



ASSOCIATION OF CONSULTING ACTUARIES

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To: HM Treasury via <https://www.smartsurvey.co.uk/s/AutumnBudget24/>

Dear All

Autumn Budget 2024 / Spending Review - Stakeholder Representation

I am writing on behalf of the **Association of Consulting Actuaries (ACA)**.

The ACA welcomes the opportunity to provide input. Members of the ACA are all qualified actuaries – mainly Fellows of the Institute and Faculty of Actuaries. All actuarial advice given by our members is subject to the Actuaries' Code. Members provide advice to thousands of employers and pension schemes on the design and financial management of occupational pension arrangements. Our members advise the majority of the largest schemes in the UK with total private sector assets exceeding £1 trillion, as well as many public sector pensions arrangements. We are therefore responding in the capacity of a representative body for professional advisors who provide advice to a range of occupational pension schemes – the underlying tax treatment of pensions is inherent in that advice.

The tax treatment of UK occupational pensions schemes is based primarily on the premise of aligning taxation with the deferral of pay and income in order to encourage and incentivise long-term saving for retirement – i.e. tax is deferred during the accumulation of pensions savings (both contributions and growth) and instead levied during decumulation. Despite the success of the UK occupational pensions system, there remain significant challenges in the level of adequate savings being built up by current and future workers as highlighted by the DWP's own research in 2023¹. Whilst we recognise the reality that Chancellors may want to review and potentially make adjustments to pensions taxation from time to time, this needs to be undertaken carefully and in full knowledge of the potential consequences for savers (and pensioners), pension schemes and employers given wider policy aims such as improving retirement outcomes and encouraging economic growth. Changes that bring forward tax revenues will likely exacerbate the adequacy challenges for current and future workers, and for current pensioners. Confidence in the future tax treatment is essential if adequate provision is to be made.

¹ <https://www.gov.uk/government/statistics/analysis-of-future-pension-incomes/analysis-of-future-pension-incomes>

As a result, we suggest the government should seek to identify an overall framework which can flex to accommodate the needs of the day and on which the political parties might agree a consensus. Any revised or updated tax regime should cater for all savers (defined benefit (DB), defined contribution (DC) and collective defined contribution (CDC)) and seek to minimise any disincentive for long-term savings. Changes should also not lead to any groups being discouraged from continuing in employment due to inflexible rules (as has occurred for example in the medical profession). In our experience, careful consultation and a reasonable timeframe are crucial to successful implementation of any changes, although we appreciate there might be a desire to introduce anti-forestalling measures.

In the Appendix to this letter, we set out, at a high level, what we see as some of the key considerations when considering potential changes to pensions taxation. Our comments are based on our deep technical knowledge and experience in what can be a very complex area.

We would be happy to discuss pensions taxation further and provide technical input into how potential or planned changes might impact occupational pension schemes at a financial or operational level including implementation considerations for any changes. Please contact me on 07799 893797 or stewart.hastie@isio.com and/or the Chair of our Tax Committee, Kirsty Cotton on 01737 274496 or Kirsty.cotton@wtwco.com.

Yours sincerely

Stewart Hastie
Chair of the Association of Consulting Actuaries Limited
On behalf of the Association of Consulting Actuaries Limited

Appendix from the Association of Consulting Actuaries

Autumn Budget 2024 / Spending Review - Stakeholder Representation

We set out below some high-level comments in relation to the interaction of pensions taxation and key policy aims. We then illustrate some of the challenges of making changes to pensions taxation through several example scenarios.

Supporting retirement adequacy

It might be thought that the success of automatic enrolment means that it is no longer necessary to offer incentives to save for retirement. That would be wrong. Although automatic enrolment has indeed been very successful in extending coverage, it will not provide the level of income that most savers expect and need - as demonstrated by DWP's own research which found that £12.5 million working age people are undersaving for retirement. To deliver anything like a comfortable retirement for this and future generations, the automatic enrolment minimum would need to be either materially stepped up or combined with other measures including greater support for risk pooling pension arrangements and voluntary "sidecars".

As such, it remains important to incentivise individuals and their employers to set aside funds for retirement – and the long-standing way to encourage pension saving has been by providing various tax incentives. Our view is that any change to those incentives which could make pension saving less attractive should not be undertaken in advance of the second stage of the pensions review which will include examination of retirement adequacy².

