Sackers

REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75:
COMMENTS OF SACKER & PARTNERS LLP

1. Introduction

The purpose of this document is to set out our comments on the HM Treasury consultation (published on 15 July 2010[1]) on the removal, from April 2011, of the effective requirement to purchase an annuity by age 75 (the Consultation).

Sackers is a firm of solicitors specialising in pensions law. We act for in excess of 800 pension schemes, including household names and a number of FTSE-100 clients. The views expressed in Sackers' response to this Consultation have been collated following discussions with a sub-group of the firm's solicitors.

2. Background

Due in part to increasing longevity and the fact that people are working for longer, the Government intends to remove the effective requirement to purchase an annuity by the age of 75 from April 2011. The Consultation sets out the Government's proposals for developing a new tax framework for retirement, namely by allowing:

- capped drawdown: a flexible drawdown model enabling individuals to choose how much to draw down annually from their pension pot throughout retirement (subject to a capped limit), or whether to draw any income at all; and
- flexible drawdown: allowing individuals to draw down unlimited amounts from their pension pot, provided they can demonstrate that they have secured sufficient minimum income (the minimum income requirement or MIR) to prevent them from exhausting their savings prematurely and falling back on the state.

We set out below our comments on a number of practical issues arising from the Consultation. However, given that many of the questions posed by the Consultation are actuarial in nature (such as the promised annual drawdown limit for capped drawdown or the MIR in the case of flexible drawdown), or aimed specifically at annuity providers and independent financial advisers, we have only addressed those issues which are relevant to our legal practice.

[1] http://www.hm-treasury.gov.uk/d/consult_age_75_annuity.pdf

3. General Comments

We support the proposed introduction of additional options for members on retirement. However, we consider that take-up of these options is likely to be limited to high earners, in particular given the MIR for flexible drawdown. High earners make up the most likely category of individuals who might wish to take advantage of the proposed drawdown options.

It is also likely that the drawdown facilities will be most frequently implemented via individual defined contribution (DC) personal pension schemes, such as self-invested personal pensions (SIPPS), rather than occupational schemes.

4. Design of the new tax framework for retirement

We note the continued use of age 75 as a proxy for the end of an individual's working life.[2] However, given continued, and projected future improvements to life expectancy, is this something that the Government intends to keep under review?

5. Availability of the drawdown options

In our experience, the majority of schemes have yet to implement an income drawdown facility for members. It is unclear from the Consultation whether schemes will be required to offer income drawdown after retirement if they do not already.

We anticipate that the imposition on DB schemes of a requirement to offer income drawdown is likely to be unpopular and onerous.

Although it would be possible, in theory, to apply the proposed new drawdown facilities in defined benefit (DB) arrangements, in practice they would be very complicated to administer. If a DB scheme member took advantage of one of the drawdown options, there would be a concern as to who would become responsible for investment of the member's remaining fund – in other words, schemes would not wish this responsibility to fall on the trustees. It would also create an additional layer of complexity in terms of scheme administration, particularly if a significant proportion of scheme members take up the option.

Therefore while increased member choice is to be welcomed, schemes which offer internal annuitisation (both DB and DC) should not be obliged to offer these options

[2] At paragraph 2.25 of the Consultation

within the scheme. In any event, members would remain free to select an alternative option at retirement on the open market.

As noted above, the drawdown options will be most easily implemented in personal pension schemes.

6. Minimum income requirement

One of the issues to be considered as part of the consultation process is the way in which the MIR should be assessed.[3] In our view this is something which could be difficult and potentially expensive for schemes to monitor. It should therefore remain the responsibility of the individual who has taken advantage of the flexible drawdown option (through their tax return, or similar reporting requirements).

7. Transitional arrangements

Consideration also needs to be given to individuals who are currently using existing drawdown arrangements. We assume that members will be permitted to keep their existing arrangements or switch to the new style arrangements.

8. Flexible retirement

On a positive note, the introduction of these options, in addition to the Government's present review of the default retirement age, may be the springboard for implementing a broader range of options for members approaching retirement.

Sacker & Partners LLP
9 September 2010

[3] At paragraph 3.4 of the Consultation

SAGA

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

6th September 2010

Dear Sir

Attached is Saga's response to the consultation on removing the requirement to annuitise by age 75.

Yours faithfully

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Response to HM Treasury Consultation on Removing the Requirement to Annuitise by age 75 - from Saga Group Ltd.

Saga welcomes the additional flexibility that the removal of this requirement provides. However, the average annuity purchase of £24,450 (ABI Statistics Q1. 2010) indicates that average pension pots are likely to be around £30,000. If so, the purchase of an annuity is likely to remain the logical option for many to provide a secure income in retirement.

The capped drawdown option appears attractive because of the ability to leave pension funds to others on death, but it is unlikely to provide an income close to that available from an annuity. This potentially rules this option out for the majority with pension funds beneath £100,000 without other income or capital to live on.

Though the removal of the age 75 barrier to annuity purchase gives increased choice to individuals as to when they retire, it is likely that the majority will still purchase an annuity at an earlier date when they cease employment and require a pension income. However, this gives an opportunity to accrue a secondary pension which could be accessed in later life if long-term care is required in a tax efficient way: if long-term care proves not to be necessary this fund should be allowed to return tax-free to the estate.

The flexibility to take an increased amount from a pension fund if there is sufficient other guaranteed income available is again an attractive feature but is only likely to be helpful to those who need it the least, i.e. those with sufficient additional pensions to pass the MIR.

The ability for value protection to run past age 75 is welcome, but since this may be a costly option whether this proposal has much impact will have to be seen.

Response to questions

Developing a new tax framework for retirement

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

This level needs to be set realistically to ensure that the income can be paid for life without depletion of the pension fund down to state support levels. The level of income should be set according to prevailing annuity rates, but should not be reviewable by age on a yearly basis; instead it should increase with inflation (e.g. LPI) to prevent future increases depleting the fund at a faster rate.

Further consultation is required

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 understand the need for economies, but given that Government is also consulting on limiting the tax relief on pension contributions any such action is likely to depress the pensions and annuity industry and will inexorably lead to lower pension pots on average .Given that the last Government began its career with a notorious pensions raid – the removal of ACT- it is inauspicious that the new Government should start with similar intent.

The return of unused funds to an estate when in capped/flexible drawdown is an added attraction to these schemes. However, a flat tax recovery charge of 55% seems unfair for those who have received just 20% tax relief on their savings.

<u>Minimum income requirement</u>

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 MIR are practical and appropriate.

It is essential to ensure that those wishing to withdraw larger amounts from their pension funds will maintain sufficient income to live. Though the consultation paper suggests that this should only include other guaranteed pension income e.g. state pension/defined benefit schemes, this could be widened to also include any capped drawdown benefits that are being taken from any other schemes.

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

The MIR needs to be set at a sufficient level for people to live on. This will be affected by their location, their age, health and by standard of living e.g the cost of living in a large detached house will be much higher than that in a retirement flat. Calculating one flat rate, though straight-forward will not be suitable for all. The level should be equivalent at least to the guaranteed pension credit as this is the minimum amount that the Government feels someone requires to live on (whether this is so is a different matter!).

The need for income will fluctuate throughout retirement with potentially a large increase towards the end of life if long-term care is required. For those in this position who have not utilised all pension funds, it may be appropriate to allow a further withdrawal from their fund or the use of these funds to purchase an enhanced annuity to pay for care.

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

The answer must be "Yes" as naturally the spending patterns will be different between individuals and couples. Preventing an individual from using flexible drawdown because they are required to maintain an income sufficient to maintain a couple does not seem fair.

A.6 How often should the MIR be reviewed

This should be reviewed on an annual basis in line with fund performance, inflation and income withdrawn. It should also be reviewed on a change of circumstances such as being widowed or change in health.

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

This should be a simple and understandable process to allow on-line assessment and an immediate response. Currently, too few people claim pension credit owing to the complexity of the application and assessment process.It is essential to ensure that people are not put off of the alternatives to an annuity due to misunderstanding the rules.

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IRM/PS

10 September 2010

Age 75 Consultation
Pensions and Pensioners Team
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Dear Sirs

We welcome the Government's consultations on the future of pension legislation and the opportunity to respond. Saunderson House is a leading city independent financial advisory firm who specialises in advising the partners of the major law and accountancy firms as well as Directors and Executives of top UK companies. Many of our clients have large pension holdings and are approaching, or have reached age 75 and thus, we have a clear and thorough understanding of their requirements and the positive and negative aspects of the current regime.

In general, we agree with the recommendations set out in the consultation subject to further clarification of a number of points.

Before answering the questions specifically set out in the consultation document, we would like to stress that any alterations to the current regime are given time to fully 'bed in'. Whilst the implication of annuity purchase dates back to 1976, the previous administration introduced radical changes in 2006 under the guise of 'Pension Simplification'. In the four years since their implementation, many minor, and in the case of the special annual allowance not so minor, amendments have been added, resulting in a far less simplified regime than that originally intended. Constantly changing legislation fosters uncertainty and additional costs to the pension industry and the general public.

Furthermore, we believe it is important that any new legislation is future proof. The consultation notes that the requirement to annuitise at age 75 was based on life expectancy in 1976. Any changes now should take into account increasing life expectancy as well as changing working lives and the annuity and savings market. "Future proofing" or certainty is a must in order to encourage individuals and the wider public to invest in long term savings vehicles for retirement.

A further observation would be that if an annual cap on contributions is proposed at c£30-45,000 per annum, then there is not really a necessity for a cap on fund values (capping growth). We certainly strongly recommend that prior rules are grandfathered.

Below I have set out our responses to the questions poised in the document and where applicable set out any areas where we believe further clarification is necessary.

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

In our experience, the maximum level of drawdown (the 120% USP limit) provides an income level that is roughly equivalent to that which could be purchased with the same funds through an open market annuity. We recommend that this level of income is set for the entire period a client remains in income drawdown subject to the current 5 year review as under the current USP arrangement.

We acknowledge the Governments concerns that the removal of ASP, and the corresponding lower limit of 90% of the maximum GAD rate, could result in depletion of pension funds; however, the requirement for regular income reviews and the practicalities of income withdrawal, together with the reducing level income required in the later years of retirement, mean that, in our opinion, few clients would fully deplete their pension portfolio before their death.

Furthermore, income drawdown in the form of USP is recommended to a great number of our clients due to the flexibility offered rather than with the aim of withdrawing the maximum level every year.

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

We generally welcome the Government's proposed changes to maintain the "Exempt, Exempt, Taxed" system of pension saving and the decision to continue the tax-free Pension Commencement Lump Sum.

The consultation proposes that PCLS would be able to be drawn post age 75; however, age 75 remains the age at which funds would be subject to a lifetime allowance test. Under the current regime, the withdrawal of PCLS is a benefit crystallisation event and therefore subject to a lifetime allowance test. We request clarification as to whether the withdrawal of PCLS post age 75 would result in a further lifetime allowance test.

We welcome the changes to reduce the tax charge for members over age 75 whose funds are vested; however, we consider the increase in recovery charge for those under age 75 with vested funds from 35% to 55% to be high. Whilst some people will have received tax relief at the top rates of tax (40% or 50% for this year only), many people will have only received basic rate relief. A charge of 55% of the value of any unused pension upon death would appear to more than compensate the Government. We would, therefore, consider a charge closer to that of inheritance tax more appropriate, say 40-45%.

The proposals to levy a charge upon the members death on unused unvested pension funds for those over age 75 require further clarification. In this scenario, PCLS as part of the clients' estate would be liable to a 40% IHT charge as opposed to a 55% charge if left undrawn within their pension portfolio. This might be deemed unfair.

Chartable donations being taxed at 55% on vested funds prior to age 75 and zero post age 75 seems extremely unfair when charitable donations are ordinarily treated as exempt from inheritance tax.

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 welcome the proposal of flexible income detailed within the consultation. Providing flexibility for people to withdraw their pension portfolio in excess of the capped income drawdown level will be of benefit to a number of clients. We do; however, have a number of concerns as to the structure of secure income as detailed in the consultation.

Firstly, long term retirement saving can consist of many products of which pensions are but one example. For many clients, a pension portfolio can be supplemented by ISAs, direct investments into unit trusts, investment trusts etc, as well as insurance bonds both onshore and offshore, cash interest and property income. It would therefore be inappropriate to consider secure income merely as being produced by a pension portfolio. A purchase life annuity (PLA) for example could also be considered a secure form of income for life (although these cannot increase in line with RPI and therefore would not meet the secure criteria as set out in the consultation).

Secondly, the need for the income to take into account expectations of future costs of living also needs to be clarified. Whilst we acknowledge that the impact of inflation can seriously erode the level of future income, a number of our clients currently receive large pension payments that are guaranteed for life but do not currently increase.

Furthermore, the cost of increasing annuities is considerable and it takes many years for the income produced by an increasing annuity to overtake one that is level. For a 60 year old male the level annuity rate is c5.5% compared to c3.2% for a LPI increasing annuity. In this instance the LPI increasing annuity takes 23 years to overtake the income produced by a level annuity and a total of 41 years for the cumulative total income received to be greater.

As the consultation notes, expenditure decreases with age and considering the impact that increasing annuities have on income, we have doubts that an increasing income should be a requirement of secure income. We would therefore, suggest that a fixed level of income over a certain level at a certain age would also be considered secure.

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

The consultation states that Research by the Centre for Economics and Business Research concluded that average peak expenditure levels in retirement are around £423 per week or c£22,000 per annum. The consultation also states that expenditure decreases with age. We would suggest that the level of MIR should be set at this level for the beginning ages of retirement decreasing proportionately from age 75.

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

We would agree that a different level of MIR should be set for individuals and couples. Indeed couples should be allowed two pension fund lifetime allowances even if there is only one working spouse.

6) How often the MIR level should be reviewed

We recommend reviews are conducted every 5 years as with current lifetime allowance reviews.

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

We would imagine that any income that is guaranteed for life will come from a form of contract between the individual and a life office or pension scheme. We would therefore suggest that a copy of the policy documents, P60 or annuity certificate, showing the level of income, would be sufficient.

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 comments in this regard.

9) How the industry, Government and advice bodies such as CFEB can work to ensure that the 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 important that any new legislation is effectively communicated to the general public. In our experience, even some of the most senior people in the top UK companies do not have a good understanding of pensions and their options. It is for this reason that fully qualified independent financial advisers are an important point of contact for all those wishing to invest in a pension.

As a Chartered Financial Advisory firm, Saunderson House has made the commitment to achieve the highest possible standards within the industry and ensure that our clients receive the best possible, fully independent advice.

All of our graduate staff, as well as our more experienced members, are required to achieve Chartered Financial Planner status and as a firm we welcome the requirements that from 2012, all those that provide financial advice hold the Diploma in Financial Planning.

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

Falling annuity rates as a result of lower gilt and bond yields, as well as increasing longevity, have forced annuity rates down. The increase in enhanced and impaired life annuities have also had a significant effect and it these which we believe could have an unintended consequence on legislation.

If you have any questions regarding any of our responses, I shall, of course, be pleased to discuss them with you.

Yours faithfully

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31st August 2010

Age 75 Consultation Pensions and Pensioners Team
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London SW1A 2HQ

Dear Sirs,

Removing the Requirement to Annuitise by age 75

Schroders plc is an independent asset management house managing £164 billion on behalf of institutional and retail investors, financial institutions and high net worth clients from around the world, invested in a broad range of asset classes across equities, fixed income and alternatives.

We welcome your proposals to bring extra flexibility to people saving for their retirement. This is particularly important in an era where annuities are increasingly perceived to be offering poor value, and the cost of inflation protection is high. Giving retirees over seventy five the opportunity to draw income whilst leaving their pension assets invested will be an important way to deliver a better funded retirement for many pensioners as well as making savings in a pension more attractive generally.

Our responses to your specific questions are in the appendix, but we wanted to summarise our key thoughts here:

1) Minimum Income Requirement (MIR)

We believe there should be more flexibility in what constitutes secure income. Your current proposals would compel many retirees to purchase an annuity to top up their secure income to the MIR before they could enter flexible drawdown arrangements. The cost of providing ‘guaranteed’ income is very high from a provider’s perspective, this translates into poor returns for many annuity purchasers. For this reason, we feel that there should be an option to have non guaranteed income count towards the MIR, subject to a suitably large buffer and regular reviews to ensure that the MIR is met on an ongoing basis. We explain how this might work in the appendix.

Cont/…..

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2) Tax Framework for Retirement

We believe there should be more flexibility in respect of any residual assets left on death. Specifically, there should be an option to rollover the deceased's remaining pension assets into the pension plans of any specified beneficiaries (rather than restricting to dependents, with an upper limit on the ages of eligible children). Giving more flexibility in this area would help build up the pension assets of future generations which we know are at risk because of the generally low contribution rates into DC pension plans together with the widespread decline of final salary schemes.

We would welcome the opportunity to discuss these ideas in more detail should you consider this to be useful.

Yours faithfully

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APPENDIX

Detailed Feedback on Removing the Requirement to Annuitise by age 75

Developing a new tax framework for retirement (Chapter 2)

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

Schroder Response - No view

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.

Schroder Response:
We generally agree with the principles underpinning the new tax framework as set out in Box 2A, save for principle 5 where we think a little more flexibility should be considered. Specifically, there should be an option to rollover the deceased's remaining pension assets into the pension plans of any specified beneficiaries (rather than restricting to dependents, with an upper limit on the ages of eligible children). Giving more flexibility in this area would help build up the pension assets of future generations which we know are at risk because of the generally low contribution rates into DC pension plans together with the widespread decline of final salary schemes.

The pay as you go state pension benefit represents a generational transfer of income from workers to retirees. Allowing residual pension assets to be left to ones heirs provides a transfer of assets in the other direction. By requiring that these assets be available only to provide pension benefits and still subject to the Lifetime Allowance ensures that tax advantaged savings are not abused. Assets held potentially for several decades, with income being reinvested could make a meaningful contribution to the next generation's pension needs.

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.

Schroder Response:
We appreciate the need for balance as set out in paragraph 2.9 of the consultation but we believe there should be more flexibility in what constitutes secure income. Your current proposals would compel many retirees to purchase an annuity to top up their secure income to the MIR before they could enter flexible drawdown arrangements. The cost of providing 'guaranteed' income is very high from a provider's perspective, this translates into poor returns for many annuity purchasers. For this reason, we feel that there should be an option to have non guaranteed income count towards the MIR, subject to a suitably large buffer and regular reviews to ensure that the MIR is met on an ongoing basis.

A simple example illustrates how this might work in practice:

> *Say the minimum requirement is £15,000 p.a. An individual has £7,000 income guaranteed through a combination of state and occupational pensions. An extra secured income of £8,000 would therefore be required.*

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> *Under the proposed approach, an annuity would have to be purchased. For a single male aged 65, securing this £8,000 p.a. through an annuity escalating at 3% p.a. would cost approximately £165,000.*
>
> *The UK Equity Income sector, as classified by the IMA, currently has an average yield of 5%, so to generate the same £8,000 income would require £160,000 investment in an average fund from that sector. This income is not guaranteed though, so it is appropriate to require a buffer to protect against fluctuations in future income. Using a margin of say 20% would require a ring-fencing of £192,000 to meet the minimum income requirements.*
>
> *While more expensive than an annuity, income in most scenarios is likely to grow more quickly than 3% p.a. Over the twenty years to end 2007, dividends on the All Share index grew at a compound rate of 5.0% p.a. Even if we include the financial crisis, dividends in the 20 years to end 2009 grew at 2.9% p.a. A further crucial advantage is that the asset is not consumed on death, but remains available to provide further pension benefits in the future (as described above).*

The administrator of any flexible drawdown approach would need to validate periodically that the minimum income requirement was being met, with any shortfall being addressed via a transfer from a retiree's flexible drawdown pot into the ring fenced secure income pot.

Permissible holdings for this 'investment' part of the secure income portfolio should be limited to UCITS, NURS and Life funds to ensure a reasonable level of diversification. Assets assigned to meet the MIR should be designated as Locked Away Products (LAPs) not available for any other purpose. Investments in LAPs should be available for switching into other funds provided that they remain LAPs and continue to meet the MIR standard. Also there should be a deemed maximum yield (say 7.5%) for each fund in the investment portfolio to stop funds with potentially very high running yields skewing decisions towards funds where there could be unduly high risks of capital loss. For the purposes of calculating the secure income, the income of the investment portfolio would be calculated as the lower of the actual funds yield, and the deemed maximum yield.

Whilst giving this flexibility does create some extra administration requirements, it offers significant benefits in that:

- *It offers the potential to extend the period of investment into retirement, thereby increasing the potential for much better returns*
- *It offers a practical alternative to individuals wanting to avoid the perceived poor value offered by annuities*

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

Schroder Response:
We believe it should be set as a proportion of the average wage, subject to periodic reviews. We have no view on how it should be adjusted for different ages.

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

Schroder Response:
A higher rate for couples seems intuitively attractive, however it would introduce potentially significant complexities, from an administration perspective, when both parties have their own pension assets. For this reason, we would set a rate just for individuals but err on the higher side as to the absolute level of the MIR.

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

Schroder Response: Every year as with the state pension.

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

Schroder Response: DC Fund administrators will need evidence to demonstrate that MIR requirements are being met. We believe that this can best be served by the submission of annual statements showing income derived from other eligible sources, state pension, defined benefit entitlements and annuities. Platforms will no doubt need to charge an annual administration fee to cover the costs of policing the system.

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.

Schroder Response:
Giving more flexibility to allow non guaranteed income count towards the MIR limit together with the ability to pass down residual pensions assets to future generations are the two most important areas to improve your proposed arrangements. In so doing the attractiveness of saving in a pension will be further enhanced.

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.

Schroder Response:
General education can help, but we see advice from a professional adviser as being critical for most people to reach the right decision for their own specific circumstances.

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.

Schroder Response:
We feel that your proposals, together with our suggested changes, should help avoid the dependency on annuities as the only way to secure income in retirement. This should mean better value for money for pensioners and the cessation of a somewhat distorted market sustained by the existing annuitisation rules.

Removing the requirement to annuitise by age 75

Introduction

Scottish Life is the pensions specialist arm of the Royal London Group, the UK's largest mutual life and pensions company with a multi-award winning income drawdown proposition which currently holds 19.1% of the total income drawdown market and 40.9% of the external unit-linked category[1].

This means we are extremely well placed to provide information and feedback on this market.

We have a reputation for innovation in the market, and are committed to constantly improving our proposition, both in the individual and group pensions markets. In 2009 this was recognised by Scottish Financial Enterprise who named us as overall winner in the category of Innovation in customer focus.

As a specialist in this area we very much welcome the government's proposals to provide more flexibility and choice to retirees.

Our specific responses are as follows.

Developing a new tax framework for retirement (Chapter 2)

A.1 The level of an appropriate annual drawdown limit for capped drawdown.
We do not believe there is a strong case to change the existing limits applicable to unsecured pensions.

Any change to these limits would result in system changes for providers, particularly if the link to the GAD tables is removed. This should not be a major factor if consumers were suffering disadvantage, however we do not believe this is the case and would oppose change for change sake.

Basing the limits on the GAD tables provides consistency with the income range which could be provided by a conventional annuity. This in turn prevents individuals from withdrawing too much income and draining their retirement fund, especially in the early years after retirement when individuals are relatively active.

There may be benefit in reducing the upper limit to 100% of GAD for simplicity however we would prefer to leave the additional flexibility of 120%.

We would advocate however that the table be extended to provide age-related limits past age 75. Whilst this does allow much higher withdrawal rates for older lives we believe the argument to treat all ages consistently is stronger. We would be happy to facilitate more regular reviews for this age group in order to mitigate the risk of too high withdrawals.

Likewise we believe the GAD tables should be regularly updated to reflect changes in mortality.

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.

[1] ABI market share figures, quarter 2 2010.

We applaud the proposal to allow PCLS to be taken after age 75 and the removal of the frankly heinous tax of 82% which applied to lump sums paid from Alternatively Secured Pensions in the event of the member's death after age 75.

We agree that 55% is a fair deduction for those individuals who have received higher rate tax relief on their pension savings, however we believe it is disproportionate for those who received only basic rate relief and a rate of 40% would be more equitable. This would also be consistent with the current rate of inheritance tax, and would preclude savers moving their money away from pensions in order to avoid the higher charge.

We are a little surprised that the restriction on contributions after age 75 has not been removed. This would seem to act against the government's stated intention to support saving and encourage individual choice.

In contrast imposing the 55% recovery on uncrystallised funds after age 75 and treating this as a BCE seems to be a sensible move which strikes a balance between incentivising people to start drawing their benefits without unfairly penalising those who don't. The primary purpose of pensions should be to provide an income in retirement however allowing those who have saved hard some scope to pass on their money to their heirs is a powerful incentive to keep saving.

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 believe the definition of secure income should be any income which is payable for life, which for most people is likely to mean annuity income, but should also include scheme pensions from DB arrangements.

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

This is a crucial point. If the MIR is set too low then there is a risk that some individuals will spend their retirement savings too soon and run out of money to support themselves in later years (i.e. they will end up back on state benefits). If it is set too high relatively few people will be able to take advantage for the Flexible Drawdown option.

