have avoided annuitising their pension fund with the specific aim of leaving it to charity will therefore be heavily penalised. Consequently, it will be the charity that will lose out.

With people encouraged to work longer, this change would have an increasing impact on donations. At the current time charities are facing many economic pressures due to a combination of factors including VAT and fuel duty rises, the end of Gift Aid transitional relief and the imminent spending cuts. It would be a very damaging extra blow if the income from pension fund legacies was cut by more than half.

The Government has emphasised the role of philanthropy in their vision for the future. Nick Hurd has asked departments to find ways to encourage greater levels of giving. Tax breaks have been shown to be a very effective way of doing this. We believe this measure runs counter to the Government's wider aims and ask that it is reconsidered.

Last month, CFDG responded to the Treasury's *Tax Policy Making: A new approach*. We highlighted that often, the charity sector are not viewed as key stakeholders in the tax policy making process despite being affected by the majority of changes to the tax code. We would strongly ask that the charity sector be consulted on all tax changes, not just those that are explicitly targeted towards charities. In this case the sector was not engaged or made aware of the possible changes, despite the change having the potential to significantly affect charity funding. In previous cases, inadequate consultation with the sector has led to secondary, reactive measures later on. This has in the past cost both the sector and HMRC/HMT time and money.

We would welcome a meeting with you to discuss this issue in further detail. Please contact Chris Wood at chris.wood@cfdg.org.uk or 0845 345 3192.

Yours sincerely

Megan McInally
Policy Manager

CC: Cerys Morgan HMT
Sheryl Scott HMRC
Jackie McGeehan HMT

THE CHARTERED INSTITUTE OF TAXATION

Removing the requirement to annuitise by age 75
Response by the Chartered Institute of Taxation

1. **Introduction**

1.1. The Chartered Institute of Taxation is pleased to be able to comment on the consultation document published by HM Treasury on 15 July 2010.

1.2. We do however note that the consultation period, at 8 weeks, is 4 weeks shorter than is recommended as good practice in the code on consultation. We do not understand the need to rush the consultation over the main holiday period, especially when Finance (No. 2) Act 2010 extended the age at which income benefits have to be taken from by 2 years to age 77 and the stated intension is not to legislate until Budget 2011.

2. **Executive summary**

2.1. We welcome the Government's intention of making pension saving more attractive to individuals by giving them greater choice on how income in retirement may be received.

2.2. We are, however, unsure whether the proposals, as currently framed, are practical and fair. The rules are not as simple as they could be and the proposals for setting a minimum income for those opting for 'flexible drawdown' are particularly cumbersome.

3. **Removal of age limit requiring people to either annuitise or otherwise secure a pension**

3.1. Although most people will continue to opt to purchase an annuity on retirement the removal of the age limit is welcome as it will provide greater flexibility to choose when to secure a pension.

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3.2. We do however note that the Government intends to abolish Alternatively Secured Pensions (ASPs) leaving individuals with 2 choices: either annuitizing or entering into an unsecured pension arrangement. We think the Government should reconsider this and leave individuals with an alternative option for securing a pension other than annuitisation.

3.3. The proposal to extend the ability to enter into an unsecured pension arrangement (USP) (currently only available if under age 75) to everyone regardless of age is welcome.

3.4. We do however think that extending the USP model to permit individuals to draw down unlimited amounts where they can demonstrate they have a sufficient minimum income will be problematic (see below).

3.5. We also note that the Government is to review the level of the existing annual USP limit (currently 120% of the value of the equivalent annuity based on the tables provided by the Government's Actuary's Department (GAD)). The consultation document advises that the Government is concerned that individuals could exhaust their pensions savings if the current level is maintained. In our view the maximum drawdown ('capped drawdown') limit should not fall below 100% of the GAD rates.

3.6. Additionally, since USPs will now extend beyond age 75, GAD rates that go beyond age 75 will be needed.

4. New tax framework

4.1. We note that the existing provisions that enable a pension fund to be paid out as a tax-free lump sum will remain where an individual dies before age 75 and has not taken any income from the fund. In our view the age limit should be removed and this provision extended to beyond age 75.

4.2. We also note the proposal that funds remaining upon death (whether previously accessed or not) will be taxed at 55%. This compares with the current rules for USP which tax any unused funds at 35%. Historically the 35% rate was set as the basic rate plus 10% (but was not reduced when the basic rate reduced). The additional 10% being added to allow for tax on the tax exempt growth of the fund. In our view the proposed 55% tax rate is too high and will operate as an 'effective compulsion' to annuitise. We think that this aspect of the proposals should be looked at again; it would seem harsh to tax those that received tax relief at 20% on their pension contributions at a rate of 55%.

5. Minimum Income Requirement (MIR)

5.1. The proposed 'flexible drawdown' alternative will enable accelerated (taxable) payments to be received out of the pension fund, including a second lump sum, provided the individual has demonstrated they have already secured sufficient minimum income in retirement to prevent them falling back on the State.

5.2. While this will provide flexibility to those who may need to call upon their pensions savings for a particular purpose it will add a new layer of complexity and we would suggest just having 'capped drawdown'.

5.3. We think that the MIR concept is cumbersome and will require a lot of detailed rules, which will be messy to operate in practice. We assume individuals will have to prove that they meet the MIR on each occasion that they wish to receive a payment in excess of the capped drawdown limit?

5.4. We do note that there will be further consultation on the amount of the MIR and would suggest that the calculation needs to be simple (e.g. a figure of £X per annum with scale additions for dependants).

5.5. We are also unclear why life annuities will only be included in the calculation if they increase (in line with inflation) each year. In our view it should be possible to take 'fixed rate' annuities into account as well.

6. The UK annuity market

6.1. We welcome the intention to remove the restriction on taking pension commencement lump sum benefits after age 75 and also to extend the trivial commutation rules beyond age 75.

6.2. However, we are disappointed that the 2 year extension to the age 75 rule in Finance (No. 2) Act 10, enacted as a temporary measure whilst these proposals are finalised, did not include increasing the age at which the pension commencement lump sum must be taken to age 77.

7. The Chartered Institute of Taxation

7.1. The Chartered Institute of Taxation (CIOT) is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

The CIOT's comments and recommendations on tax issues are made solely in order to achieve its primary purpose: it is politically neutral in its work. The CIOT will seek to draw on its members' experience in private practice, Government, commerce and industry and academia to argue and explain how public policy objectives (to the extent that these are clearly stated or can be discerned) can most effectively be achieved.

The CIOT's 15,000 members have the practising title of 'Chartered Tax Adviser'.

The Chartered Institute of Taxation
10 September 2010