In particular, it is clear that occupational pensions currently play a crucial role in providing individuals with income in retirement. Indeed, government statistics indicate that occupational pensions provide more income than either personal³ or State⁴ pensions for the average pensioner. This shows that the present tax and national insurance reliefs are widely distributed with the majority of pensioners having an occupational pension. In our view the value of such reliefs needs to be considered by the Treasury in the context of encouraging significant private pension provision now that helps to offset the need for materially higher State pensions and other state aid in the future. This also means that it is essential for employers to be encouraged to provide occupational pensions over and above any statutory minimum; employers are more likely to allocate time and resources to supporting retirement if it remains attractive to provide pensions to all their employees including higher paid individuals.

Our view is that the primary purpose of the tax relief should be to incentivise provision of income (on retirement or following death). If changes were made to the tax treatment of assets or investment return within pensions, then, at least similar changes should be made to other tax advantaged vehicles.

We look forward to contributing further to the debate on retirement adequacy as part of the second stage of the pensions review.

² <https://www.gov.uk/government/news/chancellor-vows-big-bang-on-growth-to-boost-investment-and-savings> and <https://www.gov.uk/government/publications/pensions-review-terms-of-reference-phase-one/terms-of-reference>

³ In 2022/23 the median occupational pension was £210, whereas median personal pension income was £63. The notes say that the £308 from private pension income includes both occupational and personal pension income, so the overall split isn't clear but supports that occupational pension income is far more significant. Source: Pensioners' Incomes: financial years ending 1995 to 2023: data table 3.1

<https://www.gov.uk/government/statistics/pensioners-incomes-financial-years-ending-1995-to-2023>

⁴ The median State pension was £198

Supporting growth

Making use of surplus assets

We note that the first part of the pensions review is already exploring whether DC pension scheme assets can be used to support growth, so we haven't commented further on that.

We hope that the Labour Government will take forward ideas⁵ to facilitate greater use of current and future DB surpluses to support employers and pension scheme members. Combining this with appropriate incentives and initiatives to support increased savings for today's workers can create a virtuous circle whilst still protecting the pensions of previous generations of workers.

Ensuring that any legislative change gives value for money

Whenever legislative changes are proposed, pension schemes require advice on the impact, and administrators need to update their systems and communications. For many occupational pension schemes, the resulting costs will ultimately fall on the employer and so divert their resources away from investing in growth. Therefore, change should only be considered if it is cost effective – tinkering is a waste of resource.

In assessing the cost effectiveness, the complexity of the change needs to be considered compared to other options and the tax revenues raised. For example, whilst the option of reintroducing a Lifetime Allowance (LTA), could target a minority of savers, it still requires extensive and complex administration changes relative to the potential tax that could be raised.

Further, it would be much better to make one carefully considered change than a whole series of changes. For example, if a particular allowance were to be reduced, we suggest that the level is set by considering what amount acts as an appropriate incentive as part of the adequacy considerations under part 2 of the pensions review – rather than setting at a level that delivers the necessary tax gain this year, only to be amended again in a couple of years, as happened on successive occasions with the LTA.

Limiting the cost to employers of any extension to national insurance (NI)

Extending the scope of employer NI to employer pension contributions would directly increase the cost of the workforce. A similar situation arose when contracting out was abolished. Then employers were permitted to either increase member contributions or reduce DB rights going forwards to offset the additional cost. Similar measures could be considered. Either way, we would expect the additional costs to impact employers' capacity to recruit and pay their employees impacting jobs and future pay.

Possible annual allowance easements to support entrepreneurs

The annual allowance can limit the pension contribution for successful small businesses owners who might want to make substantial pension contributions later in their working lifetime, on successfully cashing out their business – having been unable to do so before because they were investing all resources into their business. The Government could consider easements to the annual allowance regime for such individuals, perhaps for those who are eligible for Business Asset Disposal Relief⁶. There are many possibilities including:

- Extending carry forward to those who weren't in a registered pension scheme (perhaps only if would have been eligible for UK tax relief on pension contributions in that period, i.e.

⁵ <https://www.gov.uk/government/consultations/options-for-defined-benefit-schemes>

⁶ <https://www.gov.uk/business-asset-disposal-relief>

effectively a residency test). Currently, carry forward is only available to members of a registered pension scheme for the tax year in question.

- The above could be combined with a longer carry forward period for such individuals.
- A higher annual allowance

Alternatively, the Government could consider introducing an annual allowance that increases with age (though that would need to be objectively justified as non-discriminatory).

Supporting pension scheme consolidation

We note the government emphasis on consolidating pension schemes into a small number of much larger schemes. However, there are currently legislative barriers to doing so for some schemes and consolidation will need government support.

Specifically, occupational pension scheme members may have a right to take their pension before the normal minimum pension age (NMPA) (currently 55) or for a scheme-specific lump sum (SSLS) of more than 25% of the value of their benefits. Many pension protections apply to those with significant benefits – but NMPA AND SSLS protections apply to the full range of members – indeed, typically, though not exclusively, SSLS applies to members with modest benefits.