We believe that the first of these risks is the greater and must be avoided at all costs. Some commentators have suggested that the MIR should be set at the level of state benefits. This would be a mistake on two counts:

1. State benefits are designed to provide a subsistence level of income. Most pensioners would require a higher level of income to be considered "comfortable". The Pensions Policy Institute suggests an income of at least £280 per week (£14,560 a year) is required to provide an adequate standard of living in retirement[2], at age 65 however this varies over the course of retirement.
2. It does not take into account potential need for increased income in later life to fund long term care. The Government estimates that the average 65 year old will need care that costs over £30,000 during their retirement, and that around 20% of today's 65 year olds will need care costing over £50,000 during their retirement. Pensioners who enter residential care homes could incur costs at

[2] Pensions Policy Institute: "fourth report into retirement income and assets". Feb 2010

around £26,500 per year for care and accommodation during an average stay of 2 years[3]. Given the government's current concern regarding how these costs will be met it makes no sense not to ensure pensioners utilise their existing savings.

We would therefore suggest that the MIR must be set well above the level of means tested benefits. A limit of £25,000 would be just above the average wage and consistent with care home fees.

Whilst this may limit the number of people who can pass the test, the mere possibility of being able to recover one's whole pension fund should still be a positive influence on saving for retirement.

The use of age-related factors to calculate the MIR is logical however it would lead to more complexity. We strongly suggest having a higher single value which could apply to all ages rather than a scale of different values.

A.5 Whether a different MIR should be set for individuals and couples.
It should be set at individual level. A joint life basis would be extremely complicated to administer.

A.6 How often the MIR level should be reviewed.
We suggest that the level of the MIR is linked to increases in the state pension to avoid the need for frequent reviews. Based on this premise a review of the limit every 5 years should be sufficient.

A.7 How to minimise unnecessary burdens for individuals and industry in the assessment of the MIR.
It is essential that the MIR is simple to understand and implement. It seems likely that task of verifying that the MIR has been met will fall to the Flexible Drawdown provider. This will require the developments of new systems, for a relatively few number of individuals. If the requirements are too onerous providers will choose not to offer this option.

We would prefer either self-certification (via the application form) from the individual or some form of certification from the local tax office/DWP.

The UK annuity market (Chapter 4)

A.8 Whether other legislative or regulatory barriers remain whose removal would enable industry to provide consumers with more attractive products without incurring fiscal or avoidance risks.
We would strongly advocate the removal of the restriction on amalgamating separate pension plans after benefits have been taken. There is currently a condition, under The Registered Pension Schemes (Transfer of Sums and Assets) Regulations 2006, which prevents the transfer of crystallised pension funds into another existing pension arrangement. This means the customer needs to maintain separate policies, usually at a higher cost than if the assets were held within a single plan. This is particularly onerous because of the structure of some pre A-Day drawdown plans which are designed as a cluster of separate policies.

If these individuals were allowed to transfer all their existing pension arrangements, both crystallised and uncrystallised, into a single arrangement it would be easier for them to track the performance of their plan. Moreover while the saver is likely to benefit from the more favourable charging structure applicable to larger find sizes, it would have no effect on government revenues.

[3] Pensions Policy Institute "Retirement income and assets: do pensioners have sufficient income to meet their needs? April 2009

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.
More information should be available to individuals at specific stages in their lives. Providers can and should play their part by ensuring that pre-retirement information is sent out well before the client's planned retirement date. The government and advice bodies also need to recognise the value of financial advice and encourage consumers to use it.

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.
According to ABI figures 99.6% of annuitants purchase their annuity before age 75. The new flexibility is likely to be attractive to many savers but we believe few will use it in practice. The impact on annuity providers should therefore be minimal, and certainly less than the effect of Solvency II and falling interest rates.

If the MIR becomes an ongoing test and is linked in some way to increases in the cost of living there may be an increase in the demand for index-linked annuities. We therefore suggest the MIR test should be a one-off event.

Additional comments
In the impact assessment (in paragraph 28) estimates are given on compliance costs. It is our view that the one-off cost of compliance has been underestimated. We expect the one-off compliance cost to be somewhere in the region of 10 times these figures.

Scottish Widows response to HM Treasury consultation document on removing the requirement to annuitise by age 75

Scottish Widows, which is part of Lloyds Banking Group, welcomes the opportunity to provide input into this consultation. When combined with the heritage brands of Clerical Medical and Halifax Life we are the UK's largest investment, pensions and savings provider. In particular, we are a leading provider of unsecured pension.

Scottish Widows welcomes the proposals to relax the restrictions on pension income after age 75. Although annuities offer good value and are the best option for most consumers, the need to annuitise appears to be a deterrent to pension contributions for many people. Research for the Scottish Widows UK Pensions Report in 2010 revealed that two out of five (41%) of those who expressed a view would increase the amount they paid into a pension or their overall savings if there was greater flexibility in how they could access their pension in retirement.

If you have any questions or would like us to expand on any aspect, please do not hesitate to contact me.

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Key points

1. We welcome the proposals to relax the rules on drawing of pension income after age 75. The current regime is too inflexible, and the narrow income limits and penal taxes on death make alternatively secured pension unattractive.

2. We do not see the benefits in allowing a pension commencement lump sum to be drawn after age 75, and there are significant practical drawbacks.

3. We are not in favour of flexible drawdown. It introduces great complexity, will be very difficult to monitor and will only be available to those with very large pension funds.

4. We believe that the proposed tax charge on death of 55% is too high, especially below age 75.

5. We would like to see the current ASP option to leave money to charity on death, tax-free, retained under the new regime for all drawdown arrangements.

6. We would like more flexibility to be available in income levels from annuities.

7. We believe that April 2011 is too tight a timescale for legislation to be agreed and for providers to implement it. We suggest implementation in April 2012.

Our detailed response follows the numbering of questions in Annex A.

Developing a new tax framework for retirement (Chapter 2)

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

As a general point, the published 'GAD' rate tables should be constructed so that they can be applied to the drawdown fund without further adjustment. So, for example, if the maximum is 120% of an annuity rate this would be the factor published, rather than the annuity rate. This approach would be simpler for providers, advisers and consumers. It would also, if desired, allow the Government to set principles to be used in setting the limits, with the Government Actuary making proposals on how the principles should be implemented and calculating the resulting factors.

Setting an appropriate income limit for capped drawdown involves balancing the danger of a rapidly reducing income in later retirement against allowing individuals flexibility in their retirement income. We suggest two possible approaches depending on where the balance is set:

1. Set the limit at 100% of the amount of level annuity based on the age of the individual. Drawdown is an option that it invariably sold with financial advice, and sustainability of income is a key part of the advice process. Advisers should not recommend high income levels unless clients are able to sustain a reduction in drawdown income because they have other resources to fall back on. This

approach recognises the income level as principally an advice issue, with regulatory limits only needed to prevent abuse. Setting the maximum at 100%, rather than 120%, of the equivalent annuity increases protection against abuse, as well as being simple and easily understandable.

2. Multiply the age-related annuity rate by a factor depending on the age at the review. This factor could reflect the likelihood of income having to be substantially reduced at subsequent reviews if the individual is still alive, which would mean that it would reduce with age as the effect of 'mortality drag' (loss of the cross-subsidy inherent in annuities) increases. As suggested above, the factor would be incorporated into the published tables.

Our preference is to retain the simplicity of option 1.

Consideration should also be given to the frequency of income reviews. One drawback of the current ASP regime is that having yearly reviews of maximum income makes it inherently unstable and vulnerable to short-term market movements. On the other hand, five year gaps between reviews make them too infrequent to respond to longer-term changes. We suggest that triennial reviews throughout retirement would be appropriate. We do not believe there then needs to be a facility for annual reviews of maximum income on request, particularly if flexible drawdown is introduced.

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.

As a general principle, we are happy that pension income should continue to be taxed at income tax rates.

We believe that applying a 55% tax charge is unduly penal, especially before age 75. It does not seem fair that where pension is uncrystallised there is no tax charge at all, while if the pension commencement lump sum has been taken, but perhaps no income, the rate jumps to 55%.

There should also be an appropriate balance between the rate of tax payable on death benefits and the rate payable on lifetime income. If there is not, consumers have an incentive to reduce the fund value as quickly as possible, which increases the danger of inadequate income in later life. Again, we suggest two possible options:

1. A flat-rate tax on death, perhaps at 40% which is both consistent with the rate of inheritance tax and the highest rate of tax relief most consumers will have received on contributions.

2. A 35% tax charge on death before age 75, and 55% after that. As well as reducing the differential with uncrystallised arrangements, this reflects that basic rate taxpayers will often invest in drawdown at younger ages, especially if they draw the pension commencement lump sum but no income initially, whereas at older ages drawdown is much more likely to be appropriate for higher-rate taxpayers.

Our preference is the simplicity of option 1.

A welcome innovation to pensions legislation with ASP was the ability to leave funds remaining on death to charity, tax-free. We suggest that consideration should be given to allowing this facility for all funds in drawdown, regardless of age.

We are not in favour of allowing the pension commencement lump sum to be drawn after age 75, except for the existing 12 month window for payment after entitlement arises. There are a number of reasons for this:

- It is much simpler if the lifetime allowance test coincides with crystallisation, which implies a maximum age of 75.

- It is difficult to see any consumer benefit in deferring, especially if a 55% tax on death is applied. If the lump sum has been taken the maximum tax liability is 40% inheritance tax.

- We believe that having a cut-off point at age 75 is a useful constraint in encouraging individuals to draw retirement benefits, including giving the ability to start payments to those who refuse to respond to our communications.

- From an administrative viewpoint, it will be much more complicated to make changes if the PCLS can be taken after age 75. It will mean making significant changes to processing for pre-retirement contracts as well as for drawdown ones. The cost of this will be substantial.

Similar considerations apply to trivial commutation lump sums, with the added issue that those eligible for them generally need the money anyway. We would like the age 75 limit to apply for all lifetime lump sum payments.

Finally, we believe it is dangerous to rush in the changes, especially because an April 2011 introduction would mean that legislation would not be finalised until around three months after implementation. It would also be extremely challenging for providers to change systems by April, especially to cater for flexible drawdown. We suggest implementation in April 2012 with the current provisions allowing unsecured pension to continue to age 77 applying until then.

Minimum Income Requirement (Chapter 3)

We do not support the introduction of flexible drawdown. It introduces a great deal of complexity, will be extremely difficult to monitor and will only benefit the better-off. It also goes against the principle that pension savings are designed to provide retirement income and introduces dangers of abuse, including through short-term investment by higher-rate taxpayers. This could require subsequent anti-avoidance measures. In addition, a substantial proportion of provider revenue coming from long-term investment in large pension arrangements, and if these were largely withdrawn it could affect charges for lower-value plans. Finally, developing flexible drawdown for April 2011 will be extremely challenging for providers. .

With these reservations, we answer the following questions on the assumption that flexible drawdown will go ahead.

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.

Given that the majority of annuities bought are level in payment and the individual may already have purchased one before choosing flexible drawdown, we believe it should be possible for a level annuity to count towards secure income. This would need to be at a higher level than if there was escalation built in. We suggest that the Government could produce tables of equivalent income levels required for different escalation bases. This would also allow distinction to be made between LPI annuities and ones guaranteeing RPI or CPI increases.

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

We believe that the MIR needs to be set high, especially because there is uncertainty about how means-tested benefits will apply in the future and because there is an inflation risk if an LPI or fixed-rate escalation annuity is used. Even with a fully price-indexed annuity there is a risk if means-tested guarantees continue to rise in line with average earnings.

As a rough guide, the benchmark might be around £300 a week for individuals, which is well clear of current means-testing, but with higher levels where inflation-proofing is not guaranteed. This might mean that a 65 year old male with full basic state pension would need to have secured income using a fund value of around £250,000 before flexible drawdown would be possible.

While we recognise that the risks are higher at younger ages, for simplicity we would prefer MIR to be the same at all ages. There might need to be some extra weighting built in to allow for the risk.

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

On balance, we would favour this, but giving couples the option to be treated as individuals if they chose to.

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

We suggest that the MIR level should increase automatically in line with average earnings.

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

We believe that MIR should be evidenced through self-certification, with no requirement for the pensions industry to police it. If it turns out that false information was deliberately provided, it should be possible for any claim for means-tested benefits to be adjusted, perhaps through the deliberate deprivation rules.

The UK annuity market (Chapter 4)

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

We would like to see more scope for flexibility in annuity payments. For example:

- Annuities that start at a higher level and reduce at state pension age. This would help those who are made redundant late in their careers and need additional income to tide them over until SPA.

- Annuities that increased at a set age, such as 85, or when long-term care is needed. This would reflect the need many people have for increased income as their health deteriorates.

- Annuities where consumers can choose to take a reduced income in certain years and 'reinvest' the balanced to increase their income in future years.

This would require changes to the circumstances in which a lifetime annuity can decrease, as laid out in The Registered Pension Schemes (Prescribed Manner of Determining Amount of Annuities) Regulations 2006 (SI 2006/568).

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

The pensions industry has put considerable effort in recent years into ensuring that consumers are aware of the options available to them at retirement, including the open market option. ABI research has shown that a sizeable majority do consider these options, although many then choose to remain with their existing provider. It is also much easier for consumers to exercise the open market option following the introduction of the ABI's Options initiative.

With drawdown available beyond 75, there will be an increasing need to reinforce the benefits of annuities, including explanations of how they deliver value for money and the cross subsidy involved. The industry can work with CFEB and others on this.

There will also be implications for 'lifestyle' investment strategies, with appropriate communications needed for customers.

As a result of the proposed changes, FSA COB rules for income drawdown and the basis for critical yield calculations will also need to be reviewed.

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.

In general, increased use of drawdown is likely to make 'standard' annuity rates more expensive because those in poor health are more likely to choose drawdown. However, the rise in annuities with ill-health enhancements was already having this effect, so the additional impact may be relatively small. In general, increased usage of drawdown should improve the industry's ability to provide suitable annuities where they are the appropriate option.

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

10th September 2010

To whom it may concern,

Re: Age 75 Consultation

I write on behalf of SHIP Equity Release following HM Treasury's invitation to submit evidence on its proposals to remove the requirement for pensioners to annuitise by age 75.

SHIP is the UK trade association for responsible providers of equity release products. Launched in 1991, SHIP is dedicated to upholding a strict code of conduct for its members that is designed to protect consumers and ensure safe, regulated growth of the industry. SHIP now represents around 90% of the UK equity release market.

Equity release products are being increasingly used as an option to fund retirement and supplement pension savings. As the UK trade association for this sector of the retirement market, SHIP welcomes the Government's intention to engage with interested parties to re-invigorate pension saving and we wish to comment on the impact that these specific proposals will have on the broader retirement funding sector.

In particular, SHIP wishes to comment on the steps that Government and industry can take to support sustainable mechanisms for retirement funding.

5) **What steps can the Government and industry take 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?**

SHIP welcomes the Government's decision to remove the requirement to annuitise by age 75 and strongly agrees with the principles of giving individuals greater flexibility to choose retirement options that are best for them providing that the individual meets the yet to be defined MIR and therefore will not exhaust retirement savings and return to relying solely on the state.

Recent research conducted by Age UK has found that pensioners are not using one option to finance retirement, but a funding portfolio including private pensions, savings, investments and equity release.[1] Against the backdrop of severe challenges to state finances and restrictions to both public and private sector pension schemes, SHIP also recognises the need to limit the burden on the state and the needs for individuals to use their assets as effectively as possible.

Housing statistics from the Department for Communities and Local Government reveal that more than two thirds of over 65s are homeowners without a mortgage, dependent on low to modest incomes.[2] As a greater proportion of wealth is now held in residential property assets, equity release is becoming an ever more viable and sustainable option that can be realised alongside other funding arrangements for a greater range of people in retirement.

By giving investors more freedom to choose how they secure funding for retirement will inevitably lead to an even more complex and confusing financial retirement landscape. SHIP therefore welcomes the initiative to simplify the annuities scheme to make it less restrictive, thus ensuring that individuals have access to a wider range of retirement planning and will have greater choice over how they can plan for retirement.

SHIP believes that transparency and simplicity must be a fundamental principle of any revised tax relief regime so as not to engender mistrust in people of the benefits of saving or in their pension schemes. Confidence and trust is paramount to encourage regular saving throughout employment, which in turn should be the bedrock of all retirement planning.

Independent research commissioned by SHIP has found that 70% of people would like the Government to do more to educate them about retirement financial planning. Consequently, SHIP believes that Government should take a lead in providing transparent and unbiased advice on the widest range of opinions available to those planning for retirement. Government and industry should work together to encourage individuals to take advice from regulated advisors that specialise in at/post retirement planning.

SHIP would also urge Government to work together with business and the financial sector to ensure that consumers trust their pension plans and encourage regular saving. SHIP believes that a key facet of this work can be achieved by Government taking steps to counter low awareness and understanding of the benefits, potential risks and subsequent safeguards of the full range of retirement funding products, including equity release.

SHIP has already begun to analyse how equity release and state benefits interact and the level of understanding amongst consumers and I would like to draw your attention to the working group, chaired by Baroness Hollis that will include market providers, advisors and consumer organisations to analyse the implications of equity release on people's eligibility to state benefits and ensure they are receiving correct information to enable them to make informed decisions.

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[1] Overton, Louise (University of Birmingham for Age UK: 2010), Housing and Finance in Later Life: A study of UK equity release customers, p.4

[2] Department for Communities and Local Government (2008), Housing in England 2006/07

Collaborative working and industry-government interaction will be increasingly important as the current working generation approach retirement. If current trends continue, there will be increasing pressure on individuals to save for retirement independently and make use of their assets. It is therefore paramount for pensions policy to allow people to build a broad retirement portfolio without financial penalty.

Yours faithfully,

Andrea Rozario
Director General, SHIP Equity Release

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Response to Consultation Documents

- Restriction of Pension Tax Relief

- Removing the requirement to annuitise by age 75

Introduction to Skandia

Skandia in the UK is a leader in the new model of long-term investments, offering flexible and tax efficient solutions that enable intelligent investment choice and serve the lifetime needs of its customers. Launched in 1979, Skandia UK has grown to become the top UK fund platform provider by funds under management - £29.2 billion as at 30.06.2010. A significant amount of these funds are represented by pension assets. In particular £3.5 billion of funds are held on behalf of 15,000 clients who are drawing income from their pension assets.

Skandia's products are solely distributed through the advice channel as it believes that financial advisers are best placed to lead the way on the journey from traditional products towards investment solutions.

Skandia response to the consultation documents

The Government have published two consultation documents which in their current form could lead to an increase in complexity in the pension tax regime. As the pension savings regime becomes more complex the more difficult it becomes to get consumers engaged with pension savings. This is particularly important when considering the reduction of the annual allowance to £40,000 as this will impact on many more individuals than the alternative Higher Rate Tax Relief Charge, particularly among the self employed.

Skandia believes that the Government have a choice. They can either achieve their policy aims with minimum impact on the existing regime, or use their policy objectives to deliver a much more simplified regime which should deliver more consumer engagement.

The minimal impact solution would-

- retain the Higher Rate Tax Relief Charge,
- Capped Income to reflect the existing Unsecured Pension Scheme rules,
- GAD tables for USP to be extended until age 85, where they would become constant
- Flexible income to be subject to a minimum residual Capped Income Fund, instead of introducing complexities through having a Minimum Income Requirement

We believe however that the Government is opening the door to a radical simplification of the pension tax system that could create a win, win, win, win situation.

- The Government will win because it will deliver the reduction in tax relief provided by pension savings.

- HMRC will win because there will be less complexity making control of the system less onerous, and less contact from tax payers and advisors for clarification,
- Pension providers will win as a result of being able to reduce administration and the abolition of many complicated rules that lead to errors and reworks,
- The Pension Saver will win because they will be able to better understand the system and the options available to them that may then encourage them to save more for their retirement providing less long term reliance on the State.

The main points of such a regime would be-

- Annual Allowance of £40,000
- No Lifetime Allowance
- Flexible retirement options
- Maximum tax free cash capped at 25% of £1.8m

We set out in the Appendix the detail of how we see such a regime operating.

Skandia would urge the Government to go for the radical approach we detail. However if there is no appetite for this approach at this time, we would strongly recommend that the Government does no more than make the minimal changes we have described above.

Whatever route the Government takes, Skandia has serious concerns about the timing of the requirement to annuitise changes. The measures contained in Finance Act (No 2) 2010 are durable until June 2012. Even minimal proposed changes require extensive literature and system revisions that will have to be in place before the effective date. Providers will have great difficulty in complying with these requirements from April 2011, when in August 2010 they have next to no detail of what the changes will be. We therefore strongly recommend that these changes are not introduced until April 2012.

Skandia
August 2010

Detailed Response to Questions raised in the Restriction of pensions tax relief discussion document.

We believe the alternatives suggested in the discussion document are more complicated than the introduction of the Higher Rate Tax Relief Charge. We therefore would recommend not introducing the alternatives suggested unless they are part of a simplification process that would include the abolition of the Lifetime Allowance. Our responses below should be read with that in mind.

Q. The Government would remove the exemptions from the Annual Allowance test in the year benefits come into payment. We welcome views on any other changes that might be necessary to ensure the Annual Allowance operates effectively and to address the risk of avoidance that could lead to further significant and potentially adverse changes to the regulatory regime

Removing the exemption for the Annual Allowance test in the year benefits are taken is key to ensuring a reduced Annual Allowance functions effectively. Our views on the other exemptions from the Annual Allowance are provided in reply to the relevant question below.

For the Annual Allowance to function effectively there must be a method of exempting, to some degree, those unfortunate hard cases caused by one-off spikes in pension accrual. A ‘spike valve’ is required that enables individuals to utilise unused annual allowance in the three previous tax years to alleviate any excess charge that would ordinarily apply. This would avoid having to consider complex methods of Defined Benefit scheme design that seek to smooth or cap accrual for scheme members, and would provide a consistent approach for Defined Benefit and Defined Contribution pension schemes.

We agree that there will need to be rules enabling individuals to transition to a reduced Annual Allowance where they may have already exceeded it by virtue of an input period that began in 2010 -11 tax year ending in 2011-2012.

Q. By only taking newly accrued amount of annual pension in a Defined Benefit pension into account, the use of flat rate factors potentially creates an opportunity for Defined Benefit pensions to be used to grant additional pension value without this counting toward the Annual Allowance test. We welcome views for limiting this, including the option of requiring a CETV calculation, age related factors, in specific circumstances to capture the value of certain pension enhancements

It is important that past service is included for the purpose of assessing Defined Benefit pensions against a reduced Annual Allowance, otherwise the full value of Defined Benefit accrual would be understated and create a disparity between Defined Benefit and Defined Contribution schemes.

We agree that a flat rate factor is the simplest and most cost effective method to administer and straight forward to understand.

Q. We welcome views on whether exemptions from the Annual Allowance limit should be granted in particular cases including the cases of death, serious ill health, redundancy, ill health, transfers and divorce

We agree that there should be an exemption from the Annual Allowance test where a member draws a serious ill-health lump sum, and in the event of death.

We do not believe that significant abuse would result from exempting the Annual Allowance test where benefits are taken early on the grounds of ill-health. However, we cannot see why there should be an exemption from the Annual Allowance in cases of redundancy, transfers or divorce. We would urge the Government to resist creating complexity through creating partial exemptions for these latter cases.

Q. We welcome views on the appropriate level of the Lifetime Allowance, other issues associated with its operation in the context of a reduced Annual Allowance, and on the trade-off between these and the level of the Annual Allowance

We are concerned with the Government proposal to reduce the Lifetime Allowance. We believe such a proposal will increase complexity as a further level of transitional protection would be introduced for those with pension saving above a reduced Lifetime Allowance.

A reduced Annual Allowance takes on the role of limiting the tax relieved funds that can accrue under a registered pension scheme, so that the Lifetime Allowance ceases to have the relevance it once had. We therefore feel that the natural consequence of a reduced Annual Allowance is that the Lifetime Allowance should be abolished. This would simplify administration, and remove a complexity that for the majority of individuals has little or no bearing. We provide detail on how the regime could operate without a Lifetime Allowance in the Appendix.

Q. We welcome views on the merits of capping relief at 40% as an additional means of restricting pensions tax relief and the trade-off between this and the level of the Annual Allowance

We agree tax relief on pension contributions under the Annual Allowance should be capped at 40% rather than at the individual's marginal rate. This comment is made on the assumption that the Government is minded to remove the 50% rate of tax once economic conditions improve. It would not be justifiable to provide 50% tax relief on benefits in payment could only be subject to a highest rate of tax of 40%.

Q. We welcome views and evidence on the benefits and burdens associated with aligning the pension input period to the tax year

We believe the argument for moving the pension input period in line with the tax year has merit and in so doing negates the need to refer to pension input periods.

Currently, a scheme with multiple arrangements can have multiple input periods. The system is complicated to understand for the individual, creates additional administration for Defined Contribution scheme administrators and difficult for the Revenue to monitor effectively. A reduced Annual Allowance will mean that more people will have to assess whether they have exceeded the Annual Allowance with multiple reference points to consider. Such complexity is unworkable in practice. A combination of a pension input period aligned to the tax year with a 'spike valve' as described Q1 above is a solution to this issue.

