Dear Sirs

I am writing to you following a letter dated 5th August sent by Mark Hoban at HM Treasury to my MP Theresa Villiers. Mark Hoban has asked that if I have particular views on the proposed changes then I need to send them by email to yourselves before 10/9/2010

I worked for over 23 years at Investment Director level in a major Assurance Company

Technical comments are shown on the e mail below from Dentons my Pension Consultants, and follows much previous correspondance between Theresa Villiers , Mark Hoban and Yvette Cooper over the last few years

My main point as a Pensioner is that the rule changes must cover those 50% of pensioners who die before the average expectation of life at
retirement-- both my wife and I have serious medical problems and cannot take out life assurance protection

In my opinion a self investment pension is more suitable than a Pension linked to fixed interest rates for pensioners in poor health. I have worked very dilligently for many years to build up a Pension Fund for our family welfare and do not wish a Life Assurance Company to make a substantial profit on our early deaths to help pay a Fixed Pension longer- for somebody else who lives a long time and had not built up a sufficient fund

I suggest the email below is practical and well considered by an Expert Administrator who works full time on Pension Costs/Benefits

Yours sincerely

Jeffrey Selwyn FCA

From: Ian Stewart [mailto:ian.stewart@dentonspensions.co.uk]
Sent: 20 August 2010 13:13
To: Jeffrey Selwyn
Subject: Age 75 Rule Changes

Dear Jeffrey,

Many thanks for the correspondence from the Treasury. On the whole we welcome the proposals which seek to introduce greater flexibility in the extraction of pension benefits and more sympathetic approach to the treatment of the benefits on death after age 75. I would however make the following observations:-

1) It is proposed that the new tax rate payable on the lump sum distribution amount to 55%. Whilst this is a significant improvement on the draconian penalties introduced by the last Government, where the tax charges were a massive 82% combined with a potential deregistration charge, it would appear that the charge is to be introduced from a members pension age, i.e the date they take benefits, which could be from age 55. This is a retrograde step, under the current rules on death before age 75 the fund can be returned less 35% tax. Furthermore, the vast majority of pension scheme members will only have received basic rate relief on their pension fund contributions, and even allowing for the tax friendly environment/growth offered by the scheme, 55% looks too high.

2) The proposals offer members the ability to withdraw additional funds, provided a certain level of benefits has been 'secured'. The Consultation Paper suggests such secured benefits could include state benefits. I am not convinced that using state benefits is a workable solution. Firstly, everyone has different entitlements from the state in respect of the basic state pension, graduated pension, SERPS and S2P.
Secondly, State pension benefits don't come into payment until age 65 presently (and for women between 60 and 65 depending upon date of birth) , so someone under state pension age couldn't rely on such benefits if they wished to access additional funds. Thirdy, the state pension age is changing gradually from 65 to 68 by 2046. This would mean that different individuals would be adversely affected depending upon age. Our suggestion would be for the minimum level of pension to be secured by an annuity purchase. The level of such pension should be identical to the basic state pension at the date the annuity is secured. Such pension should be an index linked basis, and if the individual is married at the date it is secured it should include a 50% spouses pension.

I trust these observations are of use.

Regards

Ian Stewart

Pension Consultant

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Group:

Eversheds LLP's Response to the Treasury's Consultation Paper 'Removing the requirement to annuitise by age 75'

1. Background

We set out below our response to the Treasury's consultation paper 'Removing the requirement to annuitise by age 75'. Our pensions team is the largest in the country with over 60 specialist pensions lawyers. Our clients include trustees and employers of a number of the largest occupational pension schemes in the UK and of the leading insurance companies.

This response represents our views on the consultation document and not those of our individual clients. However, in forming our views we have taken account of our clients' interests and concerns.

2. General comments on the consultation paper

We welcome the proposal to remove the obligation to purchase an annuity by age 75. We believe this will provide greater flexibility in relation to retirement decisions even if the proposed options are not actually used. We also believe it may provide an impetus to the annuity market to introduce new products which may be needed to fully implement the proposals. However, we would urge caution to ensure that the level of Minimum Income Requirement ('MIR') is set at an appropriate level and that the methodologies used throughout are simple and easy to administer.

3. Response to Specific Questions

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

Clearly care needs to be taken that the level is set so to minimise the risk that individuals will run out of money. In particular, care will need to be taken to ensure that individuals do not become reliant on the State particularly in relation to long term care costs later in life. However, the level of 120% of the value of an equivalent annuity currently allowed under the current annual USP limit seems to have worked well. We would, therefore, consider that an amount around this level would be appropriate.

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

We welcome the abolition of the 82% tax charge on ASPs. However, we are concerned that the proposal to introduce a 55% recovery charge is punitive given the rate of tax relief initially granted, particularly for basic rate tax payers.

Our concern is that this will allow only wealthy individuals to take advantage of the new proposals.

We are also concerned about the proposal not to make any changes to the contribution limit, the age at which the lifetime allowance test is conducted or lump sums associated with these rules on the basis that the age of 75 is a proxy for the end of an individual's working life. This is, in part, at odds with the drive for flexible retirement. Potentially, an individual may never retire so it seems inappropriate to impose such proxy ages.

3.3 **The Government welcomes views on what income should be considered 'secure' for the purposes of the MIR and whether proposals for the life annuity income that can be considered for the MIR are practical and appropriate.**

In general, the proposals for the MIR seem sensible. In line with 3.6 below we would recommend that consideration be given to occupational pension schemes that wind up or enter the Pension Protection Fund after the pension has been taken. In such circumstances, it is possible that the level of the pension for an individual will be lower than that originally paid. This may also apply to ill health pensions payable at a trustees discretion which, in certain cases, can be reduced if the member regains health at a later date. In both cases the minimum income is likely to change for the relevant individuals. Linking in with 3.6, we would, therefore, recommend that the MIR level be assessed at reasonably frequent intervals.

3.4 **The Government welcomes views on what an appropriate level for the MIR should be and how the MIR should be adjusted for different ages.**

It is accepted that a balance has to be struck between a MIR which is appropriate for all individuals and administrative simplicity. In light of the general complexity within the pension industry as a whole, we recommend that a swing be in favour of simplicity.

One further consideration is that the capitalised value of the MIR may again lead to this being a facility which is only open to those with the largest pension provision. A policy decision, therefore, will need to be taken on whether to allow a facility for only wealthier individuals or reducing the MIR with corresponding risks to state benefits.

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

As the state pension for a couple is lower than two combined single state pensions, we would recommend that the MIR be calculated in similar fashion.

3.6 **The Government welcomes views on how often the MIR level should be reviewed.**

Again, care will need to be taken to state the correct balance administrative complexity in reviewing the MIR level. In our view a review every 12/24 months would seem appropriate.

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

We accept that there will be additional administration required. We recommend that simplicity of operation is the key to a successful implementation.

3.8 **The Government welcomes views on whether other legislative or regulatory barriers remain his removal would enable industry to provide consumers with more attractive products without incurring physical or avoidance risks.**

We do not feel able to comment on this point.

3.9 **The Government welcomes views on 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.**

We welcome the new financial advice service and annual financial health check. We believe that this will allow more individuals on moderate to low incomes to have access to financial advice that is otherwise costly to purchase through the private sector.

We would also welcome a drive by the Government to encourage all individuals to take more responsibility for their savings for later years (either through retirement pension or other saving provision). This is a drive which can be coordinated with the introduction of personal accounts.

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

We have no comment on this issue.

Eversheds LLP
9 September 2010

Fidelity International Response to HM Treasury Consultation on Removing the requirement to annuitise by age 75 - 10 September 2010

Introduction

Fidelity International welcomes the Government's reviews of pensions policy including the current consultation on removing the requirement to annuitise by age 75 and the separate consultation on an alternative approach to pensions tax relief (to which Fidelity International responded on 27 August 2010).

It is our view that UK household saving is inadequate when considered both against historic levels and the level required to support the increasing life expectancy in retirement coupled with rising healthcare and nursing costs linked to longevity. We would welcome a root and branch review of savings and investment policy with a view to both enhancing incentives for medium and long-term savings and removing disincentives for medium and long-term savings.

Our Response

We have set out below some general observations on UK annuity policy. We have then responded to some of the specific questions in the consultation document.

What should be the yardstick to judge changes to annuity policy?

We believe any changes to annuity policy should be justified against certain criteria including the following:

- Do they promote pension savings across the board?
- Do they increase simplicity and avoid adding complexity?
- Do they promote flexibility and choice?

Equally, any measures which discourage certain segments of the working population from pensions savings, which increase complexity and reduce choice should be carefully reviewed.

The Impact of the financial crisis on pension outcomes

We have been calling for the removal of the compulsory annuitisation rule for a number of years. In our opinion, it is an unduly restrictive rule which removes individual choice and responsibility; and has led to poor outcomes in 2007-2010 for retirees who were heavily invested in equities. This cohort will have had no opportunity to benefit from the uplift in global equity markets if they were reaching age 75 in this period. This episode demonstrates that the time for annuity reform is ripe.

Endorsing the Government's Choice Agenda

The world of defined contribution pensions is characterised by choice notably around investment options. For too long this choice has been restricted to the accumulation phase.

Accordingly we welcome the current consultation on the decumulation phase and endorse the Government's commitment as set out in the Foreword "to ending, from 2011, the current rules that effectively require individuals to purchase an annuity by age 75". Their replacement by a choice agenda that hands back control to individuals of their pensions pots in retirement is a welcome step to reinvigorating pensions savings.

Promoting choice whilst preventing depletion

We fully acknowledge the Government's legitimate desire to ensure that safeguards are put in place to prevent individuals depleting their pension pots and falling back on the State. Clearly the purchase of an annuity guarantees an income for life – however there are other mechanisms which can be put in place alongside annuity purchases to ensure the Government's overarching public policy objective is achieved.

The current paper discusses a new framework for income in retirement involving capped drawdown and flexible drawdown (subject to demonstration of a Minimum Income Requirement or MIR). We welcome the discussion of these two drawdown options and believe they both have a role to play in the new choice agenda for retirement. In particular we believe that the proposals on flexible drawdown permitting drawdowns without an annual limit (subject to demonstrating a MIR) will create strong incentives to save.

Minimum Income Requirements & Minimum Capital Requirements

The mechanism of the MIR is only one way to ensure that depletion is avoided. As an alternative to the MIR, we believe the Government should allow a Minimum Capital Requirement to be demonstrated for flexible drawdown. Individual retirees would choose whether to opt for a MIR or a MCR.

In the case of the MCR being chosen by a retiree, a certain minimum level of capital would be stipulated by Government. Flexible drawdown up to this MCR level would be permitted and this would enable the entire pension pot to remain invested with significant upside potential to the retiree. The level of the MCR could be reviewed periodically. We would envisage that the MCR should initially be set at a level no lower than £150,000.

<u>Responses to specific questions in the consultation document</u>

A1 The Government welcomes views on the level of an appropriate annual drawdown limit for capped drawdown (Paragraph 2.17);

Our view is the current 120% of GAD is still a reasonable limit and that this test should be applicable for the entire drawdown period rather than a reduced basis post age 75. The proposal is to remove the age 75 rule and our view is this should be removed when reviewing the applicable rate of drawdown.

We would recommend the review period to monitor sufficient levels of income and available assets be amended to an annual event**.**

A2 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 (Paragraph 2.25);

"Whilst recognising that the purpose of tax relief is to incentivise taking of an income in retirement, as opposed to facilitating estate planning, the imposition of a tax recovery charge on unused funds of around 55% appears excessive when compared against the current level of 35%. This would be particularly onerous to basic rate taxpayers. Our understanding is that this change is designed to be broadly tax neutral, but without proper explanation from HMT this will be seen as a 'stealth' tax. This runs the considerable risk of alienating people away from pensions.

An alternative option which the Government may wish to consider would be a lower tax recovery charge on unused funds of around 25% with the remaining value added to the estate for the purposes of IHT. This would mitigate the charge on the less wealthy but would produce an effective charge of 55% on those liable to IHT.

A3 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 (Paragraph 3.9);

The Government proposes in paragraph 3.7 that to be secure the MIR should inter alia take into account reasonable expectations of the future cost of living. The Government continues in paragraph 3.9 that life annuity income should be allowed for the purposes of the MIR "providing it increases annually by at least LPI". This would exclude level annuities from the calculation of the MIR. This would be a very significant policy shift and defies the reality of annuity purchases in the UK – the bulk of annuities purchased in the UK are level annuities and to exclude them from the calculation of the MIR would ensure that flexible drawdown would remain the preserve of the very rich.

In addition it could be seen as an attempt by the Government to skew the annuity purchase market towards index-linked annuities. Again this would be a very significant policy shift and defies the reality regarding the cross-over point for index-linked annuities i.e. the point when the individual actually receives more income from an index-linked annuity than the level annuity. If inflation is running at 3% it could take almost 2 decades to reach the cross-over point. Even at a 5% inflation rate, it could take over a decade for an index-linked annuity to exceed a level annuity (see in this regard, Fidelity International Viewpoint Paper from September 2008 Retirement Income: Making the right choices). This is why index-linked annuities may not always represent good value.

4 The Government welcomes views on what an appropriate level for the MIR should be and how the MIR should be adjusted for different ages (Paragraph 3.15);

We would welcome consideration of a Minimum Capital Requirement or MCR as an alternative mechanism permitting flexible drawdown (see in this regard above paragraph on Minimum Income Requirements and Minimum Capital Requirements). We would envisage that the MCR should initially be set at a level no lower than £150,000.

A5 The Government welcomes views on whether a different MIR should be set for individuals and couples (Paragraph 3.17);

We feel that there should not be separate MIR bands for individuals and couples. In order to provide a simplified model for both individuals and the industry a single MIR basis would be preferable.

A6 The Government welcomes views on how often the MIR level should be reviewed (Paragraph 3.18).

We believe it would be appropriate to uprate the MIR each year in accordance with the uprating of the basic state pension. The MCR could also be uprated periodically. It would be preferable if uprating was rounded up to whole numbers.

A7 The Government would welcome views on how to minimise unnecessary burdens for individuals and industry in the assessment of the MIR (Paragraph 3.20)

If a MIR is set it would seem appropriate for HMRC to provide a statement to the individual on their total income which could them be supplied to providers as evidence. This approach would limit the opportunity for false declarations.

If a MCR is set, providers would be best placed to monitor the MCR.

A8 The Government welcomes views on whether other legislative or regulatory barriers remain whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance costs (Paragraph 4.8);

In order to support the maximum choice for consumers, the new flexibility and the associated rules need to be constructed in such a way as to allow consumers who wish to do so to manage their own finances, as well as those who wish to seek professional advice. Currently, the combined effect of HMRC's legislative requirements and the requirements of the Financial Services Authority mean that even well educated, engaged consumers find difficulty in managing their own drawdown funds.

Whilst many consumers will require professional financial advice to take advantage of the new flexibility, the costs of such advice could be prohibitive or unwelcome for some consumers, and the Government will need to work with the FSA and its successor body to ensure that the new flexibility is available to as many consumers as possible, consistent with the principles of consumer protection.

A9 The Government welcomes views on how the industry, Government and advice bodies such as CFEB can work to ensure that individuals make appropriate choices about what to do with their retirement savings in the absence of the requirement to purchase an annuity by age 75 (Paragraph 4.12);

Our view would be that the communication from providers would need to be clear on all the options available to the individual. Specifically, we would recommend appropriate consumer testing of the options for the new flexibility to establish whether a well informed consumer is able, having benefited from generic advice, to adequately understand their choices, make an informed purchasing decision, and understand the ongoing communication regarding their pension fund.

A10 The Government welcomes views on whether the proposed reforms have unintended consequences that may affect the market's ability to supply annuities at attractive rates or prevent the annuity market being able to meet likely demand for annuities (Paragraph 4.13).

One consequence of the Government's proposals to promote use of index-linked annuities will be increasing demand for index linked gilts. The Government will need to carefully assess whether it intends that DMO should meet this demand.

Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
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Jonathan Deakin
Age 75 Consultation
Pensions and Pensioners Team
Room 2/SE
H M Treasury
1 Horse Guards Road
London
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10 September 2010

Our ref: Annuities

Dear Mr Deakin

Removing the requirement to annuitise by age 75

This is the Financial Services Consumer Panel's response to the H M Treasury Consultation Paper: Removing the requirement to annuitise by age 75.

The Panel is not in a position to respond to all of the questions within the Paper and we have focused on the issues raised in Chapter 4. Our detailed comments, which are mainly concerned with the need for consumers to have access to affordable advice and genuinely helpful information about annuities and the new alternatives, are set out below.

The Panel welcomes in principle the proposals to open up the market to retirement products other than annuities, which arguably do not always deliver value for money. There is clearly a consumer need for more competitive products that deliver good consumer outcomes. The Panel will consider further the impact of this wider market on consumers, particularly in terms of access to affordable advice, the suitability of different types of product and how to make best use of small pension pots. We will be happy to input our views at a later date.

The Panel has recently commissioned research into annuitisation and consumer detriment. This will be published on the Panel's website at www.fs-cp.org.uk in the autumn.

Chapter 4: The UK annuity market

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

The Panel is not aware of specific legislative or regulatory barriers to providing better products, that could be removed without risk. The annuities market is however moderately concentrated and there may be wider competition issues that impact on the efficiency of the market as a whole.

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

The Panel's recent unpublished research, which included analysis of market data, concluded that the majority of annuitants are getting the best annuity rate, either by switching, the trustees of their scheme selecting the best provider or from their existing provider. But there is evidence that around 25% of annuitants do not appear to make an informed choice and may be suffering detriment as a result. The extent of this detriment is difficult to assess, but research analysis suggests that individuals could be losing around £200 per annum, with the total level of detriment estimated to be between £8mn and £17mn per year. Many of those suffering detriment seem likely to be individuals with smaller pots for whom advice may be inaccessible, unaffordable or intimidating. This is an issue that needs to be addressed as the nature of the decision to be taken is a personal one, based on individual circumstances. So while we fully support a wider programme of information and education, ultimately there can be no substitute for suitable advice.

Organisations such as CFEB and advice agencies could, given sufficient resources and support from industry and Government, play a vital role in explaining in plain language the options that will be available to those approaching retirement and perhaps setting out the factors that individuals should be taking into account when considering what action to take. CFEB does of course produce a number of helpful leaflets for consumers already on the subject of pensions and retirement. This would also help to address some of the general lack of understanding amongst some consumers about annuities in general – although a greater understanding of annuities would not necessarily lead to greater take-up of these products. There should be a single integrated and focused public awareness/education strategy to deal with the new arrangements for retirement saving ahead of the introduction of the changes, with clear objectives that should be assessed to ensure that the programme delivers what is required.

There is scope too for this information to be included in the 'wake up' packs that are sent by firms to consumers approaching retirement, which already include Moneymadeclear information. No doubt the Government, FSA and the relevant trade associations will be taking steps to ensure that advisers are provided with the information they need about the new retirement options to advise consumers on the right product for them.