These protections are lost on transfer unless the transfer is a “block transfer”. One of the conditions is that the individual has not been a member of the receiving pension scheme for more than 12 months⁷. Many schemes would look to consolidate benefits under a master trusts, but an individual might have joined the master trust some time ago from an unrelated employment. It is therefore not straightforward to meet this condition.

With the NMPA rising in 2028 to 57, another set of protections has been created, and this time, there is no 12 months restriction⁸.

Please could the 12 months restriction also be removed for the existing NMPA and SSLS protections (that have applied since 2006). The potential loss of these protections makes it harder for trustees to agree to consolidate benefits.

Additionally, where a member has DB, DC and a SSLS under the same scheme, the SSLS formula usually penalises the member if only the DC rights are secured. This likely financial penalty makes it harder for trustees to agree to consolidate DC rights. Please could the formula be reviewed.

Finally, employers often have several older, often smaller, pension schemes which can have unusual circumstances e.g. S615 schemes. There is little incentive to “consolidate” one scheme if the employer cannot also consolidate the other older, smaller schemes, so there needs to be flexibility to enable this to happen smoothly. We would be happy to discuss the changes that would be necessary here.

Changing pensions taxation and reliefs

At the outset, we hope lessons can be learned from previous pension changes before making any further changes. For example, one of the reasons for the success of automatic enrolment in extending coverage was the cross-party consensus and the time taken⁹ to develop the legislation. By contrast,

⁷ <https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm063150#IDAGGSUC> and <https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062240>

⁸ <https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062250#block>

⁹ The Commission behind those reforms reported in 2004/5, a consensus was reached resulting in legislation in 2008, phased in from 2012 to 2019.

on 15 March 2023, the previous Government announced that the LTA would be abolished and attempted to do so by 6 April 2024. The industry highlighted our concerns with this timetable.¹⁰ Despite the best efforts of industry and HMRC, this deadline could not be met without some flaws in the provisions. This led to HMRC suggesting¹¹ that affected members delay taking their benefits until the legislation is corrected – still not achieved at the time of writing.

More generally, if changes were to be considered, then this would be an appropriate time to improve other aspects of the system. We would be very happy to expand on this.

The above illustrates that for successful implementation there needs to be both consultation with industry and sufficient time to implement any changes.

Whilst the headline figures¹² of pensions “tax relief” are published by Government regularly, actually assessing the cost of tax relief to the state is not straightforward. Ideally, the tax relief given on contributions should be offset against the income tax received when those benefits are paid. As this would be very challenging to do, instead the statistics count the cost of current tax relief on contributions for today’s employees and then nets off the tax receipts from current pensions (and flexible withdrawals) for today’s pensioners. This comparison has the effect of overstating the cost of tax relief by comparing the current workforce’s relief (which is growing due to the increased membership of schemes) against the receipt of tax from a smaller pensioner population.

Further, the tax relief statistics do not reasonably represent the opportunity cost for the government to make changes to save costs. We welcome that the statistics now identify that £2.8bn of the £42.5 income tax relief on contributions¹³ relates to Deficit Reduction Contributions (DRCs) for private sector defined benefit pensions savings, but there is no corresponding split of the £15.3bn identified as NIC relief on employer contributions to net pay arrangements.¹⁴ DRCs are made by employers to address funding shortfalls in defined benefit pension schemes needed to deliver obligations accrued to date across the membership, in respect of current active members but also those who have left service and who are pensioners or deferred pensioners. It seems unlikely that HMRC could ever charge members the taxes arising on these.

The four main areas of pension tax relief are generally considered to be: band shifting (where the marginal rate of tax on pensions paid is lower than that when the pension contribution was made), no NI on employer contributions, tax advantages on investment returns, and tax-free lump sums. There are also other tax advantages, such as on death.

We have not sought to set out an exhaustive list of considerations in this submission, but by way of illustration, we have highlighted the range of potential issues under different tax change scenarios from the perspective of both the pensions industry and savers. We hope this helps to highlight the need for careful consideration and consultation before making major changes as well as reasonable implementation timescales.

¹⁰ <https://aca.org.uk/wp-content/uploads/17-August-2023-ACA-response-LTA-abolition-draft-clauses-policy.pdf>

¹¹ <https://www.gov.uk/government/publications/pensions-schemes-newsletter-158-april-2024/newsletter-158-april-2024>

¹² <https://www.gov.uk/government/statistics/personal-and-stakeholder-pensions-statistics/private-pension-statistics-commentary>

¹³ There is a further £4.3bn of income tax relief on investment income leading to a total of £46.8bn

¹⁴ £4.8 + £0.8 + £9.7 from Table 6.2. See footnote above.