Q. We welcome views on the appropriate reporting requirements on pension schemes to provide statements of the total pension input amount over the pension input period

We do not believe there is an issue for Defined Contribution schemes as members will be reasonably aware of the contributions that have been paid into the scheme (the current annual disclosure statement, required by regulations, provides details of the contributions paid during the previous 12 months).

However, there is a greater argument for Defined Benefit schemes to provide a pension input statement for all active members after the end of a tax year because it will not be immediately obvious to an individual what their pension input is in respect of the scheme.

Detailed Response to Questions raised in the Removing the requirement to annuitise by age 75 Consultation Document

Removal of the effective need to purchase an annuity at age 75

We welcome the proposals to remove the current rules that effectively require individuals to purchase an annuity at age 75. We would urge the Government to go further and introduce further simplifications to the income drawdown regime. This could be achieved if the Lifetime Allowance was abolished. We set out full details of our proposals in the Appendix. Our responses below should be read with that in mind.

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

If the Government is not minded to simplify the tax regime, Capped Income should be determined by the existing USP rules with GAD tables extended out to age 85.

However, we would strongly urge the Government to simplify the regime. If they are prepared to go down this route much simpler rules could be adopted.

Income drawdown has evolved as an annuity substitute. To reflect annuities maximum income determined by reference to long-term gilt yields. We believe that this should not be the case. Unlike annuities, drawdown funds tend to have a small proportion invested in such assets. Drawdown income limits are also of short-term relevance, accurate at the point of calculation but effectively out of date within a month if gilt yields change.

Drawdown should be considered as a completely separate product to a lifetime annuity and its maximum income calculated to ensure funds are not eroded prematurely. It would be more appropriate and simple if there was one consistent table, which determined capped income, calculated on the basis that the drawdown fund increases at a prescribed rate (for example 5% per annum) and income had to be sustained over the expected lifetime of the individual, using standard mortality tables. At older ages where life expectancy is less than 5 years the expected lifetime should always be 5 years. We believe an assumed rate of 5% p.a. growth of the drawdown fund will produce an income equivalent to the existing 120% drawdown calculation with a Gilt Yield of 4.5%.

Capped income would be reviewed annually and the mortality assumption in the standard table should be reviewed every five years.

As a matter of interest, our experience of approximately 15,000 people with unsecured pension funds is that roughly one-third draw no income, one-third draw maximum income with the balance drawing somewhere in between. The one third who are drawing maximum income include a large number who are in the process of phasing their income and have only crystallised sufficient funds to provide their immediate annuity income. To us this indicates that most individuals who enter income drawdown manage their funds and income responsibly.

A. 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 do not believe MIR is the correct route to follow, please refer to our proposals in the Appendix.

However if the Government is minded to go down this route, we agree that secure income should include lifetime annuities and scheme pensions. There are instances where such pensions can fall in value and these may not be able to meet the ‘secure income’ requirement. For example, we anticipate that investment linked lifetime annuities would not meet the secure income requirement. Similarly, a scheme pension under a small money purchase scheme, is not that much different to income drawdown, i.e. poor investment performance could lead to a reduction in the pension being paid.

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

The benefits system is complex so that defining a specific level of MIR to meet the policy aim is extremely difficult. Consequently, we believe that instead of having complex rules to determine MIR there should be a minimum residual fund set in regulation and reviewed from time to time. This would limit flexible income so that the individual would always have a residual pension fund to provide pension benefits. A residual fund of £150,000 should be able to provide an income that when added to the state pension entitlement should be sufficient to avoid dependency on the state. .

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

We believe the MIR should not differentiate between couples and individuals. It would add complexity and inflexibility where income requirements change following death or divorce that could not be reflected as securing a guaranteed income is a one-off event. However, these complications are avoided if the residual fund approach is taken.

A. How often the MIR level should be reviewed

Assessment of the MIR (or a minimum residual fund amount) should not create an unnecessary burden on individuals or Administrators. Consequently, reviews should not take place more frequently than every 5 years.

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

If the Government does go down the route of MIR, the annuity market can play an important role in designing products to meet the MIR. Consideration should be given to allowing a lifetime annuity to be reduced by the equivalent of the State Pension once it comes into payment. This would reduce the cost of securing the annuity at outset enabling more individuals to benefit from the flexible drawdown option, without increasing the burden on the State.

Individuals should be able to self-certify that they meet the MIR with the drawdown provider. Any flexible drawdown taken could be a reportable event, to help HMRC monitoring.

MIR also needs to be considered in the context of a QROPS. Where an individual is subject to the member payment provisions, a QROPS wanting to provide flexible income would have to assess whether the member met the MIR. This may be an irrelevance for an individual who is resident in another country and unlikely to become a burden on the UK. This creates a moral dilemma. However a QROPS should reflect UK legislation and if a minimum requirement does not apply people will transfer to QROPS and then drain their funds using Flexible Income. We believe a minimum residual fund requirement would avoid such issues.

APPENDIX

A Simplified Pensions Tax Regime

Our Proposals are as follows-

Annual allowance

The Annual Allowance should be £40,000 indexed linked to the increases in Average Weekly Earnings.

Defined Benefit accrual should be valued using a flat rate that reflects the full actuarial value of Defined Benefit Accrual. On this basis separate cash accrual in a Defined Benefit scheme should be discounted at an equivalent rate.

Where a low annual allowance applies there is a danger that members of Defined Benefit Schemes who have additional Defined Contribution regular savings could accidentally incur an annual allowance charge. Similarly many with highly fluctuating earnings may be unable to determine what they can put aside as pension savings until long after the tax year end and will be unable to maximise savings, or will overestimate their earnings and create unintended excess contributions.

Therefore it should be possible to utilise any unused annual allowance from the previous 3 tax years to avoid spikes.

We have no objections to input periods being aligned with tax years, provided unused annual allowance can be carried forward as we have described.

Lifetime Allowance and Tax Free Cash

A notional Lifetime Allowance of £1.8m should be retained. However, only tax free cash should be measured against the Lifetime Allowance. The lifetime allowance charge should be abolished except where primary protection limits as described below, have been breached.

By restricting tax free cash to 25% of the notional Lifetime Allowance the advantages of funding beyond that amount are greatly reduced. This would lead to a behavioural change that would remove any incentive to create funds above the Lifetime Allowance. We believe that this is a far more efficient way of achieving the same aim.

The above proposals will lead to some transitional issues, seeing that there is no need to track Tax Free Cash paid at benefit crystallisations except where the member has Primary Protection.

To overcome this we would suggest the following transitional arrangements.

Primary Protection with Cash Rights at A Day over £375,000 – No change would be required as the notional Lifetime Allowance would apply.

Enhanced Protection with cash rights at A day over £375,000 – No change would be required as tax free cash is a percentage of the crystallised value in these situations.

Scheme Specific Tax Free Cash protection – The protected amount at A Day should be increased by 20% (increase in Lifetime Allowance since 2006) until the date these reforms are introduced. Thereafter the amount should increase by Average Weekly Earnings. The same increases should apply to the value of the member's rights at A Day. 25% of any excess crystallisation value should also be able to be taken as tax free cash. However this is subject to a restriction of 25% of (£1.5m less value of member's rights at A Day) increased as above.

Individuals who have partially crystallised their benefits – Pensions in payment will be multiplied by 25 times their current amount at the first crystallisation event after introduction of these reforms. 25% of that amount will be deemed to be the tax free cash taken to date and carried forward to future crystallisations.

Other transitional issues

Primary protection – No change will be required as a result of the abolition of the Lifetime Allowance Test. Existing rules can continue using the notional Lifetime Allowance of £1.8m

Enhanced Protection – again no changes would be made to the existing rules.

Block transfer restrictions - we believe these are an unnecessary complexity and act as a barrier to consolidation of small pension funds.

The pull of protected tax free cash sums which is easily understood by members acts as a counter balance to being able to be able to take best advantage of the annuity market by consolidating funds in one place which is not well understood by the average pension scheme member. Individuals should be able to consolidate under the one scheme all their protected tax free cash sums. That scheme would then apply the aggregate of the calculations above, when determining the tax free cash sum available to the member.

Protected Retirement Ages should in our opinion be phased out. If effect has not been given to a protected retirement age by 2020 then the right will be lost. For those with a protected right to retire at 50 the only individual affected by our proposal would be those aged under 36 in 2006. This would be a very small segment of the overall pension market and would largely be professional sportspersons and those in similar occupations who would have already taken advantage of crystallising benefits at their protected pension age well before 2020. Phasing out of the protected pension age will also remove the ability to augment those funds from contributions or transfers of normal scheme benefits and access the benefits before age 55 using the protected pension age legislation.

Until 2020, block transfer rules should remain in respect of protected retirement ages.

Higher Rate Tax Relief

Higher rate tax relief should be restricted to 40%. Government has an objective to remove the 50% tax band when economic conditions improve. Therefore, it is unlikely that 50% tax will be paid on the emerging benefits.

Crystallised Benefits

Our proposals above concerning the Lifetime Allowance would mean that all BCE Tests would be removed from the system except BCE 1, taking tax free cash. This would facilitate being able to take tax free cash beyond age 75.

All rules specific to age 75 could therefore be removed from the regime, other than that being the age at which pension inputs must cease.

Income drawdown has been designed as an annuity substitute, which it is not. Annuity principles do not apply to drawing income from a portfolio of assets. Therefore the rules should reflect the product it is and not the product it is an alternative to.

The limit on Capped Income should be fixed at a level that income should be drawn at a level amount over the expected life expectancy of someone the same sex of that age. It would be a great simplification for all concerned if a standard table was produced showing by age the permitted percentage of fund that could be drawn as capped income. We would suggest that assumed rate of interest to be 5% per annum..

Reference to returns on 15 year gilts are not relevant to the product. Those who choose income drawdown, do so, in the main because they believe a portfolio of assets including equities will over time produce a higher income stream than conventional annuities.

Simplification on this basis would enable many rules that require the tracking of money at arrangement level to be removed from the regime. This would enable more efficient consolidation of drawdown funds, particularly where clients have USP contracts with many providers that reflect their arrangement structures and are a mixture of pre and post A day crystallisations.

Flexible drawdown is a welcome proposal. It enables those with income drawdown to meet unexpected demands for capital during retirement. A simple method of protecting the state is required.

Flexible income must be accompanied by protections to the state. We believe the MIR proposals are over complicated when trying to meet this aim. It would be far more straightforward to insist that a residual fund of £150,000 remains in the drawdown fund after the payment of a Flexible Income amount. This should provide a capped income amount, that when added to the state pensions should be sufficient to provide income for the individual to avoid state dependency.

Death Benefits

We agree with the single tax charge on all crystallised benefits at around 55%. This would create a behaviour whereby individuals do not take benefits just because they are available, but when they are required. This could encourage people to work longer and retire with larger retirement income.

However coupled with our proposals for the effective removal of the Lifetime Allowance an anomaly will be created. Where a member has a scheme pension any lump sum payment connected to that scheme pension is currently treated as a defined benefit lump sum death benefit, (unless the member has elected for it to be treated as a pension protection lump sum death benefit).

We believe that all defined benefit lump sum death benefits where the amount is determined by reference to an amount of scheme pension being paid should be treated as pension protection lump sum death benefits.

Also any Defined Benefit Lump Sum Death benefits paid on death after age 75 should be taxed at the same rate as death benefits from crystallised benefits.

We appreciate that the Government could be concerned that excessive sums could be paid on death from uncrystallised benefits. We do not believe this is a great risk as such benefits have to be employer funded and usually insured. Market constraints will therefore apply. However if this is a great concern a tax charge could apply to any amount of uncrystallised benefits paid on death in excess of £1.8bn.

Tax relief

The above measures will achieve the Governments aim to restrict the cost of pensions tax relief. The need to do this is temporary as a result of the position of the country's finances. We would urge the government to commit to reverse these savings as financial conditions improve.

We believe that the need to encourage individuals to save for their retirement is essential for the long term future of the country. We feel that the best way to do this is to provide more than basic rate tax relief on pension contributions paid by the lower paid. This could be done by increasing the rate of tax relief on contribution above the basic rate, or by reducing the National Insurance Rate in respect of pension contributions paid. This may support other pension reforms being introduced.

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Our Ref: JM/JB/4.22 September 9th 2010

Dear Sir or Madam,

TREASURY CONSULTATION: REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75: COMMENTS BY SPC

We welcome the opportunity to contribute to the above consultation.

INTRODUCTION TO SPC

SPC is the representative body for a wide range of providers of advice and services to work-based pension schemes and to their sponsors. SPC's Members' profile is a key strength and includes accounting firms, solicitors, insurance companies, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. SPC is the only body to focus on the whole range of pension related services across the private pensions sector, and through such a wide spread of providers of advice and services. We do not represent any particular type of provision or any one interest - body or group.

Many thousands of individuals and pension funds use the services of one or more of SPC's Members, including the overwhelming majority of the 500 largest UK pension funds. SPC's growing membership collectively employs some 15,000 people providing pension-related advice and services.

This consultation document has been considered by SPC's, Actuarial, Administration, Legislation and Money Purchase Committees, which comprise representatives of actuaries and consultants, pension administrators, pension lawyers and product providers.

RESPONSES TO THE CONSULTATION QUESTIONS

Paragraph 2.17: The Government welcomes views on the level of an appropriate annual drawdown limit for capped drawdown.

We see no strong reason to depart from the current annual USP limit.

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

1. The intention to continue to use age 75 as the point at which the lifetime allowance is tested is appropriate, but changes to the rules would be needed. For example, where funds exceeding the lifetime allowance are taken as income rather than as a lump sum, the lifetime allowance charge can be paid by the scheme administrator on funds at a rate of 25%, with the member being subject to income tax on the income.

If there is no requirement to take an income at age 75, or indeed at any age, it will need to be clarified how the lifetime allowance charge will be paid on the excess crystallised funds.

2. There would appear to be little purpose in retaining the age 75 limit for tax relief on contributions. The relief would be capped at £3,600, unless the individual is in employment. We recognise the trend to work beyond the state pension age, but very few people will be in employment at age 75, so we would not expect the costs of tax relief to be high.

3. We agree with the suggestion to remove the age 75 limit for pension commencement lump sums, trivial commutation lump sums and value protection lump sums.

4. The aim of a tax charge on death is to recoup the tax relief granted, since it will not produce an income on which tax would have been levied. The concept of the MIR seems to indicate that the government is less concerned at income taking the form of a lifetime stream. This would point to a lower tax rate on death, which more closely reflects the tax relief received and takes account of the opportunity, which is nearly always taken, to have a tax free lump sum. The tax relief given on contributions to a fund will not all have been at the higher rate during the accumulation stage, but, even using 40% and reflecting a tax free lump sum, a rate less than 55% would be indicated. Taking HMRC's indication from their published statistics of average tax relief of 30%, the rate should be 40% (i.e. 30 over 75). This focuses only on the relief on contributions, but the relief within a fund is not unique to pensions, since an individual can get the same relief in other ways, for example in an ISA.

   A higher rate on death than on withdrawals encourages funds to be drawn, which might not prove to be in the interests of individuals or, indeed, the State.

Paragraph 3.9: The Government welcomes views on what income should be considered "secure" for the purposes of the MIR and on whether proposals for the life annuity income which can be considered for the MIR are practical and appropriate.

We suggest that any income, which is secured for life, should count towards the MIR.

We are not clear why an annuity should invariably need to build in annual increases for it to qualify. It should be possible to set the MIR in terms of a level of escalating pensions or a higher level of overall pensions. That is, if the overall pension payments (escalating and non-escalating) are sufficiently high, flexible drawdown should be permitted.

Paragraph 3.15: The Government welcomes views on what an appropriate level for the MIR should be and how the MIR should be adjusted for different ages.

SPC does not have a view on the appropriate level for the minimum income requirement.

We accept that there may be greater uncertainty at younger ages as to future needs over the remaining lifetime, which leads to a higher risk that funds could be depleted sooner, and which would support a higher MIR at younger ages.

Age-adjusted MIRs would naturally introduce some additional complexity, which may not necessarily be welcomed or conducive to the effectiveness of the reforms. This may need to be borne in mind.

Paragraph 3.17: The Government welcomes views on whether a different MIR should be set for individuals and couples.

We question whether MIR should always contain a contingent spouse's benefit in the case of a couple. We would suggest there should be some leeway. If both parties in a couple have pensions and the couple's rate of MIR is higher, then both collectively will be subject to a higher bar than if both were single. This seems to be penalising those in marriages and civil partnerships.

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

We have no comment on this question.

Paragraph 3.20: The Government welcomes views on how to minimise unnecessary burdens for individuals and industry in the assessment of the MIR.

We suggest that the initiative should lie with individuals to provide the necessary evidence, possibly on the basis of standard official wording, that they have the necessary resources to meet the MIR.

Paragraph 4.8: 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.

SPC has no collective views on this question.

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

We suggest that the development of CFEB's work will be an important foundation for the development of advice and information.

Paragraph 4.13: The Government welcomes views on whether the proposed reforms have unintended consequences, which might 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 practicalities of introducing greater flexibility in the intended time period might prove to be more demanding than expected. The timescale is very short in comparison with the introduction of the Finance Act 2004 Pension Taxation Regime.

Finally, it may be worthwhile exploring greater flexibility within capped drawdown, so as to allow access to funds in a more flexible way, which would help to encourage long term saving. Examples would be a one off option to take an additional 25% taxed lump sum and a lower rate of death tax if funds are transferred to another person's pension fund, i.e. other than a spouse or dependant. Other options to consider could be a more generous tax rate if using pension savings to secure a long term care package.

Yours sincerely

John Mortimer
Secretary

Hello, I am a SIPP, cash ISA and Stocks and shares ISA holder and future pensioner.

I welcome your desire to add flexibility to current pension system.

However I have a concern that your proposals will affect barely 1% of the population.

Clearly it all depends on what level you set the minimum desired secure income - I saw one figure of £420 a week quoted as the maximum needed by a pensioner.

That equates to £22K a year (net of income tax !) and presumably you will be wanting this to be index linked.

Assuming a 3% pension pot will provide this, then one would need a pension pot of £733,333 to provide this index linked pension and that is before factoring into taxing this income at 20%!!

Then you state that the only other income that can be taken into consideration (in assessing whether an individual can provide a basic guaranteed sum in perpetuity) is pension income - what about income from Cash and Stocks and shares ISAs. The Treasury have encouraged us to save using these options as well and it is entirely plausible that an individual will have built up sums from £300K- £500K in both if one had been putting the maximum amounts into these sources for a period of 30 years. Why ignore them????? I agree that no other assets should be taken into account as the system would become unwieldy if factoring into the equation such issues as large equity available in property.

If you ignore these other sources and set the minimum pension income from purely pension sources too high, then one will need a gargantuan pension pot to fulfil your requirements (around £1M) before it would be possible to start using this additional flexibility.

Once those sorts of figures come out, it will generate negative publicity and actually turn people away from pensions more than ever!

So the minimum income level needs to be pretty low, certainly nowhere near £22K index linked and other legitimate government encouraged savings vehicles need to be brought into the calculation as well. It is not difficult to require an individual to forward a note of the balances on their cash or shares ISA to the relevant pension provider when setting the level of pension drawdown allowed.

Kind regards

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Fergus Kerr
Partner

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Our ref: J:\Marketing\Bus Dev\as\1027.doc

23 August2010

Dear Sirs,

Consultation Paper 'Removing the requirement to annuitise by age 75'

The St. James's Place Wealth Management Group offers investment and wealth management advice to businesses and individuals. Funds under management are currently valued at £22.4 billion and 40% of our new business is pension related. St. James's Place does not offer annuities and therefore encourages clients to use the open market option when they want to purchase an annuity.

We broadly welcome the proposed changes, especially the abolition of ASP and the reduction in tax charges on death after age 75, and set out our comments on some of the points raised in the above Consultation Paper.

'Capped Drawdown'

We are unsure why there is a need to reduce the level of income below 120% before age 75.

While we understand the concern about funds being depleted, we feel that a better solution would be to shorten the Review period (eg retain a similar position to now with 5 year reviews to say age 80 and annual reviews thereafter).

If this measure is enacted, we would also be concerned about transition arrangements for individuals already in Unsecured Pension. Reviewing all existing cases immediately would introduce a significant administrative burden. This could be avoided if any such change took effect at the end of that reference period or when Additional Fund Designation next occurs. This approach is similar to that adopted at 'A' Day.

Minimum income requirement

In principle we are in favour of the proposals for 'flexible drawdown'.

An income set above the Pensions Credit (both Guarantee and Savings credit) figure and levels at which the individual would qualify for Council Tax benefit would seem to be an essential. Whatever level is set becomes a 'target' and there is therefore a significant risk that people could fall within the benefits net at a later date and a figure of twice the Pensions Credit would seem to be appropriate. It would therefore be sensible to have different levels for individuals and couples, providing that the income of both individuals in a couple can be taken into account on assessing whether one individual can benefit from 'flexible drawdown'.

Ignoring the impact that State Pensions will have on members who defer taking benefits until after 65, using the FSA's Comparative Annuity Tables, a £10,000 annual income would require the following funds for a single life 3% escalating annuity:

Age	*Male*	*Female*
55	294,000	307,000
60	258,000	272,000
65	222,000	234,500
70	182,500	195,750
74	151,400	162,300

By using annuities, pensions in payment and state pensions as the acceptable forms of 'secure income), if the MIR level increases in line with CPI/RPI, then the only checks would seem to be needed at the point that 'Flexible Drawdown is taken'. This would seem to minimise the administrative burden.

We believe that there is also a case for including pensions that are level, providing the initial amount is sufficiently high that it is unlikely to fall below the MIR in the future. For example, assuming 3% increases and average life expectancy of 85, a level pension of 2.5 x the MIR for a 55 year old is likely to remain above the MIR for their life.

Other

We are pleased with the suggestion that tax free cash can be taken after age 75, but would welcome clarification of how this would interact with the 55% tax charge on death. Would any lump sum that has not been taken be exempt from the 55% charge?

While we welcome the reduction in tax on death after age 75, we would like to understand the rationale for increasing the rate of tax on death before age 75 as this seems a significant increase from the current 35%. We note that paragraph 1.5 of this Consultation Paper states that 'on average, a healthy 65 year-old male can now expect to live for 21 years, a 65 year-old female 24 years' and believe that the adverse public reaction to this change could again deter people investing for retirement through pensions and that consequently the additional revenue this measure is likely to raise is small.

We note that Scheme Pensions have not been included in this Consultation Paper. We believe that there should be no distinction between Scheme Pensions and drawdown (whether or capped or flexible) in money purchase schemes.

At present HMRC rules mean that on transfer of rights under Unsecured Pension to a new Scheme, the new Scheme has to set up different Arrangements to preserve the same income levels and review dates as the ceding scheme. Under the pre 'A' Day regime, it was possible to combine Arrangements on transfer. It would ease administrative requirements if the new Scheme could combine Arrangements. In addition under the current regime it is not possible to combine Arrangements after age 75 even though the Review Dates become aligned at that point. We note the intention to retain a review at age 75 (2.24) and wonder whether the opportunity could be taken to allow different Arrangements to be combined at that point. As well as decreasing the administrative burden on the Scheme Administrator, these simplifications would reduce the confusion for the member.

Please do not hesitate to contact me if you require clarification of the points made.

Yours faithfully,

Ian Price
Divisional Director - Pensions

Standard Life plc

Response to:

HM Treasury consultation document

Removing the requirement to annuitise by age 75

September 2010

Introduction & Executive Summary

We are supportive of your policy aims of removing unnecessary restrictions, increasing choice and improving flexibility. We agree that pension saving needs to be made more attractive, and have long argued for greater flexibility over how people are allowed to take retirement income.

Our view is that a capped drawdown regime, with a reduced rate of tax on death, introduces the flexibility and choice which consumers desire. Further options might be added to cater for residual concerns. For example, remaining funds could be passed down to other non-dependant family members' pensions at a lower rate of tax than the rate payable where the fund is paid to the estate. Or perhaps tax breaks applied where the fund is used to meet long-term care costs. The main reforms which we would support are:

- Capped drawdown with greater flexibility that better fits the needs and preferences of consumers. We make a number of suggestions about how this might work
- A fixed rate of tax on death of 40% or tax should apply at the marginal rate of tax in the year of death. This represents a fair reclaim of tax relief and ensures that there is no incentive to either draw funds too quickly or use pensions as an estate planning tool
- A limit on capped drawdown of 120% of the amount of an equivalent annuity, with additional withdrawal flexibility
- Permitting income drawdown funds to be used as an alternative to guaranteed income in meeting the MIR, either at a fixed lump sum equivalent or as a percentage of the maximum withdrawal
- Removing the upper age of 75 for tax relief

In our view the flexible drawdown regime, as proposed, is not necessary. The concern of people saving for retirement is not that they need to get all their money back out of their pension fund, but that the money that is in the pension fund is not lost, particularly on premature death. There is also a strong customer objection relating to the fairness of the current high tax charge on death.