It will be important for consumer-focused information material to be clearly identifiable and separate from marketing material. In this respect the use of the Moneymadeclear brand would be helpful.

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

The paper makes clear that the Government is already aware of the potential detrimental impact of Solvency II on annuity markets and annuity rates. The Panel is not aware of any unintended consequences from the specific proposals contained within the Paper that could hinder the delivery of the right products to individual consumers.

Yours sincerely

Adam Phillips
Chair
Financial Services Consumer Panel

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Age 75 consultation
Pension and Pensioners Team
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23 August 2010

Dear Pension and Pensioners Team

Removing the requirement to annuitise by age 75

We are grateful for the opportunity to comment on this Discussion Paper and set out our responses below.

Developing a new tax framework for retirement (Chapter 2)

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

Logic suggests that the current limit of 120% GAD is too high to be maintained throughout life. As the GAD rate is based on life expectancy, then it seems unrealistic to expect that, on average, an individual could draw down 20% more than that each year without their fund running out before they die. 100% GAD seems a more suitable level.

However, GAD rates should no longer be based on a maximum age of 75, as this would produce unrealistic comparisons between the drawdown and annuity options.

Any measurement should continue to be against GAD rates as they are from an independent source, and are easy to obtain and track.

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 agree with the proposal that the income that is drawn down should continue to be subject to income tax and with the continued availability of the tax free pension commencement lump sum.

- We are unclear from the consultation of the exact position of those who do not want to draw any benefit at all by age 75 and would appreciate clarification.

  We are assuming that anyone in that situation would not automatically be assumed to be in USP and that the crystallisation event does not occur until the individual wants to take the pension commencement lump sum and/ or income withdrawal or annuity payments. For example someone who takes both PCLS and purchases a lifetime annuity at, say, age 78 (having not taken any drawdown payments) would not be deemed to have been in USP at all.

  If that is correct, we assume that even though the LTA check would be done at age 75, it would be possible for the individual to benefit from future investment growth without a further LTA check at date of starting to draw benefits. It is not clear whether the maximum PCLS would then be based on the value at that point in time or restricted to 25% (or other appropriate percentage) of the fund value at age 75 – we are assuming that the former would apply but again would appreciate clarification.

- There does not appear to be any recognition in the consultation paper of phased retirement, where an individual crystallises part of their pension pot to buy benefits and leaves the balance uncrystallised (with or without continuing to contribute).

  We would appreciate confirmation in the technical paper of the effect of the proposals in those circumstances.

- We welcome the efforts to simplify the tax rules on death but are concerned with the detail.
  - The removal, in most cases, of any IHT liability in addition to the recovery charge will ease administrative burdens and is welcomed.
  - The rate of recovery charge itself seems high at 55%, particularly as the same rate will apply on death at any age and irrespective of the tax status of the individual; the recovery charge should continue at 35% for basic rate tax payers. An additional charge could be collected through the tax system for higher rate tax payers to reflect the additional reliefs from which they had benefited.
  - There is logic in applying the recovery charge on death after age 75 irrespective of whether the funds have been crystallised into USP or not.
  - There does not appear to be logic in applying different rules in similar circumstances where the individual has not reached age 75. We would suggest that any death benefits (from crystallised or uncrystallised funds) paid up to age 75 should be free of a recovery charge.

- We welcome the extension of value protection lump sums, trivial commutation lump sums and pension commencement lump sums beyond age 75.

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 pension income for the purpose of the MIR should include State Pensions, scheme pensions with LPI and lifetime annuities with LPI (or 2.5% escalation).

With regard to other potential sources of secure income, it is not clear from the consultation paper whether 'life annuity income' is intended to include purchased life annuities as well as lifetime annuities purchased with pension funds. There does not appear to be any reason to exclude purchased life annuities as they are as secure and are similar in all other respects (apart from taxation) to lifetime annuities.

As DC schemes are no longer obliged to offer LPI increases, this could disenfranchise people who fail on this point but are drawing secured pensions well in excess of the MIR level. Given that it would take just over 28 years for an annuity escalating at 2.5% to reach twice the original level, consideration should be given to offering a flat rate alternative minimum of no more than 2 times the LPI based MIR, or some other simple criteria.

We note that technical provisions will cover both flat rate annuities and pensions already in payment and would urge the Government to find a simple way in which future flat rate arrangements could also be included. Consideration should also be given to including those flexible annuities which include a guaranteed minimum income.

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

A figure of around £15,000 seems appropriate as this would give a cushion against future benefit changes. We do not believe that the MIR should be age related. Whether an income level is adequate can vary from time to time and in response to many different stimulate, so attempting to govern this with an age measure seems inappropriate.

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

We do not believe that it is fair or feasible for the MIR to vary between individuals and couples. The individual's status at the date of having to prove MIR could vary in either direction within a very short period afterwards due to marriage, separation, divorce or widowhood etc. It would not be feasible to expect providers to monitor status after outset.

Conversely, if separate limits did apply, it would not be fair to expect the same limit to continue despite subsequent changes. It might also skew behaviour away from marriage/civil partnerships in later life to avoid increased minima being required.

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

The optimum period depends on a number of factors such as the inflation level, stability or otherwise of state benefits etc. On balance we propose that it is reviewed each year, with the change effective from the beginning of the next tax year. The review could be undertaken, in line with various other reviews, in September so that providers and advisers have sufficient time to inform and advise as appropriate.

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

This really comes down to the level of proof that is required. At some point, an individual who is receiving a state pension, a scheme pension or a lifetime annuity will have been given a statement of the amount payable. However, that statement may be produced several years before the individual opts for uncapped drawdown and will not show the effects of any indexation since outset, or may easily have been lost.

It would not be practical for the individual (or USP provider) to approach all the sources of that income for an up to date statement of entitlement. Equally, a bank statement would only show the net amounts being paid from a source to the individual; it would not specify the gross entitlement or confirm the type of payment.

Self assessment or self certification is widely accepted in many areas and seems to be the most practical option here. The individual would be asked by the drawdown provider to submit a schedule showing the source of payment, reference number and gross annual payment. Referring back to A3, it would be essential that the individual clearly understood the difference between LPI linked and flat rate payments in order for the correct MIR total to be calculated.

If self certification is not thought to be robust enough, then consideration could be given to an industry wide agreement whereby Government, schemes and providers could have a speedy on-line checking system to verify the information given by the individual.

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.

Consideration could be given to reinstating the ability to commute the balance of annuity in the event of an individual not surviving any guaranteed payment period. There would be no loss to HMRC if that balance were taxed.

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.

It would be helpful to include generic case studies in the pre-retirement packs (industry wide examples) as providers cannot guide individual unless going down the individual advice route.

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 foresee any adverse effects from these proposals. The majority of individuals currently tend to annuitise within 5 years of their planned retirement age and this is likely to continue.

The main concern would be if the Government were to stop issuing suitable gilts to support the annuity market.

The introduction of NEST and automatic enrolment is likely to have a far greater effect on the annuity markets as large numbers of individuals with small pension pots will be looking to annuitise.

I hope you will find our comments to be useful and would be happy to discuss further if you wish. I can be contacted at the above address; by telephone on 0845 2664253; or by e-mail: martin.palmer@friendsprovident.co.uk

Best regards

M Palmer

Martin Palmer
Head of Corporate Pensions

FURNSHILL PENSION SERVICES

Pensions and Pensioners Team
Room 2/SE
HM Treasury
1 Horse Guards Road
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17 August 2010

Dear Sirs

AGE 75 CONSULTATION

Please find enclosed the response to the above consultation for your consideration.

The writer is regulated by the Financial Services Authority to provide advice under the Financial Service & Markets Act 2000. The views of the writer contained in the enclosed response are personal, and not those of the company who employs him.

Yours faithfully

Furnshill Pension Services.

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Response to Removing the Requirement to Annuitise by Age 75

Foreword

1.1 FPS welcomes the Government's intentions to end the rules creating an effective obligation to purchase an annuity. The proposals are sensible, creating a mature framework for pension planning.

1.2 Any regulations should be long terms sustainable. Any changes should deliver benefit to the taxpayer and to the member. FPS believes that the proposed changes will do this. The proposals will deliver increased tax revenues to the taxpayer.

1.3 It should be made very clear than the new regulations are not appropriate to those who would be reliant on income derived from the pension fund in retirement. The drawdown is inherently risky. Those who need or require certainty of income should still consider annuity purchase; this still represents best value for those on lower incomes, or who will be reliant on the income in retirement.

1.4 The changes in April 2006 were meant to deliver simplicity. The rationale was that by making pensions simpler, more people would save for their retirement. This failed to deliver. Subsequent changes to pension's legislation make the situation more complex. Some increase in pension savings did occur, but it was the wrong type of savings – predominantly from the very wealthy who had previously not saved significant amounts into pension funds.

1.5 Complexity is not something that should be avoided at all costs. In order to deliver fairness, and avoid situations which could lead to loopholes being formed, some degree of complexity may be necessary. The new regulations will mostly effect those with higher levels of pension savings, and those individuals will be able to afford any advice necessary.

2 Response to Questions

A.1 The current method of calculating the pension in drawdown is simple. However, FPS believes that, if drawn, the current maximum level of pension is unsustainable. Furthermore, the five-year reviews of the maximum level of pension are too long. This compounds the problem of overdrawing from a pension fund by delaying the time in which any overdrawing is corrected. Reviews should therefore take place every three years.

The basic method of calculating capped drawdown should be the same for USP. However, only 100% of GAD should be permitted to be drawn.

The current rules for determining when calculations can take place are unnecessary, and should be removed. Reviews should be able to take place at anytime a member requests, but at least every three years. Additionally, reviews should take place immediately after part annuitisation, or after a pensions sharing order has been implemented.

A2 The intended approach is sustainable, and delivers value for the tax-payer. The Government is correct in confirming that the most usual method of drawing income will be annuity purchase. The Government should also ensure that the legislation is robust enough to prevent abuse.

There are areas that require further guidance. The new approach maybe used by some advisers to recommend individuals in final salary schemes give up these valuable benefits in order to transfer to defined contribution schemes. This is likely to involve substantial transfers generating substantial commissions. The Financial Services Authority (or its successor) should provide guidance about what it would consider "miss selling".

A3. The Government is correct in considering State Pension as being secured income for the purposes of MIR. However, FPS believes that recognising only LPI-linked annuities for the purposes of MIR would create demand for this type of annuity, when it may not be the right type of annuity for the member.

It is right and proper that the Government wants to ensure that the member is never again a burden on the State. FPS also understands that this is the reason that the Government believes that some form of indexation should be built into a MIR. However, there are other alternatives.

As State Benefits will be indexed, the gap of concern is the difference between MIR and State Benefits being paid. The member could decide to plug the gap using an index-linked annuity. However, FPS believes that the member should also be able to plug the gap using other types of annuity income. However, if the annuity income is not LPI-linked, there should be some form of discounting of the income being provided. This would mean for non-LPI-linked annuities, a greater annuity income would be necessary to satisfy MIR.

The form of discounting would also be useful for other types of annuities, such as with-profits or other forms of asset-backed annuities. The member would also not be penalised for making provision for a spouse.

The basis for the discounting should be on annuity rates. Therefore, if a member needed to generate £1,000 of LPI-linked income in the year to get up to the MIR, and this cost £24,500, then the member should be able to spend £24,500 on an annuity of his/her choice and still meet the MIR. If the member elected for a level annuity, the income would be £1,363.31. If the member elected for a joint life level annuity, the income would be £1,252.58.

The mechanics for applying the discounting can be based on actual annuity rates, by obtaining comparative quotes, or by tables supplied by GAD. This does add a layer of complexity, but permits additional flexibility, maintaining choice of annuity products and keeps an open market in annuities.

A4 The MIR should be linked to the level of the Pension Credit. The Pension Credit takes no account of age, and therefore neither should MIR. By ensuring that the member has more income than would allow qualification for Pension Credit, the member will not be able to become reliant on the State in the future. Anything more than this is unnecessary; anything less than this is undesirable.

A5 The MIR should not take into account the marital status of the member. Current pension provisions do not require this. Pensions cannot be shared between partners, other than in the event of divorce. FPS believes it would be unfair to require this when assessing income against MIR.

A6 Once a member qualifies for flexible drawdown, there should be no further test against MIR. The requirements are for an LPI-linked income; if the Pension Credit increases by a faster rate than LPI, that is not the fault of the member, and they should not be penalised for it.

A7 The member need only provide a State Pension Statement, along with evidence of other forms of secure income.

A8 The annuity market is open, and innovative products are being developed. FPS has no further thoughts.

A9 For the vast majority of individuals, annuity purchase will still be the correct vehicle for income provision. The appropriate bodies should put their energies into ensuring that those coming up to retirement who have lower levels of pension are make aware of their options, such as the Open Market Option, including smoker rate and enhanced annuities. It is this group of people who require more assistance, as they are less likely to seek or be able to afford advice.

For those who wish to consider drawdown, it is important that financial advice is sought. A member who is considering drawdown should be provided with sufficient information to allow them to make an informed decision about the future options. Most of this information is currently provided to those going into drawdown, but some illustrations can be 20 or more pages long.

FPS is not arguing for shorter illustrations, or less information being provided to members. The illustrations provided to members before they go into drawdown should, on one prominent page, have a summary of certain information, a "Consumer Friendly" illustration. This should include the value of the fund going into drawdown, the income being requested, and what income could be provided from an annuity. The residual value of the fund should be projected forward for 15, 20 and 25 years (currently projected to 75, but there is no real relevance of that date anymore) in today's terms (mid rates discounted by 2.5%). The pension that could be taken from that residual fund should also be shown. The critical yield required to sustain that level of income should be declared ("Critical Yield B" – current life office quotes only provide this at specific request of the adviser).

FPS believes that this information should be in a prescribed format, so it is clearly laid out, with industry-wide caveats and risk warnings. The rest of the illustration would be able to provide further information, such as projections on 5%, 7% and 9%. The rest of the illustration would allow the adviser to explore the risks and requirements with the client.

A10 The proposed reforms would have the effect of skewing the annuity market towards LPI-linked annuities. This has not been a popular part of the annuity market.

3. Further Comments

3.1 The Government has confirmed that, for those who die before 75 without accessing their pension funds, death benefits will remain tax fee. In light of Fryer and Ors V HMRC, the Government should clarify the Inheritance Tax position.

3.2 On death prior 75 when funds have been drawn, the current rate of tax on a lump sum death benefit is 35% tax. FPS believes that the tax charge of 55% is appropriate for those over 75, and represents a welcome alternative to the current position. However, the increase in the tax charge on the lump sum death benefit for those who die under 75 represents an unwelcome change to pensions' legislation.

It is right that the Government seeks to protect pension schemes from being used as inheritance tax avoidance vehicles. Therefore, setting the lump sum death benefit tax at 55% for those who die after 75 is appropriate. However, those who die before 75 do so from a serious illness or other unfortunate circumstances. The 35% tax charge is a fair charge for those who, sadly, do not live sufficiently long to derive full value from their pension fund.

FPS believes that the 35% tax charge should be retained for those who die before 70. Between 70 and 80, the tax charge should be increased by 2% each year, so that 45% is paid for those who die at age 75, and the full 55% tax charge is paid for those who die age 80.

3.3 There are a number of wealthy individuals who have amassed funds in registered pension schemes. These members, by virtue of their wealth, are never going to be reliant on means-tested state benefits. However, for a variety of reasons, these individuals have saved funds into registered pension schemes. Given the Government's requirement to reduce the national deficit, it would be appropriate to allow very wealthy individuals the ability to take their funds in entirety without reference to MIR. Tax would be paid at 50% on withdrawals. This would be of benefit to the Exchequer, as it would deliver increased tax revenues, and move funds from tax-advantaged to taxed environments.

For members who wish to avoid having to prove they meet MIR, they would need to provide evidence, by way of audited asset statement, of net assets of an appropriate multiple of the lifetime allowance (perhaps three or four times).

Of course, there is a danger that some of these individuals fall back to be reliant on state benefits at some point in the future. However, such a scenario is unlikely, and the Government would have benefited from a significant windfall tax being paid on the pensions in the first place. The ability to avoid MIR should only apply from 65 onwards.

The demand for such an easement would be limited. However, the windfall to the Government would be of benefit.

- END-

FUTUREFOCUS

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RESPONSE TO: REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75

DATE OF RESPONSE: 05 AUGUST 2010

Introduction

We welcome the Government's proposals aimed at reforming the regime applicable to members in retirement and to simplify the mess created by the previous administration regime due to the ill-considered framework introduced for Alternatively Secured Pension (ASP) and then further modified shortly after introduction.

General observations

The author of our response has many years experience as an independent financial advisor and pension practitioner and is used to dealing with corporate entities, employees within companies and high net worth private individuals in relation to their pension planning. A large number of our private clients are in retirement and therefore we have much practical experience in advising people in relation to annuities, income withdrawal and related planning.

It is our view that the previous administration failed in their attempts to "simplify" pension provision in the UK. Furthermore an array of scandals over the last 20 years or so in relation to pensions and constant tinkering with the legislative framework (for occupational and personal pensions) has undermined confidence and made them less attractive to many people.

We therefore very much welcome the current administration's attempt to simplify the framework and to undo some of the unwelcome changes introduced in recent years. That said we are concerned at the piecemeal approach that is being taken and fear that the outcome could be creating a different type of complication rather than real simplification.

As importantly we feel that a considered overview of the whole system for funded pension provision in the UK and its competitive context is necessary in order to develop a cohesive and attractive long-term solution that is also durable. We would therefore encourage Government to look at more wide-ranging reform of sponsored pension provision in the UK and consider the creation of a harmonised and simpler regime for the future.

The existing pension provision in the UK has been based around a taxation framework of exempt, exempt and taxed (EET). We are not persuaded that the upfront tax relief regime has worked in terms of stimulating pension saving by the masses and believe there is an argument to be made in favour of reducing taxation incentives upfront and offering greater tax incentives in retirement. This could lift more people out of poverty in retirement and simplify the taxation affairs for our aged population whilst making pensions more attractive and less expensive to the Exchequer in coming years.

At the same time we believe that if any new framework is designed carefully, Government could offer individuals the opportunity to transfer their accumulated pension wealth from the existing tax regime and into the new tax regime. There would be some form of taxation charge applied on transfer to recoup some of the historical tax breaks given, which would naturally be a good revenue raiser at this stage.

We would also favour looking at the whole regime for long-term savings in the UK as there are numerous products in the market competing for the same savings. We believe by bringing the regimes together in a harmonised fashion that more could be done to stimulate long-term saving whilst giving individuals reasonable access to capital and/or income during that accumulation phase.

We have responded in those areas where we feel suitably qualified and experienced to comment using the referencing shown within the consultation document.