Scenario 1: moving to TEE/flat rate relief and/or applying employee NI to pension contributions

Moving from the current exempt, exempt, taxed (EET) approach to a TEE or “T+”EE system or a flat rate approach to pensions tax relief, or imposing employee NI on employer pension contributions, would likely have a significant impact on individual and employer commitment to pensions savings levels and therefore exacerbate adequacy of retirement saving for current and future workers as referenced above. Unless the flat rate relief was at an adequate level, we would expect such changes to be particularly acute across lower and middle paid workers.

For members building up benefits in a DB scheme (including most of the public sector), such changes would require a more accurate value to be placed on DB pensions accrual. The simplifications underlying the 16:1 factor for valuing pension savings for the purpose of calculating DB pension input to assess against the annual allowance are set out in the GAD Report¹⁵. For example, that report notes that “the factor does vary materially for changes in the assumed age”¹⁶. There would need to be a debate between fairness and simplicity, which would involve further analysis, but we suspect that any such factor would need to be age-related – and subject to formal review by GAD, as happened for contracting out rebates¹⁷. Taxing pension inputs in such a way would affect a much wider range of individuals than higher earners.

Even if the only reason for the 16:1 factor is for putting a value on DB accrual for annual allowance purposes, the factor should still be reviewed. In 2010 the Government Actuary’s Department (GAD) recommended¹⁸ that the 16:1 factor should be reviewed after ten years. Such a review is therefore now overdue.

For annual allowance charges, subject to meeting certain criteria, members have the option to ask their schemes to meet the charge. This is equivalent to either having a variable accrual rate or a deduction from the benefit. Schemes are not set up to administer benefits in this way and so it would be impractical to offer scheme pays for each individual to meet their specific income tax/NI charge. This means that individuals would need to find the money to pay the income tax/NI charge themselves – which will be problematic for many, particularly lower to middle earners.

Scenario 2: Introducing some sort of asset levy

An asset tax would be disproportionately expensive to implement in DB pension schemes which have sought to match their assets and liabilities – particularly where they have bought in annuities, but also where they have adopted a sophisticated matching structure.

For individuals, depending on how the charge was levied, it would complicate their investment decisions, potentially not only as to which assets to buy, but also whether to invest in pensions or ISAs. Individuals might put disproportionate weight on the possibility of another similarly levy, ignoring other more important factors, and make poor investment decisions.

¹⁵ https://webarchive.nationalarchives.gov.uk/ukgwa/20130102183550/http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm

¹⁶ Para 3.60

¹⁷ <https://webarchive.nationalarchives.gov.uk/ukgwa/20080609145044/http://www.gad.gov.uk/Publications/> see Quinquennial review.

¹⁸ https://webarchive.nationalarchives.gov.uk/ukgwa/20130102183550/http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm “Government Actuary’s Department report: Reducing the annual allowance”

Scenario 3: Reducing the Lump Sum Allowance

If the Lump Sum Allowance is reduced to generate material tax revenues, then this will reduce the scope to take expected tax-free cash for a wide range of members, not just high earners. In line with previous reductions on limits under the LTA regime, there might also be further grandfathering provisions which would need to be taken into account.

In terms of operational implications, administrators will need to:

- Update systems (including calculations and communication material) – this can easily take six months and takes resource away from other pressing projects such as preparing for pensions dashboards
- Send information to members in good time for them to make a decision - for DC members, there is a statutory requirement for schemes to send out information at least four months ahead of the retirement date – and many schemes aim to send this out six months in advance

The above demonstrates that if changes affect how benefits can be taken, or their tax treatment, implementation should be at least a year after final legislation.

For some individuals, reducing the scope to take tax-free cash might affect the shape of their benefits (with more taken as income and less as a lump sum). For others, for example where a separate lump sum is part of the benefit design (more common in the public sector), members might receive significantly less money – particularly if the lump sum pushed them into higher tax bands.

Pension challenges in the public sector

The tapered annual allowance is confusing and complicated and we understand caused significant problems in the public sector. We suggest that HMRC carry out a cost benefit analysis of the taper. If it was necessary to maintain the tax-take from the tapered annual allowance, our view is that given a choice of a slightly lower annual allowance or the tapered annual allowance, we would prefer the former.

We also note that GAD suggested¹⁹ the 16:1 factor should be reviewed if there were any material changes to pension provision for a significant proportion of affected individuals and specifically noted the (at that time) ongoing work of the Hutton review. This is another reason for reviewing that factor (see Changing pensions taxation and reliefs above).

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¹⁹ Footnote number 15, para 1.5