Whilst our response addresses many of the questions raised by the introduction of the flexible regime, we are clear that it would be our preference to have only the capped regime but with additional flexibility. The following points summarise our key concerns:

- The flexible drawdown regime creates the opportunity for widespread tax avoidance. We strongly recommend that HM Treasury reconsider its decision to proceed with flexible income drawdown
- Overall, the proposed reforms add unnecessary complexity when greater simplicity is needed to aid consumer understanding of and engagement with retirement saving
- Introduction of all elements of the proposals might prove challenging by 6th April 2011

Section 1- The reforms which we support

A workable alternative – capped drawdown with greater flexibility

As noted in the introduction to our response, we do not believe that flexible drawdown is the solution to the public's concerns. Whilst we argue strongly against the flexible drawdown regime, we are also sympathetic towards the general aim of providing greater flexibility to those approaching and in retirement. We therefore make some suggestions where we think flexibility might be improved without introducing the opportunity for widespread tax avoidance.

Allow those with capped drawdown to exceed the limit once in every 5-year unsecured income review period

Those with funds in income drawdown may feel frustrated at being unable to access more than the upper income limit, particularly where they need funds to meet a capital expenditure need such as a large value purchase or home improvements.

Allowing those in capped drawdown to withdraw twice the capped limit once in each 5-year review period would allow significant additional withdrawals and thus give people the flexibility to manage their expenditure needs.

For example, in years 1, 2 and 3, X draws 120% of the basis amount, in year 4, 240% of the basis amount and in year 5, 120% of the basis amount.

An alternative would be to simply set the capped withdrawal limit at a higher percentage of the basis amount for all years and not allow this to be exceeded at all. This would have the benefit of greater simplicity.

Apply a lower rate of tax on death if funds are transferred to another person's pension fund (other than spouse or dependants)

In general terms, we think that the tax system should encourage people to use their savings in a way which reduces the tax burden of others. The proposed death tax is calculated on the basis that funds are removed from the pension wrapper and placed directly into the estate of the deceased. The death tax rate therefore reflects tax relief originally given that needs to be reclaimed.

The beneficiaries of the estate are then free to reinvest their inheritance in a pension fund. For example, if A bequeaths the net value of their £10,000 pension fund to their daughter B, she will receive £4,500 on A's death based upon your proposed tax rate of 55%. However, if B is a higher rate taxpayer, she can reinvest the £4,500 in a pension which grosses back up to £7,500. It can therefore be seen that the effective tax rate on A's pension fund, taking both transactions into account, is 25%.

We would suggest that rather than force people to transfer their pension fund to their estate on death, they are simply allowed to bequeath it to their beneficiaries' pension pots but with a lower rate of tax than the death tax.

Many of our customers and their financial advisers have expressed a strong interest in such an option and we believe that it would be a popular change.

Greater flexibility and a reduced tax rate if withdrawals are used to secure long-term care costs

Another use of retirement funds, which is in the national interest, is to pay for long-term care costs.

According to the financial services provider, LV=, the average period spent in nursing care is 30 months at an average cost of £88,140. In many instances, the cost is much higher.

Capped drawdown is inflexible when used to meet nursing home care costs because the maximum withdrawal is capped, let's assume at 10% of the fund for someone of the age most likely to require long-term care. Therefore, even someone with a fund of £200,000 can only withdraw £50,000 over a 30-month period. The remaining £150,000 would pass to their dependants or estate if they died at the end of this 30-month period.

This limitation means that, in the absence of any other income or capital, the local authority is unable to obtain a contribution from the individual of any more than the capped drawdown limit.

We would suggest that in this situation, the local authority is allowed recourse to half of the capped drawdown fund in order to pay care fees where the individual is married or has dependants, and the whole fund where the individual is single.

Whilst this may not prove popular, it could be made more acceptable by introducing another option. Rather than wait until the point at which they require care, individuals in capped drawdown could be allowed to withdraw up to say 120% of the capped limit each year, of which 20% could be used to future fund long-term care provision. The 20% withdrawal could be taxed at say 10% or even nil to encourage people to pre-fund their own care needs.

The second part of this suggestion (pre-funding long-term care) could be introduced on its own.

The rate of tax on death

The proposal is to levy a 55% tax charge on death, in order to recoup tax relief already received, and in recognition of the fact that the fund is not being used to provide income.

Therefore, the appropriate tax rate should reflect the tax relief received and the tax-free lump sum.

For someone having received tax relief at the basic rate the appropriate reclaim charge is 26.67% i.e. 20%/75% (75% = 100% less 25% tax-free cash)

At the average rate of tax relief received of 30% - see HMRC statistics Table 7.9 (Note 4) – the reclaim rate should be 30%/75% = 40%

At the higher rate of income tax, the charge should be 40%/75% = 53.3%

The current tax charge on residual funds returned to the estate on death whilst in unsecured pension or value protection is 35%. This tax rate was set when income tax rates and therefore rates of tax relief were broadly similar (they were in fact slightly higher) to what they are today. If this tax rate was seen as a fair rate of reclamation in 1997, why is this rate seen as insufficient now?

Whilst the proposed charge also reflects the reclaim of gross investment income and nil capital gains, there are strong arguments for not taking this into account:

- It makes the reclaim charge excessive for basic rate taxpayers. Even taking into account the relative cost of gross roll up to upfront relief for year 2008/09 (see Table 7.9), the total reclaim for a basic rate taxpayer should be around 38%.
- The bulk of the tax relief cost of gross roll up is in respect of £1tn of defined benefit assets
- People who have saved in a pension could have had gross roll-up anyway by either investing in an ISA, investing in a nil-taxed spouse’s name, investing in gains-targeted assets and using annual capital gains tax allowance or investing offshore and encashing investments whilst a nil-rate taxpayer or by assigning investments to a nil-taxed spouse.

We suggest that the rate of tax charge on death should be set at 40% to coincide with the rate required to reclaim the average rate of tax relief.

The behavioural implications of setting a high rate of death tax

By setting a higher rate of tax on death (55%) than on lifetime withdrawals (0% to 50%), lifetime withdrawals are encouraged. Whilst it is currently the case that the tax rate on death (70%) is also higher than the tax rate on lifetime withdrawals, and therefore lifetime withdrawals are encouraged now, the current cap on lifetime withdrawals prevents retirement savings from being quickly depleted.

But by removing limits almost completely, funds saved for retirement can be withdrawn immediately. This is not in the long-term interests of the UK if these withdrawals are spent or given away. Those who can afford to should be encouraged by the tax system to:

- Fund their own long-term care costs
- In some circumstances their health costs
- Use excess savings to the greater benefit of others – for example through gifts to charity
- Pass pension funds onto the next generation which further fosters a culture of self-reliance
- Maintaining their property in good order so that the next generation does not face excessive restitution costs

Yet the proposed flexible regime encourages the opposite behaviour. It encourages people to take a short-term view, rather than one which will better serve the long-term national interest.

In Canada, withdrawals and the residue on death are subject to income tax at a typical rate of 35% to 40% depending upon the Provincial residence of the individual. In Canada, there is also a greater sense of personal responsibility to meet one's own costs for health and care.

The Canadian system also has an additional safeguard in that it is not possible to take withdrawals above the capped level from any pension funds that originated in company pension plans (both DB and DC), even if these have subsequently been transferred to an individual plan. Therefore, only voluntary savings built up in individual plans (third pillar pensions) can be disinvested as a lump sum.

Monitoring the origin of drawdown funds (to prevent withdrawals originating from company plans) is likely to prove administratively cumbersome, so we do not suggest that the UK replicates this aspect of the Canadian system. However, we think that the equal tax rates in Canada for lifetime and death withdrawals strikes the right balance.

A tax rate on death of 40% would be broadly equivalent with the current rate of higher rate tax, and therefore neither encourage or discourage early withdrawal. An alternative would be to include any residual fund in the final income tax assessment and apply tax at the deceased's highest marginal rate.

Using income drawdown to meet the MIR

We think that it should be possible to meet the MIR with income drawdown capital as well as income. The Irish flexible drawdown rules cater for this possibility by allowing people to hold capital in an Approved Minimum Retirement Fund rather than force them to buy an income to meet a minimum income requirement.

Forcing people to buy annuities, which are essentially portfolios of gilts and investment-grade corporate bonds, is unlikely to be well received by the wealthier customers who might take advantage of flexible drawdown. In our experience, these are the customers most likely to attempt to maximise the investment return from their savings by investing in equities and property.

Policies that increase demand for index-linked annuities will exert further pressure on the market for index-linked gilts. Demand for long-term index-linked assets already causes price distortion and further demand will exacerbate this problem. Benefits arising from post-1997 defined benefit accrual also need to increase in line with price inflation. As DB schemes continue to mature, fewer schemes will seek to match indexation with equities or property and instead seek to match assets more closely to the liability. There is already a strong trend in DB assets moving from equities to bonds.

Given the potentially adverse implications on bond markets by forcing the purchase of escalating annuities, allowing people to use drawdown funds relieves this pressure and helps people optimise the return on their retirement savings in line with their attitude to risk.

Retaining pension capital, rather than locking it up in an annuity also allows people to use their fund more flexibly in later life such as paying for care home fees. Once bought, annuities are extremely inflexible.

The following suggestions show two ways in which income drawdown funds can be taken into account in meeting the MIR:

1) Income drawdown income (whether drawn or not) could be used to meet the MIR. We recognise that drawdown income is not secure for life if drawn at or near the maximum level allowed. However, drawdown income can be sustainable if set at an appropriate level.

   We suggest that income drawdown income should count towards the MIR at up to 75% of the maximum allowed under capped drawdown. For example, if the capped drawdown limit is set at 120% of the basis amount, drawdown income counting towards the MIR would be limited to 90% of the basis amount.

   The fund backing drawdown MIR would remain in capped drawdown and income withdrawals limited to the lower figure.

2) A pension capital equivalent could be used to meet the minimum income requirement. No income withdrawals would be permitted from such MIR capital.

   Income from state pensions (and contracted out elements of DB schemes) should be at least £7,500 a year for most individuals. A capital requirement equal to the difference between the MIR and £7,500 could be set based on an index-linked annuity rate of say 4% (a proxy for index-linked annuity rates somewhere between 60 and 65). For example if the MIR is set at £14,000, the capital requirement would be £14,000 less £7,500 = £6,500/4% = £162,500.

Although the MIR capital requirement would be met at the point flexible drawdown begins, that capital might fluctuate with market movements, so a safety margin should be built in. To allow reasonable leeway for investment movement, we suggest that only if funds fall below say 70% of the MIR capital requirement, that the individual is forced to buy an index-linked or fixed escalating annuity at that point.

The MIR capital requirement should be set in expectation that MIR capital might fall. This is why we suggest a figure of £200,000 – even if this fell by 30% to £140,000, there is still sufficient fund to buy an index-linked income of around £6,000.

Allowing people to retain a fund MIR also allows for greater future flexibility than annuities which, once bought, cannot be restructured or encashed. For example, this could be useful to allow capital to be extracted to meet long-term care costs.

A suggested simplification

If someone with income drawdown has taken annual income in advance and then designates/adds further funds into the drawdown pot, the maximum income limit (GAD limit) is recalculated.

If the new limit is lower than the previous annual income, the excess above the new GAD limit is treated as an unauthorised payment.

We suggest that any in such circumstances (where the new designation triggers a new GAD limit review downwards) that the limit previously determined at the 5-year review should remain in place until the next 5-year review or until a further designation of funds results in an upward movement of the GAD limit.

Section 2 – Reforms which we are not in favour of

Unnecessary complexity created by flexible drawdown

Flexible drawdown adds unnecessary complexity to the retirement rules, yet is only useful (or at least intended for use) by a very small proportion of savers. As we explain below when we examine gaming dangers, we think its use will be much more widespread than perhaps is intended.

As noted earlier in our response, there is no customer demand for the proposed flexible drawdown option. This is reinforced by our experience in Ireland where Standard Life is a leading provider of Approved Retirement Funds (ARF) and Approved Minimum Retirements Funds (AMRF). Of the 5,000 customers with ARFs, fewer than 10 have chosen to liquidate their ARF and leave the required 63,500 Euros in an AMRF. Those liquidating their fund have done so because of financial hardship.

Flexible drawdown would also appear to run contrary to the general principle of pension saving. Tax relief is given in return for doing the responsible thing and saving up to meet one's own retirement income needs. Flexible drawdown, whilst only useful for a tiny minority of savers, sends out a confused message to all savers that this principle no longer applies.

The two main existing tax incentivised savings regimes, ISA and pension, are capable of meeting the needs of virtually all savers. Savers looking for greater flexibility over how they use the product of those savings can clearly choose ISA over pension. Allowing pension savings to be withdrawn as a lump sum blurs the helpful distinction, which consumers already associate with each of these tax wrappers.

A general theme of Standard Life's consultation responses and work with government has been to promote greater simplicity. We think that greater simplicity aids communication and ultimately improves levels of engagement with retirement saving. The added complexity introduced by flexible drawdown, especially when it can only be used by a few people is, in our view, unwelcome.

Deliberate gaming dangers

The flexible regime introduces many opportunities for those seeking to avoid tax. We illustrate some of the potential loopholes below. These examples seek to highlight tax planning using the flexible drawdown regime that will be widely used and therefore result in high levels of tax leakage.

Despite not having spent a great deal of time exploring tax avoidance opportunities, we have come up with four examples. The market will come up with many more.

The desire to retire abroad has been increasing in recent years with those leaving the UK being our wealthiest pensioners, and therefore those most able to exploit advantages from using flexible drawdown. Our estimates from official figures (Long-term International Migration statistics) suggest that even without the new incentives presented by flexible drawdown, around 20,000 people each year choose to permanently relocate to another country at retirement. Over 1.1m British nationals now receive their state pension abroad – around 10% of all people receiving state pensions.

Qualifying recognised overseas pension schemes (QROPS) are used as tax avoidance schemes, but many investors have been reluctant to use them because of lack of trust of the providers involved. The tax advantages gained by using QROPS are also marginal.

Despite their limited usefulness and the reluctance of many to transfer their pension to unheard of pension providers, QROPS have been extremely successful. An article published earlier this year by Financial Adviser revealed that 7,300 people transferred pensions worth £0.5bn to qualifying recognised overseas pension schemes (QROPS) in the two years following A-Day on 6th April 2006.

The proposed flexible regime allows significantly improved tax avoidance opportunities over QROPS, without the need to transfer away from a trusted pension provider. Therefore, we would expect flexible drawdown to attract a much greater number of customers than QROPS has, but as we explain in the first example below, this will not result in any new revenue for HMRC – quite the reverse in fact.

It should also be borne in mind that people who have large enough pension funds to opt for flexible income drawdown will also have financial advisers. Therefore, tax-planning techniques, such as income recycling, will be widely used by wealthier people approaching and in retirement.

Although those marketing these avoidance techniques (accountants, financial advisers, providers) are required to report them to HMRC, in practice, it will be very difficult to prevent abuse. A huge volume of unnecessary anti-avoidance legislation will also be generated.

For example, the tax-free lump sum recycling rules introduced by the previous government are highly complex yet virtually impossible to enforce. We are not aware of any case that has been successfully challenged by HMRC under these rules.

It will be equally difficult for the Government to prevent the tax avoidance opportunities we highlight below.

The Government should be very concerned about this type of behaviour as any expected increase in tax receipts from people using flexible drawdown rules could prove illusory.

We strongly recommend that the Government reconsider the wisdom of proceeding with the flexible drawdown regime.

Gaming examples

Example 1 – take pension whilst non-resident

Mike is age 65 and has recently stopped work. He qualifies for a state pension of £8,000 a year (a combination of basic state pension, SERPS and state second pension) and has £1.4m in a SIPP. Mike is also in receipt of a defined benefit pension of £12,000 a year, giving him a total guaranteed lifetime income of £20,000 towards meeting the MIR.

The MIR is £14,000, so Mike can take the whole value of his SIPP as a lump sum, three-quarters of which will be taxed. Mike is also considering moving abroad, at least for part of each year.

Mike's adviser has told him that for tax residents of Cyprus the tax rate on pensions received from overseas is just 5%.

The UK has a Double Taxation Treaty with Cyprus meaning that Mike will not be taxed on the same pension income twice if he is deemed tax resident in Cyprus when he draws income from his pension. In other words, if he is tax resident in Cyprus and pays 5% income tax in Cyprus, he will not have to pay any UK income tax on any income taken, even although the UK rate is much higher, and the pension income is paid from the UK.

His adviser also tells him that HMRC may still attempt to tax him on income arising in the UK, but that he can transfer his SIPP fund to a Cypriot Qualifying Recognised Overseas Pension Scheme (QROPS), of which there is currently a choice of four schemes, if this becomes an issue. If he does this, the Cypriot QROPS benefits must still be taken in accordance with UK flexible drawdown pension rules, unless he has been non-resident for five or more complete tax years, but the income will arise in Cyprus and not in the UK.

After considering the QROPS option, Mike and his adviser believe that he will still avoid UK income tax under double tax treaty rules even if he draws income from his UK SIPP.

Mike takes a tax-free lump sum of £350,000 from his SIPP and places the remainder in flexible drawdown. He sells his house in the UK and moves permanently to Cyprus on the 5th of January 2012. By early July 2012, Mike has been in Cyprus for 183 days. Under Cypriot tax law, this establishes Mike as tax resident in Cyprus, and he now has to pay Cypriot tax on his pension income. But he can also now claim double tax treaty relief on his UK pension income in accordance with the UK/Cyprus Double Tax Treaty. Mike completes a UK DT/Individual form and applies for exemption from UK tax on his UK arising income, and this is granted in December 2012, when the HMRC confirms that it is happy that Mike has established that he is no longer resident in the UK.

In January 2013, Mike takes the remaining £1,050,000 out of his SIPP under the flexible drawdown rules and pays £52,500 in Cypriot tax on this withdrawal. Had he withdrawn this sum whilst resident in the UK he would have paid ten times more tax - about £500,000. HMRC collects no tax revenue from Mike's pension.

Having already been taxed on his flexible drawdown withdrawal, Mike is now free to return to the UK, without facing further UK tax on the income withdrawal, should he decide that he no longer wants to stay permanently in Cyprus.

<u>Example 2 – Recycling of income</u>

Peter is 55 years old and earns £180,000. He has been with his current employer for 15 years, building up a defined benefit pension of £45,000 payable from age 60. Peter also expects a state pension of £5,000 a year at age 65. He also has a revalued defined benefit pension of £20,000 from previous employment payable at age 60. The rules of this scheme allow Peter to draw his pension early subject to an actuarial reduction of 5% a year – if he takes it now, at age 55, he is entitled to a pension of £15,000 a year for life.

His wife Joanne, who is 56, spent many years out of the workplace caring for their two children. Joanne has no private pension and expects to receive a state pension of £2,000 a year from age 63, in seven year's time. Joanne is now back in full-time work and earns £40,000 a year but with no pension entitlement. She intends to work through to state retirement age.

Peter's employer is in financial difficulty and has offered Peter an enhanced transfer value (ETV) to persuade him to rescind his right to the defined benefit pension. He has been offered £746,667.

He is also being made redundant, but has been engaged by his current employer on a part-time consultancy basis for a payment of £45,000 a year.

Peter realises that the ETV is probably less than the value of the pension but he has total pension entitlement of up to £70,000, which far exceeds his expected retirement income need. He also realises that when this comes into payment he will have to pay 40% tax on about £25,000 of it, when all his pensions are in payment at age 65.

Following advice, Peter decides to take the ETV of £746,667 which he puts into drawdown immediately, taking a quarter of the fund (£186,667) as a tax-free lump sum. He also draws the deferred defined benefit pension of £15,000 a year, which meets the MIR. These vested pensions use up £1.046m of his lifetime allowance.

From the remaining £560,000 in his drawdown fund, Peter draws £80,000 a year under flexible drawdown (as this withdrawal is more than the maximum allowed under capped drawdown) taking his total taxable income up to £140,000 (£45,000 consultancy income plus £15,000 income from the deferred defined benefit scheme plus £80,000 flexible drawdown withdrawal).

From his income, Peter pays £40,000 into a self-invested personal pension. This is within the annual allowance. He gets 40% tax relief on this but it also restores his personal allowance, adding extra tax relief of 20% on £12,950 of the £40,000 payment. In total Peter has gained relief of £16,000 on the pension payment and recovered £2,590 by keeping his personal allowance intact – an effective rate of tax relief on his pension contribution of over 46%.

He gives the other £40,000 to Joanne who invests it in a personal pension with 20% tax relief. Over Joanne's seven final years of working, Peter transfers £280,000 of pension withdrawals to Joanne. He also continues to put £40,000 a year into his SIPP.

Ignoring investment fluctuations, Peter's flexible drawdown fund is now zero but has been replaced by a new SIPP fund of £280,000 and Joanne's personal pension fund is also £280,000. Each is entitled to a tax-free lump sum of £70,000.

When she retires, Joanne does not qualify for flexible drawdown as she does not meet the individual MIR, but capped drawdown allows her to draw up to 7% of her fund as income. After taking her tax-free lump sum, Joanne draws £4,500 a year from age 63, which keeps her pension income within her personal allowance. She increases withdrawals to £7,400 a year when she reaches 65, again within the personal allowance for those aged 65-74. So Joanne pays no tax on her pension.

Peter also retires at age 62, before his state pension is payable. He already has the DB pension of £15,000 a year in payment and draws another £15,000 a year from his remaining £210,000 SIPP drawdown fund. He has the flexibility to draw around £30,000 from his SIPP fund without paying higher rate tax until his state pension begins in three year's time.

By reinvesting income withdrawals in Joanne's pension, Peter has almost certainly avoided paying 40% tax on his pension. £280,000 of his fund has been transferred to his own SIPP on a tax-neutral basis and another £280,000 to Joanne at a tax cost of 20% (40% tax on income out, 20% tax relief on contributions in).

Joanne avoids paying tax on both the lump sum and income she takes from her pension pot. In this way, they have avoided paying 40% tax on the £20,000 of annual income exceeding the basic rate tax band, had Peter retained his DB pensions. This more than offsets the 20% tax cost of transferring funds to Joanne.

Were it not for the higher withdrawals permitted by flexible drawdown, Peter would not have been able to recycle pension income so quickly.

Example 3 – NICs avoidance

Joe runs a private security firm and employs three former police officers, Tom, Dick and Harry. Each of them earns £20,000 a year, but this is supplemented by their police pensions, which are already in payment. They pay tax at 20% on their whole earnings because their police pensions use up their personal allowances. They also pay national insurance contributions (NICs) of £1,571 a year each and Joe pays employer's NICs of £1,828 for each (£5,484 in total). Each takes home £1,202 a month after tax and NI.

Joe's financial adviser has thought of a great trick to avoid paying NICs using flexible drawdown. This works if Joe sets up a small pension scheme, using an off-the-shelf trust deed and rules, which his adviser can set up for £2,000.

If Tom, Dick and Harry are prepared to sacrifice their salaries in return for a pension contribution, their monthly salaries can be paid into the pension instead. All three are over age 55, so can take the pension contributions straight back out of the pension under the flexible drawdown regime.

Joe speaks to Tom, Dick and Harry and explains that although he has previously told them he can't afford to give them a pay rise this year, he has found a way to increase their pay by £1,571 (nearly 8%) if they agree to wash their pay through a pension.

Another condition for this scheme is that each has sufficient income to meet a minimum income test, the MIR, which all three pass using their police pensions. All agree to go ahead with the proposal.

So, Joe sets up the pension scheme, with all four of them the trustees. The scheme sets up a single bank account as its sole asset and Joe makes monthly payments into the scheme bank account of £5,000 a month. The scheme bank account deducts 20% income tax (£1,000) a month and pays this directly to HMRC. As NICs are not payable on pension income, the other £4,000 is distributed immediately as income to Tom, Dick and Harry, each receiving £1,333 a month (a £131 a month rise on what they were receiving before).

Joe also sees his employer's NICs cost fall by nearly £5,500 a year, which more than offsets the cost of setting up the pension scheme.

The total revenue lost to HMRC is around £10,200 a year.

This type of NICs avoidance scheme is not possible with capped drawdown since income withdrawals would be limited to less than 10% of the fund built up from contributions.

Unintended consequences

As well as people who deliberately use the flexible drawdown rules to their advantage, there is another group of people who might start with more innocent intentions, but end up costing the taxpayer more.

Example 4 – Inadvertently requiring state support to pay care home fees

John and Mabel have a house in the UK valued at £500,000, John has a state pension of £6,200 a year (a combination of basic state pension and SERPS), a private DB pension of £6,000 a year and £291,000 held in a personal pension. Mabel has a state pension of £4,800 a year and a defined benefit pension of £1,000 a year. John and Mabel have other savings of £130,000 mainly held in bank deposits and cash ISAs. They currently use the personal pension to supplement their income - they need around £27,000 of income a year.

The MIR for an individual is set at £14,000.

John and Mabel have just turned 75 and their health is beginning to deteriorate. They are keen to pass on as much of their wealth to their children and grandchildren as they can reasonably afford to, and minimise inheritance tax.