A1 – Whilst we recognise and welcome the simplicity involved in using tables devised by the Government Actuary's Department (GAD), we believe the adjustment factor presently applied is too high and is creating in practice scenario where individuals can withdraw income each year that is 20-30% higher than the single life annuity otherwise available at the time of calculation.

A drawdown strategy needs management and advice and will involve investment in risk-seeking assets in order to gain additional return to meet those higher costs and offset the benefit of the annuity. The overhead costs are therefore higher when compared to an annuity and the mortality cross-subsidy gained in an annuity is not available whilst a person is in drawdown.

We would therefore recommend that the existing format be retained for the sake of simplicity but would suggest that the annual capped drawdown is based upon 100% of the GAD limit rather than the 120% limit presently applied. When the additional overhead costs are allowed for there is still some risk of capital depletion even at this level but we believe this represents a more manageable upper limit and suspect many individuals would be better advised to draw at some lower level in any event – perhaps where the fund will need to provide for a spouse or they are likely to be particularly long-lived.

A2 – Whilst we appreciate that the Government is seeking to be innovative and flexible and recognising issues that present themselves in reality in retirement, we are concerned that the proposals will create a new form of complexity rather than the necessary degree of simplification.

Whilst there is much to commend the flexible drawdown model proposed we believe that any such structure should only be introduced as part of a wider reform of pension provision as described in our introductory text. Whilst we recognise and accept that you are putting mechanisms in place to safeguard the State from having to pay benefits to those individuals that deplete their pension funds too early by following a flexible drawdown strategy (whether as a result of recklessness or poor decision making), we are not convinced that the typical person embarking upon income withdrawal presently needs this degree of flexibility.

We would favour a movement back to a 3-yearly review cycle for the existing annual income withdrawal limit. Once that limit is set (at 100% of GAD as proposed above) we would propose that the aggregate limit is then policed over the 3-year cycle. For example if the calculation yielded a maximum of £10,000 per annum gross, the total income allowed over that 3-year cycle would be set at £30,000. This would then mean that an individual could withdraw say £8,000, £8,000 and then £14,000 or £0, £0 and then £30,000 without being expose to tax penalties.

This would allow for a degree of flexibility to meet unforeseen expense without necessarily accelerating or increasing the risk of fund depletion. For anyone that has (and will) continue to withdraw at the maximum level each year they would not benefit from this flexibility, which I believe is entirely reasonable, as to offer more flexibility is simply accelerating the risk of fund depletion. This measure also has merit in that it would form part of one overall income withdrawal regime rather than adding complication by effectively having two parallel regimes.

A3 – In the event you do move forward with the regime proposed we are concerned about the definition of income that is regarded as "secure" for the purposes of the MIR. The requirement for secure income to be derived from the State pension and/or an escalating annuity/pension is potentially discriminatory for the many individuals (particularly in the private sector) that might be securing an annuity with a defined contribution (money purchase) arrangement.

When one looks at the flow of income from a level or escalating annuity, and consider the payback period on an escalating annuity, it is often more desirable for the individual in planning their retirement finances to receive more income sooner through a non-escalating annuity. This does not appear to be regarded as "secure" presumably because its buying power could be eroded by inflation and someone could become eligible for benefits at a later date.

For this reason we would favour a regime that is more in line with that adopted by the Republic of Ireland whereby the secure income level is set some margin above the level at which an individual could qualify for benefits and would therefore mean that State pension and non-escalating annuities can be taken into account. To the extent that they do not have sufficient "secure" income a requirement could be imposed to hold a certain proportion or monetary amount of their income drawdown pension fund in a safe and secure asset class in order to ensure there was no risk of them claiming State benefits at some later date. National Savings could issue some form of index-linked stock that could be suitable for this purpose and this could also serve a purpose in raising fund for Government.

A4 – In making pensions more attractive it is not only necessary to make them more flexible but at the same time the structure needs to be made simpler. Whilst it might be entirely reasonable and fair to introduce age-related actuarial factors for assessing MIR we believe there is merit in adopting a flat-rate amount. Many individuals are unlikely to have sufficient wealth or appetite for investment risk to deploy an income withdrawal strategy where they are properly advised. We would therefore suggest that if a flexible drawdown strategy is implemented the MIR might be set at a relatively high level of say £20,000 per annum gross of other income but without the need for annuities considered to be indexed.

A5 – In the spirit of simplicity and clarity we believe that MIR should be set on an individual basis and not aggregated for couples.

A6 – We believe the MIR level should be reviewed annually by Government but formally reassessed for each individual at the review date for their income withdrawals. The present system generally allows for 5-yearly reviews prior to the age of 75 but we have proposed 3-yearly reviews above and would expect this cycle to be maintained throughout life under the new regime.

A7 – We believe the introduction of flexible drawdown is ill-considered and monitoring and policing the MIR and relying on declarations from the individual introduces cost and risk to the industry. As stated above we would favour maintaining the current USP regime but with 3-yearly intervals and the ability to vary income within the 3-yearly cycle on a year-by-year basis. This gives the merit of flexibility and simplicity and does not depend upon the consideration of outside income sources.

If MIR and flexible drawdown are to be introduced we would favour a flat-rate MIR figure set at a sufficiently high level that you need not be concerned with inflation and the ability to ring fence part of the pension fund to top-up to the MIR level for those individuals that do not meet it presently.

A8 – We feel there is an ill-considered obsession with imposing a penal rate of taxation on any leftover pension fund on death. This leads to clients and their advisors developing strategies whereby pension funds are depleted ahead of other personal wealth if only to reduce exposure to taxation.

Consider for example that a couple can leave £650,000 of personal wealth presently between them without any liability to inheritance Tax (IHT). Any excess estate left is then taxed at 40% if they undertake no tax planning whatsoever.

Due to the tax breaks given on pension funding you are proposing that a higher rate of tax (say at 55%) is imposed on the leftover pension fund on the second death. Whilst we accept there is a degree of logic in this, any reasonable financial planner would encourage clients to deplete their pension fund ahead of their non-pension wealth thereby eradicating the fund exposed to tax at 55% first. We cannot believe it is in the public interest to have a tax policy that encourages people to spend their pension wealth ahead of other wealth!

As long as any remaining pension fund on death is passed to the next generation of the family as pension wealth this will help to reduce the dependency of future generations on the State and tax will be earned on those pension funds in the future. We would therefore suggest you either:

- Maintain the current USP regime whereby the pension fund is generally exempt from IHT on death but subject to a 35% tax charge; or
- Determine that any leftover USP (following the death of the member and their partner dependant as relevant) is regarded as part of the estate for IHT purposes and taxed at the prevailing rate.

Furthermore with the increasing international mobility of people the tax regime imposed upon death benefits in UK pension funds in income withdrawal is encouraging more people to look at the QROPS regime. By making the death benefit regime more favourable you are increasing the probability of UK citizens retiring abroad leaving their pension fund in the well-regulated and familiar regime of the UK, which should be more beneficial to the economy than them transferring pension rights abroad.

A9 – Whilst pensions has always been subject to change throughout my career, the pace of that change has accelerated over years and we appear to have gone through a phase over the last 10 years or so where there has been constant tinkering with the regime. As ever the law of unintended consequences prevails and whilst some of the changes were intended to simplify matters the overall effect is that a different kind of complication has been created.

Whilst is it welcome that the Government wants to take action in the short-term to correct some of the obvious errors we believe that a root and branch review of the totality of UK pension taxation legislation is necessary. The outcome should be to create a new unified regime where the emphasis perhaps moves away from the exempt, exempt and taxed approach to something different offering much greater simplicity and flexibility at the time when it matters, that is, in retirement. We are convinced this could be done in a way that is Exchequer neutral (or potentially positive). At the same time the Government could take the opportunity to create a new harmonised savings regime that brings together competing products such as pensions and ISAs under one umbrella vehicle.

Beyond this there is no doubt that a programme of education is needed that seeks to make individuals fully aware of the need that exists to plan and save for their retirement and to move away from reliance on the State.

A10 – We would regard the movement into income withdrawal as being unsuitable for the great majority of UK citizens. Many enjoy valuable guaranteed defined benefit final salary arrangements and would not be well-advised to take the risks associated with income withdrawal when they have a known and predictable situation.

For the great majority of those individuals with pension rights in defined contribution arrangements, and given the low level of the average fund value, we believe that the risk and cost involved in following an income withdrawal strategy would render it unsuitable.

As such whilst the spirit and intent of the removal of forced annuitisation is to be welcomed it has to be recognised that it is only a small percentage of the population that will probably ever take advantage of it. For many people a conventional annuity paying a guaranteed income for life with no complexity and no need for ongoing advice in entirely sensible and prudent.

We therefore do not see why the changes proposed should have any material impact upon the annuity market although if more people do opt for income withdrawal ahead of annuity purchase it clearly could have some adverse impact on the mortality cross-subsidy and the level of annuity rates. That said wider economic policy and increasing life expectancy has had a much greater impact on annuity rates in recent years than the availability of income withdrawal and we believe this will remain the case for the future.

Colin Donlon

Colin Donlon FCII FPFS
Managing Director - FutureFocus Advisory Limited

Hargreaves Lansdown Response to the HM Treasury consultation on removing the requirement to annuitise by age 75

About Hargreaves Lansdown

- Hargreaves Lansdown is a leading provider of investment management products and services to private investors in the UK.

- Founded in 1981 by Peter Hargreaves and Stephen Lansdown, Hargreaves Lansdown floated on the UK stockmarket in May 2007 and is currently included in the FTSE 250 index. Hargreaves Lansdown is a broad and diversified business and has established a reputation for providing high quality service and value for money products to private and corporate investors.

- Key features of Hargreaves Lansdown's business include:

➢ Providing investment products (including ISAs, SIPPs, funds, equities, venture capital trusts and pensions), as well as fund selection, stock broking, advisory, discretionary and asset administration services.
➢ Administering approximately £16.3 billion of assets through Vantage directly on behalf of approximately 318,000 private investors. In total, Hargreaves Lansdown has £17.6 billion of assets under administration and management.
➢ The group manages £1.9 billion of funds through its own range of proprietary multi manager funds and a discretionary management service, of which some £600 million is held within Vantage.

The proposed reforms of the compulsory annuity purchase rules present a well-balanced solution to the challenge of improving investor choice at retirement with the need to protect the taxpayer from any possible increase in welfare liabilities.

The proposed tax charge on death has been set at too high a level. We recommend that this be reduced to 45%.

It is essential that HMRC create transition rules for existing drawdown investors to avoid industry overload next April. We estimate that there are at least 200,000 drawdown investors who will be affected by these changes.

Shopping around at retirement should be the default for all investors.

<u>Developing a new tax framework</u>

The Capped Drawdown income limits should be set at a level which can reasonably be expected to sustain an investor's income for their entire period of retirement, irrespective of how long this lasts.

Investors should be allowed to draw an income from age 55. The initial level of income should be set at a level which is broadly equal to the level of income that a healthy individual would receive from a level monthly annuity; effectively this would be 100% GAD limit.

Capped Drawdown plans should be subject to three yearly income reviews, rather than the current five years. Reviews should become more frequent as investors grow older, moving to bi-annual and possibly annual reviews as investors move into their 80s and 90s.

In order to further reduce the risk of investors depleting their retirement fund as they get older, it may be necessary to restrict the maximum income they can withdraw to less than 100% of a conventional lifetime annuity. This is because the rates for individuals in the 80s and 90s would be very high, being based on a life expectancy of only a few years.

<u>Tax charge on death</u>

The 55% tax charge on death is too high. We propose that it should be set at 45%.

If the tax charge stays at 55% then the following outcomes are likely:

Flexible drawdown
Investors who are eligible for flexible drawdown will maintain their pension fund in pre-retirement up to age 75. By doing this they can ensure that in the event of their death, any undrawn pension funds will be paid out free of tax. Whenever they require any cash, they will shift whatever income they require into a drawdown plan and then immediately draw it as income.

From age 75 it will make more sense to draw cash from the fund and pay marginal rate income tax on it, rather than keeping it in the pension. This is because the investor is unlikely to suffer any further tax charge on the money once it is out of the pension – IHT is currently only paid by around 15,000 estates every year. Whereas if the money is kept within the pension then it will ultimately be subject to a 55% tax charge.

Capped Drawdown

Capped drawdown investors won't have the choice to withdraw the capital from their pension fund. Neither are they likely to be subject to an IHT charge on death.

This means that they are being presented with a choice between buying an annuity and losing all their capital on death (notwithstanding death benefit options on annuities), or taking on the investment risk of a drawdown plan. The drawdown plan has higher maintenance demands in terms of charges, investment management and advice and still results in the investor losing more than half their fund on death. This does not seem like an equitable proposition and means the tax charge will fall most heavily on those who for whom it is least appropriate.

<u>Age 75 cut off</u>

We agree with the proposals to continue using age 75 as a cut off point for tax relief on contributions and the lifetime allowance test. This will require some redefining of the Benefit Commencement Events so that investors moving into drawdown after age 75 aren't subject to a second BCE test on assets which has already been tested at age 75.

<u>Transition rules</u>

In order to minimise the disruptive impact on the existing USP sector we recommend a transition period for anyone in USP at 5 April 2011.

Without this, tens of thousands of investors will have to make decisions on how the new Drawdown rules will affect them and how they want to deal with these rules. This decision making process would have to be completed before 6 April 2011; we believe it unlikely that the pensions industry could cope with such an intense schedule.

A transition period of 1 year could be adopted for existing drawdown, meaning that they wouldn't come under the new rules until 2012.

<u>Minimum Income Requirement (MIR)</u>

Income which can be considered for the purposes of satisfying the MIR should include:

Final salary pension income
Inflation-linked annuity income
State pension benefits
Any other form of guaranteed lifetime annuity income

The MIR should be set at an initial level of £12,000 a year and should be linked to a recognised index so as to facilitate effective financial planning. The same MIR should be set for all ages for the sake of simplicity. The younger an investor is when they go into flexible drawdown, the larger the accumulated pension assets they will need to satisfy the MIR. An annuity of £12,000 per annum at age 55 costs around £420,000 for a male investor and £440,000 for a female investor. By contrast, at age 65 the capital cost has fallen to £298,000 and £317500 respectively.

Investors who have not yet reached their state pension age would not be able to use their state pension to satisfy the MIR, thereby substantially increasing the value of private assets they would have to have accumulated to qualify for flexible drawdown.

For the sake of simplicity, the same MIR should be used for all individuals, irrespective of their marital status.

Using a single MIR, published every year and linked to a recognised index would encourage investor engagement with the cost of funding a sustainable pension.

In order to minimise the effect on the industry of dealing with the MIR, we recommend that all pensions produce on request by the member, a standard format MIR statement which confirms the level of inflation linked annual income provided by the scheme to the member.

The Annuity Market

Shopping around at retirement should be the default solution for all investors. The Open Market Option is an experiment that has failed to meet investors' needs and should be scrapped.
The FSA's Conduct of Business Sourcebook rule 19.4 should be amended so that pension providers are required to send retiring investors information on shopping around, rather than information on their own decumulation options.

We would be happy to discuss this submission in more detail if required.

Contact

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Removing requirement to annuitise - response to consultation

This response to the Age 75 Consultation has been prepared by the writer, Stephen Hart. I am a solicitor, having specialised in pensions law since 1996, currently employed in the UK by one of the largest international legal firms. I am a member of the Association of Pension Lawyers, and a voluntary adviser for The Pensions Advisory Service. The views expressed are entirely mine, rather than of those organisations or my employers.

I speak on pensions courses, and write journal articles on the subject on occasion. I am currently aged 60, and thus have an immediate personal, as well as professional, interest in the subject matter of this consultation.

While I can confirm I agree with the Government's approach to reform, as referred to in question A.2, my response concentrates primarily on the questions raised in chapter 3 of the consultation (regarding the MIR). I consider that those in chapters 2 and 4 are more suitable to be addressed by actuaries, investment advisers or insurers, than by a lawyer.

A.3 Secure income

The proposal as to which income is "secure" is correct. Income which is payable now and for life, may derive from:

- The State Pension (including SERPS and S2P).
- Occupational pensions.
- Annuities (whether from pension schemes or purchased from other sources)

As proposed, this will need to be subject to an appropriate level of indexation.

In the case of some occupational pensions, the indexation requirement may be a problem, as the extent of indexation can depend on the period over which the pension entitlement accrued, and how much of it is a Guaranteed Minimum Pension. Different parts of the pension may well be indexed at different amounts. Where this is the case, an actuarial formula will be needed to estimate the likely indexation of the pension as a whole.

A.4 Appropriate level for MIR

The appropriate level of MIR should be at least that at which no person will claim State benefits, which I believe is broadly equivalent to the highest ONS expenditure needs estimate quoted in table 3.A of the Consultation. That amounts to £185 per week, or £9,620 per annum. It is suggested that this should be quoted on an annual basis, which is more realistic for the expenditure patterns of the (relatively wealthy) population to which this issue is relevant, and perhaps rounded up to £10,000 per annum.

Where a person's relevant income from the State Pension and occupational pensions does not satisfy the MIR, he or she should be required to use enough savings to buy an annuity sufficient to bring the total income up to the MIR level.

I disagree, however, with the proposal that the MIR might be met at any age from 55. At present, USP extends to age 75, which is the age up to which the benefits of those who die without having accessed their savings are tax-free. It is intended that this tax treatment should continue to apply to age 75. Although the capped drawdown proposal would extend the right to USP further, there is no reason to introduce flexible drawdown earlier. At younger ages, there is more uncertainty about future inflation. Also, individuals' personal expenditure needs may change, as may their income, for example if a spouse dies (and a dependant's pension becomes payable), a partnership ends, or "guaranteed" pensions fail to be paid in full.

So it would be preferable for the decision on whether the MIR is met not to be taken too early. One might even argue it should be taken as late as possible. In addition, some unnecessary work will be involved in considering the MIR for individuals who, in the event, do not survive to 75, or decide they wish after all to annuitise before that age.

A better course of action would be to retain 75 as the age up to which USP is available, in its capped drawdown form, and then for flexible drawdown to be permitted if the MIR is met at that age. Those wishing not to be restricted to the drawdown cap, should be expected to produce their evidence on the point between their 74th and 75th birthdays.

In other words, 75 will effectively be the age at which a decision will be expected, whether to annuitise pension savings or put them into drawdown, and the maximum age at which the tax free lump sum will in practice be taken. So it is the age at which the decision on flexible drawdown should be made.

If this point is followed, it will also have the result that there is no need for different MIR levels at different ages, which will retain a degree of simplicity in the proposals.

A.5 - Individuals and couples

Simplicity will also be retained if there is no special arrangement for couples. Each individual should have to justify his or her own MIR, and thus the application for flexible drawdown. In the current world, each spouse is expected to be primarily responsible for his or her own financial arrangements, and there is no good reason for allowing a couple to have a lower joint MIR to justify flexible drawdown. Each spouse's own income at age 75 should be considered individually, and in the event one spouse may be able to take flexible drawdown while the other may not.