John has £12,200 of pensions counting towards the MIR, leaving him to buy a further £1,800 of index-linked pension which he buys on a joint-life 100% reversionary pension basis with £36,000 of his personal pension fund. John can now take the remaining £255,000 from his drawdown fund. He will take this at a rate of £85,000 a year, using flexible drawdown, to avoid losing his personal allowance by exceeding £100,000 of income (although he loses age allowance for these years). He pays an average rate of tax on each £85,000 withdrawal of 33%. Had John planned earlier – say from 60 or 65, he could have withdrawn funds at a lower rate of up to £30,000 a year to avoid having to pay higher rate tax.

Ignoring investment fluctuations, John is able to withdraw his excess fund (£255,000) over 3 years. He continues to use some of this to top up their joint income. After tax is deducted, he now has £140,000 in cash to add to the £130,000 in bank deposits and ISAs, a total of around £270,000.

They buy a single life purchased life annuity in Mabel's name with £150,000 of their bank deposits and ISAs which generates an income of 5% (£7,500 a year). This gives them the total income they need of £27,300 a year. With the remaining £120,000, they carry out maintenance on their house and gift most of the remainder to their children and grandchildren in equal shares, but retain £20,000 on deposit for emergencies.

John now has income of £14,000 a year from which Mabel will receive a reversionary pension of £9,000 should John pre-decease her. Mabel has income of £13,300 from which John will receive a reversionary pension of £2,000 a year should Mabel pre-decease him.

They are both happy that their income need is covered and that they have managed to pass assets to their children and make provision for their house to pass to the children too, whilst avoiding inheritance tax completely. As far as they are concerned, they have fully met their objectives.

A few years later, John's health deteriorates further and he has to go into a nursing home because Mabel and their family are unable to care for him at home.

The only substantial funding he has is his £14,000 of pension. This will meet only about 30% of the care cost. Mabel needs her own £12,300 of income to meet her living expenses – in fact she probably needs more than this, as their joint income was previously £27,300.

Based upon the £20,000 in the bank, John and Mabel also have to pay around £1,200 a year to the local authority towards John's care.

The value of the house is unlikely to be taken into account whilst Mabel continues to live there.

Had John not been allowed to withdraw his income drawdown fund so quickly, the local authority would have had recourse to John's drawdown fund to help meet his care costs.

Had they not spent or given their liquid assets away, John and Mabel would have been forced to meet John's whole care costs as their liquid assets would have exceeded £23,000.

Administrative difficulties

The flexible regime will be difficult to administer because of the requirement to check the guaranteed lifetime income MIR. Pension providers are not in a position to do this because we do not know what other permanent lifetime income that our customers have, nor do we have any legal right to obtain or hold that information. There is also no way for providers to verify that what we are being told is in fact correct.

Therefore, we can only administer this through either:

- Self-certification; or
- Confirmation from HMRC (which does have a complete view of each individual's income) that guaranteed lifetime income meets the MIR

Our view is that the customer should self-certify MIR income and the MIR capital alternative.

Tight timetable for introduction in April 2011

The timescale for introducing these changes looks optimistic. The consultation closes to responses in September, and it is unlikely that draft legislation will be published before early December. Even then, these will be draft rules and, therefore, providers are unlikely to commit expensive and scarce IT resource, until they have near certainty of the final rules.

In practical terms, providers will have a maximum of three months to analyse and scope the change requirements, build and test systems, which is not long enough. In addition to IT systems, administration processes will need to be changed, literature changed and staff trained (both administration and advisers) and tested.

However, if the changes are less far-reaching, such as the proposed changes to the capped regime only (i.e. the merger of unsecured and alternatively secured pensions) then this could be delivered in a shorter timescale.

We make a number of suggestions below which we think could be introduced on a phased basis. For example, in relation to one suggestion we make about pension funds being used to fund long-term care costs, it might be better to wait for the outcome of the review being carried out by The Commission on the Funding of Care and Support, before proceeding with any changes to pension rules

Section 3 - Our answers to your set questions

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

The appropriate level of the capped drawdown limit is in line with the current USP limit of 120% of the basis amount. This limit should continue after age 75.

Limits after age 75 should be calculated in accordance with mortality data for actual age rather than current alternatively secured pension rules which require post age 75 limits to be calculated in accordance with mortality data for a 75-year-old.

This means that the government will need to publish tables for over 75s. The regular reviews of maximum permitted drawdown levels will prevent retirement funds from being exhausted.

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.

Calculation of the lifetime allowance

We agree with the intention to continue to use age 75 as the point at which the lifetime allowance is tested but changes will need to be made to the rules. For example, the current rules allow the lifetime allowance charge to be paid by the scheme administrator from income at a rate of 25%, which is then subject to income tax in the hands of the member. This gives an effective rate of tax of 55% assuming an income tax rate of 40% i.e. £100 less £25 = £75, £75 less 40% (£30) = £45. Therefore tax is £55.

If there is no requirement to take an income at age 75, or indeed ever, how will the lifetime allowance charge be paid? What if benefits are passed to a spouse or dependant without income having been taken by the member? Or is the 25% option unavailable at age 75? Will the tax charge simply be 55% of any excess over the lifetime allowance at age 75 and be payable at that age? Or will the tax charge on all benefits at death be regarded as collection of the charge?

Age 75 limit for tax relief

Age 75 is also the current limit for pension tax relief. Our view is that this limitation can be safely removed. In order to make pension contributions above the deminimis level of £3,600, you must be in employment and although there are a few people working after age 75, numbers are low.

Some people over age 75 may make use of their deminimis limit to buy further pension income, because their pension income is insufficient to meet their needs. Although tax relief is available on these contributions, government should welcome greater self-provision as it reduces dependency on state support. In this case, it could increase the contributions of individuals towards their own long-term care costs. If the individual simply gives their capital away (before care needs arise) rather than buy an income with it, that capital is not available to local authority to assist with funding care costs.

In any event, the number and size of contributions after age 75 will be low and, therefore, the tax relief costs will also be low. We therefore think that there is no need to retain this restriction.

This would be in keeping with the general move towards allowing greater flexibility for people in transition from work to retirement.

Such a change would be in line with plans to remove the default retirement age. The age 75 limit for tax relief appears age-discriminatory when viewed in this context, particularly when children are allowed to contribute to a pension from birth.

Pension commencement, trivial commutation and value protection lump sums

We agree with the proposal to remove the age 75 limitation for these benefits.

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.

Lifetime income not capable of assignment should count towards the MIR. Income drawdown (capital and/or income) should also count towards the MIR. This should include income in payment from:

- State pensions
- Defined benefit pensions
- Income drawdown as a fixed capital requirement or as a percentage of the capped drawdown limit
- Annuities with fixed escalation of 3% or above, linked RPI, LPI (RPI with a 2.5% cap) or in future CPI or LPI annuities with a CPI reference

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

The people who will take advantage of the flexible drawdown regime are likely to be relatively wealthy. Therefore, we would not expect these people to deliberately fall back on the state for benefits such as pension credit. However, they might deliberately seek to achieve maximum support towards long-term care costs by giving capital away.

We note your comments about the requirement falling with age as greater certainty arises, but would also draw attention to your previous comments about long-term care costs. Requiring a MIR of say £14,000 could result in significant funding costs for local authorities as current long-term care costs average £36,000.

In truth, it is difficult to set the MIR at any level. If you aim for completely risk-free (of falling back on the state) then the number of people capable of using flexible drawdown will be very small. On the other hand, setting a MIR below means-testing thresholds would be a high risk but more inclusive strategy.

We suggest an appropriate balance point is a measure of minimum living expenses. The Joseph Rowntree Foundation recently said that a single person (working age) needs at least £14,400 before tax a year to live to an acceptable standard.

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

A MIR should be set for individuals and couples, however, one partner within a couple should be able to use the individual MIR without having to meet the couples MIR. The Joseph Rowntree Foundation report indicates that an appropriate gross earnings figure for a retired couple is around £21,000 (£407 per week).

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

We suggest that an initial review is taken after one or two years and that further regular reviews are taken at five-yearly intervals.

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

HMRC is better placed than the pensions industry to assess whether the MIR is met. People may be reluctant to share information with insurers, other pension schemes and their financial adviser about their sources of income and pension savings.

On the other hand, HMRC should have a complete picture of any individual's pension income, the amount of that income and whether it is fixed or increasing.

Alternatively, self-certification with penalties for false declaration is a workable alternative.

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 greatest risk of fiscal or avoidance risk will lie with the flexible regime rather than the capped drawdown regime. We would suggest that you reconsider the extent of the flexibility allowed.

The industry has already been hugely innovative in the post retirement market during the last few years. Developments include, impaired life annuities, postcode annuities, short-term annuities, variable annuities, money back guarantees, flexible annuities that allow review at a given age or after a given period. The removal of ASP minimum and maximum income limits will allow further innovation.

The current pension tax rules are unnecessarily prescriptive in insisting that once bought, pension income (lifetime annuities and scheme pensions) can only be reduced in very specific circumstances.

Yet a flat or increasing level of pension is not the 'shape' of income which best suits people's needs. Advisers and our own customers tell us that many people would prefer a higher level of income in the early years of retirement, followed by a lower rate thereafter, with a very high income needed by some in the later stages of their lives to pay for care needs.

Matching income with a U-shaped income need or 'retirement smile' is impossible under current pension rules (Finance Act 2004). Yet the industry is capable of creating solutions to meet this need using a combination of term, immediate and deferred annuities.

We would welcome further discussion with the Government to explore some of the possible options.

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

The people who will take advantage of the new flexibilities will have a financial adviser, who will help them make appropriate choices.

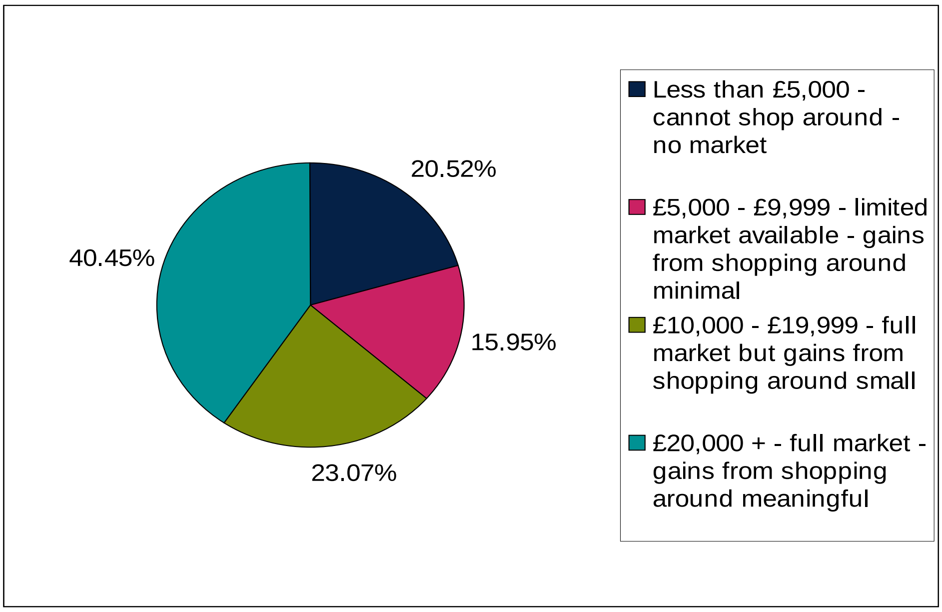
The industry has already made significant advances in recent years in ensuring that individuals are well informed. The ABI introduced the idea of wake-up packs, which the FSA subsequently formally adopted. These have been the subject of continuous improvement and guidance for providers has been developed. These now contain sufficient information to alert people to the variety of options available.

However, we would note that not all providers abide by the guidance. We have appealed directly to FSA to force these providers to improve via Treating Customers Fairly, but the FSA appears reluctant to take action.

Recent ABI research reveals that two-thirds of people shop around for an annuity, which is near to optimal given that around 40% of annuity purchase prices are less than £10,000, where no or a very limited open market exists. Whilst a strong lobby has suggested that shopping around is limited, notably the Pensions Income Choice Association (Pica), the facts suggest that consumers are already using the OMO where appropriate. It should also be noted that Pica acts out of self-interest rather for the benefit of the consumer.

Many customers – more than 25,000 (out of 122,000) who bought annuities in the second quarter of 2010 are unable to shop around because no market exists under £5,000 purchase price. Standard Life's minimum is £5,000, but many providers start at £10,000.

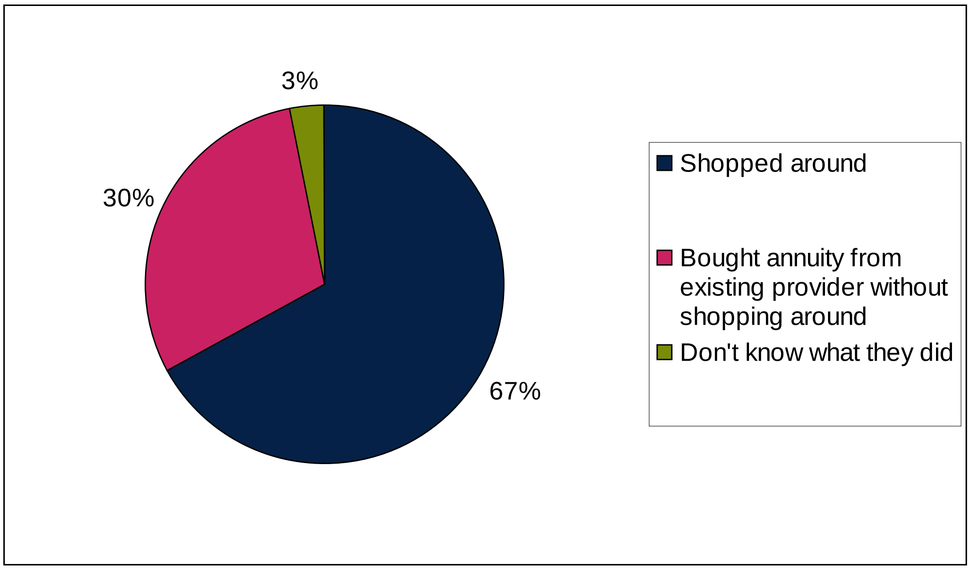
ABI figures for Q2 2010 show that over 20% of people have pots which are too small (less than £5,000) to allow them shop around. See following graph for market breakdown:



Between £5,000 and £10,000 purchase price, whilst a few providers enter the market, choice is still limited and gains to be made from shopping around are small – typically £1 or £2 a month at best.

Equally, advisers are not interested in small purchase prices because the typical commission is 1.5%, which would yield only £150 income on a £10,000 purchase price. This is insufficient to cover the cost of advice and administration involved in helping customers exercise the OMO.

Despite these drivers working against shopping around, the recently published ABI research ‘Annuity Purchasing Behaviour’, reveals the following information:



This shows that two-thirds of customers do shop around (the same as in a 2008 FSA survey). In the second quarter of 2010, nearly 82,000 out of 122,000 customers shopped around.

With 25,000 people unable to shop around (because their annuity purchase price was less than £5,000), this suggests that only 15,000 people who might achieve a better rate fail to shop around. The reason for this might be due to the extremely limited market and/or the limited benefit of shopping around.

The industry has also made significant advances in helping people exercise the OMO through the Options initiative. This ensures that funds are transferred quickly between providers. However, not all pension providers have signed up to Options including, notably, some high-profile members of Pica.

One area for improvement is the use of impaired-life (smoker and underwritten) annuities. Take up of such annuities by eligible customers can be improved through changes to wake-up packs. However, we would note that these annuities are not available to those with a small purchase price.

New tools have also been developed to help people make the right choices including The Pensions Advisory Service's Annuity Planner. Further promotion of these tools will help people who can't access advice (because their fund is too small) make appropriate choices.

The Association of British Insurers has a number of plans to further improve the retirement experience, which we support, but we would emphasise that this process is already working well for most people despite the claims of some self-interest groups.

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.

As noted above, the requirement to provide index-linked income and even fixed indexed income will put further pressure on underlying assets, principally long-dated gilts. Our suggestion of an alternative drawdown income or capital requirement would ease these pressures.

About Standard Life

Standard Life is the leading provider of workplace and self-invested personal pensions in the UK. Founded in Edinburgh in 1825, the company provides pensions, life assurance and investment management to over 6.5 million customers worldwide. Group assets under management currently exceed £179bn (as at 30 June 2010).

In 2006, after 80 years as a mutual company, the Standard Life Assurance Company demutualised and Standard Life plc was listed on the London Stock Exchange. We now have 1.5 million individual shareholders in more than 50 countries.

The Company currently has around 10,000 employees across the UK, North America, Europe, India, and China. Scotland remains very much at the heart of Standard Life's operations: the company employs nearly 6,000 staff in Scotland, the majority based in Edinburgh.

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Sun Life Financial
of Canada

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

8th September 2010

Dear Sirs

Re: Removing the requirement to annuitise by age 75

I have the pleasure in submitting the following comments on the above consultation. SLFC Assurance (UK) Limited is focused on providing flexible and innovative product solutions for customers in and approaching retirement. Our responses reflect our business focus and the fact that an important element of public policy is to permit & encourage an individual to fund their retirement by investing.

Our responses to the questions listed within the consultation paper are noted below.

If you have any questions or wish to discuss our response in more detail please do not hesitate to contact Ian Browne, Product Proposition Manager, on 01452 637203 (ian.browne@sloc.co.uk).

We believe that we have a lot to offer regarding this consultation.

Yours faithfully

Fleur Hobbs

Fleur Hobbs
Company Secretary, Sun Life Financial of Canada

Chapter 2 – Developing a new tax framework for retirement

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

We believe that the current method of a minimum of zero and a maximum of a 'standard rate' are appropriate income limits for capped drawdown. This offers a simple, straightforward and consistent way of applying the limits to the amount of income someone can withdraw from their pension fund. The difference between the two limits also offers people the ability to match their fluctuating income requirements with their fund. Many different sources of research (including our own) have identified that expenditure in retirement is not level but instead is cyclical.

The 'standard rate' should be set at a sustainable level of income that manages the risk of someone's fund running out before they die. We have developed, as part of our pension proposition, a methodology for assessing someone's sustainable level of income that can be withdrawn from a unit-linked pension fund. This takes into account their fund value, age, gender, an assumed investment return, future charges, and choice of death benefits. We would welcome the opportunity to present this methodology to HM Treasury with the aim of developing an appropriate 'standard rate' that can be used by all.

There are some features of the current method that we believe could be changed to remove unnecessary complexity and make it more appropriate over the long term.

We question whether the current arrangement structure of income drawdown needs to persist, whereby separate arrangements need to be identified within one pension scheme with independent minimum and maximum income rates, pension years and review periods applying. People already have the option of being able to trigger an ad hoc review of their income limits and thereby align all their arrangements. However, this still necessitates administration, recording and reporting and therefore represents a unnecessary burden both on the individual and pension scheme for no discernable benefit. This flexibility and choice should be taken forward further. We propose that each scheme that offers capped drawdown only needs to apply one set of income limits to the funds it holds no matter what the original source or crystallised status of the funds were (whether it was from the current scheme, other schemes, uncrystallised or crystallised or a combination of all). The benefits of this would be a much simpler and straightforward approach for both providers and consumers without exposing HM Treasury to any risk.

We also question the current standard review period for income drawdown of five years. We think that this represents too long a period, during which the maximum income limit can potentially become unsustainable for the funds to which it applies. We believe this review period should be shortened. We propose a review period of three years which represents a more prudent balance between acknowledging that the fund fluctuates in value due to the nature of the underlying investments and the need to make capped drawdown sustainable over the long term.

Finally, in the current methodology, the 'standard rate' moves up and down frequently because of monthly changes in gilt yields. We think it would be more appropriate if this 'standard rate' was not so sensitive and only changed on an annual basis.

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

We welcome the Government's intention of reforming the pension tax framework and believe that this consultation should not only consider the responses submitted directly to it, but also the responses to the consultation regarding restrictions of pension tax relief.

The two consultations overlap regarding the application of a Lifetime Allowance. With the Government's clear policy intention of significantly restricting the current levels of tax-relieved pension contributions by adjusting the Annual Allowance downward by approximately 4/5ths, we question whether the Lifetime Allowance is required going forward. Decisions taken in response to this consultation should not ignore the fact that the Lifetime Allowance could change significantly due to the other consultation. As both consultations have been issued by HM Treasury, we expect the responses to both consultations to be aligned.

Under the consultation it appears that there is an intention to permit uncrystallised funds after age 75 but with more complicated pension commencement lump sum rules and higher death benefit lump sum taxation. We do not think this is necessary. This change would just add complication with no benefit. Pension funds are accumulated to provide an income in retirement. This principle should be strengthened as part of this consultation rather than diluted. This is because there is a risk that these proposed changes will send the wrong message to the public about what pension funds should be used for. Therefore, the rules regarding uncrystallised funds should be consistent and different rules after age 75 should be avoided. This consultation should focus on the options and flexibility available to someone when they crystallise their benefits.

The principle of EET (Exempt, Exempt, Taxed) remains within the pensions tax framework and any measures to allow someone access to the majority of their pension fund as a lump sum should ensure that tax is reclaimed and cannot be avoided.

Chapter 3 – Minimum Income Requirement

The principle of the MIR is a very important one and a balance needs to be struck between the three objectives of simple, fair and flexible. We think the most important of those three objectives is simple and this is will be the overriding objective of our responses to A3 – A7. For many years pensions have suffered because of complicated legislation and this has left the general public disillusioned. For this consultation to be a success, it needs to achieve an outcome that is simple.

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.

It is our view that any income that is guaranteed for life and cannot be surrendered should be considered secure. It does not necessarily have to be pension income. To strengthen our view the provision of this income, whether it is from the state or private sector, should meet a minimum financial strength assessment to protect against the guaranteed income defaulting.

The consultation acknowledges that inflation risk needs to be managed in order for the MIR to work. Many studies have demonstrated that the rate of inflation that applies to someone in retirement is significantly higher than the national average. The consultation's proposal that an LPI linked secure income would be an appropriate risk control is inadequate. Inflationary pressure increases exponentially over time. We think the most effective way of controlling it is to shorten the time period. Therefore, we propose that the availability of the MIR should not be linked to the normal minimum pension age (currently someone's 55th birthday) but instead be a stand alone age that is older. We consider a 'minimum MIR age' of 70 as appropriate.

In addition, it is not possible to provide a retirement income that increases each year at the rate of inflation that applies to someone in retirement. Therefore the income that is considered secure for assessment against the MIR should, in principle, be based on a level income. This is by far the most simple and straightforward way. If someone is in receipt of an escalating income and wants to include it in the assessment against the MIR then an appropriate method should be developed to make this escalating income comparable to a level income at the time of the assessment.

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

We agree with the Government that the MIR should prevent someone from falling back on the state. In setting the MIR, the Government should focus on the necessities that income will be spent on. From the information provided in the consultation document, the MIR should take into account expenditure needs (£185 per week), housing costs (£40 per week) and the potential for ill-health & disability costs (£250 per week). Therefore, for a single person the MIR should be set at £475 per week. In line with our answer in A3, this should be the 'single life MIR' level at age 70. Using standard pension annuity rates as a basis for calculation, a single man aged 70 would need assets of approximately £350,000 to secure a level income that would meet this MIR requirement. This clearly demonstrates that flexible drawdown is only suitable for people who have significant sources of wealth.

We propose that this MIR level should be the same for all ages after age 70. By restricting the availability of the MIR from age 70 the uncertainty about future expenditure requirements is diminished to such an extent that adjusting it for different ages is not required.

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

In principle we think that the MIR should be different for individuals and couples to reflect the differing expenditure needs of those two types. The level of the MIR for couples should protect the surviving partner on death.

Following on from the figures we have provided in answer to A4, a couple's total income needs would be £712 per week (£475 x 1.5). For assessment against a 'joint life MIR' and the availability of flexible drawdown, the couple would need to demonstrate that their total joint income met this level and, when the either of them dies, the survivor would receive an income of at least £475 per week. If they were unable to meet this requirement then flexible drawdown would be unavailable to either of them. If one of them were to die, the survivor could have the option to be assessed for the MIR on a single life basis.

You could introduce a feature where both of them could become eligible for flexible drawdown at the same time. Using standard pension annuity rates as a basis for calculation is more difficult in this instance. We estimate that the couple would need assets in the region of £550,000 to £600,000 to secure an income at the 'joint life MIR' level to permit both of them to enter flexible drawdown. This would be much lower than if they both did it on a single life basis so would encourage couples to act together.

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

The single life MIR, joint life MIR, minimum MIR age and minimum financial strength requirement (that we have proposed) should be reviewed annually by Government.

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

Under our proposals, individuals will be able to ask for a statement detailing the level of secure income that they receive and that the provider of the secure income meets a minimum financial strength requirement. Similar to the rules that govern pension sharing on divorce, providers should have the option to charge a reasonable fee for this 'MIR activity' to cover the costs that they incur.

The individual will then have the information necessary to declare to a flexible drawdown provider that they are eligible and also declare it on their self-assessment tax return.

The flexible drawdown provider will need to notify HMRC of anyone who is in receipt of pension fund monies from a flexible drawdown arrangement.

We believe that this framework would not burden individuals or the industry.

Chapter 4 – The UK annuity market

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

The income flexibility that currently exists in income drawdown (and which is most likely to continue in capped drawdown) should be also be mirrored and made available within an annuity contract. Currently under SI 2006/568, so called 'flexible annuities' can exist that offer a level of income flexibility similar in principle to income drawdown. However, the legislation does not provide the same level of detail or clarity on how these annuities should operate. By allowing these types of annuities to have the same income flexibility legislation as a drawdown product, it would permit a more direct comparison and ease of understanding. This in turn would clearly differentiate the flexible annuity as being more appropriate if someone wanted an income (due to mortality cross subsidy within the annuity). This would endorse the Government's stated aim that pension funds should provide an income.

We think that the Government should undertake an assessment on whether allowing annuities to be paid tax-free directly to care providers to meet the costs of ill-health and disability in retirement is more tax efficient than taxing the income and then subsidising the care costs. If it is more tax-efficient then the Government should permit annuities to be paid tax-free to care providers.

Within the current pension tax framework, when a term certain guarantee comes into payment because the annuitant has died during the term, a discounted capital value of the future income payments forms part of the deceased estate. Given that the recipient of this benefit is liable to income tax, we do not consider it fair or necessary that this benefit should also be potentially liable for a 40% inheritance tax charge. In a significant number of cases this rule adds nothing more than a complication to the process of administering the death of an annuitant. Making this benefit exempt from inheritance tax would be welcomed because it would simplify the process without having a noticeable affect on the Government's tax revenue.

Since A-Day, a small number of providers (including ourselves) have each met with HM Revenue & Customs to discuss products that provide income guarantees in contracts that have unit-linked investments. An issue exists where the value of the assets fall and subsequently reduces the maximum income levels that are permitted under legislation. HM Revenue & Customs have advised that the provider of the income guarantee can add 'notional units' to the fund value to ensure that the guaranteed income level is not greater than the maximum income level. These notional units can only be used for this purpose. Instead of providing advice on an individual provider basis, we would welcome HM Revenue & Customs confirmation of this approach as acceptable publically in their guidance notes.

We would like to see the Open Market Option extended to include other forms of pension income products. Currently, you can only use an Open Market Option to move your crystallising fund to an annuity. By extending this to other products, such as capped drawdown, it would level the planning field and offer consumers more options.

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

Any measure that is introduced that improves transparency and help individuals make the right choices is desirable.

One of the main criticisms of the annuity market by individuals is that the choice over the annuity purchase is final. Research that we have recently undertaken tells us that individuals struggle to think over the long term in their retirement. The finite decision of an annuity purchase is too much for many. Legislation currently permits a transfer from one annuity provider to another. Unfortunately, this legislation is not well known and hardly any annuity provider permits transfer once an annuity has been purchased. By making this option more widely known and encouraging annuity providers to adopt this option it will give people more comfort over their choices and the facility to change their decisions in the future. This will assist individuals in making more appropriate choices.

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

We have no comments to make in response to this question.

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

ACCA welcomes the opportunity to respond to HM Treasury's consultation paper on the future of annuities. This response has been compiled with the input of ACCA's Pensions Committee, which comprises senior members of ACCA with long experience of pensions matters from the perspectives of employer, trustee, auditor and financial advisor.

ACCA strongly supports the Government's decision to end the obligation for individuals to convert their defined contribution (DC) pension fund into an annuity by the age of 75. We have long considered that the blanket requirement on this issue is unfair on pensioners, primarily since it makes them and their future retirement income dependant on the annuity rates which are available at the time of annuitisation. To impose a deadline by when they have no choice but to annuitise unreasonably restricts their financial choices and condemns many to a poor rate of return. A further significant drawback with the current requirement is the loss to the annuitant's estate, on death, of the residual value of his fund.

We accept that annuities do have and will continue to have the compelling virtue of providing a guaranteed income for life, and agree that there will remain a prominent place for them in the framework of UK retirement provision. But the introduction of more flexibility into the rules relating to DC pensions will provide the opportunity, for those individuals who wish to exercise it, to exercise more control over how their pension savings are used, both during their retirement and after their death.

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This initiative by the Government is especially welcome and logical given the light of the seemingly definitive swing away from defined benefit schemes to DC schemes.

Q1 The level of an appropriate annual drawdown limit for capped drawdown

The appropriate level will need to take into account the possibility, under the new arrangements, that individuals will retain their capped drawdown plans for the rest of their lives. It will also need to take into account the additional freedom to be afforded to those with larger funds who can demonstrate additional regular sources of income.

In then light of these factors, we consider there is an argument for setting the drawdown cap at a lower level than that which currently applies to USPs; we suggest 100% of the value of an equivalent annuity.

Q2 The Government's intended approach to reforming the pensions tax framework

As stated above, we fully support the policy decision to remove the requirement to annuitise by the age of 75. We also endorse the rationale of continuing with the EET approach, whereby the recovery of tax on pensions is deferred until after retirement.

We believe that the new arrangements offer a very significant benefit to savers in that they will have greater freedom to bequeath the residual value of their funds to their dependants. The opportunity they will have under the proposals is to use their residual funds to provide a pension for those dependants. We see this as a significant opportunity to encourage pension saving and to make it attractive both to the current generation of savers and the next. Savers should be able to bequeath their residual funds to their surviving spouse, who should in turn be able to pass those funds on to their children.

The taxation of residual funds which are not bequeathed will be less attractive to savers since it is proposed to levy a tax recovery charge of around 55%. This would represent a significant increase on the current recovery charge, although it would act as an additional incentive to bequest funds.

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Q3 What income should be considered 'secure' for the purposes of the MIR?

We agree that income from state pensions and inflation-linked occupational pension schemes can be regarded as 'secure' income for the purposes of the proposed MIR.

We consider that there is an argument for recognising, additionally, additional sources of wealth. Given the rises in property values in recent years, many pensioners will be in the position of having substantial amounts of equity in their property, yet may be in receipt of only modest levels of state or occupational income, and thus will not qualify for the additional flexibility discussed in the paper. We suggest therefore that consideration be given to recognising equity values in respect of one off excesses of the standard drawdown cap. This could be made conditional on the pensioner demonstrating his need for funds in relation to, for example, urgent medical treatment.

Q4 The appropriate level for the MIR

Setting a uniform figure for the MIR is problematical since different people will have different needs and differing entitlements to state support. It would be unfair not to recognise, for example, the special needs of disabled people. The alternative, though, to assess the MIR on an individual basis is likely to be unworkable. Therefore, an approximation of the spending needs of an individual or couple needs to be made which enables higher needs to be factored in.

Providing for an age-related differential would be in keeping with the data on patterns of retirement expenditure and with the principle of flexibility. Any such calibrated approach will need to take into account, though, that people will retire at different ages and many individuals will already be drawing their pension while continuing to work under 'flexible retirement' arrangements.

Additional comments

Under paragraph 1.4, the paper suggests that the Consumer Financial Education Body will be directed to provide a national financial advice service which will also offer individuals and families an annual financial health check. There is nothing wrong with providing as wide a range of information as possible on investment

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choices. But the point needs to be made that there is no substitute for financial advice provided by a qualified and regulated adviser who is in full possession of the client's circumstances.

One additional point which suggests itself, following the removal of the age-related requirement on annuities, and also the Government's current consultation on the default retirement age, concerns the restriction on tax relief on pension contributions once an individual has reached the age of 75. If there is to be no upper age limit on employment, and indeed if it is Government policy to encourage individuals to remain in the workforce for as long as they are able to (and to defer the drawing of their pensions), there would seem to be no convincing reason why older workers should be prevented from continuing to make pension contributions on the same basis as their younger colleagues.

I hope these comments will be of help.

Yours faithfully

J P Davies
Head of Business Law

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tax incentivised savings association

TISA RESPONSE TO HM TREASURY CONSULTATION PAPER

REMOVING THE REQUIREMENT TO ANNUITISE BY AGE 75

September 2010

The Tax Incentivised Savings Association – TISA - (until July 2007, the PEP and ISA Manager's Association, PIMA) has a growing membership of over 110 organisations interested in the UK market for retail financial services products, from Child Trust Funds, through Individual Savings Accounts to Pensions. We have an Advisory Council in Retirement Saving whose observations and thinking have contributed to this response. We are distinguished by the very wide scope of our membership, from banks, though investment houses and life and pension providers, to distribution organisations and IFAs. We are not, therefore, restricted to representing a sector approach, but rather the views of a very broad church indeed. We also, as an organisation, start from the principle that what is good for the consumer must, in the long term, be good for the business of our membership.

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 think that we need to work towards 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 we 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 jurisidictions 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 rather mystified as 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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9 September 2010

Age 75 Consultation
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Dear Sir or Madam

Removing the requirement to annuitise by age 75

Towers Watson is a leading global professional services company with 14,000 associates around the world. In the UK we have particular strength in the area of pensions and we advise over half of the 100 largest corporate pension schemes.

We welcome the proposals to remove the effective requirement to annuitise by age 75 and the increased flexibility afforded by the new rules for defined contribution arrangements. We believe that the proposed changes could bring about increased choice and flexibility for both individuals and pension providers. However, we have some concerns as to the timescale for introducing such changes.

Our answers to the specific questions asked are set out below.

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

We believe that the current annual limit of 120% of the basis amount is appropriate under the new regime, for withdrawals made before and after age 75. However, it might be appropriate to make some changes to the way this is calculated.

Currently the GAD rate used to calculate the maximum limit is determined by reference to the yield on 15 year gilts, which is currently only 3.5 per cent. We suggest that this is reviewed, for example the new capped drawdown rate could be linked to the return on a different index, such as corporate bonds.

We suggest that for individuals aged 75 or over, the maximum level of income withdrawn should be reviewed triennially. This is less frequent than currently applies to alternatively secured pensions (ASP). The maximum level of income for those aged under 75 should continue to be reviewed every five years, as at present.

A.2 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

It is unclear whether flexible drawdown will only be available within a capped drawdown arrangement. There are many occupational defined contribution (DC) arrangements that do not wish to provide income drawdown to members, as the cost of doing so is prohibitive. Under the new regime schemes are likely to want to offer members the facility to drawdown a taxed lump sum in certain circumstances, but not to draw down an income stream. For example, an individual retires with a defined benefit (DB) pension and, after taking his tax-free cash from his AVC/DC funds, there is only, say, £10,000 left to purchase an annuity. It could be quite attractive to the member for the balance of the fund to be paid out as taxed capital sum from the scheme, rather than the individual having to proceed with a transfer of the AVC fund to an external pension provider before being able to access the capital sum. Furthermore, external providers are unlikely to be enthusiastic about receiving transfers for relatively small funds, which would then be paid out as a taxed capital sum shortly afterwards. If these transfers were accepted, then the external provider could well impose a minimum investment term and/or impose high charges on the transaction, which would limit the availability of this option to all but the wealthiest.

We would urge the Government to consider extending the option of withdrawing taxed capital lump sums to defined benefit arrangements. At present, members have to transfer their DB benefits to a DC provider, if they want to designate funds for income drawdown. However, members who have reached their normal pension age (NPA) might not be able to transfer their benefits, as they no longer have a statutory right to a transfer value. Furthermore, if the abolition of contracting out on a DC basis results in the prohibition of transfers from contracted out DB schemes to DC schemes, this will reduce the choices available to individuals. We appreciate that a change to the legislation to permit lump sums greater than 25 per cent to be taken from a DB scheme is a much more complex issue and would require substantial changes to both HMRC and DWP legislation. However, we believe that it should be achievable to introduce such a change from April 2012.

We welcome the abolition of the age 75 requirement for payment of pension commencement lump sums (PCLS), trivial commutation lump sums and pension protection lump sums.

In relation to undrawn funds on death under an income drawdown arrangement, it is not clear how the Government has arrived at a recovery charge of about 55 per cent. The current special lump sum death benefits tax charge on unsecured funds is 35 per cent, which was considered adequate to recover past tax relief when it was introduced. Apart from the introduction of a 50 per cent tax charge for higher earners, tax rates are no higher now. However, we appreciate that to set a tax charge lower than the current inheritance tax charge (40 per cent) would encourage individuals to retain funds to pass on to their beneficiaries. Therefore, we suggest that a tax charge of 35 per cent should continue to apply to undrawn funds designated for income drawdown on death before age 75. A higher tax charge should apply on death on or after age 75, for example 55 per cent.

The consultation states that Inheritance tax (IHT) will not ordinarily apply to unused pension funds remaining after death in addition to the recovery charge[1]. However, it is not entirely clear what this means.

At present, IHT does not normally apply in respect of pension scheme benefits in most circumstances where the member dies aged under 75. After someone reaches age 75, any remaining funds under an alternatively secured pension fund will be subject to a specific IHT charge, in addition to an authorised payment charge. We urge the Government to make it clear whether the intention is that the specific IHT charge that currently applies to ASP is to be removed (although the payment might still be subject to IHT under the general IHT rules), or that IHT will never apply if the recovery charge is paid. If it is the former, the Revenue will still have power to intervene on the basis that an individual failed to exercise his/her option to take benefits, if such benefits remain undrawn under income drawdown after age 75 (e.g. Fryer V HMRC). It would be helpful if the Government could publish guidance on when IHT might apply, as it did when income drawdown was first introduced.

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

We urge the Government to ensure that the definition of secure income is as straightforward as possible, so that individuals and schemes/providers can clearly identify the pensions/annuities that can be included for the purpose of the MIR. We suggest that secure income should include any pension or annuity in payment that includes provision for it to be paid at the same or increased level, for life. Level annuities are

[1] Removing the requirement to annuitise by age 75, page 12

very popular with individuals due to the high cost of purchasing an increasing annuity, and to exclude them would reduce the extent to which the new flexibility will be used. We believe the provisions to enable individuals who have already purchased, or are receiving, a level pension or annuity to benefit from the new rules should apply equally to those who purchase or receive such pensions after the new rules are introduced.

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

If the Government's aim is to re-invigorate private pension provision[2], then the MIR should be set at a reasonably low level. We appreciate the Government's concern that individuals should not be able to exhaust their pension savings to the extent that they might need to call upon means-tested State benefits, but it is important that the bar is not set unnecessarily high simply to provide complete and absolute certainty on this point. We agree that younger individuals are likely to have higher living expenses, for examples mortgages or other loans. Therefore, we suggest that the 'standard' MIR should be set by reference to a fixed age, and adjustments made if an individual wishes to draw benefits before or after that age. For example, if the level of the MIR was set at, say, £12,000 per annum at age 65, if someone wished to drawdown benefits at an earlier age, the MIR could be increased by a set factor according to the number of years before 65 that they draw benefits. This would be easy to administer and understand.

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

For the sake of simplicity, we suggest that the same MIR applies to individuals and couples. We acknowledge that this might result in a higher MIR than would otherwise be the case for a single person living alone with no dependents. However, if a different MIR applied for individuals and couples, there would inevitably be difficulties in defining a couple, for example, would this include married couples (or those in civil partnerships) only, or couples who are co-habiting.

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

We suggest that the level of the MIR should be reviewed periodically, say every 5 years, at which time an assessment can be made as to how well the MIR is operating.

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

The MIR certification process should ideally be a one off event, at the time that an individual first wishes to drawdown funds in excess of the 'cap'. If an individual wishes to take their benefits in tranches, for example drawdown funds annually over a period of five years, it seems an unnecessary administrative burden for the individual and provider to ascertain that he or she has sufficient secure income to meet the MIR each time that benefits are drawn. Furthermore, if a lower MIR applies at higher ages, if an individual has sufficient secure income to meet the MIR at, say 59 it seems unlikely that he or she will not have sufficient secure income to meet it at a later age, say 70. In this example, given that all of the member's undrawn fund could have been drawn at age 59, a further test seems unnecessary.

If schemes are to be responsible for satisfying the requirement that an individual has sufficient secure income to meet the MIR, we urge the Government to clearly state what evidence individuals must provide. If it is found that the individual did not have sufficient secure income, it is likely that the drawdown provider would have to seek legal advice if they wished to rely on the defence that they "acted in good faith", thus incurring unnecessary costs. Whilst insurance companies providing income drawdown products can easily charge for any additional administrative work incurred in offering flexible drawdown, this is not likely to be the case for occupational schemes, which might be prohibited from scheme rules from charging individuals. This is also likely to deter schemes and providers from offering flexible drawdown.

It would be helpful to have a standard form that schemes providing the secure income could use to provide individuals with the necessary evidence required. The individual could then pass this on to any drawdown provider or scheme from which he or she wishes to access funds above the 'cap'.

[2]Removing the requirement to annuitise by age 75, page 7

Your faithfully

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Consultant

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By email

13 September 2010

Dear Sirs

Removing the requirement to annuitise by age 75: consultation response

Travers Smith LLP is a firm of solicitors in the City of London with a specialist Pensions department. We act for trustees and employers of a wide range of occupational pension schemes. They include schemes sponsored by a wide variety of private sector employers, as well as local authorities, regulatory and professional bodies and not-for-profit organisations. These include some schemes with more than 100,000 members.

We have no comments to make on the policy issues involved in the proposal to remove the requirement to secure a pension by age 75. Our concern is to ensure that all references to age 75 in pensions legislation (including some DWP legislation as well as HM Treasury/Revenue & Customs legislation) are given consideration.

We have prepared the enclosed chart for our own internal purposes and we thought it might be helpful to share this with you. The chart seeks to identify all references to age 75 in pensions legislation (though we give no assurance that it is complete). It then outlines what we think the proposals in your consultation paper mean for each such reference. In some cases, this is clear because the point is addressed specifically. In other cases, we have formed a view as to what is probably intended or we have stated that we cannot tell what might happen. This column (headed "Consultation proposal") should not be taken as indicating what we think should happen: it merely says what we think is being proposed.

We hope that you will find this useful.

Yours faithfully

Travers Smith

Travers Smith LLP

Age 75 references in pensions legislation

Legislation	Provision	To do with…	Consultation proposal	Notes
Finance Act 2004	S165(1)	Unsecured pensions and alternatively secured pensions	Alternatively secured pensions no longer available; unsecured pension provisions to be amended	
	S167(1)	Unsecured pensions and alternatively secured pensions	Alternatively secured pensions no longer available; unsecured pension provisions to be amended	
	S188(3)	Tax relief on contributions	No tax relief beyond age 75: restriction to be retained	
	s216(1)	Benefit crystallisation events (BCEs) 5 and 5A	Age 75 BCE to be retained	
	Schedule 28, paras 6, 7, 8, 9, 11, 20, 21, 23, 25	Unsecured pensions and alternatively secured pensions	Alternatively secured pensions no longer available; unsecured pension provisions to be amended	
	Schedule 28, para 16A	Death after reaching age 75 (excessive dependants' pensions)	Consultation indicates that pensions to dependants will be authorised if they start after age 75. But this provision is to do with excessive dependants' pensions so the age 75 threshold may be retained	
	Schedule 29, para 1	Pension commencement	Age 75 restriction to be	

		lump sum (PCLS)	removed	
	Schedule 29, para 4	Serious ill-health lump sum	Not mentioned	
	Schedule 29, para 5	Short service refund lump sum	Age 75 restriction to be retained	
	Schedule 29, para 7	Trivial commutation lump sum	Age 75 restriction to be removed	
	Schedule 29, para 7A (transitional)	Trivial commutation lump sum (TCLS)	Not mentioned specifically but restriction seems likely to be removed (i.e. as for standard TCLS)	
	Schedule 29, para 10	Winding-up lump sum	Age 75 restriction to be removed	
	Schedule 29, para 11	Lifetime allowance excess lump sum	Age 75 restriction to be retained	
	Schedule 29, para 13	Defined benefits lump sum death benefit	Indicated that lump sum death benefits will continue to be tax free (subject to the lifetime allowance) but only on death before age 75. So restriction seems likely to be retained	
	Schedule 29, paras 14, 16	Pension protection lump sum death benefit Annuity protection lump sum death benefit	Age 75 restriction to be removed Age 75 restriction to be removed	
	Schedule 29, para 15	Uncrystallised funds lump	Indicated that lump sum	

		sum death benefit	death benefits will continue to be tax free (subject to the lifetime allowance) but only on death before age 75. So restriction likely to be retained	
	Schedule 29, para 17	Unsecured pension lump sum death benefit	Unsecured pension provisions to be amended	
	Schedule 29, para 18	Charity lump sum death benefit	Not mentioned	
	Schedule 29, para 20	Trivial commutation lump sum death benefit	Age 75 restriction to be removed	
	Schedule 29, para 21A (transitional)	Life cover lump sums	Indicated that lump sum death benefits will continue to be tax free (subject to the lifetime allowance) but only on death before age 75. So restriction likely to be retained	
	Schedule 32, paras 2, 5, 14	Benefit crystallisation events (BCEs)	Age 75 BCE to be retained	
	Schedule 36, para 36	Pension protection lump sum death benefit Annuity protection lump sum death benefit Unsecured pension fund lump sum death benefit	Age 75 restriction to be removed Age 75 restriction to be removed Unsecured pension provisions to be amended	

Pension Schemes Act 1993	S28A(3)	Interim arrangements (alternatively secured pensions and unsecured pensions)	Alternatively secured pensions no longer available; unsecured pension provisions to be amended	DWP legislation
RPS (Authorised Payments) Regs 2009	Regs 9, 11, 12	Commutation payments for members who have *de minimis* pensions	Age 75 restrictions to be removed	
	Reg 16	Payments of arrears of pension after death	Not mentioned (but seems logical that restriction will be removed)	
Taxation of Pension Schemes (Transitional Provisions) Order 2006	Art 25A	Stand-alone lump sums	Not mentioned specifically but age 75 restriction seems likely to be removed (i.e. as for PCLSs)	
	Arts 29, 30, 31, 32	Unsecured pensions and alternatively secured pensions	Alternatively secured pensions no longer available; unsecured pension provisions to be amended	
RPS (Provision of Information) Regs 2006	Reg 3, para 17	Lump sum payment after the death of a member aged 75 or over	Indicated that lump sum death benefits will continue to be tax free (subject to the lifetime allowance) but only if death is before age 75. So requirement to report likely to be retained	
RPS (Relevant Annuities) Regs 2006	Reg 3	Annual amount of a relevant annuity	Not mentioned but seemingly no longer any need to assume a member over age 75 is age 75	

PPF (Compensation) Regs 2005	Reg 19	Commutation of PPF compensation	Like a PCLS, so age 75 restriction seems likely to be removed	DWP legislation
OPS (Discharge of Liability) Regs 1997	Reg 11	Condition for discharging liability to provide benefits	Not mentioned but age 75 restriction seems likely to be removed	DWP legislation
PPS (Disclosure of Information) Regs 1987	Reg 5(4)	Pre-retirement information to be given to personal pension members about protected rights	Not clear. Protected rights to be abolished in April 2012 anyway	DWP legislation

Travers Smith LLP
(NDW)
September 2010

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10 August 2010

Dear Sirs

I have read with interest your consultation document "Removing the Requirement to Annuitise by Age 75".

Our IFA practice deals almost exclusively with converting pension funds into pension income streams.

As individuals build up capital through a variety of methods and assets as well as pensions, I believe that the proposal that the Minimum Income Requirement (MIR) be based solely on pension sources is neither fair nor reasonable. The income from a LPI protected purchased life annuity should be allowed to count towards the MIR.

This product is suitable for inclusion towards the MIR because:

1. It is similar to a pension life annuity by covering the whole of an individual's life
2. It is easy to understand
3. The tax treatment of PLAs is well established
4. It is not subject to abuse by the individual.
5. It can be easily verified
6. it can be taken out in either single or joint life depending whether the MIR will be available to individuals or couples.

Yours faithfully

Ian Clarkson

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Independent Financial Adviser

10 September 2010 – UNISON Response to HM Treasury Consultation on removing the requirement to annuitise by age 75

UNISON represents well in excess of a million people working across our public services throughout the UK in local government, the NHS, education, social care, housing, policing, transport, utilities, community and environmental services. They carry out many different roles in a diverse range of settings, within policy frameworks determined by their particular employer, relevant local and regional bodies, and central Government. They are also united by a common aim. It's their job, every day, to work for the public good – tackling disadvantage, extending opportunity, building stronger communities and improving everyone's quality of life.

Although in the main our members have access to and are in defined benefit pension schemes there exist a significant number that are in defined contribution pension schemes with this number likely to grow in time. This means that many of our members will face the annuitisation issue come their retirement.

These consultation proposals seem to be principally aimed at benefitting the financially privileged few rather than solving the real problems of defined contribution pension provision

- It is UNISON's view that any increased flexibility for people approaching retirement is welcome and if it helps them to pass savings on to their dependants after their death rather than an annuity company it may well be that this will encourage greater levels of saving, especially if combined with other thoughts around early access to funds where needed.
- Overall, however, the impact will be modest and only likely to benefit those with relatively large funds. The vast majority of people will still need to access income as soon as they finish working and so the option of deferring their annuity will simply not be viable.
- It is commonly reported that the average retirement fund in the UK is less than £30,000 and yet general advice is that Unsecured Pension Arrangements (USP's) should not be considered for individuals with pension pots of less than £100,000. Furthermore, with the Government seemingly proposing a Minimum Income Requirement of £300,000 for Flexible Drawdown it would appear very much that these proposals are only really an issue for the top few per cent of the richest

pensioners who do not need to worry about whether their pension pot will run out before they die.