It is true that this could mean that one spouse (typically the husband will have the greater fund) may be able to deplete his assets through flexible drawdown, while the other will have little or no income, which could result in her relying on State benefits in the event of his death. However, this could already happen in current circumstances, or in the future, where the spouse with funds may purchase an annuity for his life alone, which will therefore cease payment on his death. It is suggested that in reality this is not a common scenario.

A.6 - MIR reviews

The review of the MIR would appropriately be reviewed annually, since it will need to be considered in line with changes in the cost of living, and most other levels of benefit and tax are reviewed each year. This does not necessarily mean that it should be adjusted each year; if the initial figure is rounded up, as suggested above, there should be scope for changes to the MIR to occur at less frequent intervals, perhaps only when an increase by a multiple of £1,000 is justified.

A.7 - Minimising burdens

Suggestions have already been made which will tend to minimise the burden of assessing the MIR - carrying it out only at a specified age, and having no special arrangements for couples.

Further to this, it is likely that individuals seeking to prove they meet the MIR should only have to provide a statement certifying that they have an income of a certain amount, payable for life, and indexed in a specified manner.

Such a certificate should be in a standard form, available with little difficulty from

- the DWP, for State pensions
- the pensions administrator or trustees, for occupational pensions
- the insurer, for annuities.

The individual would then have to complete the appropriate application, attaching the certificates to support it.

Stephen Hart

September 2010

Removing requirement to annuitise by age 75 - Response

This response is on behalf of James Hay and the IPS Partnership. As a major provider of Defined Contribution Schemes (Self Invested Personal Pension Schemes and Small Self Administered Pension Schemes) we have a vested interest in the outcome of this consultation. Failure to take this opportunity to amend the pension tax rules for the better will have a detrimental effect on the future well being of our business. Given the importance of a healthy, thriving pensions industry to the economy, failure will hinder the Government in pursuit of its goals of debt reduction and sustainable economic growth.

We must stress that our response is not motivated solely by self-interest for the reasons set out below.

People are living longer. This fact impacts on pension savings in two important ways. Individuals will remain in work longer and as a result of this will defer accessing their pension benefits until later in life. For some, deferring will be combined with phased retirement in response to a gradual reduction in their work commitments over a number of years. Secondly, the time spent in retirement will be longer.

Flexible pension tax rules are essential in meeting the first of these challenges by allowing individuals sufficient freedom as to how and when they take their pension benefits. The ability to vary income levels is also important.

Meeting the second challenge will require individuals to have sufficient funds to deliver the income required to support a comfortable retirement however long that lasts. Here the pension tax rules must be structured in such a way that funding through a pension scheme is an attractive proposition to encourage the necessary financial commitment from individuals. Making the accumulation phase of retirement provision attractive is achieved not only by making available the necessary pension funding tax breaks, but by maximising the flexibility to be had in the retirement/de-accumulation phase.

Therefore, we fully support the Government's aim of fostering a new culture of saving in the UK by tackling the inflexibility in the pension tax rules.

Not being an annuity provider we lack the necessary insight to comment constructively on the ways of improving the UK annuity market. Our views have therefore been restricted to cover the questions raised in Chapters 2 and 3 of the document.

- The level of an appropriate annual drawdown limit for capped drawdown

  In arriving at a figure the Government must aim to strike a balance between keeping pensions as an attractive way of providing for retirement and the risk that funds will be depleted causing reliance on the State. Therefore the cap should not be less than the current USP maximum i.e. 120% of GAD. This keeps things simple. Individuals and advisers are familiar with this limit and the way it is calculated and for drawdown providers this would avoid any costs associated with the system changes required to accommodate a new maximum.

- 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 by age 75

In terms of the tax framework we support the tax deferred nature of pension saving (i.e. the EET model) and the ability for individuals to take part (normally 25%) of their pension fund as a tax-free lump sum. Individuals view this tax-free lump sum as an attractive feature of the system and it seems sensible that any deferral of benefits beyond age 75 should include the pension commencement lump sum (PCLS).

We accept that the primary aim of a pension is to provide income for retirement and not to pass on wealth to future generations. According to the consultation document an increase in the charge from 35% to 55% on the death of a member before age 75 while drawing income is designed to recover the tax relief received when building up a retirement fund. This increase seems excessive and for this reason our preference is for keeping this charge at 35% before age 75.

The 55% charge will encourage individuals to defer taking benefits as, on death before age 75, uncrystallised rights will not suffer any charge which goes against the primary aim. Maintaining the charge at 35% will offset this somewhat and preserve the appeal of pensions.

Age 75 is reasonable point at which the anti-avoidance measures should kick-in. Therefore a 55% tax charge from this age is justified.

The keeping of the requirement for testing against the lifetime allowance at age 75 is fine provided that there will be no further test beyond age 75 (other than BCE 3). Where benefits remain uncrystallised beyond age 75 a further test when benefits are taken would only add to the administration burden of pension providers.

It would seem reasonable to set the level of the lifetime allowance charge where uncrystallised money purchase rights at age 75 are in excess of the lifetime allowance at 25% (rather than 55%). The justification for this is that in most cases the majority of the fund will eventually be used to provide an income. In meeting the charge the scheme administrator will reduce the individual's pension fund in order to pay it. This might be considered unfair, and do nothing to encourage pension saving, if after reducing an individual's fund in this way subsequent investment performance is poor making a bad situation for the individual worse. These issues can be avoided if the test was deferred until benefits were taken i.e. no test at age 75 in these circumstances. The lifetime allowance charge will again be linked to how the excess is used (income and/or lump sum). Any poor investment performance post 75 may result in no charge applying when benefits are taken countering any suggestion that the system is unfair.

- The level of the Minimum Income Requirement (MIR)

  Three of the five questions posed in Chapter 3 of the consultation document deal with the setting of the MIR at an appropriate level. We have offered no views on this for reasons that will become apparent on reading the rest of this document.

- 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

  Regardless of what income sources are considered secure many high net worth individuals will find meeting the MIR easy enough and will be able to extract capital from their pension fund in a tax efficient manner. Such individuals are likely to be in the fortunate position of being able to control their income streams. Therefore it would be possible under the flexible drawdown proposals, having met the MIR, to extract pension income over say a period of between 3 to 5 years. Normally 25% of the amount taken from the pension scheme is tax-free with the majority of the pension income likely to attract only basic rate tax. Given the level of tax relief enjoyed by these individuals during the accumulation phase this could be viewed as an abuse of the tax system.

  Example

  An individual aged 65 in receipt of a scheme pension of £13,875 pa (which say is sufficient to meet minimum income requirement) and also has a self invested personal pension with a fund value of £200,000.

  Based on personal allowances & tax rates remaining unchanged over the next 5 years the individual can take a pension commencement lump sum of £50,000 at outset and £30,000 per annum under the proposed flexible drawdown. The annual tax bill will be as follows:

Income source	**Income**	**Tax rate**	**Tax due**
Scheme pension	£6,475	0%	£0
Scheme pension	£6,475	20%	£1,295
SIPP	£30,000	20%	£6,000

  If we assume no investment growth over the 5 year period, the individual by age 70 will have withdrawn all the funds from the self invested pension incurring an income tax liability of £30,000 (£6,000 x 5) spread over the 5 year period. This works out at an average rate of tax of 15% (30,000/200,000) on the total SIPP withdrawal.

- How to minimise unnecessary burdens for individuals and industry in the assessment of the MIR

Individuals, their advisers, and scheme administrators will need to familiarise themselves with regulations and guidance on the MIR information requirements. In addition scheme administrators will have HMRC reporting responsibilities. It is not immediately obvious as to how to minimise the burden associated with this without compromising the success of the legislation. In the spirit of simplification this is unwelcome.

For the reasons given above our recommendation is for the flexible element of income drawdown to be dropped leaving capped drawdown to operate as has been suggested before and after age 75.

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James Hay and IPS Partnership

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Response to Consultation
Date: 10 September 2010
Prepared for: HM Treasury
Prepared by: Hewitt Associates Limited

Response to consultation on removing the requirement to annuitise by age 75

Introduction

Hewitt Associates provides leading organisations around the world with expert human resources consulting and outsourcing solutions. Hewitt has offices in more than 30 countries and employs approximately 23,000 associates.

Hewitt Associates is pleased to submit a response to the consultation on removing the requirement to annuitise by age 75.

We address below each of the issues on which views have been requested. If you would like to discuss any aspects of this response further, please contact Richard Lunt (0207 939 4164).

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

In our view, the principle here should be that opting for drawdown should not significantly increase the likelihood that increased (means-tested) State benefits would be paid. Up to now, because of the high administration costs, drawdown has been restricted mainly to those with larger 'pots'. With annuity rates currently at a historic low, it is understandable that annuity purchase may appear unattractive to many pension savers. Nonetheless, there remain good reasons why drawdown remains unsuitable for, or at least should be approached with extreme caution by, those with modest pension pots.

Following the abolition of the requirement to annuities at age 75, we expect drawdown to be more widespread (particularly while annuity rates remain low) and there is a strong case for restricting the amount to something below 100% of the Basis Amount.

Apart from the administration costs, it is worth bearing in mind that someone who draws down at 100% of the equivalent annuity will find that this level cannot be sustained at the next review unless investment returns achieved are significantly in excess of the bond yields on which annuity premiums are based. At higher ages this effect, known as "mortality drag" can be very high. For example, an individual aged 80 would require outperformance of 5% to compensate for delaying annuity purchase by a year. This suggests that there could be a case for having age-dependent limits.

At present the maximum percentage is 120% up to age 75 and 90% for ages over 75, but using an age 75 based Basis Amount regardless of age.

continued on next page

1. The level of an appropriate annual drawdown limit for capped drawdown cont/…

At present the maximum percentage is 120% up to age 75 and 90% for ages over 75, but using an age 75 based Basis Amount regardless of age.

If the limit applicable after April 2011 were to be a flat percentage for all ages (before and after 75), then the modelling we have carried out indicates that the value should be below 100%, but the precise value will depend on the assumptions used, not the least of these being the assumed age at death.

However, if an age-related scale were used, and assuming the amount being drawn down would still be subject to regular review (perhaps every 5 years), limits on the lines set out in the table below might be appropriate. We suggest that the Basis Amount should be calculated using annuity rates for the relevant age, including some allowance for future indexation.

Age	Below 65	65 - 69	70 - 74	75 - 79	80 - 84	85 or above
% of Basis Amount	110	100	90	75	60	50

Further details of our analysis of 'mortality drag' and the rationale for the limits suggested above are set out in the Appendix to this response.

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 proposals for taxing death benefits and other aspects of the tax framework in Chapter 2 seem reasonable.

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?

Clearly, the only income that is 'secure' is income from an annuity (including purchased life annuities), pension income from registered pension schemes and state pensions, although all of these are subject to some form of insecurity, for instance from pension schemes falling into the PPF and government change of policy on state pensions. We agree that level, as well as increasing, life annuity and pension income should be taken into account, after adjusting by an appropriate (age-related) discount factor (as appears to be suggested in footnote 13 on page 14 of the consultation paper).

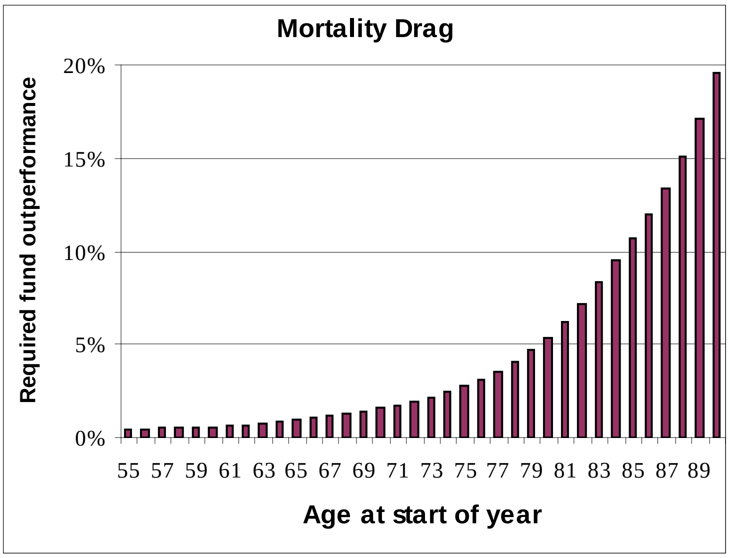
continued on next page

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? Cont/…	However, although we realise this goes beyond the question specifically posed, our preference would not be to take account of income alone but also to consider whether a robust methodology could be developed for including capital in the assessment, as is the case in Ireland (see Appendix B of the consultation paper). A relatively straightforward methodology would be to divide the capital (including the drawdown fund itself, but excluding the value of a main residence unless the individual were single and living alone) by an annuity factor, add any secure income and test against a limit that might be age-related. We do not see the necessity for capital to be ring-fenced for it to be taken into account. In order to protect against potential abuse, a consequence of opting for flexible drawdown, having satisfied the MIR, could be ineligibility for any future means-tested benefits (as recently suggested for drug addicts who refuse medical treatment). If this were not considered viable, then there could be a requirement for assets to be ring-fenced in specially designated funds, as in Ireland.
4. What an appropriate level for the MIR should be and how the MIR should be adjusted for different ages.	The MIR should be based on the income level at which any minimum income guarantee or other means-tested State benefits would not be available, plus a margin. This begs the question of whether means-tested nursing home care should be included in the equation. This is clearly a political decision related to future policy on whether nursing home care will be available free for all. Excluding a main residence from the MIR calculation may be considered adequate for the purpose of setting aside nursing home costs from the equation. As well as the MIR being age-related, it should also take into account the level of inflation proofing in any annuity income, with higher level of annuity income being required where this has less that full inflation indexation and differentiating level income, LPI income of a variety of natures and investment-linked annuity income (see 3. above).
5. Whether a different MIR should be set for individuals and couples.	Yes, and allowance should be made for the expected reduction in pension on the member's death.
6. How often the MIR level should be reviewed.	The level of the MIR itself should be reviewed annually, so that the minimum threshold for 'new entrants' to flexible drawdown is kept up to date. Individuals should be required to carry out their own MIR checks at regular intervals so long as they continued in flexible drawdown. This requirement would fall away in cases where all of the drawdown funds had already been cashed. But it might help to put the brakes on in cases where relatively 'sensible' amounts are being drawn down, but the 'stable' income, or capital equivalent, has fallen behind the MIR, or the unsecured investments have done badly. This underlines the need for the initial assessment to be very robust.

7. How to minimise unnecessary burdens for individuals and industry in the assessment of the MIR.	The level of the MIR should be set by government and, as indicated above, should be regularly reviewed, probably annually. In assessing income and capital against the MIR, self-certification may be considered adequate, with heavy penalties for deliberate misstatement. An alternative would be for a professional (individual or firm) subject to FSA regulation to carry out the certification. We would not expect that certification would be carried out by a government agency unless a significant charge, sufficient to cover all costs, were levied. The most recent certification could be included in annual tax returns.
8. Whether other legislative or regulatory barriers remain whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance risks.	A number of proposals for a step-up in basic state pension at a higher age than state pension age (say 80), have been aired recently. This might be linked to the possibility of allowing NEST, or occupational pensions at a similar level, to be taken as a term annuity or drawdown up to age 80 which would help to smooth income in real terms over the lifetime of a pensioner. One reason why drawdown is seen as attractive is because conventional annuities are currently widely perceived not to offer good value, as the annuitant is 'locked-in' to a low level of income. Investment-linked annuities do exist and potentially offer a more satisfactory alternative than drawdown for many pension savers. Any measures to encourage the development of a competitive range of such products would be welcome, provided these were accompanied by proportionate and effective safeguards against mis-selling etc.
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.	It would be helpful to have some clarity, including objective guidance for individuals, regarding the purpose and implications of 'de-annuitisation'. It has been suggested that the need to annuitise discouraged voluntary pensions saving, but there are now other stronger tax disincentives for those likely to have considered it! Individuals need to understand the implications - they will have to pay (through lower pensions) for the passing on of capital (less 55% recovery charge) to the next generation and complicated administration and policing. Although investment returns higher than the bond yields on which annuity rates are based are available, these are inevitably accompanied by increased risk. The potential consequences of this need to be understood. Drawdown will remain inappropriate for the majority for whom provision of an adequate retirement income, rather than capital preservation, should be the priority.
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.	If drawdown becomes widespread, providers might become more concerned about the risk of selection by those individuals who do opt for annuity purchase. There could be particular implications for providers of 'impaired lives' annuities. However, on the whole we consider that the annuity market at present remains competitive. This could be threatened if a significant number of insurance companies pull out of the market, because of reduced demand because of the measures under consideration here or otherwise.

Appendix

The chart below shows the required investment return in excess of bond yields (left-hand axis) in the twelve month period relating to the year of age in order that mortality drag will not result in a lower stream of income under drawdown compared to annuity purchase:



Note that above age 90 the rates become so high as to be totally unrealistic, so we have not shown them.

In order to demonstrate the effect of mortality drag on initial fund size, we show below, on the same assumptions as above, the initial fund size required if an individual is to obtain an annual income of £5,000 pa increasing in line with assumed price inflation of 2%. The initial fund size required depends on the actual age of death. The chart shows the initial fund size assuming age of death of 90, 95 and 100 for various ages at start of drawdown. Investment outperformance of drawdown fund over a notional bond fund underlying annuity prices is 2% pa. Expenses have been ignored for the purposes of the comparison.