- UNISON believes there are far greater issues with defined contribution pension provision and annuities and that the Government is sending out a clear message in failing to deal with these that it's more concerned with dealing with issues that favour the relatively financially privileged few at the expense of the mainstream majority whom face a greater probability of relative poverty in retirement.

Apparent survivor benefit tax inequality

- The consultation paper proposes that USP's should continue beyond age 75 but redesigned as "capped drawdown" with any residual fund on death being available as a lump-sum death benefit payable to dependants after the deduction of a recovery charge to reflect the income tax relief previously given.
- Under current rules this charge is 35% before age 75 and it is proposed that it would go up to "around' 55% under the new rules. There would be no inheritance tax to pay on this lump sum although it has been made clear that the new rules must not provide incentives to encourage pensions to be used as inheritance tax planning vehicles. The recovery charge will reflect this and the position will be reviewed if it is perceived that pensions are being used for this purpose.
- UNISON considers it unfair that the dependants of those who received tax relief at 20% on their pension contributions may suffer a recovery charge at a rate of 55% and we believe this to be disproportionately unfair for lower to moderate income earners and would welcome this anomaly being reviewed.
- Despite the fact that we believe your proposals to essentially apply to the financially privileged few it's our view that in the future there will be relatively low paid workers in defined contribution pension schemes whom will have little choice other than to work for longer in a desperate bid to try to build up meaningful pensions. We believe your proposal to potentially apply a 55% tax charge to any residual fund on death post age 75 is inherently and disproportionately unfair for low to moderate income earners.

A missed opportunity for better protecting intergenerational pension saving

- We feel this consultation paper misses a potential opportunity in failing to consider the possibility of allowing both crystallised and uncrystallised residual pension funds on death to be transferred into the pension plans of beneficiaries without any tax charge being applied, whom in turn would have their own pension plans kick-started. Cascading pensions down the generations in this way could reduce the need for future generations to make their own pension saving or at least supplement existing provision and could help to reduce potential burdens on the State.

Conclusion

UNISON, although broadly supportive of the principle of making existing annuity terms more flexible, essentially believes that the proposals outlined in the consultation document will only benefit a very small elite band of high earning pension savers and that the main pitfalls of defined contribution pension provision, are yet again, being overlooked. Furthermore, UNISON calls for better tax equality in respect of the tax charges applied to residual funds on death and would like consideration to be given to better protecting and promoting intergenerational pension saving through allowing residual funds on death to be simply transferred into an appropriate pensions vehicle for dependants without a tax charge being applied.

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10 September 2010

Dear Sirs,

Response to Consultation Paper on "Removing the requirement to annuitise by age 75"

Please find enclosed a response to HM Treasury Consultation Paper on "Removing the requirement to annuitise by age 75" from the Pensions Institute (CASS Business School), University of Bristol and University of Bath.

The Pensions Institute (www.pensions-institute.org) based at CASS Business School, undertakes high quality research in all fields related to pensions, and communicate the results of that research to the academic and practitioner community. It has established an international network of pensions researchers from a variety of disciplines, providing expert independent advice to the pensions industry and government.

We attach two reports produced by the Pensions Institute:

The first of these reports 'Ending compulsory annuitisation: What are the consequences?' published in July 2010 was widely circulated and designed to stimulate the debate about the proposal to end the mandatory requirement to purchase annuities in pension schemes as formally announced in the Budget Statement on 22 June 2010 and subsequently expanded upon in the HM Treasury consultation document 'Removing the requirement to annuitise by age 75' released on 15 July 2010.

The second report 'Ending compulsory annuitisation: Quantifying the consequences?' is intended to provide a quantitative assessment of the issues raised in the first report. We also provide policy recommendations in relation to this proposal.

In section 9 of this second report we provide answers to the questions posed in the consultation.

We are sending these documents by e-mail: please could you confirm receipt?

Yours faithfully,

David Blake (CASS Business School),
Edmund Cannon (University of Bristol),
Ian Tonks (University of Bath)

ASSOCIATION OF PENSION LAWYERS

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Date 8 September 2010 Our Ref KSW Your Ref

Dear Sirs

Age 75 Consultation

On behalf of the Investment Committee of the Association of Pension Lawyers, I write in response to the Consultation Paper relating to removing the requirement to annuitise by age 75.

We welcome the proposed flexibility and believe it will encourage the development of products in the retirement market. However, it is important that the new regime is not overly complex as otherwise it will end up being only accessible by those who can afford complex financial advice.

We have the following specific points in relation to the matters covered in the consultation document.

1. In relation to the drawdown limits, it is not for the APL to suggest amounts. However, we would suggest allowing some variation in the limits. For example a higher limit could be permitted in one year out of every five, or unused amounts in one year could be carried forward. This would allow some of the advantages of flexible drawdown without the need to annuitise a minimum income.

2. We note the suggestion to remove the need to take a pension commencement lump sum before age 75. It is not clear from the consultation paper whether this change is to apply to all arrangements or just money purchase arrangements. We see no reason for a difference in treatment between defined benefit schemes and money purchase schemes.

3. The consultation paper does not mention whether the age 75 limit is to be retained for serious ill-health lump sums. We believe that such an age limit should be retained, otherwise members would be able to defer crystallising their benefits until they were sufficiently near the end of their life to claim a serious ill health lump sum.

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APL WEBSITE: www.apl.org.uk

(23088612.01)

4. In relation to the minimum income requirement, we had the following comments.

(a) We are not sure why a secure income needs to be in payment. A deferred annuity or deferred right under a defined benefit scheme, where the member has the ability to bring the benefit into payment, is as secure as a right which is in payment and would typically increase in amount during a period of deferral.

(b) We are not clear why it is necessary for the secure income to include LPI increases. We note that the Government intends to permit existing annuities which do not include LPI increases to count as secure income. However, we do not think this would go far enough. A significant number of members of defined benefit pension schemes have rights from service before 6 April 1997 which do not have any entitlement to annual increases. Under the proposal, when those benefits come into payment they would not qualify as secure income no matter how large the pension. In addition, compensation under the Pension Protection Fund would not qualify as secure income as it provides lower levels of indexation than the proposed LPI. We suggest that the proposals should be adjusted to allow non-increasing pension rights to count as secure income – perhaps with a higher income amount required from such rights.

(c) We suggest that care is needed to ensure that the requirement for the income to be guaranteed does not place unnecessary restrictions on innovation in the retirement market. The past few years have seen the development of products which include a minimum income guarantee backed by a regulated insurance company. Whilst some such arrangements are technically income withdrawal, the income guarantee gives equivalent security to an annuity. Such products should therefore count towards the minimum income requirements for flexible drawdown.

Should you have any questions on these comments, or wish to have the APL's input on any draft legislation in relation to these proposals, please let us know. Please contact Keith Webster on 0207 367 2387 or keith.webster@cms-cmck.com.

Yours faithfully

Keith Webster

The APL is a not-for-profit organisation whose members comprise over 1,100 UK lawyers, including most of the leading practitioners in the field, who specialise in providing legal advice on pensions to sponsors and trustees of pension funds and others, including the largest pension funds in the UK. Its purposes include promoting awareness of the importance of the role of law in the provision of pensions and to make representations to governments and other organisations on matters of relevance to APL members.

Dorothy Wheeler
Pensions Advisory & Support Services

RESPONSE TO CONSULTATION REGARDING THE REMOVAL OF THE AGE 75 RULE

I have read the consultation document with interest and, overall, welcome the proposed changes. However I do have the following observations/comments to make:

Chapter 2 - age 75

2.12 & 2.14

These are welcome proposals.

Most of my clients are entrepreneurs, having built up their businesses over the years. They have made provision for retirement through small self administered pension schemes (SSASs) and many have invested wisely and well. They have welcomed the relaxations in the annuity purchase requirements over the years and some are now drawing incomes direct from their schemes either via unsecured or alternatively secured pensions (USPs and ASPs).

2.17

The ability to draw 120% of an equivalent annuity has always seemed crazy to me although many of my clients in USP are taking the maximum since they wish to deplete their funds as much as possible in view of the iniquitous tax charges currently in place on death after 75.

I would suggest a limit of 100% would be more appropriate.

2.22

Currently any funds remaining in a pension arrangement on death after 75 can be re-allocated to other members less a tax charge of approximately 82%.

I suggest that re-allocation is still an option albeit that you will wish to recoup some tax. Re-allocation will have the effect of enhancing the recipient's pension fund and thus helping to ensure that he is able to achieve the Minimum Income Guarantee.

Chapter 3 - minimum income guarantee

3.7

I welcome the proposal that there should be total flexibility but also fully support the idea that there should be a minimum income requirement so that there is no possibility of an individual exhausting his savings and then falling back upon the State for support.

You have stated that only pension income should be taken into account for this purpose. I would ask you to consider income from other investments. A number of people save for retirement by investing in a range of things such as property. They also draw income from investments such as bonds. At the moment the value of other assets counts when looking at eligibility for Pensions Credits etc.

All of my clients have saved or are saving for retirement in a number of ways. They have a range of investments including their main residences. Account needs to be taken of this fact when assessing whether they satisfy the Minimum Income Guarantee.

Certainly annuities should also qualify as guaranteed income.

3.20

At the moment members of registered schemes have to produce evidence of transitional protection against the A Day changes if they wish to be exempt from some of the taxation consequences of having funds in excess of the Standard Lifetime Allowance. I would have thought that something similar could be devised for the Assessment process.

Chapter 4- the annuity market

4.8

I am unable to comment on this issue being an adviser and not an insurer.

4.12

Any existing adviser worth his salt already advises clients about their options and would be able to advise on any changes as they have in the past. There could be a minimum qualification requirement as proposed in the FSA's RDR.

4.13

I am unable to comment on this issue being an adviser and not an insurer.

Comments regarding the Government's other proposals

You have proposed that the Annual Allowance should be reduced substantially. This will affect, in particular, those entrepreneurs who have always contributed to their pension arrangements as and when they could afford to do so. Many have not paid any contributions for themselves in the lean trading years whilst continuing to contribute for their employees. Your proposal will substantially affect their ongoing ability to ensure that they build up adequate retirement savings.

I understand that you are also proposing to reduce the Standard Lifetime Allowance. There has, until recently, been a tradition in the UK that legislation is never retrospective. A reduction would destroy confidence in the whole system.

Dorothy Wheeler
BA FCII FPFS – Chartered Financial Planner **8th September 2010**

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Consultation response

Age 75 consultation
Pensions and Pensioners Team
Room 2 / SE
HM Treasury, 1 Horse Guards Road
London, SW1A 2HQ
DATE: 7 September 2010
RESPONSE BY: Which?

Which? welcomes the removal of the requirement to annuitise by 75. The age 75 rule was first introduced over 30 years ago and before these proposals there had been no increase the age limit. We believe that the rule is outdated and have argued consistently that consumers need greater flexibility. This is especially the case following increases in longevity. There has been an increase in the average male life expectancy of over 3 years since 1988. 77% of men and 85% of women aged 65 now are expected to live to 75 or later.[1]

We view it as an important principle that government policy should not force people down a single path when it comes to choices regarding their retirement income. However, a minimum level of secure income should be necessary to avoid an individual becoming a burden on the State. Tax relief has been provided to encourage people to save and this should only be clawed back on death.

Consumers continue to be hit by falling annuity rates with the average annuity rate declining by 7% in the first seven months of this year. At Which?, we want the emphasis to be on greater flexibility, but it will also be important to demonstrate that this will lead to better outcomes for those who exercise it and will have a positive effect on those who still take out annuities.

We acknowledge that annuities will continue to remain the right choice for many consumers. The costs of income drawdown combined with the risk of running out of money mean that it will not be suitable for most consumers. The majority of DC pension pots are below £100,000 – a level at which income drawdown is not normally suitable. Therefore, alongside these proposals there must be a comprehensive strategy to improve the operation of the Open Market Option (OMO) and to deal with the possible consumer detriment which may arise from consumers exercising income withdrawal for longer periods of time.

[1] Office for National Statistics, Interim Life Tables, 1980-82 to 2004-06

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An increase in pension provision following the proposed pension reforms combined with further increases in longevity and a growing trend of working beyond retirement age should increase the number of consumers able to take advantage of the increased flexibility in the longer term.

Which? are jointly[2] funding research being conducted by the Pensions Policy Institute into many of the issues being considered in this consultation. This research will be published in early 2011.

Developing a new tax framework for retirement (Chapter 2)

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

This issue will be examined in the research being conducted by the Pensions Policy Institute, sponsored by Which? and a consortium of consumer/industry groups.

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 support the principle that on death, pension saving that have been accumulated with tax relief should be taxed at an appropriate rate. We also support the principle of ensuring that the tax charge which applies does not allow people to avoid inheritance tax liabilities.

The potential impact on government tax revenue and expenditure of the various options presented and the impact of different tax charges on death will be examined by the research conducted by the Pensions Policy Institute.

It is important that the increased flexibility maintains the essential purpose of pension saving as a means to provide an income in retirement. In 2006 the Irish Government found that of the 6,200 individuals who had taken advantage of the additional flexibility by establishing an Approved Retirement Fund (ARF) only 638[3] (10.3%) were using them to provide an income. The remaining 89.7% were simply accumulating tax-free gains on their funds. The Irish Government concluded that:

[2] With a consortium including the ABI, IMA, DWP, Partnership and Prudential

[3] 6% were being used to provide a regular income with irregular, ad-hoc withdrawals being used by a further 5%

> “The intention of the ARF legislation was to develop an alternative flexible income stream in retirement which would obviate the necessity for annuity purchase. Based on the evidence available (and in the absence of details on each individual ARF fund and the particular circumstances of each beneficial owner) it appears that this is not happening. Rather it could be said that ARFs have allowed the diversion of retirement provision into simple tax-advantaged savings schemes for those who do not need them to produce a regular income stream.”[4]

Therefore the scheme would need to promote the purpose of income enhancement, not permanent capital accumulation.

We support the proposal to remove the age 75 limit on value protection lump sums, pension commencement lump sums and trivial commutation lump sum. Alongside this, we support a wider review of the trivial commutation limits and the rules applicable to individual pension schemes. We note that in line with the freeze in the lifetime allowance the level of trivial commutation will also be frozen. This reduces the number of people able to take advantage of the flexibility of trivial commutation.

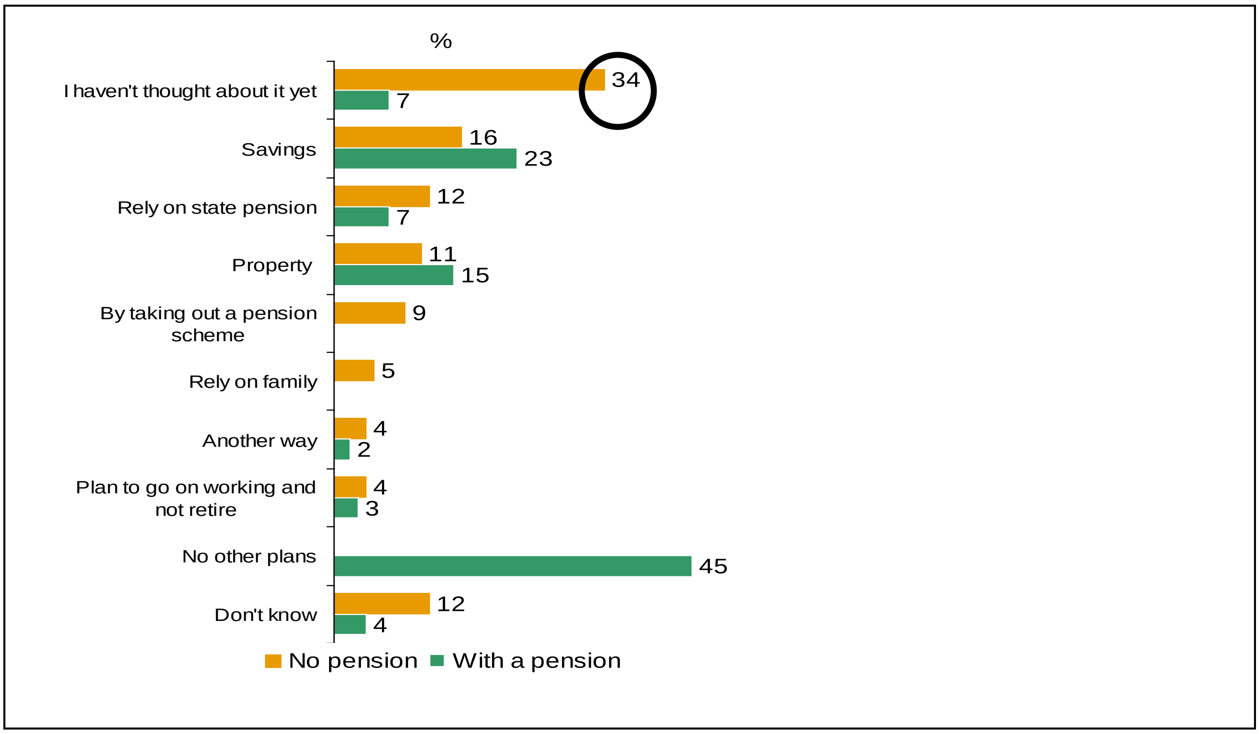
Minimum Income Requirement (Chapter 3)

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.

Our research has found that some consumers have a variety of plans to finance their retirement including savings income and property. Limiting the income considered ‘secure’ to pension income may significantly reduce the number of people able to take advantage of the additional flexibility. One possible option would be to require the deposit of a certain fixed amount of capital in a linked fund in order to be able to take advantage of the additional flexibility. Whilst this would not have to be immediately converted into a secure income it would ensure that this amount would be converted into a secure income at some point in the future. However, this would add to complexity.

[4] Department of Finance, Budget 2006, Volume III: Internal Review of certain tax schemes, page G.22, http://www.finance.gov.ie/documents/publications/other/revtaxreliefsvol3.pdf

Chart 1: Other plans (apart from pensions) for financing their retirement



Source: Which? Pensions research July 2010 *Q.3 Apart from your pension, do you have any other plans to finance your retirement? / Q5 And how, if at all, do you plan to finance your retirement? BASE – all adults UK currently working or seeking work (555)*

We note that 87-89% of annuities currently bought are level annuities and that the pensions industry does not typically offer annuities which increase by the minimum of CPI or 2.5%. Index-linked and escalating annuities as a whole still account for a small percentage (6-7%) of the market.[5] The Government will need to explore with the industry the possibility of such products emerging and whether there will be sufficient competition to offer value for consumers.

An alternative to requiring the secure income to be index-linked would be to specify an amount of income which could be bought by a level annuity, which would be far enough above state benefit level to keep an individual out of

[5] ABI, Research paper number 8: Pensions Annuities, 2008

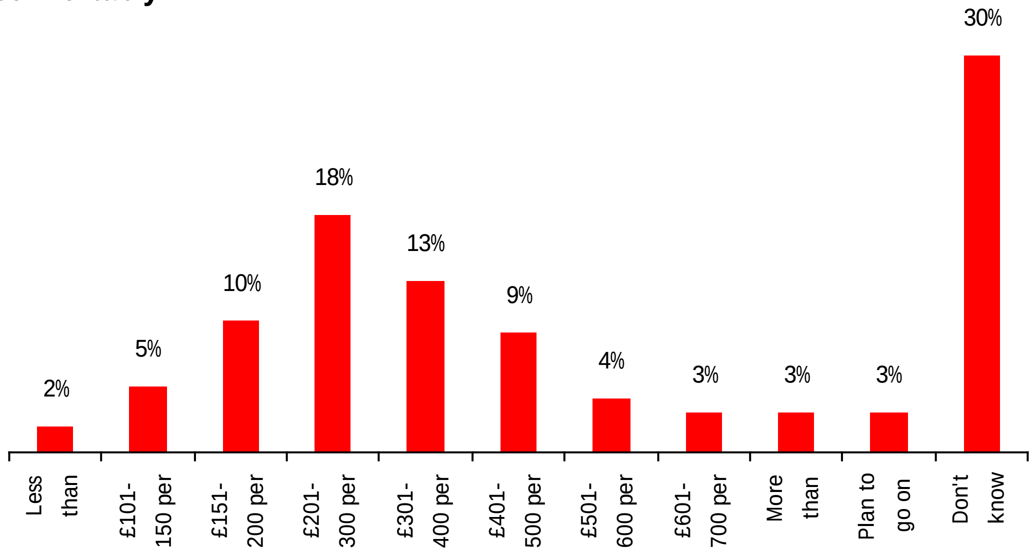
entitlement to state benefits, allowing for reasonable inflation over the period. Whilst this would not stop the individual falling back onto state benefits in the event of a burst of high inflation, this would also be the case with the current proposals where pension income could count as secure if it was uprated by a maximum of 2.5% a year.

We would also expect the income paid from a 'purchased life annuity' to be considered 'secure'. The level of income considered secure would also need to reflect the different tax treatment of income from purchased life annuities.[6]

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

This issue will be examined by the research currently being conducted by the PPI. Our most recent research found that consumers expect to need an average of £329 per week (after tax) to live on in retirement. They were asked to consider expenditure on all essentials and small luxuries necessary to live comfortably. However, three in ten were unsure about how much they would need.

Chart 2: Weekly income consumers expect to need in retirement to live comfortably



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[6] Under current rules income tax is not due on the 'capital' part of the gross payment and therefore the amount of after-tax income received from a purchased life annuity will be greater than that received from a pension annuity

***Source**: Which? Pensions research July 2010 Q 6. Thinking now about when you retire, how much money a week do you think YOU will need to live on to have a comfortable retirement? This should include everyday expenditure should as food and clothing, transport, housing costs (i.e. rent/mortgage), bills, and any small luxuries to live "comfortably". BASE – all adults UK currently working or seeking work (555)*

It is important to note that whilst, initially, the additional flexibility would only be available to a minority of individuals the number will increase following the introduction of auto-enrolment and wider access to good value pension schemes. For example, a man aged 25 earning £25,000 and contributing 8% of their earnings into a pension would be able to generate an index-linked income of over £12,000 a year if they retired at 70.[7] This would be in addition to their entitlement to a Basic State Pension and S2P.

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

We would support setting a separate level of MIR for individuals and couples. The couples limit would be lower than for two separate single people. However, the MIR for couples would need to ensure that sufficient income would be available to the survivor following the death of their partner.

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

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

We support the approach for the individual to be required to provide information to their drawdown provider to allow for the release of the funds. The level of the MIR will need to be reviewed annually and immediately following any changes in benefit levels.

[7] This assumes that they are a basic rate taxpayer, that their contributions grow in line with earnings (4% a year) and that returns from their pension are 6% a year after charges.

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.

In pensions generally, our research shows that consumers can be confused by technical jargon and can feel overwhelmed by the amount of choice. There is a clear recognition that they need to be guided, but no sense of who they can trust.

Many consumers will have little knowledge or understanding about the decumulation decisions they will have to make at retirement. For many, retirement will seem a long way off and they may not understand the process for transferring their accumulated fund into an income. When it comes to purchasing an annuity they may seek to rely on external advice and guidance. In August 2009, Which? conducted research amongst our members about how they did or how they will decide which annuity to buy. 49% of members took advice or will take advice from an IFA. 22% took or will take the annuity their pension provider recommends. 16% used / will use newspapers/magazines and 21% used / will use the internet.

Decisions about decumulation and annuities can be relatively complex and for most consumers, purchasing an annuity will be a once in a lifetime choice. Consumers will therefore not have experience of engaging with these decisions. They will find it difficult to recognise or evaluate the benefits of switching and to determine whether they are obtaining a good deal. Our general experience of switching products is that once consumers have gone through the process once, they are more likely to switch in the future.

There is also evidence that consumers are more uncertain about the type of decumulation product they want to purchase. The FSA's Consumer purchasing outcome survey found that found that 29 per cent of consumers had no idea about the type of products they wanted and a further 27 per cent had only a vague idea about the type of product they wanted.

At Which? we analyse switching in a number of markets by considering the "switching journey" which consumers need to go through when they switch products. This has a number of stages.

1) Awareness: Consumers are prompted to switch by becoming aware that they may not be getting the best deal.

2) Information gathering / obtaining advice: Consumers gather information about alternative products and/or obtain advice from a third party.

3) Choose / buy: Consumers weigh up the different options and make decision as to which to buy.

4) Post mortem: Consumers reflect on the costs and benefits of their decision and decide whether to switch products again.

Despite the significant gains available in some cases, relatively few consumers choose to exercise the Open Market Option (OMO) when purchasing an annuity. The switching journey can break down at any point. For example, consumers may be aware that they are not getting the best deal but find the information gathering exercise too complex. They may want to seek independent financial advice, but be unable to find an adviser they can trust or afford, or may feel that they lack the basic knowledge to understand the advice given.

We believe that the Government should continue to support the work of the Open Market Option group (currently located within the DWP). We would advocate the following steps:

- Continued effort by the industry to improve the clarity of its retirement literature. Enforcement action should be taken by the FSA against any provider with unclear literature.

- Expanding the FSA comparison tables to include all providers and requiring those providers which now offer annuities based on postcodes to remain on the tables.