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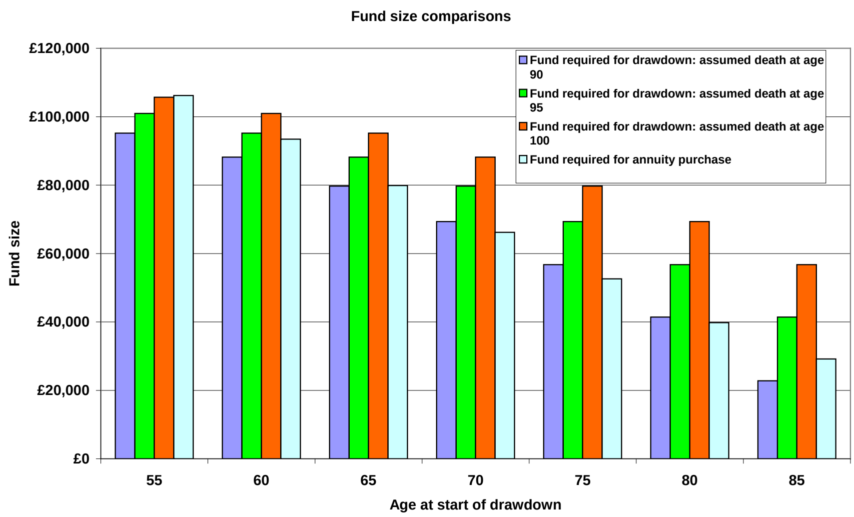
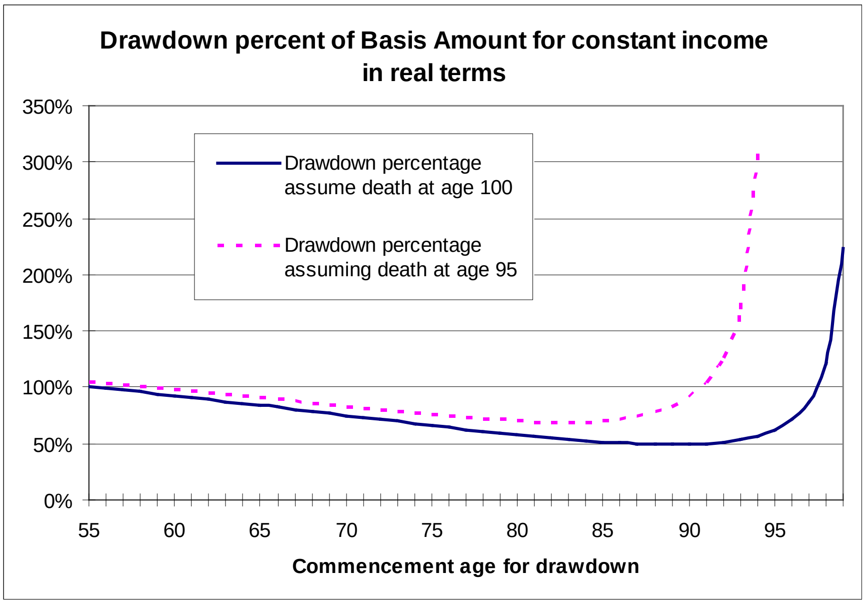


Assuming fund sizes as above at start of drawdown, the percentage drawdown required over the lifetime of an individual assuming that the individual is to obtain an annual income of £5,000 pa increasing in line with assumed price inflation of 2% is shown in the graph below



Basis Amount is calculated using a discount rate of 2% p.a., but the graph would be of a similar shape if a different discount rate were used. The main point to draw from this is that if the amount to be drawn annually is to be the same, in real or absolute terms, the percentage should not be a fixed 100% of the basis amount at all ages, but should theoretically vary by commencement age. This approach would enable a 'sustainable' drawdown limit to be identified for each commencement age, based on reasonably conservative assumptions about how long the individual would live and how the drawdown fund would perform.

continued on next page

The maximum amount to be drawn down would be reviewed at regular intervals (perhaps every 5 years), taking account of the amount of funds remaining and the drawdown limit for commencement at the individual's current age.

At present, the maximum percentage is 120% up to age 75 and 90% for ages over 75, but using an age 75 based Basis Amount regardless of age.

We suggest that the Basis Amount should in future be calculated using annuity rates for the relevant age that contain some allowance for future indexation (as for the MIR).

Using the approach outlined above, 'sustainable' age-related drawdown limits might be as set out in the table below. The figures in brackets illustrate higher limits that might be permitted if an increased risk of reductions at future reviews were accepted.

Age	Below 65	65 - 69	70 - 74	75 - 79	80 - 84	85 or above
% of Basis Amount	95 (110)	85 (100)	75 (90)	65 (75)	55 (60)	50 (50)

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Dear Sirs

Removing the Requirement to Annuities by Age 75 – Consultation

Overall, we welcome the Government's proposals to reform the ways in which pension scheme members can draw pension benefits.

In relation to specific questions raised:

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

We agree with the proposal to retain the EET approach to the taxation of pensions, with tax relief for contributions and benefits (with the exception of the commencement lump sum) subject to income tax. Without tax relief at the contribution stage we believe the pension system is unlikely to generate sufficient interest to achieve the Government's objective of increasing savings to allow individuals to take responsibility for their financial future.

However, we have some concern concerning the taxation of death benefits.

2.22 states, inter-alia that "death benefits for those who die before age 75 without having accessed their pension savings will remain tax-free". How will new legislation deal with the situations such as that in the case of the Personal Representatives of Arnold deceased? Is it the intention to legislate to allow death benefits before 75 to be paid free of inheritance tax, or will this remain linked to normal retirement age as specified in the Scheme Rules or personal pension contract? There is currently an emphasis from Government on working longer and retiring later, and there remains a risk of individuals who have been encouraged to work beyond their previously anticipated retirement age being penalised if there is not clarity in this area.

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We also note your comments concerning potential abuse of pension tax relief's for the purposes of inheritance. How will it be possible to distinguish between those individuals who have minimised their draw down of funds to achieve such an objective and those who have chosen to defer retirement and merely fail to survive as long as they initially expected? Clearly applying a motive test after the relevant person has died will be impractical. In the longer term the ability of individuals to abuse the system in such a fashion may be curtailed by the proposed changes to the limits on contribution which will prevent the accretion of pension funds of the size sometimes seen at the moment without significant tax charges on the contributions.

- The Government welcomes views on 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.

There is no mention within the proposed definition of the MIR of defined benefit scheme pensions in the context of secure income. While it is true that not all defined benefit pensions are entirely secure, this is not within the individual pensioner's control and, therefore, such benefits are unlikely to be capable of being manipulated by individuals who might subsequently become a burden on the State. Consequently we feel such income should be included within the definition of secure income.

- The Government welcomes view on whether a different MIR could be set for individuals and couples.

While the expenditure of many couples is not twice that of a single person, individuals are now taxed separately and it would seem an unnecessary complication to introduce such links for this purpose. In addition, if the objective is to prevent individuals becoming a burden on the State, such an issue is likely to rise in practice where one or both of the pensioners enter care. In this case the expenditure of a couple is likely to be twice that of the relevant individuals as care home costs will be the same for each.

Overall, as noted above, we welcome the proposed changes to the pension's regime and believe that the overall emphasis is broadly correct.

Yours faithfully

I Abrey
Partner
For and on behalf of Hillier Hopkins LLP

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Removing the requirement to annuitise by age 75 – HMT consultation

Response by Donald Hirsch, Head of Income Studies, Centre for Research in Social Policy, Loughborough University.

Context

I lead the team that produces the Minimum Income Standard, referred to in Table 3.A of this consultation document. This response deals solely with two questions:

- How should one interpret the MIS figures in a way that would be useful in setting a Minimum Income Requirement?
- What is the case for using these figures compared to others to define the Minimum Income Requirement?

This relates to the discussion in Para 3.12 of the document:

3.12 The level of the MIR should therefore be a reasonable proxy for an income level above which the likelihood of an individual prematurely exhausting their pension savings and falling back on the state is minimal. Some examples of possible measures of minimum retirement income are outlined in Table 3.A below:

Table 3.A: Measures of retirement income

	Guarantee Credit	Expenditure Needs (ONS)	Minimum Income Standard (MIS)[14]
Single	£132.60	£151.30 - £185[15] (before housing costs)	£147.41 (before housing costs)
Couple	£202.40	£337.70[16] (after housing costs)	£222.22 (after housing costs)

Measuring minimum incomes for pensioners through MIS

The Minimum Income Standard shows what financial resources people need in order to afford a minimum acceptable standard of living as defined by members of the public. The pensioner version of this is based on detailed research with mixed-income groups of pensioners, who made decisions about the items needed in a minimum household budget for pensioners. These decisions were supported by expert inputs, to ensure for example that nutritional standards were adequately being met. Details of the method and results are at www.minimumincomestandard.org. The standard has become widely recognised as a benchmark supported by sound research.

Note that a measured minimum standard is a more meaningful measure of minimum *needs* than the expenditure figures shown in the middle column of Table 3.A. These figures are based on actual expenditures (in the case of the couple, on average spending for all households). Whether they measure average spending or spending by lower income groups, expenditure figures cannot measure need, since everybody's expenditure is to a large extent a consequence of their available financial resources, rather than showing whether people have more or less than they require as an acceptable minimum.

The figures used in the final column of Table 3.A are not quite accurately labelled. Both of the figures are what we call the ‘headline budgets’: they do not cover rent/mortagage, so to some extent are ‘after housing costs’ figures, although they do include water rates, which in poverty measurement are not part of the ‘after housing costs’ measure of income. However, in comparing the MIS totals to the Guarantee Credit figures, we should also deduct council tax, since people on the minimum will receive council tax benefit on top of Pension Credit.

The figures comparable with Pension Credit (ie excluding rent and council tax) are £133.49 and £203.65 – in both cases only about £1 more than the Guarantee Credit.

Thus, setting the Minimum Income Requirement at the MIS level would at least require a pensioner to have an income equal to £133.49 for singles or £203.65 for couples after deducting their council tax and any rent/mortgage. A stricter condition would be to require them to have an income equal to these amounts *plus* their actual council tax plus any rent, in order to avoid the state having to have council tax benefit or housing benefit liabilities that could have been avoided had more income been taken as an annuity.

Could MIS be a reasonable basis for setting the Minimum Income Requirement for annuities?

The objective of this policy is to ensure that pensioners who use pension pots other than to generate annuities leave themselves with enough to live on and do not have to fall back on the state. As the paper points out, there are difficulties in setting it just in relation to Pension Credit, given people’s varying entitlements and uncertainty about the future course of benefit policy. An alternative would be to set it at what seems a reasonable minimum living standard for a pensioner, based on MIS, and to disqualify anybody who has used pension assets other than for annuities from claiming Pension Credit in the future.

At present, MIS and the Guarantee Credit are very similar in level. In the future, they could diverge. MIS is updated regularly to take account of both the rising cost of the pensioner budget and changes in minimum living standards as defined by the general public. Pension Credit has in recent years been uprated in line with earnings, but there is no long-term commitment to continue with that form of uprating.

Whichever criterion is used, it is impossible to guarantee that a pension income that is enough today will be enough in the future. However, using the MIS as a benchmark in combination with a disqualilfication from future Pension Credit entitlement would have advantages. Knowing that people’s pension incomes are at or above current minimum living standards would avoid a situation under which this disqualification causes a pensioner to be in dire poverty at some time in the future, and the state felt morally obliged to bail them out. While it is true that norms of living can rise in real terms during the period of a pensioner’s retirement, most pensioners accept that their living standard will not go up more than inflation in these circumstances, since pensions generally are rarely set to rise faster than prices while in payment. (Clearly, as with any system for setting the minimum requirement, the pensions to which it referred would have to be inflation-linked.) On the other hand, as new pensioners came into the system, any MIS benchmark used to set the Minimum Income Requirement would increase to take account of changing norms because of the way it is updated.

This kind of system could also have the beneficial side-effect of taking more people out of means-testing, voluntarily foregoing the possibility of future means-tested recourse to the state for pension income in exchange for greater flexibility over use of pension assets. This would help increase pensioners' feeling of self-sufficiency rather than dependency.

For further clarification please email donald.hirsch@googlemail.com.

HORNBUCKLE MITCHELL

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

6 September 2010

Dear Sirs

Removing the requirement to annuitise by age 75 – response to consultation paper

As a leading UK pension company Hornbuckle Mitchell is a keen advocate of pension reforms designed to encourage higher levels of retirement provision. We are the largest independent provider of member-directed pension schemes and provide both Self-Invested Personal Pensions (SIPPs) and Small Self-Administered Schemes (SSASs). We were established in 1982 and have over 14,000 pension members, 4 offices with over 200 staff and in excess of £2bn of assets held in our schemes.

Like many in the industry we call for early publication of the draft legislation. It is a short deadline for April 2011 and we need to plan ahead with the resources required to implement these changes.

As a SIPP and SSAS provider we have many members who prefer more flexible options to an annuity, we therefore welcome in particular the option for flexible drawdown which will appeal to many of our high net worth scheme members.

We ask for early publication of changes to drawdown income limits and guidance for the transition of current members in unsecured pension (USP) and alternatively secured pension (ASP) to the capped drawdown model. This will require system and process changes, and corresponding staff training, with a challenging deadline for April 2011. As great a lead-in time as possible is needed by providers seeking to allocate their resources for the coming year.

We recognise that the level of capped drawdown will need to be lower than the current 120% to prevent funds running out if it is to be available at any age. However lowering the level significantly will reduce income that can be taken and the corresponding income tax payable to the Treasury. It may also have the affect of pushing more individuals to the less flexible annuity route.

We do not feel we are in a position to provide views on the appropriate level of the minimum income requirement (MIR) and the lack of this information at this stage means we are unable to assess how many of our scheme members are likely eligible for flexible drawdown.

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The intention to keep the complexity of the MIR test to minimum is welcome not only from the perspective of the burden to scheme administrators and individuals but also to minimise the potential for errors within a complex area.

We request that the amount of calculation required by the scheme administrator is kept to a minimum and offer two proposals for a system of certification. We can envisage a system along the lines of the lifetime allowance tests and benefit crystallisation event certificates where the individual is told the level of the MIR that is met following the establishment of an annuity or qualifying scheme pension. This certification can be provided to the flexible drawdown provider as evidence. An alternative is for individuals to apply for an MIR certificate from HMRC in a similar manner as members had to apply for Enhanced and Primary Protection certificates.

We do not provide annuities so will not comment in respect of this part of the paper.

We look forward to the early publication of the draft legislation and corresponding guidance.

Yours faithfully

Dave White
Managing Director
Hornbuckle Mitchell

As you will be aware, while I was the MP for Arundel between 1997 and 2005 (holding various Shadow Treasury appointments including Shadow Chief Secretary) I took a leading role in arguing for the removal of the requirement to annuitize by 75, as I believe this discourages retirement saving and can have unforeseen and unfortunate results reflecting changes in interest rates and inflation.

My objective was, however, always to remove the requirement for all – without the obligation to annuitize to bring pension incomes up to Minimum Income Support levels: this could only be achieved by restructuring state pensions to deliver a single state pension at 70 above Minimum Income Support levels. I encountered so many cases, particularly of women, who had e.g. £30,000 in a money purchase pension who bitterly resented having to surrender this for a paltry annuity, and who would have hung on to the capital "to the last" if permitted, to pay nursing home bills.

In today's world we should think of Retirement Saving, rather than more narrowly pension saving where much of this is increasingly done by ISA saving (running at over 3 times the level of individuals' personal pension contributions). People increasingly prefer ISAs as they are simpler and also like having a tax free income in retirement.

Philosophically I believe it is up to the individual to choose whether they want the tax benefits in retirement, or relating to their contributions; but in both cases, it is for them to do what they wish with their Retirement Savings.

My main proposal is that any assets remaining upon death (e.g of the surviving spouse) can be transferred, free of tax, to their heirs' pension schemes, e.g. whether through a family pension scheme, through the heir becoming a beneficiary of the deceased's pension scheme or the assets simply being transferred to the heirs' existing pension schemes. Income tax would be paid on the persons drawn down by the heirs.

If the heirs wish to spend such residual assets, it is appropriate to have a tax charge on their inheritance although I suggest this should be in line with the top rate of income tax, as such is analogous to the pension scheme member having drawn the assets as pension.

But if remaining assets were transferable to heirs' pension schemes without a tax charge, I believe this would be a major stimulant to pension saving and frugality – comparable to how buying a house has been seen and used by millions motivated by creating capital for their children on their demise.

I see no logic in there being a different tax regime for those who die before accessing their pensions, as between those up to and those above the age of 75. The rules as proposed are ageist, and constitute a fiscal incentive to opt for Euthanasia at 74¾!

If individuals work beyond 75 and wish to continue to contribute to their pension savings I see no reason why tax relief should not be available – to stop tax relief at 75 is also ageist.

The LTA should be tested/applied when people start to draw their pension and not at a particular age – to do so also ageist.

On a wider point the objective of the proposed new tax framework is described as to give individuals greater flexibility over the use of their pension savings. This is a good objective. I believe, however, that there should be the bigger objective of encouraging and increasing Retirement Saving which has fallen substantially over the last decade, threatening major additional burdens on the State/tax payer. The reasons for this are several, but there is the need for something specific which is seen as attractive by people to motivate them to save more for their old age – hence my above proposal.

I suggest the determinant of MIR should be the Minimum Income Support level at which individuals cease to be entitled to welfare benefits (i.e. other than in extraordinary situations).

I would welcome the removal of the 75 age limit on the annuity protection lump sum death benefits and any other legislative or regulatory barriers which remain.

With regard to the annuity market my only "radical" comment is as to whether the State might consider re-entering this market: it was a major participant in the 19th Century. The ability of the private sector life insurance industry to provide the volume of annuities required going forward, at reasonable rates, is questionable. The Government selling annuities would also constitute (as it did in the past) an alternative way of raising finance to the issuance of gilts. Clearly there is a competition issue here which would need to be addressed in a fair fashion – but this was managed in the past.

In terms of encouraging people to shop around for annuities, all that I think would be practical is to oblige existing pension saving providers to deliver to their new potential customer annuitants a list of the names and addresses of all (or e.g. the major 20) other annuity providers.

With regard to draw down rules the minimum draw down limit of 55% after the age of 75 should be abolished. The rules should be the same as prior to the age of 75, i.e. USP limiting the maximum draw down: this might be increased by e.g. 2% p.a. of the equivalent annuity.

Much better, with a wider reform which delivered a state pension at 70 of at least the minimum income support level (where there is no entitlement to welfare) draw down rules at over 70 could be abolished.

Kind regards

Howard Flight

Consultation Subject	The removal of the effective requirement to purchase an annuity by age 75 from April 2011, announced in the Emergency Budget in June 2010
Consultation Issued by	HM Treasury (July 2010)
Response from	HSBC
Contact Details	Andrew Clough 02380 722324 Andrew.Clough@HSBC.com

Introduction

HSBC welcomes the Government's commitment to a new set of rules that will allow maximum flexibility without undue complexity, including the removal of the effective requirement to purchase an annuity at age 75.

The paper explains the value of annuities as an effective way of both insuring against longevity risk and avoiding the risk of falling back on the state. We believe that annuities are likely to be the most suitable product for the majority of individuals and therefore we welcome the paper's consideration of choice in their retirement income. In our view this places great importance on the advantages of using open market options and different annuity features such as dependants pensions, guarantees, escalation and protection.

We welcome the consultation on effective ways in changing the rules. This document gives below our responses to the questions raised in the paper.

Chapter 2 - Developing a new tax framework for retirement

A. 1 The current Unsecured Pension limit would seem to be an appropriate level for the new limit on capped drawdown. This is because it roughly equates to what the individual could provide by exercising his ongoing free choice to buy a single life level annuity.

A. 2 The intended approach to reform appears to be entirely reasonable and the increased flexibility very welcome. In particular, we agree with the proposed changes to the rules on taxation of death benefits, the removal of the age 75 limit on certain lump sums and retention of the age 75 limit in the specified areas. However we have reservations about a tax rate of 55% being too high as this is significantly higher than the rate of relief received on contributions. It would be more appropriate to link this tax rate to the marginal tax rate of the individual.

Chapter 3 - Minimum Income Requirement

A. 3 We agree that the proposals in the paper (for what income should be considered 'secure') are practical and appropriate.

A.4 The level of the Minimum Income Requirement and the adjustment for age is a more difficult question. However, we would advocate a simple measure, e.g. a percentage of the basic single person's state pension. This should be the same at all ages as any attempt to match it to models of income needs at different ages would be overly complex to apply and disregard the many variations in individual needs. This test should be applied only once.

A.5 We note the arguments for and against the Minimum Income Requirement being set for couples. However, applying a different level for couples is again more complex and, more importantly, the existence of a spouse/partner is only one of many varying factors in individual circumstances that will change over time. Therefore, on balance, we do not believe that it is appropriate to set a higher level for couples.

A. 6 It would be appropriate to review the level of the Minimum Income Requirement annually and this would be straight forward to apply if linked to an appropriate index or the level of state benefit.

A. 7 Unnecessary burdens must be avoided or the benefits of the changes will be lost by default. For both individuals and the industry, the calculations need to be simple to understand and easy to evidence. We would not expect the industry to be responsible for the assessment of the Minimum Income Requirement.

Chapter 4 - The UK Annuity Market

A. 8 We have not identified any specific barriers that we think should be removed.

A.9 We believe that more could be done to ensure that individuals make appropriate and informed choices. The continuing need to ensure people make the right retirement choices at the right time will be more relevant to more people than the removal of the need to purchase an annuity at age 75. HSBC would look favourably on consumer education initiatives in this area.

For workplace schemes, education and easy ways of offering retirement counselling should be made available. In addition a system of basic advice should be provided, although it may in some cases flag up the need for full advice. Consideration should be given to small annuity sizes, where the cost of providing full advice can be prohibitive and use of an Open Market Option is currently impractical.

A. 10 The changes will not, of themselves, remove the appropriateness of annuities for the vast majority of people where such security is important in their individual circumstances. Therefore we cannot see that this will have any unintended adverse consequence for the annuity market, although care is needed to ensure that only the right people defer purchasing an annuity (clearly this option is not appropriate for low risk individuals).

The option of a protected annuity rate is something likely to be attractive. To achieve this, the tax charge on the protected amount on death needs to be closer to the basic rate of tax as this is the rate that many investors would have received on their contributions. For example, the current 55% tax charge is not appropriate for basic rate or non–taxpayers.

REMOVING THE REQUIREMENT TO ANNUITIZE BY AGE 75

This is Hymans Robertson LLP's response to the proposals published for consultation purposes by Her Majesty's Treasury on 15 July 2010.

GENERAL COMMENTS

We are supportive of the decision to increase the number of options available to those with money purchase pension funds. It is consistent with encouraging people to take responsibility for their finances. We believe, however, that the change must be accompanied with clear and readily available information about the sorts of circumstances in which drawdown may be a practical possibility, and effective warnings to those for whom it may be unsuitable. It must be clearly communicated that drawdown is suitable only for those who have sufficient funds to sustain it, and who have other sources of income such that they are not entirely reliant on the performance of their drawdown funds to provide them with the income that they require. The FSA and its successor could assist by providing guidance to regulated firms about the advice to be given to prospective drawdown customers about the risks and rewards of such products. For example, if an individual is unable to provide evidence of other sustainable sources of income, there might be a minimum purchase price of £100,000.

Whilst the proposed changes will prevent some people from being forced to purchase an annuity when the market is unfavourable, they should be aware of the risk that annuity rates could be even less attractive to them by the time that a secured income is required.

The changes may result in selection against annuity providers, making annuity rates less favourable to purchasers, and making them even less likely to consider annuities as a product that could provide them with value for money.

ISSUES HIGHLIGHTED IN THE CONSULTATION PAPER

Our responses to some of the matters about which HMT specifically requested comments are as follows.

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

We are not aware of any evidence that the existing USPs and ASPs limits are inappropriate, so we suggest retaining the 120% cap as currently applies to USPs.

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 agree that there is no particular reason why PCLS, TCLS and value protection lump sums should cease to be available once a person attains age 75, and are therefore supportive of the Government's proposal to remove the restrictions.

There is an element of arbitrariness and guesswork in the choice of the age at which uncrystallized funds are tested against the lifetime allowance and the age at which contributions tax relief ceases to be available. We see no particular need for an age-discriminatory restriction on the availability of tax relief, when the Government's declared intention is to apply a tax charge that will recover the relief given in the past. In our response to the Treasury's consultation paper on pension tax relief we questioned the continued need for a lifetime allowance if the annual allowance is to be reduced to the levels proposed by the Government. Even for very high-earning employees, the proposed annual allowance is unlikely to lead to pension accrual substantially over the lifetime allowance when actual career earnings profiles are taken into account.

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.

Footnote 13 to paragraph 3.9 suggests that the Treasury will consider the positions of those people with occupational pensions or lifetime annuities that are already in payment when they make the decision to enter into ‘flexible drawdown’. We agree that this is desirable. Those pensions or annuities could be substantial, but not index-linked, and current rules would obstruct re-arrangement in order to satisfy the MIR, because of the requirement that scheme pensions and lifetime annuities must not decrease from one year to the next. Whilst not specifically part of this consultation, we take the opportunity to suggest that some form of pragmatic age-related adjustment might be made to convert non-increasing income to ‘secure’ income for MIR purposes by applying an age-related factor (e.g. for someone age 65, a non-increasing pension of £10,000 pa is treated as an index-linked pension of £7,000 pa for MIR purposes).

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

We refer to our general comments, in particular that drawdown is suitable only for those who have sufficient funds to sustain it, and who have other sources of income to fall back on. Attempting to design an age-related MIR around the various measures of retirement income and expenditure needs described in section 3 would be complex and to a great extent futile. Whilst a low MIR may assist with the flexibility objective, it may significantly increase the risk of even moderately wealthy individuals falling back on the state. We suggest, therefore, that the MIR should be set conservatively high initially, say £10,000 pa, and reviewed after a suitable period against the policy objectives of the proposals.

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

We suggest that it should be set individually to avoid undue complexity. Again, we consider that flexible drawdown is only appropriate for individuals and couples with sufficient wealth that the ‘savings’ in expenditure needs for couples (as compared with twice the level of single income) are not material.

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

Given the difficulty in balancing the objectives of flexibility and not incurring a cost to the Exchequer, we suggest that regular reviews are required, perhaps every three to five years. It might also be appropriate to include some automatic annual increases to the MIR (in line with increases in the Consumer Prices Index) subject to any over-ride from the regular reviews against policy objectives.

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

Set the MIR cautiously high, accepting that it cannot be done precisely, so that for the individuals involved the particularly complex elements of income (means-tested benefits) are unlikely to be relevant.

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 question.

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

We refer to our general comments earlier in this response.

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 note the possibility that uncapped and flexible drawdown may be perceived as attractive by those with lower expectation of life (both real and perceived). This might lead to the remaining pool of annuity purchasers being regarded as being in better health overall by providers, thus increasing the cost and reducing the attractiveness of annuity purchase. It might also lead, however, to better marketing of ‘enhanced’ annuities as a competitive response.

ENQUIRIES

If you have any comments on this response, please address them to Douglas Huggins, whose contact details are below.

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For and on behalf of Hymans Robertson LLP

ICAEW TAX FACULTY REPRESENTATION

TAXREP 34/10

PENSIONS: REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75

Comments submitted on 10 September 2010 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales in response to the consultation document issued on 15 July 2010 by HM Treasury

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PENSIONS: REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75

INTRODUCTION

1. In this document we present the comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales ('ICAEW') on the consultation document '*Removing the requirement to annuitise by age 75*' ('the condoc') issued by HM Treasury ('HMT') on 15 July 2010 at http://www.hm-treasury.gov.uk/consult_age_75_annuity.htm.

2. We are pleased to have the opportunity to respond to this consultation. We would be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. On 8 September 2010 we attended a meeting jointly with other professional bodies with HMT and HMRC, in which we were able to put forward some key comments and concerns and discuss aspects of the discussion document.

4. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals to change the tax system, and which apply pari passu to pensions.

WHO WE ARE

5. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

6. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

7. The Tax Faculty is the focus for tax within ICAEW. It is responsible for technical tax submissions on behalf of ICAEW as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire.

MAJOR POINTS

8. We believe that the regime that is decided upon should be simple and straightforward.

9. We welcome the proposals to enable those aged 75 and over to enter into unsecured pension ('USP') instead of an alternatively secured pension ('ASP').

10. We also welcome the imaginative proposals for flexible drawdown, subject to more work being undertaken before a decision is made as to the form that this will take. This is because we have concerns that, as flexible drawdown is likely to be appropriate only for a limited number of people, mis-selling could result unless there are sufficient safeguards and the regime is simple enough to enable the risks to be explained and understood by an average person. Getting the rules right for flexible drawdown should not hold up implementation of USP for those aged over 75.

11. As an alternative to the proposal for flexible drawdown at any time after becoming 55, we suggest that consideration be given to allowing individuals to draw down income outside the capped USP regime from their pension fund only if as a result of ill health they have to go into a residential or nursing home or need caring for at home.

12. However much some people perceive that annuities are not good value, there are many advantages to buying an annuity and many risks attaching to drawdown. Annuities offer guarantees whereas USP and ASP do not. Additionally, the annuity market now offers many flexible options, including investment-linked annuities which can deliver similar benefits to drawdown but often at lower cost and less risk.

13. We welcome the commitment that the tax-free commencement lump sum will continue and trust that that means that the proportion of the fund which can be received tax-free will remain at 25%.

14. We consider that the proposed rate of recovery tax on funds at death is too high at 55%. We consider that a rate nearer to 35% would be more equitable than a rate of 55%, and which is more consistent with the existing rules. A 55% tax rate can only be described as penal for basic rate taxpayers, and in particular for those currently in USP drawdown who would have budgeted (on behalf of their beneficiaries) on the basis of a 35% claw back.

15. We welcome the proposal that IHT will not ordinarily apply to pension funds that have not been crystallised.

16. We welcome the fact that the zero rate recovery tax for those under 75 who have not vested their funds will remain. We question why those over 75 who have not vested their pension funds should be discriminated against.

17. We also welcome the continuation of a tax exemption where the pension funds are passed on death to dependants but would welcome clarification of certain issues relating to this.

18. We should also welcome the retention of the current rule whereby pension funds left to charity are exempt from a tax charge on death.

19. We do feel that the ideal outcome of this consultation would be legislation that helps close the savings gap. This requires consistency and simplicity and joined-up thinking between HMRC and the main regulators in this area, mainly the Financial Services Authority which deals with advice to the public, and the Pensions Regulator. Across the majority of the population financial literacy is low and this needs to be addressed. People also need to be aware of the changes being introduced under the Retail Distribution Review and its relevance to them as consumers.

20. One way in which the regulators can help people make the right decisions is to ensure that information provided to those who are about to vest their pension funds is in a standard format that explains in terms capable of being readily understood by the average person the available options and recommends that independent advice be taken.

COMMENTS AND RESPONSES TO SPECIFIC QUESTIONS

Chapter 2 Developing a new tax framework for retirement

The current tax framework

21. The proposition in para 2.3 that pension funds are exempt from tax should be moderated by the fact that tax credits on dividend income are not refundable, which has significantly reduced the investment returns within pension funds.

Principles for a new tax framework

22. We are content with the principles for a new tax framework for retirement outlined in Box 2.A in para 2.10 subject to two points.

23. First, in Principle 4 we particularly welcome the commitment that the tax-free commencement lump sum will continue to be available: we should welcome confirmation that this does mean that at least 25% of the fund (rather than a lesser amount) will continue to be able to be available tax free. Without this guarantee, many will decide that pension saving is no longer viable.

24. Secondly, Principle 5 refers to an exemption from a tax charge on death except where the unused funds are used to provide pensions for dependants. We have been told that this means that the pension fund is transferred to the dependant who can then choose whether or not to vest it and we should welcome confirmation that this interpretation is correct; if it is then we welcome it.

25. We consider that the existing additional exemption for where the funds are transferred to charity, referred to in the third bullet in para 2.7, should remain.

Options for securing a retirement income

26. We welcome the proposals in paras 2.12 to 2.16 and 2.17 to 2.19 under which people will be given greater flexibility over whether and if so when they purchase an annuity, the extension of USP arrangements to those over 75 and, subject to certain reservations, the introduction of flexible drawdown subject to demonstrating a minimum income, which together obviate the need for continuing with ASP arrangements.

USP for all over age 55

27. Whilst in principle we should like to see implementation of the extension to USP to all those aged over 55 as soon as possible, providers will require sufficient lead time after the legislation is enacted to update their IT systems, procedures and stationery.

Flexible drawdown

28. We welcome the imaginative and innovative proposals in the condoc for flexible drawdown, but subject to more work being undertaken before a decision is made as to the form that this will take. This is because we have concerns that, as flexible drawdown is likely to be appropriate only for a limited number of people, this could result in mis-selling unless there are sufficient safeguards, both by the regulatory bodies (eg Financial Services Authority) and by way of limitations as to the circumstances in which flexible drawdown can take place, and the regime including limits etc is simple enough to enable the risks to be explained and understood by an average person, ie anyone who is not a finance or pensions expert. It is vital to get flexible drawdown right including information for policyholders, and the implementation date of the flexible drawdown rules should not hold up the introduction of USP for those aged 75 or over.

29. We believe that the resulting increased flexibility may help to remove a perceived disincentive to saving for retirement by way of a pension fund, namely that annuities offer poor value. However, there are many advantages in buying an annuity and many risks attaching to drawdown. Annuities offer guarantees whereas drawdown does not, and annuity providers now offer a range of innovative, flexible annuity products, including investment linked options.

30. The risks and costs attaching to managing a USP/ASP contract over the medium term are high, and with the costs, impact of mortality drag and unpredictability of asset returns and need for ongoing financial planning and investment advice, the idea should be treated with considerable caution. For people who have policies worth, say, £250k and above and a minimum level of guaranteed income from other sources and, most importantly, the time and expertise actively to monitor their investments, flexible drawdown and the removal of an effective requirement to convert to an annuity is to be supported. However, our support is caveated because of the

investment risks which could diminish the pension fund – and the risk that widening the rules could give rise to a major mis-selling scandal (such as happened when people were given the option to opt out of employer-provided pension schemes). It will therefore be necessary for the regulatory authorities – the Financial Services Authority ('FSA') to take an active monitoring role in this area (see Question A.9), both in respect of advised and non-advised sales.

31. We have no objection to the suggestion that individuals wishing to use flexible drawdown should have a minimum secured income but have concerns as regards to how in practical terms the concept could be implemented, particularly in connection with non-advised sales. .

32. As an alternative to the proposals in the condoc of uncapped or flexible drawdown of an amount treated as income at any time after becoming 55, we suggest that consideration be given to only allowing individuals to draw down an income from their pension fund if as a result of ill health they have to go into a residential or nursing home or need caring for at home. We understand that average life expectancy in such circumstances is normally about three years, so perhaps such individuals could be allowed to draw down all, or say 20-25%, of their pension fund per year, regardless of income or capital on production of appropriate certification, eg from a doctor. Against this idea is the possibility that such individuals (who will perforce be in ill health and potentially vulnerable) who have not planned ahead, eg by entering into lasting powers of attorney, may be unduly influenced by family or third parties into entering into transactions and commitments which are not in their own best interests.

33. We welcome the commitment in Box 2.A that the tax-free commencement lump sum will continue and trust that that means that the proportion of the fund will remain at 25%.

A.1 The Government welcomes views on the level of an appropriate annual drawdown limit for capped drawdown (para 2.17)

34. It is proposed that capped drawdown will be able to continue and will be available whether one is aged over or under 75. In general terms, the present rules for unsecured pension USP arrangements, which allow for up to 120% of an equivalent annuity to be withdrawn, provide that the value of one's withdrawal has to be actuarially recalculated every five years. If the investment performance of the pension fund is poor then there is a danger that the pension pot can become seriously depleted or even exhausted during those five years.

35. We think that that anyone contemplating drawdown should take advice: see our reply to Question A.9 for our further comments. Reputable investment advisers normally recommend annual review of the value of the pension pot and warn about the dangers of depleting or exhausting the pot if too much is withdrawn. They also counsel against drawdown other than for those who have sufficient income from other sources or sizeable pension pots. Given present annuity rates which mean that 120% of a small proportion of a pension pot is still a relatively small amount of money that is being withdrawn, we cannot see any case for changing the figure from 120% whatever the age.

Designing a new tax framework for retirement

36. Para 2.21 observes correctly that the tax relief on contributions and tax-free investment growth and income (leaving aside the removal of the ability to reclaim tax credits on dividend income) and the 25% tax-free lump sum are significant incentives to save into a pension. However, we should note that these incentives have proved insufficient to increase saving for retirement probably because of the decline over the last twenty years or so in the confidence of ordinary people in the ability of pension investments to provide the quality of returns formerly associated with with-profits investment funds and guaranteed annuity rates. In addition, as pensions planning is for the long term, stability of the rules is essential, but that has been lacking over the past few years. Complicated rules that are frequently subject to review and change confuse savers and add to the cost of advice. We have anecdotal evidence that suggests that financial advisers are of the view that these

factors mean that it is uneconomic to provide advice on pensions to a substantial proportion of the general public.

A.2 The Government welcomes views on its intended approach to reforming the pensions tax framework, in line with its commitment to end the effective requirement to purchase an annuity by age 75 (para 2.25)

37. In para 2.22 first bullet we are content with the proposals that pension benefits drawn down under the new arrangements will continue to be taxed at income tax rates. We particularly welcome the commitment that the tax free pension commencement lump sum will continue to be available. We should welcome confirmation that that this will continue to represent 25% of the individual's pension pot.

38. In para 2.22 second bullet we note the proposal that unused funds shall not be subject to a tax charge on death provided that they are used to provide a dependant's pension.

39. First, we should welcome clarification of 'dependant's pension'. We have been informed that although the condoc refers to 'a dependant's pension' (paras 2.10 & 2.22) this actually refers to transfer of the balance of a pension fund as a pension fund but should welcome confirmation. We should also welcome confirmation that the dependants can pass on unused funds tax-free to their dependants (as was the case between 6 April 2006 and 13 December 2006).

40. Secondly, we should welcome clarification of 'dependant'; for example, we assume that it will include a surviving spouse and dependant children (including step-children) who are in full-time education, but should also welcome confirmation that it will include others, for example adult disabled children and other relations who are being wholly or mainly supported by the deceased at death, for example elderly siblings and elderly parents.