- Encouraging all providers to sign up to the ABI's "Options" project (which uses an electronic system to speed up pension transfers) for all of their pension products.

- Considering the development of a 'Pensions Passport' which would include information about a consumer's financial situation and health issues.

- Helping consumers to find an Independent Adviser who specialises in annuity advice.

- Consideration of making the OMO the default option for consumers. This could also include greater use of a "focused choice" process such as that considered by the new NEST scheme. The consumer would still need to consider key questions such as whether they were in poor health, if they wanted a level or escalating/index-linked annuity and whether they wanted a single or joint life annuity. However, once they had made these decisions the scheme would be responsible for finding them the most competitive deal for the annuity type they had selected.

There will also be a need for consumers to consolidate their pension funds in one place before making decisions about their decumulation options. Following the introduction of auto-enrolment, we expect an increase in the number of consumers with multiple pension pots. Given the levels of turnover in the labour market, many consumers may have built up pension funds across multiple occupational schemes, group personal pensions and stakeholder pensions, in addition to their money in the NEST scheme. Which? believes that members should be able to consolidate all of their different pension funds within the NEST scheme before taking their decumulation decisions.

Moving into income drawdown has benefits to consumers such as the potential for greater flexibility and increased investment return over the long-term. However, the Government will also need to develop a strategy to prevent any consumer detriment which may arise from a greater number of consumers exercising income drawdown for longer. We believe that this could fall into a number of categories:

- Consumers being exposed to the risks of capital loss, lower income or running out of money due to investment losses or excessive withdrawals from their drawdown arrangements.

- Whether consumers understand the additional risk of these products compared to a conventional annuity.

- The additional costs of the alternative options such as income drawdown eroding the benefits consumers gain from the additional flexibility.

- The lower levels of compensation from the Financial Services Compensation Scheme for income drawdown arrangements and those providing advice on these products.

- The exposure of consumers to 'counterparty risk' from products they hold within their pension or hybrid products designed to guarantee them a particular level of income.

- Lack of access the good quality, affordable, independent financial advice.

- Potential bias in the advice process towards the recommendation of income drawdown products due to the greater ongoing revenue available to adviser firms.

Consumer demands for increased flexibility

When non-retired DC pension owners were asked what were the most important features in an annuity, keeping pace with inflation, income security for their partners and flexibility.[8] 38% say that they want a product which will allow them to keep their options open in retirement. 28% say that they want a product which offers a guarantee that if they die before a certain date their estate will receive the remaining payments or a lump sum.

Chart 3 : What people with a DC pension are looking for in an annuity

	%
Keeps pace with inflation	46
Pays an income to my partner even after my death	39
Lets me keep my options open after retirement	38
Absolute certainty that the payments will never reduce	29
Offers a guarantee so if I die before a certain date, my estate will receive the remaining payments or a lump sum	28
I just want a straightforward product that pays a fixed income for the rest of my life – no bells or whistles	26
The ability to link the income to investments, so that the income would increase if the investments did well	20
Offers better rates for people in poor health	6
Don't know	9

[8] IPSOS / MORI, August 2010 Mintel report, Annuities

Source: Ipsos MORI/Mintel Base: 274 non-retired adults aged 18+ with a personal/money-purchase pension

Only 12% of people say that they plan to delay/consider delaying their annuity purchase (suggesting that this is not a major consideration for many consumers prior to retirement). However, ABI research among recent purchasers of annuities found that 23% had previously deferred the purchase of the annuity. In particular this was stated by those aged 66 years or over (63%). This suggests that although many consumers don't imagine deferring initially, they do so as they near retirement age.

In addition to this desire for flexibility there are indications of a growing trend towards phased retirement. While for some this may be out of necessity or for others simply a lifestyle choice, with the Government encouraging people to work for longer and abolishing the default retirement age this trend is set to continue. According to Aviva's latest Real Retirement Report 68% of adults aged 16 or older say they intend to work beyond the current state retirement age[9] – this is up from 52% in 2005.

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 continue to believe that annuities will remain the right choice for many consumers. The average purchase price for an annuity is around £25,000 and 75% of annuities are purchased from the proceeds of funds worth less than £30,000. The FSA has made it clear that it is usually considered appropriate for a consumer to have a pension fund of over £100,000 in order for them to be considered to benefit from income drawdown.

CFEB will be able to provide generic advice to consumers about their decumulation decisions and about the different types of annuities available. It will also be able to provide generic information about the Open Market Option. However, it will not be able to provide detailed advice about entering income drawdown arrangements.

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.

[9] Aviva, *The Aviva Real Retirement Report*, Issue 2, May 2010

Trends in annuity rates

Although there have been times in recent years when the annuity rate has improved slightly, the clear trend in annuity rates over the past 20 years has been downward. According to many industry commentators this downward trend is likely to continue. Indeed, by July 2010 annuity rates had already fallen by nearly 7% since the start of the year. Given the problem of many consumers not saving adequately for their retirement (if at all), it is important that further declines in annuity rates do not discourage anyone from doing so.

Chart 4 : Annual annuity rates and gilt rates, January 1990-June 2010

Note: The graph depicts the annual annuity rate for a male aged 65 with a wife aged 62. The cost of the compulsory purchase pension annuity is £100,000. The annuity is paid monthly in arrears without proportion, is guaranteed for five years and pays a 50% spouse's pension. The annuity escalates at 3% per annum. The gilt yield shown is the FT Actuaries Government Securities UK 15 Year Gilt yield

SOURCE: THE ANNUITY BUREAU

To achieve widespread support for this policy it will be important to demonstrate that its implementation will have a positive effect on those who choose not or are unable to take up the additional flexibility. The removal of those consumers who exercise the additional flexibility and do not purchase an annuity from the market could have a number of impacts.

- If those who exercise the additional flexibility are healthier than average then this should result in improvements (over the longer term) for consumers who still purchase an annuity.

- At the margin, a reduction in demand for annuities from this group should lead to an improvement in the pricing of annuities for other consumers.

- These positive impacts may be balanced by the impact that any reduction in the average size of an annuity has on the average administration costs incurred.

xafinity paymaster

Xafinity Paymaster response to HM Treasury consultation paper on removing the requirement to annuitise by age 75

September 2010

Background

Xafinity Paymaster supports an increasing number of insurance companies in the administration and payment of annuity benefits. Clients include Aviva, Sun Life Financial of Canada, Pensions Insurance Corporation, Windsor Life and many others.

Xafinity Paymaster works with well established insurers as well as new entrants to the UK annuity market.

A full range of existing annuity products is supported and at the current time more than 600,000 annuitants living throughout the world receive their annuity payment from Xafinity Paymaster.

Xafinity Paymaster does not provide advice to individuals or product providers and is accordingly focussed upon the servicing aspects of annuity portfolios and clearly has no insurer or product bias.

Xafinity Paymaster is the largest independent provider of annuity payment services in the UK.

Introduction

Xafinity Paymaster welcomes the opportunity to comment upon the HM Treasury Consultation paper on Removing the requirement to annuitise at age 75.

We have promoted change within the annuity market for many years and supported new entrants to that market as well as helping existing providers introduce a wider range of annuity products and services to the UK marketplace.

Xafinity Paymaster has consistently sought to remove administrative complexities in annuity processing and to promote a greater understanding of annuity issues for the benefit of both insurers and their policyholders.

With a combined annuitant and pensioner customer base of 2.2 million we believe that we are uniquely positioned to understand the views of those in retirement and to comment upon the Treasury proposals.

Contact:

Keith Boughton
Director, Insurance and Payroll
Tel: 01293 604223
Email: keith.boughton@xafinity.com

Overall Summary of Views

- We welcome:
  - The increased flexibility these measures will introduce for people at retirement.
  - The commitment to making the rules simple allowing people to make the right choice.
  - The recognition that annuities remain an effective way of insuring against the risk of exhausting savings prematurely and are good value in comparison with other products.
  - The withdrawal of Alternatively Secured Pensions (ASP).
  - The commitment to the Pension Commencement Lump Sum (PCLS) which is an attractive option for many at retirement and boosts capital spending throughout the economy.
  - The simplicity and uniformity planned for calculating the tax recovery charge for death benefits and we welcome the intention that death benefits paid out for those who die before age 75.
- However, we do believe that the Government can go further in some of its reforms especially where they relate to the pensions tax framework. In particular we believe that there is scope to encourage value protection for annuities and accordingly to help overcome the greatest criticism of annuities. We would propose the provision of tax free death benefits up to capital protection levels (purchase price less payments made) and the subsequent taxation of any death benefits in excess of capital protection on a simple basis.
- In addition we would advocate the requirement of a "set aside" sum to overcome the potential risk of individuals opting for uncapped drawdown falling back upon the State.
- Our greatest concerns relate to the means for provision of the right level of advice to consumers. Deciding what shape and type of product to buy at retirement is a complex process. It requires specialist advice and the reality is that it is only the wealthiest consumers who are prepared to pay for it.
- Whilst acknowledging that buying an annuity will remain the right choice for the greatest majority of consumers, the slow growth in the take up of the OMO (Open Market Option) option, shows how consumers require real guidance and support at this crucial stage.
- Whilst we welcome the establishment of the National Financial Advice Service, this is unlikely to be able to provide the level of advice and support that retirees require.
- We believe that there are a number of practical steps that the Government can take to help overcome the retirement advice financial challenge.

These include:

- Compulsory provision of the three highest comparable annuity quotations for any retiree from their existing pensions accumulation vehicle (scheme or policy). These quotations could be drawn from a CPMA (Consumer Protection and Markets Authority) portal that interacts directly with an annuity provider's quotation systems. Trustees or insurers should be obliged to ensure that a member or policyholder is directed to take advice if uncertain what to do.
- Compulsory use across the Industry of a Common Annuity Questionnaire and Application Form
- Development of advisors, similar to Legal Aid advisors or CAB (Citizens Advice Bureau) to provide specific advice to individuals at retirement. These could form part of the National Financial Advice Service teams but be focussed on the Decumulation aspect of pensions savings. Historically this area of decumulation has not received sufficient focus.
- Granting retirees the right to two half days "off work" within six months of retirement to take up appointments with these Financial Advisers or their own IFA to discuss their retirement choices.

Keith Boughton
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Keith.Boughton@Xafinitypaymaster.com

Specific Answers to Questions

The Government welcomes views on

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

The annual drawdown limit should be reviewed annually. We would suggest that whilst the risk of running out of funds can increase with age, the scope for increased investment returns is also increased. We would not support an artificial division at age 75 of USP (Unsecured Pension Arrangement) limits and would suggest that a consistent drawdown limit should apply throughout the entire retirement period. If the existing 120% limit is working successfully now then we see little reason to change this.

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 support the changes which are proposed. These are progressive and appropriate steps. However, we would suggest that there are other steps which may be taken to also simplify the pensions tax framework and assist with improving consumer perception of annuities.

We suggest that the maximum age limit of 75 for tax relief to be available for pension contributions is an artificial anomaly and should be removed.

We suggest that tax free death benefits up to capital protection levels (annuity purchase price less payments made) should be provided. This will encourage the purchase of capital protection which will help with the consumer perception of annuity value.

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 suggest that the maximum age limit of 75 for tax relief to be available for pension contributions is an artificial anomaly and should be removed. This approach should be linked to the overall MIR approach which we advocate whereby a consumer can only undertake flexible drawdown they have "set aside" the appropriate level of funds into a contingency arrangement. This approach is akin to the Irish model. This approach would stop a consumer passing an MIR test at a single point in time and subsequently spending all excess funds and, as a result, becoming more liable to require State support at a future date. The set aside amount should effectively act as a buffer to this approach and could be age determined.

If the Irish model is not followed, "secure" pensions should include static pensions and annuities discounted at a value of say 2.5% for a period that reflects the age when flexible drawdown is taken and the consumers anticipated lifespan. The discount value should be regularly determined.

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

Figures should be determined by the ONS (Office for National Statistics), including housing costs and be declared annually at the same time as other benefits in line with changes in state pension levels, Lifetime Allowances etc. The determination of MIR by age adds an unnecessary complication.

If the "set aside" model is adopted then the "set aside" amount should also be declared at this point in time and be applicable for anyone wishing to drawdown during the next financial year.

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

Yes, as per the approach taken with State pension system. MIR rules should permit a couple to apply to be able to combine their pensions and or annuities for the purpose of assessment for MIR. This gives couples the choice.

6. How often the MIR should be reviewed.

Annually, as part of the annual Budget review.

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

The provider of the uncapped drawdown vehicle should be responsible for making appropriate checks before permitting the drawdown and providing any reporting to HMRC.

The MIR is a natural part of financial planning and advice and a Statement of Entitlement, similar to a P60 or LTA certificate can be provided by pension and annuity providers confirming the amount of benefit that can be included in MIR calculations.

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

There is a risk that uncapped drawdown is marketed and sold by the provision of negative publicity around lifetime annuities. Clearly there is a role for both in the retirement market. Regulators should ensure that marketing is appropriate.

We would suggest that the revisions we have proposed to the taxation treatment upon death as detailed in A2 above will assist in ensuring a balanced playing field exists between lifetime annuities and uncapped drawdown.

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.

This is our greatest concern. Deciding the shape and type of product to buy at retirement is a complex process. It requires specialist advice and the reality is that it is only the wealthiest consumers who are prepared to pay for it.

Whilst acknowledging buying an annuity will remain the right choice for the greatest majority of consumers, the slow growth in the take up of the OMO option, shows how consumers require real guidance and support at this crucial stage.

Whilst we welcome the establishment of the National Financial Advice Service, this is unlikely to be able to provide the level of advice and support that retirees require.

We believe that there are a number of practical steps that the Government can take to help overcome the retirement advice financial challenge.

These include:

- Encouraging OMO by requiring any retiree from their existing pensions accumulation vehicle to be given comparable annuity quotations from the top three annuity providers. These should ideally be provided 6 months prior to retirement although we appreciate that, at times, retirement is "sudden" and may not be by choice. These quotations could be drawn from a CPMA portal which interacts directly with an annuity provider's quotation systems. Trustees or insurers should be obliged to ensure that a member or policyholder is directed to take advice if uncertain what to do and acknowledge that he has received alternative quotations if he chooses not to take up the OMO.
- The compulsory distribution of decision tree documents produced by CPMA to all retirees.
- Compulsory use across the Industry of a Common Annuity Questionnaire and Application Form.
- Development of advisors, similar to Legal Aid advisors or CAB to provide specific advice to individuals at retirement. These could form part of the National Financial Advice Service teams but be focussed on the decumulation aspect of pensions savings. Historically this area of decumulation has not received sufficient focus.
- Granting retirees the right to two half days "off work" within six months of retirement to take up appointments with these Financial Advisers or their own IFA to discuss their retirement choices.
- The encouragement of annuity providers to develop simple annuity products to support the small pension pots that arise. Many providers have minimum purchase prices that severely restrict a consumers ability to secure a competitive quotation for their small pension pots.

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 believe the proposed reforms will negatively impact upon the UK annuity market's ability to supply annuities at attractive rates.

However as detailed in A8 and A9 there should not be a market bias towards uncapped drawdown and there must be encouragement for the industry to develop competitive products to support the small pensions savings pots.

Contact:

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Your reference

Our reference

Date 9 September 2010

Removing the requirement to annuitise by age 75 - Response from Zurich

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Dear sir,

I respond on behalf of the Zurich Group to the consultation, “Removing the requirement to annuitise by age 75”. Zurich is grateful for this opportunity to respond to the consultation. In particular, I should mention that I found the opportunity to discuss the proposals in more detail at the meeting on 6 August very helpful.

About Zurich

Zurich provides pension investments and schemes for over 850,000 customers in the UK. Zurich is keen to ensure that the proposals will meet the needs of its customers, both existing and new, that the pension schemes which Zurich provides perform as customers expect and that customers readily understand the benefits and risks which any new options present.

Summary of response

Zurich welcomes the proposal to remove the requirement to purchase an annuity at age 75, for the reasons given below, but has a number of concerns about how this might operate in practice and suggestions as to how the proposed changes might be introduced.

Zurich believes that the fair treatment of its customers requires that the tax regime and the risks associated with the decision not to annuitise are readily understood by customers. It is also important that the tax regime for customers who have made the decision to take unsecured pension is not changed in a way that undermines their decision.

General application

As has been observed by several commentators, it is likely that the vast majority of individuals will want to retire from work significantly earlier than age 75. These individuals will typically rely on their pension savings to replace their earnings when they retire. In addition, Zurich tends to agree with observations made in the consultation paper that customers underestimate the benefits of security and good value that annuities represent.

This means that for most customers, deferring the purchase of an annuity beyond age 75 simply does not meet their needs for a secure replacement for earnings at the point of ceasing to work. The consequence is that these proposals might only appeal to a minority of individuals.

At the consultation meeting with interested parties, held on 6 August, concern was expressed that the introduction of capped drawdown could lead to problems with individuals inappropriately choosing to take capped drawdown when an annuity would be more suitable. Zurich is concerned to ensure that its customers fully understand the relative benefits and risks associated with drawdown. Other than in exceptional circumstances, Zurich does not currently offer unsecured pension other than to customers who have an unsecured pension fund of at least £50,000 and have taken financial advice from a properly qualified adviser. We know that other large pension providers operate similar safeguards. Zurich's approach to the proposals for capped drawdown is likely to involve the same safeguards to ensure that customers are treated fairly.

For these reasons, it is likely that the majority of Zurich's customers will continue to want to take their pension benefits before age 75 and that an annuity will continue to be the most suitable method of doing so.

Encouraging pension saving

The requirement to purchase an annuity at age 75 has been repeatedly criticised over many years. If removing it will encourage more individuals to take personal responsibility and to save for a better retirement, then removing it is the right thing to do. However, we are concerned that, by the time the final legislation is published, there will be little time left to implement for 6 April 2011.

The requirement to take benefits at age 75 might have been an obstacle to pension saving only for a minority of high earners who intend to work beyond age 75 or those who have sufficient other sources of savings not to need to draw an income from their pension. However, these individuals tend to be the decision-makers within employers. If removing the requirement to take benefits at age 75 encourages these individuals to support pension savings, then the proposals might result in better pension provision for a wider range of employees.

Responses to specific questions

A.1 - level of capped drawdown

Zurich welcomes the proposal to replace the existing unsecured pension and alternatively secured pension regimes with the capped drawdown regime. It is important to find a level of capped drawdown, especially for older individuals, which maximises freedom for customers but also limits the risk to customers of exhausting their drawdown fund.

Features of the existing drawdown regimes are already understood by customers and embedded in the industry, such as the setting of a maximum figure by reference to published tables and 5-yearly reviews for individuals under 75.

We suggest that a suitable level of capped drawdown should retain these existing features of unsecured pension. We wonder whether the risk of older customers exhausting their drawdown fund might be reduced by retaining the additional, existing, safeguard of calculating the relevant annuity by reference to age 75 for those individuals over that age.

If the maximum level of capped drawdown were to be reduced from the current 120% which applies to unsecured pension, we would need time to notify those customers affected by the change.

A.2 - ending the requirement to purchase an annuity

Zurich welcomes the additional flexibility for customers which ending the requirement to purchase an annuity at age 75 introduces, but is concerned that the proposed changes should result in the fair treatment of its customers.

The proposed 55% recovery charge on lump sum death benefits paid from drawdown funds seems to be greater than is necessary to recover tax relief and unfairly high, especially in respect of basic rate tax payers and for existing customers who chose to take drawdown on the understanding that the tax charge would be 35%. We suggest that setting the recovery charge at this level also risks acting as an incentive for individuals:

- to risk exhausting their drawdown funds in order to avoid what might be regarded as a punitive charge
- to annuitise earlier than they had originally planned or
- to delay crystallising their benefits.

A.3 - what forms of income should be considered secure

We agree that, to be regarded as secure, pension income should be in payment and guaranteed for life. As discussed at the consultation meeting with interested parties on 6 August, we suggest, however, that requiring income to escalate in payment is unnecessary and has the undesirable effect of encouraging the purchase of escalating annuities by customers for whom a level annuity might be more suitable.

For money purchase schemes in particular, this would represent a departure from the approach over recent years of allowing individuals to make the decision about the form of income they require. The likely future cost of living can be dealt with in setting the level of the minimum income requirement; rather than in the form of pension income which should be allowed to count towards that level.

We believe that purchased life annuities can also meet the stated criteria of an income in payment, guaranteed for life.

A.4 - appropriate level of MIR

We recognise that the objective of the minimum income requirement is to minimise the risk of an individual falling back onto state benefits. However, individual circumstances are subject to changes which cannot be predicted and the criteria for state benefits vary. This makes it difficult to set a single clear level of income.

Setting a minimum income requirement towards the lower range of possible levels has the advantage of making flexible drawdown available to a wider range of individuals but increases the risk of those individuals subsequently qualifying for state benefits. Conversely, setting the minimum income requirement towards the higher end of the possible range will minimise the risk of individuals falling back on state benefits but will limit the availability of flexible drawdown to a minority of richer individuals.

We note that the full basic state pension alone (an escalating annual income of £5,078 pa (£97.65 x 52) for a man aged 65) implies an equivalent pension fund of over £120,000 (assuming an annuity rate of approximately 4%). On the basis that the minimum income requirement must be set significantly higher than the level of the basic state pension, we think that it is inevitable that flexible drawdown will be the preserve of a few wealthy individuals.

We suggest that the level of the minimum income requirement should be set by reference to an officially-published, indexed figure, so that it is clear and easily understood. We suggest that a percentage of national average earnings or a multiple of the basic state pension would meet these requirements. This multiple or percentage would then need to be increased for younger individuals and reduced for older individuals to account for increases in the cost of living.

A.5 - individuals and couples

Zurich is uncomfortable with the idea of setting different minimum levels of secure income based on a customer's status. This would mean that, in some situations, an unmarried member could have a benefit option which is not available to a member who is married or in a civil partnership. Zurich would prefer a single level of minimum income which applies to any customer, regardless of marital status or the wealth of a spouse or partner.

A.6 - reviewing the MIR

We suggest that linking the level of the minimum income requirement to a published and indexed figure - such as basic state pension or average earnings - removes the need to review the level of minimum income. The level would automatically be reviewed whenever the associated figure is reviewed.

A.7 - minimising burdens

It is essential that the proposals are clear to customers, easy for providers to operate and do not result in significant additional costs. In particular, the minimum income requirement must be easily proven.

We suggest that the introduction of flexible drawdown could be smoothed if an individual who wishes to take flexible drawdown had to demonstrate to HMRC that he or she has sufficient secure income in payment (or will have as a result of taking benefits) to satisfy the minimum income requirement. HMRC could then issue a certificate to that individual (in the same way as for lifetime allowance protection at A-day). The individual would simply need to present that certificate to any future pension provider in order to take flexible drawdown. This would ensure that the provider always has sufficient evidence of secured income and could reduce the need for reporting to HMRC when flexible benefits are taken.

At the consultation meting on 6 August, it was mentioned that the intention is to revise legislation so that, although there would be a lifetime allowance test at age 75, benefits would not necessarily crystallise at that age. We are concerned that the proposed changes could result in pension providers being required to issue annual benefit statements (and statutory money purchase illustrations) to a small number of customers who are over age 75 and have uncrystallised benefits. We suggest that the changes necessary to do so are expensive to make and cannot be implemented by April 2011. We also suggest that SMPIs do not meet these customers' needs, since SMPIs are designed to act as a wake-up call to encourage customers to consider whether their existing pension provision is adequate, whereas customers over the age of 75 cannot make further tax-relieved pension provision and ought instead to be considering the security of their pension fund, whether their existing investment decisions continue to be appropriate and whether they need to use those funds to provide an income.

Fair treatment of existing customers in drawdown

Zurich's existing customers with unsecured pension funds elected to designate their funds for unsecured pension, rather than choosing an annuity, in the knowledge that, in the event of their death before age 75, any lump sum paid from the remaining fund would be taxed at 35%. We suggest that it would be unfair to increase that rate of tax to 55% now. However, we also suggest that a transitional rule, involving operating different rates of recovery tax for individuals depending on when they entered drawdown, does not meet the need for a clear and simple tax regime.

Anticipated treatment of Zurich's existing pension products

Zurich's existing pension plans are designed to run until age 75 at which point customers must take benefits. Other than those plans specifically designed to allow drawdown, Zurich's pension plans were not designed to allow customers to take benefits in the form of income drawdown either before or after age 75 and do not have the necessary safeguards and processes in place to protect customers. In would be extremely challenging to implement the proposed changes by 6 April 2011, even for those pension plans that are designed to allow drawdown.

Costs of implementation

In addition, over the years, Zurich has carefully built its administration systems to include safeguards and processes to ensure that customers do take their benefits by age 75. Zurich cannot remove those safeguards and processes by April 2011.

Zurich is in the process of carrying out an analysis of the costs of implementing the proposed changes but it is believed that the likely one-off cost of removing the requirement to annuitise at age 75 under all our pension plans would be many hundreds of times greater than the estimate contained in the table at paragraph 28 of the impact assessment (£2,000 for a large personal pension provider).

Yours faithfully,

Ben Carroll
Pension Marketing Executive