41. We should welcome clarification of how the suggested recovery rate of 55% is arrived at. We think that it looks high because tax relief will have been given (at least in recent years and prior to this year) at a rate not exceeding 40%. We consider that for those aged under 75 who are in drawdown (whether by way of a USP or having taken a lump sum) the proposed rise from 35% on death to 55% is penal. Pension planning is for the long term and the decision to draw down benefits would have been made in the knowledge that a 35% charge would arise on the fund if they died before age 75. Under the proposals their funds will now face a 55% charge. Such a large and unexpected tax rise is unfair and seems at odds with the spirit of the proposals as a whole and will discourage people from saving for their retirement by way of a pension scheme.

42. We recall that the present recovery tax rate of 35% with no IHT charge for those aged under 75 who have drawn benefits from their pension fund was based on average tax relief given on contributions, and, subject to any more recent analysis, that seems to us to continue to be a fair and equitable measure.

43. On the basis of the foregoing we consider that either the proposed rate of 55% should be reduced across the board to 35%. If there is to be a rise for those who are in USP and expecting a death rate of 35%, then (at the risk of making the regime yet more complicated) then there should be some form of grandfathering protection, perhaps based simply on the value of pension funds in drawdown at the date that the new regime comes into force.

44. In order to give some relief to basic rate taxpayers, but without wishing to withdraw the zero rate death charge referred to in the next bullet, we suggest as an alternative to a 55% rate that the charge on the unused pension fund be calculated by charging the value of the pension fund to income tax at the deceased taxpayer's marginal income tax rate in the year of death.

45. In para 2.22 third bullet, we welcome the fact that death benefits for those who die before age 75 without having accessed their pension savings will remain tax free. Given that part of this reform is aimed at levelling the playing field between those aged under and over 75, it is anomalous that the tax free treatment is not proposed to be available to those aged over 75 who have not accessed their pension funds. .

46. In para 2.22 fourth and final bullet we are pleased that inheritance tax will not ‘ordinarily’ apply to unused pension funds in addition to the recovery charge, and should welcome confirmation that this is an undertaking to remove the IHT charge from pension funds for those aged over 75 who are in ASP.

47. We note the government’s not unreasonable undertaking to keep this under review. The word ‘ordinarily’ implies exceptions and we should welcome clarification of the circumstances when IHT might apply to pension funds under the new regime. We trust that the draft legislation promised for later in the year will clarify this and other points.

48. As to the proposals in paras 2.24 and 2.25, we welcome the proposal to do away with the age 75 restrictions on value protection, pension commencement (ie the 25% of fund) and trivial commutation lump sums.

Chapter 3 Minimum Income Requirement

What constitutes secure income

A.3 The Government welcomes views on what income should be considered ‘secure’ for the purposes of the MIR and whether proposals for the life annuity income that can be considered for the MIR are practical and appropriate (para 3.9)

49. We are content with the principles outlined in paras 3.6 to 3.9 and agree that state and occupational pensions and annuity income should be included provided uprating in all cases is linked to inflation.

50. Many pensioners have flat rate rather than indexed-linked/escalating annuities. We note that footnote 13 says that secured income comprising flat rate annuities will not be excluded but will ‘be catered for by technical provisions at a later date’. We suggest that such provisions include a present value formula which can be applied to the future income stream to ascertain whether it will continue to be sufficient to meet the MIR.

51. Given the risks for the majority, we are not convinced that secure income should be widely defined in terms of what can or cannot be deemed to represent secure income. Drawdown is suitable only to a limited number of people who have investment expertise and sufficient genuinely secure income not to expose them to potential financial disaster later in life.

At what age the MIR can be met

52. We agree with the proposal that the age range be 55 until death.

The level of the MIR

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

53. We do not think it is unexpected that, as noted in para 3.14, the highest levels of expenditure arise immediately on retirement and in the last years of life. We suggest that in setting MIR to meet the government’s objective that individuals should not become a burden on the state, regard will need to be had to maximum average annual expenditure levels.

54. We recommend a single non-age related MIR because dates of retirement and death differ between individuals which would render an age-related sliding scale impractical.

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

55. This paragraph is in effect raising the question of whether, where the individual is married or has a civil partner, the MIR should be assessed on an individual basis or a joint basis. Personal pension funds are invested on an individual basis and will be drawn down by the owner of that fund, even if the individual is part of a couple. However, we acknowledge that the government is seeking to ensure as far as possible that drawdowns from pension funds are not followed by either the owner of the pension fund or his/her spouse/civil partner subsequently becoming a burden on the state.

56. On first blush, it would seem logical when assessing whether an individual who is part of a couple has sufficient MIR to support a flexible drawdown, that the MIR for that individual should be assessed on the basis of being part of a couple, and the secured income of both individuals should be taken into account. However, this will create complexity, especially where there are problems in obtaining income details of the other spouse/civil partner and will mean that married couples/civil partners will be treated differently from those who cohabit. These factors suggest that the MIR for an individual who is part of a couple should be based only on that individual's own secured income. This is reinforced by the fact that many of those purchasing annuities buy single life annuities.

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

57. Pension planning is for the long term and so stability of the rules and thresholds is vital. We suggest that MIR be reviewed triennially and changed only if inflation is more than a certain amount. Changes should take effect from 6 April.

How the MIR should be assessed

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

58. To obviate the need for a paper trail which involves the individual contemplating drawdown obtaining evidence from secured income providers and sending it to the drawdown provider, it will probably be simplest if drawdown providers can be empowered to seek evidence direct from the providers of secured income on provision of a signed mandate from the individual contemplating drawdown.

Chapter 4 The UK annuity market

59. Para 4.13 observes correctly that there are negative perceptions regarding annuities. This is because the perception is that a well-managed investment portfolio may, in the long term, be able to produce a similar return and the capital remains intact. However, as noted above, annuities offer considerable benefits which should not be underestimated. Annuities are normally guaranteed for life and the annuity market now offers many flexible products, including investment-linked options and flexible contracts with capital guarantees. We therefore believe that a balanced view of the relative advantages and disadvantages and risks associated with annuities in comparison to drawdown needs to be maintained.

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

60. We are not commenting on this point.

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

61. We do feel that the ideal outcome of this consultation would be legislation that helps close the savings gap. This requires consistency and simplicity and joined-up thinking between HMRC and the main regulators in this area, namely the Financial Services Authority, which deals with advice to the public, and the Pensions Regulator. Across the majority of the population financial literacy is low and that this needs to be addressed. People also need to be aware of the changes being introduced under the Retail Distribution Review and its relevance to them as consumers.

62. There is a need to help individuals make appropriate pension decisions on retirement. However, the information that people receive at retirement does not always make all the available options sufficiently clear to the average person.

63. We are concerned that many people do not seek advice and are not aware either of the importance of doing so or that if they pay a fee they may receive better advice.

64. We suggest as a start that the information that people receive at retirement from their pensions insurance company should be in a standard format which enables the average person by reading a relatively simple letter easily to appreciate the options that are available (ie that they can buy an annuity, that there are lots of different sorts of annuities ranging from, for example, flat rate single life to joint life indexed-linked with guaranteed payment periods, that the annuity can be bought from companies other than the one with whom the pension fund is currently held, or they can take a lump sum, or they can leave the pension fund invested, or they can go into drawdown with the attendant risks and advantages) and the need to seek advice. The technical information for the more sophisticated investor can be set out in an appendix.

65. We suggest that imposing such a requirement is not a task for the CFEB but for the Financial Services Authority as the main regulator dealing with retail advice.

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

66. We have no comments on this question save to observe that the need for secured income to be indexed-linked may increase the demand for indexed-linked annuities over flat-rate annuities by those who are using only part of their pension pots to buy annuities.

PCB
10.9.10

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APPENDIX 1

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independant tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see http://www.icaew.com/index.cfm?route=128518).

ILAG

Investment & Life Assurance Group
The Practitioner Voice

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

10 September 2010

Dear Sirs,

Removing the requirement to annuitise by age 75

On behalf of ILAG, I have pleasure in submitting the following comments on the above consultation.

ILAG is a trade body representing members from the Life Assurance and Wealth Management industries. ILAG members share and develop their practical experiences and expertise, applying this practitioner knowledge to the development of their businesses, both individually and collectively, for the benefit of members and their customers.

We welcome and fully support the proposed changes which should, in addition to helping to simplify the pensions system, make it a fairer arrangement. However, we do have concerns that the projected timescales are perhaps too demanding.

Some members of ILAG felt that an implementation date of April 2011 would be too short to allow sufficient time to implement the changes. The significant changes proposed, if brought in too quickly, would most likely necessitate subsequent correction to initial legislation, but a longer discussion phase would help circumvent this likelihood and in turn save the Government additional time, and cost involved in making interim changes in 2011 only to be followed by further changes in 2012.

It will take firms a number of months to update their review packs once the new rules are finalised. In addition, where the income drawdown review date is in April 2011, firms will need to send out review packs in January 2011, so changes would need to be implemented early enough to allow this.

As an alternative, introducing the changes from October 2011 might be more practical for the purposes of implementing the necessary data changes.

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Our specific comments in relation to the questions for discussion in the paper are noted below.

If you would wish to discuss our response in more detail we would be happy to do so.

Yours faithfully

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Administration Team

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Questions

Developing a new tax framework for retirement (Chapter 2)

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

We suggest that the annual drawdown limit should be retained at 120% of GAD. We have considered whether the limit should be based upon the average of annuity rates available in the market, rather than on GAD limits which are based on 15 year index linked gilts, but this would be harder to track and administer. GAD rates should continue to be capped at age 75, as we believe this gives a safety cushion against funds running out early.

If it were agreed that any changes (as suggested in our general comments above) were to be delayed until 2012 there would be additional opportunity to consider alternatives to GAD tables, for example tables based on expected general mortality, and investment, though still produced centrally by GAD.

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 need to see the more detailed proposals before committing to any definite view, for example where the pension commencement lump sum is taken after age 75, will it be based upon the fund at the time it is taken, or on the fund at age 75 when the LTA check is done?

Whilst we welcome the simplification of the rules on the taxation of death benefits after age 75, we are disappointed at the suggestion that the rate payable on the unused unsecured pension fund for those who die before age 75 will be increased from 35% to 55%. We are not arguing against the principle of clawing back an amount broadly equating to the tax relief that has been enjoyed but feel that such a high rate is unfairly penalising basic rate taxpayers.

We believe that a 55% tax rate might also attract adverse media coverage and be perceived by some sectors of the public as too being too high. This might have an unintended consequence of discouraging investments in pensions, for example, where the person would receive tax relief only at the basic rate on their contributions. Conversely, with the proposed flexible drawdown those people with large pension funds would have the advantage of being able to withdraw funds at an earlier stage (most likely at 40%) and leave little or no funds remaining at death in their pension pots.

Defined benefit schemes can provide an equivalent death benefit that is not presently taxed at the 35% rate. This further illustrates the disproportionate nature of the proposed 55% rate.

We feel that a lower rate of say 40% would be fairer.

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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.

The purpose of the MIR is to stop people falling back on the state and if they must have a minimum pension pot of say at least £150,000 they would have the means to generate the required level of income. This would be ring-fenced and could not form part of the pension fund for flexible drawdown purposes. This sum could be used to purchase an annuity or for capped drawdown.

A broader definition is required as to what is meant by secured income, and it should take into account the size of an individual's pension pot. This should not be limited to pensions from the State and pensions from occupational schemes: pensions that are paid from other sources, whether fully secured individual pensions (bought from pension providers, though possibly limited to EU pension providers), and scheme pensions paid from self-invested personal pension schemes should also be allowable. It should be noted that scheme pensions paid from self-invested personal pensions are payable at a level determined by a scheme actuary, having assessed the available funds. So there are strong arguments that such scheme pensions are as secure as scheme pensions from a large defined benefit scheme, which could be transferred to the Pension Protection Fund, with the result that the level of scheme pension is reduced.

As well as secured income, consideration should also be given to the individual's un-crystallised and crystallised pension funds in unsecured pension. This should take into account the size of an individual's pension pot by way of a simple system that can be readily understood by members of the public and be clear in its use by both providers and advisers. We propose that there should be a conservative multiplying factor that should be applied to pension amounts to convert to "capital value" for the purpose of assessing the MIR. Then, if the converted value is greater than the capital value equivalent of the MIR, flexible drawdown would be allowed.

This would stop people who do not favour annuities having to purchase one so at that they can qualify for flexible drawdown.

We believe that it is reasonable to allow for the existence of these pension funds in assessing suitability for the additional flexibility.

Taking both the above factors into account, we favour a process that will convert all income to be taken into account into a "pension value" for comparison purposes, rather than a yearly amount of pension. Using a "pension value" would introduce a level of equivalence into all types of pensions by applying simple multiples to determine a "total value". We propose that there should be a conservative multiplying factor that should be applied to pension amounts for the purpose of assessing whether the value of income exceeds the MIR, so achieving eligibility to move to flexible drawdown.

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Whilst we have considered the possibility of having variable factors we believe on balance that the simplicity offered by having a single factor outweighs the drawbacks. This will be easier for consumers to understand and as we propose conservative factors we do not feel this will cause any undue risk. It should also be noted that the type of individual with the very large pension funds required for flexible drawdown would be likely to have other significant assets.

Special consideration should also be given to those flexible annuities which include a minimum income guarantee, although by adopting the "pension value" approach, the value of the flexible annuity (as determined by the pension provider) could merely be aggregated.

It is not clear from the consultation paper whether 'life annuity income' is intended to include purchased life annuities as well as lifetime annuities purchased with pension funds. However, there does not appear to be any reason to exclude purchased life annuities.

Given that the MIR is to be measured at a single point in time, the subject of pensions sharing on divorce should be covered in the technical paper.

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

Please also see our response to question A.3 above.

We believe that the level should be below the age allowance income limit (currently £22,900) and suggest that a figure of between £15,000 and £20,000 would be appropriate (or equivalent capital value, as discussed above). We do not consider that this should vary depending on age as, in reality, there are so many different variables that will determine adequacy. With the approach we suggest in our answer to A3, the MIR would be a monetary sum. However, with this approach, the amount we suggest can be calculated as a monetary sum by applying the relevant multiplying factor.

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

We believe that the same MIR should apply irrespective of whether the recipient is single or part of a couple.

- Assuming that in this context 'couple' means married or in a civil partnership, and not other couples, differential limits would discriminate against those in formalised relationships and could have an unintended consequence of social engineering.
- As the MIR is checked at a single point in time, it is likely, or in some cases inevitable, that the recipient's status will change in the future, making that earlier check redundant.
- It is not practical for providers to be expected to keep a check on status.

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

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

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

This should be entirely reliant on a member self certification process, otherwise the costs of operating the MIR for individual members could well translate into higher costs for other members who cannot access the flexible option because they do not meet 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.

The key outcome of the proposals is to give greater flexibility yet ensure people have sufficient resources not to be reliant on the State without upsetting the fiscal balance. If this is to be achieved, it is essential to keep the proposals simple for easier understanding by non-pensions specialists – for example, flat multipliers applied to each type of pension for MIR valuation purposes backed by self-certification processes, as discussed above.

New annuity products continue to be developed. Where those contracts allow for a fund value to be quoted beyond the commencement date it would bring in additional innovation by allowing the maximum value protection amount payable to be based on that fund value rather than the original premium. This would remove the death benefit distinction between a drawdown contract and an annuity thus ensuring that the client has the greatest flexibility dependent on their circumstances.

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.

It is likely that people who could reasonably take advantage of the new proposals will also be those who will be more financial aware and take appropriate advice in any event. For the vast majority of people, buying an annuity will still be the most appropriate solution. As such, there is a need for all parties involved to continue work done to promote the Open Market Option, with Government taking the lead by building on existing work in this area.

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.

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As previously mentioned, if the very tight timetable proposed is followed, there is the risk that:

a) Pension providers will not be able to update literature (printed and system produced) in time for April 2011
b) There will not be sufficient time to think through the proposals (for example rules around the MIR) and these will need to be revisited and refined in later years.

Whether they may be fair or unfair measures like the proposed flat rate tax charge on death benefits of 55% will be seen as penal and turn people off pension savings.

We do not see these proposed reforms altering the pension income choices taken by the majority of people, as a purchased annuity will continue to be most appropriate for the majority. The need for a continuing supply of Gilts is already well-documented and so not affected by the proposals. If the proposal to require escalating annuities for the MIR is carried forward this would require the Government to issue more suitable Gilts to match this need. Otherwise the small supply of such Gilts will drive up prices and result in poor value for consumers.

Ends

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Investment Management Association

10 September 2010

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

Dear Sirs,

Removing the retirement to annuitise by age 75

The IMA[1] is pleased to have the opportunity to respond to the consultation on the reform of annuitisation requirements.

We strongly support the general policy intent behind the proposed reforms. With the shift from defined benefit to defined contribution pension saving intensifying, the need for individuals to take greater responsibility for their retirement income will only intensify. At the same time, considerable variation in retirement saving provision and employment patterns in later life will require both flexibility and innovation in the retirement income market. While individual capability and potential behaviour remains a key challenge, this is true across both the accumulation and decumulation phases, and should not in and of itself be an obstacle to reform.

However, there is considerable detail to work through in ensuring the reforms strike the appropriate balance at a number of levels, notably between individual empowerment and protection and between freedom of drawdown/bequest and tax efficiency for the Treasury. In engineering such a balance, there is also a substantial danger that rules can become complex, thereby putting up barriers to the very flexibility that the Government wishes to encourage. In particular, it is difficult to set drawdown levels that minimise the risk of running out of money without being highly restrictive.

Taking these factors into account, we suggest therefore that the Government may wish to consider establishing a minimum reserve amount that could form both the basis for moving into capped drawdown and the threshold for the flexible drawdown

[1] The IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the in-house managers of occupational pension schemes. They are responsible for the management of around £3.4 trillion of assets in this country. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.

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option. This would be comparatively simple while sending a signal about the relative appropriateness of drawdown strategies for individual savers, many of whom we believe will need some form of pooled risk solution at some point during their retirement. Just as with the lifetime limit on pension saving, any regular income from other sources (eg a DB pension) would be notionally commuted to count towards the reserve amount. If the Government still feels that a minimum income requirement, expressed as a specific income, is desirable, we would suggest permitting a wide range of eligible assets subject to appropriate risk haircuts.

On the tax side, there is an understandable desire by the Government to ensure that tax incentives are used for the purposes for which they are intended: encouraging individuals to make appropriate provision for their own retirement income. However, despite the complexity in calculating appropriate claw-back mechanisms, a single 55% recovery charge strikes us as potentially inequitable. Furthermore, the retention of the age 75 rule as a cut-off point for imposing such a charge seems to lack justification and we would suggest its total abolition.

We would also invite the Government to consider whether it might be appropriate to allow residual pension pots to pass to the pension pots of specified beneficiaries in order to help the broader goal of ensuring adequate retirement provision across different generations.

Finally, it is quite clear that the question of education and advice needs broad and substantial consideration as individuals face increasing levels of responsibility for retirement provision. We therefore support initiatives such as Moneymadeclear which aim to improve consumer understanding. By working towards higher standards in the advice industry, the RDR may also make a positive contribution, although some issues over future access to advice for certain groups do arise. Even for those remaining within the annuity market, advice may often be essential in facilitating decisions that are most appropriate to individual circumstances and risk preferences.

We would of course be very happy to discuss further with you these and any of the other issues raised in our response.

Yours faithfully,

Joanthan Lipkin,
Head of Research

Removing the requirement to annuitise by age 75

Response from Intelligent Pensions Ltd.

We are specialist financial advisers in the retirement planning field in particular 'pension decumulation' solutions with over 12 years of direct experience in advising clients and managing their retirement plans, transitioning both into and out of pension drawdown to 'secured' or 'alternatively secured' pension. We therefore have a very clear understanding of the issues raised in the consultation document, from both the technical standpoint and on a practical footing. Furthermore, as advisers in this field (as opposed to providers) we believe we also have an intimate understanding of the views and expectations of the public as represented by over 1,000 clients across a broad financial spectrum.

General Observations

Having advised on pension matters since well before the introduction of personal pensions in 1998, my personal experience is that complexity is a disincentive to retirement saving, <u>where it creates doubts in the minds of retirement savers</u>. Confusion leads to indecision or cynicism. Nevertheless, for the section of the public who most need to be incentivised, our view is that the issues covered in this consultation are not of major relevance to the issue of incentivisation.

There are two reasons for this. Firstly, for the group who especially need to start saving more to avoid being a burden on the state (who we consider to be early/mid career 'low to medium' earners) retirement itself seems a long way off, and age 75 far remoter! Nobody in this group believes that any changes in legislation implemented now will still be in place 20 or 30 years hence, so it is a 'non event' for this group.

The second reason is that for the vast majority of people for whom unsecured pension is a suitable option at retirement, it will no longer be suitable by age 75, and therefore by that age they should already have switched to annuities on simple investment criteria. This is because, all other things remaining equal, the *opportunity cost* of delaying annuity purchase rises with age as a result of the growing effects of 'mortality drag'. This reflects the higher level of mortality subsidy inherent in annuities bought at older ages.

At 75, even at current low interest rates, a guaranteed yield of 8.8% p.a. for life is available (male, normal health, single life, no escalation). Even higher yields are available for those with even mildly impaired life expectancy, and that is becoming a significant factor. There is no other investment able to provide such a fixed and secure return on such an open ended basis.

Furthermore, on the assumption that other annuity shapes (e.g. female life, joint life, escalation, guaranteed payment period) are all 'actuarially equivalent' in terms of the value for money, then the suitability of drawdown after 75 on investment criteria is extremely limited. It may be justified in a fairly small range of special situations e.g. extreme poor health (where even 'impaired life' annuity terms may not represent fair value) or a much younger spouse (where provision for spouse's pension would be expensive and the objective is to preserve the fund to secure a single life widow(er)'s pension on death).

This does not mean we do not believe there should be further reform in this area, but that the reform should focus primarily on simplification that helps remove the unnecessary complexity that creates a general backdrop of doubt and uncertainty, which (as explained above) does affect the appetite for saving across the board.

On the other hand we believe that simplicity needs to be balanced against fairness, and simple rules that are widely perceived to be grossly unfair do even more damage than complexity.

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

The GAD limit was originally intended to be a proxy for a single life level annuity. The logic was that an unsecured pension holder should be able to receive an income as high as would be available under a secured pension. This link appears to have been 'lost in transition' after the new GAD tables were introduced in 2006. We suspect that the move from 100% to 120% was solely to avoid existing plan holders on maximum withdrawals being forced to reduce their income. In fact by doing so the government effectively circumvented the revised tables, which were intended to better reflect market annuity rates which were significantly out of line with the older tables due to the effects of increased longevity.

Keeping in mind the underlying objectives of providing flexibility, in a simple and easily understood system, while avoiding the risk of a plan holder becoming a burden on the state, we consider that this is best achieved by having the limit revert to simply 100 % of GAD for both pre and post 75. This reinforces the simple logic that unsecured pension should be able to match a secured pension.

We also believe that the recalculation of withdrawal limits should revert to triennial review periods pre 75, instead of the current quinquennial period. The current combination of an artificially high withdrawal limit, a 5 year delay before recalculation, and volatile investment markets, is resulting in outcomes that are of great concern.

The proposed new legislation rightly aims to avoid an individual being able to adopt a cavalier approach and then fall back onto the state for financial assistance. This is obviously essential. However we would expect that the Government would want to be consistent in its approach to this moral hazard. We believe that the current system for calculating the withdrawal limits pre 75 results in an undue risk to the state, which Government should therefore take the opportunity to now correct.

For example, we have seen the effects of plan holders taking maximum withdrawals at 120% of GAD based on a calculation carried out before the collapse in investment markets in 2008 and carrying on (against our advice) at that level after the market crash. This results in the excessive depletion of the retirement fund and thereby increased the risk of qualification for state assistance.

A simple example illustrates the problem:

In July 2007 the GAD rate was 5.25% for calculation purposes. For a 65 year old male the GAD limit was therefore 7.7% of the fund, and the maximum withdrawals therefore 120% of that. Based on a drawdown fund of £100,000, the maximum withdrawals were therefore £9,240 p.a. At that time the FTSE ALL Share Index stood at around 3,480, since when it has fallen to around 2,800, a fall of about 20% or -7% p.a. Using simplified methodology, smoothed performance and withdrawals annually in advance, the FTSE All Share acting as a proxy for the pension plan, an investor's fund will have depleted to £47,179 by now, a reduction of over 50%.

year	fund b/f	withdrawal	remainder	growth	fund c/f
2007	£100,000	£9,240	£90,760	-7%	£84,407
2008	£84,407	£9,240	£75,167	-7%	£69,905
2009	£69,905	£9,240	£60,665	-7%	£56,419
2010	£56,419	£9,240	£47,179		

The reversion to triennial reassessment coupled with lower withdrawals would limit the scope for excessive depletion by recalculating the maximum based on the revised fund value and prevailing gilt yield. This more frequent recalculation also has the upside benefit that in the event of strong growth and/or or a rise in gilt yields the new maximum limit will allow an increase in the withdrawals. This will be particularly relevant for plan holders whose initial calculation took place in the aftermath of the collapse in markets, and will allow them to take advantage of the subsequent recovery.

Post 75, a limit of 100% will maintain consistency and simplicity. The current limits of 90% maximum and 55% minimum are a good example of the general complexity that, from the standpoint of the individual pension holder, seems utterly pointless.

There are also good practical reasons for allowing zero withdrawals after 75. For example, we have many clients who have a drawdown plan that is secondary to their own needs, but will become very important to the needs of a surviving spouse. A typical example would a retired NHS consultant, with a substantial NHS pension that reduces by 50% on death, leaving a potential shortfall for his surviving spouse. The drawdown plan that has been built up alongside the NHS pension from personal contributions should be able to be preserved after 75 for the purpose of compensating the loss of pension to the spouse. Clients currently in this situation simply cannot understand why they are being forced into taking an income from 75 that they neither need nor want.

While we agree in principle that tax relief is granted to provide an income in retirement, artificial constraints that are on the face of it unnecessarily restrictive and therefore illogical tend to be corrosive to the overall view on pension provision, and are therefore not only potentially unfair on an individual who is directly affected, but also add to the general disenchantment about pensions.

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.

Under the present legislation there is no requirement to purchase an annuity *per se* at 75, but the tax treatment of death benefits under ASP is widely considered to be unfair and disproportionate. The damage caused by the changes introduced to the tax treatment on death just a year after ASP was permitted was enormous, in damaging people's confidence in there being any certainty or consistency about the future tax treatment of their pension arrangements.

Further damage will be incurred by the application of a 55% tax charge on crystallised funds as this would be a significant increase to the current tax charge on death before 75. We have many clients whose primary motivation for deferring annuity purchase (and hence adopting unsecured pension in the meantime) was to avoid loss in the event of their premature death. These investors have by definition already taken investment risk with their retirement pots, and may have lost money due to the market conditions in recent years, but were taking a calculated risk on the basis of a 35% tax charge on the survivors death. To find out that the notional reward for the risks they have already taken is going to be reduced by around one third will obviously be given widespread publicity in the press and will further add to the general cynicism about trusting government not to move the goalposts. This would therefore be a retrograde step, reducing the incentive to save for retirement across all sections of working population, not just those who are in the wealthy category.

The original FA2006 position i.e. that the remaining fund on second death under ASP would be aggregated with the originating pensioner's estate for IHT to be assessed, was on the other hand widely accepted as being fair and proportionate. A 35% tax charge on the second death would also have been acceptable to the vast majority. If the decision to apply a more consistent tax charge across the age band is paramount to current government thinking, then a charge of 40% would seem appropriate. Although an increase from the current level on pre 75 death benefits, for those wealthy enough to stay in drawdown rather than securing their benefits through an annuity on first or second death, it would not be considered disproportionate.

Alternatively the remaining crystallised fund could be assessed for Income Tax at the rates applicable in the year of death, after applying a 'top slicing' relief. This relief could be based on 100% of the GAD limit applicable at the date of death, as a proxy for the *annual income equivalent* of the remaining retirement fund. The plan administrator would calculate the composite tax rate applicable, by applying the plan holder's tax code to the annual income equivalent of the remaining fund. The resulting tax rate would then be applied to the whole of the remaining crystallised fund.

This would be simple, fair at all ages, with a tax charge that would be broadly proportionate to that which would have been incurred over the remaining life of the plan had the taxpayer survived to normal life expectancy.

In relation to other factors that cause doubt in the minds of the saving public, our experience is that the lifetime allowance causes unnecessary concern, to say nothing of the complexity and cost to administer. In the current situation where tax relief on inputs will be controlled, and the tax on output benefits is also controlled, we cannot see what purpose this added complexity serves. Our suggestion is that the lifetime allowance be removed as it is both artificial and arbitrary in its calculation, and causes an unnecessary disincentive to save due to the uncertainty it creates before retirement about the potential extra tax charge.

However, if the lifetime allowance is to remain then we agree that age 75 remains a sensible age at which to apply the test.

We believe that there is very little demand for flexible drawdown, and that if such legislation is introduced then it must limit the scope for any fall back on state pensions to virtually nil.

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 the proposal that only income that is guaranteed and has already been secured should be counted for the purposes of MIR. We have heard some views that capital should be taken into account as well, or that prospective pension entitlements should be included. In either case this would add significant complexity, while creating additional and unnecessary risks, unless the personal capital and/or prospective pension benefits can be effectively protected against erosion. This is counter to the objectives contained in the current proposals, and in our view should be avoided.

It is proposed that pensions that at least meet the LPI requirement should be taken into consideration. For an individual whose occupational money purchase scheme provides only a flat rate pension, or whose personal pension provides a high guaranteed annuity but similarly only on a flat rate basis, which in either case might be a significant enough amount to avoid any possible risk to the state, this limitation will seem unfair.

There is also the problem that an LPI pension (or any non indexed pension) will potentially be eroded by inflation over the long term. A more robust and consistently fair approach would be to apply a discount factor to the value of any pension that is not fully index linked. The level of discount should reflect the difference in value/cost between the actual secured pension and an equivalent index linked pension.

For example, at current market rates, an index linked pension of £10,000 p.a. for a 55 year old male costs around £350,000 while a level pension costs about £190,000 i.e. some 45% less. The value of the level pension should therefore be discounted by 45% for the purposes of the MIR calculation. Similarly, a £10,000 p.a. pension with 3% fixed rate increases costs £285,000 at 55 for a male, i.e. about 80% of an index linked pension and should therefore be discounted by 20%. If discount factors are not applied, the effect is that the inflationary risk is borne by the state rather than the individual, which cannot be right.

For example a 55 year old with an LPI annuity who meets the MIR marginally could find the real value of the LPI pension reduces by over 50% by the time they reach 90. The actual average inflation rate necessary to lose 50% of the value against RPI by that age is only 4.55%. In a long term context that is not a remote prospect.

Allowing secured pensions with less than LPI to be included in the computation of MIR (subject to the discount factors explained above) will also allow greater flexibility when securing pension benefits at an earlier stage of retirement. This would allow a plan holder contemplating the possible future use of flexible drawdown to avoid the extra cost of securing any inflation protection at that earlier stage, which might be wholly unnecessary where the individual is in a position to 'self insure' against the risks of inflation, through other financial resources.

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

We believe that the MIR should be set at the highest level that can be justified in order to minimise the risk to the state, while taking into account the potential effects of inflation over the longer term. If flexible drawdown is to be available from 55, the term could extend to 45 years or more in some cases, and the inflationary risks are therefore very considerable. The only safe basis for minimising the risk to the state is to assume that the individual does eventually require care in their later life, and we believe that regardless of the age of the individual at the time of seeking qualification for flexible drawdown the MIR calculation should be based on that potential scenario. A simple solution would be to pick a large enough figure that might be considered 'safe', such as £30,000 p.a. and have that reviewed every 5 years, rather than attempt to be too precise in the calculation basis.

As we have indicated above, with certain exceptions, only the very wealthy should even consider continuing in drawdown beyond 75, based on simple investment factors. In the vast majority of cases plan holder will be best advised to progressively switch to annuities from around 70 onwards, at an age, level and rate of conversion depending on immediate market conditions and the priorities, needs and risk tolerances of each individual.

Those clients who might be advised to remain in drawdown, rather than secure their remaining pension through an annuity, for the special circumstances where doing so would be considered suitable (terminally ill, much younger spouse) would be highly unlikely to want or need to take higher withdrawals than the 100% of GAD we have suggested, unless for meeting care costs.

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

We consider that 5 yearly intervals would be appropriate.

A7. How to minimise unnecessary burdens for individuals and industry in the assessment of the MIR?

The setting of a high rate to apply across all ages will remove unnecessary burdens along with tables provided by the Government Actuaries Department to calculate discount factors for non index linked pension for MIR purposes.

As with the table for GAD limits for unsecured pension, the MIR tables would be referenced by age and gilt yield. As well as one table for LPI pensions there would need to be tables for two fixed rate increases (0% and 3% would make sense both being in common usage), with extrapolation or interpolation to calculate the discount for other rates. Separate tables would be needed for contingent spouses and dependants pensions.

A8 to A10

We have not responded to the remaining questions raised under Chapter 4 but as a general comment would highlight that the advice issues surrounding 'pension decumulation' are considerably more complex that may be immediately apparent, and while education may provide some help, there is a serious risk of a little knowledge being extremely dangerous. We believe Government should encourage people to seek expert professional advice, in all cases.

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REMOVING THE REQUIREMENT
TO ANNUITISE BY AGE 75

IoD Response to HM Treasury Consultation Paper

About the IoD

The IoD was founded in 1903 and obtained a Royal Charter in 1906. It is an independent, non-party political organisation of approximately 45,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 80% of FTSE 100 companies and 60% of FTSE 350 companies have IoD members on their boards, but the majority of members, some 72%, comprise directors of small and medium-sized enterprises (SMEs), ranging from long-established businesses to start-up companies.

Introduction

We welcome the opportunity to respond to this consultation, proposing as it does considerable liberalisation of the way in which people can draw funds from their accumulated pension assets. We have long believed that the current inflexible rules around retirement income provision have been a major disincentive to save for the long term in a pension, and would particularly welcome further development of the idea of inter-generational transfer of pension assets.

However, we also think that the current proposals carry flaws and risks. In particular, we believe that the provisions seeking to avoid pensioners becoming reliant on the "state" point up that reform and simplification of the current state retirement benefit architecture must be the starting point for worthwhile reform of all other aspects of the system. We have called for the abolition of means tested state retirement benefits and provision of a decent, universal, basic state pension as a right. If this were put in place, much greater liberalisation of the retirement income regime from private saving would be possible. We believe that people, where they have a choice and the knowledge to do so, are already using other vehicles, such as ISAs, for retirement planning and are not necessarily convinced that the current proposals will go far enough to make pension saving attractive again.

Response

We would not propose to answer the questions posed in detail, but would make the following observations:

- We welcome the "direction of travel" this Paper sets out. We think that, as far as possible, we should not prescribe how people access their retirement funds and believe the evidence from other jurisdictions suggests that the vast majority of people are not profligate with their retirement funds, even where annuitisation is not absolutely required. The Australian experience is relevant here, as is the experience of 401K pensions in the United States. We know from published research that the requirement to buy an annuity, when the workings of that annuity are understood by consumers, is a deeply unpopular aspect of the current pension regime. This is irrespective of what we might think of in terms of a "guaranteed" income for life being available. The "death" of the pension fund on the death of the pensioner is especially disliked and annuities make little worthwhile impact on issues such as long term care costs.

- We also welcome the Principles for a new tax framework for retirement set out on page 8. of the Paper and would particularly welcome further exploration of Principle 5. which appears to propose the future capacity for inter-generational transfers of pension assets, subject to tax. We would think that where such a transfer is from one pension fund to another, there should be no need for a tax charge at all.

- The proposal for Flexible Drawdown is welcome, though the trigger to show a Minimum Income Requirement at that stage we believe needs further work. We suspect that the current proposals could be complex in implementation and difficult to police in terms of keeping people from being reliant on "state" benefits. It might well be easier to require a "capital" value to be kept in the remaining fund – perhaps £150,000 – rather than attempting to specify an income level. This requirement will also tend to mean that these proposals are of use, in practice, only for the largest fund holders. The received regulatory wisdom from the Financial Services Authority is, in any case, that Unsecured Pension as we currently know it is unlikely to be “suitable” for anyone with a fund of less than £100,000. We also think that the proposals as cast presently might well be subject to abuse and think further work will need to be done to prevent this. However, as indicated earlier, we fully support the direction of travel.

- The need for the Minimum Income Requirement (MIR) is triggered by the perceived need to keep those who are better funded in retirement off state means-tested retirement benefits. We believe that the current system of Pension Credits and Savings Credit can act as a disincentive to save and triggers precisely the sort of complexity potential in the MIR. We think that provision of a decent, universal, basic state pension at or above the current Pension Credit level would provide the clearest possible incentive for further saving whilst radically clarifying and simplifying the surrounding pension architecture. Such a system would remove the requirement for MIR altogether.

- We note that the age of 75 will remain the point at which various events kick in, such as the inability to claim tax relief on further pension contributions. Given the increases in longevity, we think this age should be raised to 80 at least and kept under review. In particular, given the proposed restriction of tax relief for higher earners via the Annual Allowance route, we are a bit mystified at to why the Lifetime Allowance remains in existence, never mind a test for it at 75.

We hope these observations are helpful and look forward to further engagement to help make a success of this policy initiative.

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