ASSOCIATION OF ACA CONSULTING ACTUARIES

St Clement's House, 27-28 Clement's Lane, London EC4N 7AE
Tel: +44 (0)20 3207 9380 Fax: +44 (0)20 3207 9134 EMail: acahelp@aca.org.uk
Web: www.aca.org.uk

3 November 2010

REF 935070

To:
Matt Robinson, HMT

Please reply to:
Miss K Goldschmidt
Lane Clark & Peacock
30 Old Burlington St
London W1S 3NN

Sent by email

Dear Matt

Policy issues arising from the proposed reduction in the Lifetime Allowance

I am responding on behalf of the ACA to the invitation to make representations about the policy issues arising from the proposed reduction in the Lifetime Allowance (LTA), including in particular the timing of the reduction and the proposed "pension growth protection".

We have confined our specific comments to the Lifetime Allowance changes but we do intend to comment separately on other aspects of the overall measures.

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

General comments

In its overall framing of the measures being introduced it appears that the Government has listened to respondents to the earlier consultation who emphasised the paramount need for simplicity. It is important not to lose sight of this when implementing the reduction in the LTA and developing the necessary transitional protections.

We were not initially in favour of the proposal to reduce the LTA, when this was raised in the July 2010 discussion document. We regarded the reduction as bringing additional complexity, and it could be retrospective in effect. However, the Government's latest report indicates that revised costings are such that the resulting impact on the reduced annual allowance offers a much better outcome. However, this is subject to the availability of appropriate transitional protection for individuals most directly affected by the reduction.

We endorse the principles for the new protection regime that are set out in Annex B to the consultation response – namely for taxation not to be retrospective; to respect the long term nature of pension; to be easy for individuals to understand; to minimise administrative burdens for pension schemes, employers and HMRC; and support the stability and predictability of the UK pensions tax system.

Adherence to all of these principles in practice may, however, prove challenging.

In particular, it is difficult to see how a Lifetime Allowance fixed at £1.5 million with no immediate commitment or stated intention to increase these figures in future can be conducive to long-term pension planning and the stability and predictability of the pensions tax system. We would like to see a clear commitment that the new Lifetime Allowance will be indexed, at least in line with prices, in the future, if not immediately from 2012/13.

Specific comments

Our specific comments on the particular issues on which views are sought are set out in the Appendix to this letter.

Yours sincerely

Karen Goldschmidt

Chairman of the Pensions Taxation Committee of the Association of Consulting Actuaries
DDI 0207 432 6622
Fax 0207 439 0183
karen.goldschmidt@lcp.uk.com

Appendix

The LTA is being reduced, should this be from 6 April 2012, or 2011?

We agree that the reduction should be deferred until April 2012, as the Government currently proposes, because:

- Individuals need to have sufficient time to take major pension planning decisions based on legislation that is in its final form.
- Where changes in occupational pension arrangements are required, these may take some time to implement, especially if consultation and re-negotiation of remuneration packages (or flex arrangements that provide for changes only on a specified anniversary date) are involved.

However, this is on the basis that the requirement to opt-out of future pension provision (to obtain the growth protection proposed) is also effective from 6 April 2012. If the opt-out is required to be from April 2011, then that brings forward the key decision-making date to April 2011 – and would once again result in individuals and employers having insufficient time to make properly informed and considered decisions.

This is also on the basis of no "anti-forestalling" measures being introduced for the intervening period - such measures would again create the immediate need for costly advice and additional decisions. We do not consider that further anti-avoidance, or anti-forestalling measures would be required for the 2011/12 tax year, if the reduction is deferred until 2012. The Special Annual Allowance (up to 5 April 2011) and reduced Annual Allowance (from 6 April 2011, or earlier in many cases) will effectively prevent excessive pension inputs by individuals intent upon exploiting the availability of the existing £1.8 million LTA for a further year. Where 'carry-forward' is available, this is likely to reflect past under-provision in the case of individuals who would be in a position to pay substantial one-off contributions. The scope for individuals with Primary or Enhanced Protection will be further constrained by the restrictions that already apply under that protection.

Pension growth protection

Our reading has been that your aim – unless consultation responses suggest otherwise – is solely to offer one protection – the "pension growth protection" - as proposed (in paragraph B.8 of the response document). It would be helpful to have confirmation that the reference in B.4 is only a statement of principle, and not to a separate proposed regime. We are aware that some readers think the document proposes a further protection option on offer to individuals in addition/as an alternative to the "pension growth protection", involving any member with accrued benefit of value of over £1.5m being able to register that as a personal LTA, with further pension saving possible albeit potentially ultimately subject to an LTA charge. (We note that this ambiguity does compromise the interpretation you can put on responses).

Assuming that only one new regime is to be available, the approach outlined in B.8 seems – in the short time we have to consider it – to be sensible and in principle looks to be simple to operate compared to measures modelled on the 2006 protection regime. (Registration for the protection would presumably not involve providing any numeric information to HMRC – the member would presumably register with HMRC, and then when showing the certificate to a scheme, the scheme would check its own files that the member had opted out before the relevant date, and rely on a member declaration that he had not been an accruing member of any other scheme)

Such a new protection should be available irrespective of whether the accrued pension rights are already in excess of £1.5 million at the date of the reduction – the individual would have to take a view on the value of protection based on their projection of when investment returns (DC) or deferred pension revaluation (DB) might lead their benefits to exceed the £1.8m valuation.

In order to keep the legislative changes required to implement the new protection regime to a minimum, our initial view is that it would be adequate for legislation to make a statement to the effect that wherever reference is made (for any purpose) to the LTA for tax years from 2012/13 onwards, this should be taken to be £1.8 million, where it would otherwise read £1.5 million, for individuals who have pension growth protection. Members with the protection would then need to ensure that their scheme administrator is aware of the certification (so that for example reports of LTA percentages would work to the correct baseline).

We suggest that the protected LTA should automatically be increased in line with any future increases in the standard LTA (even if this comes without any immediate commitment of indexation).

We do note several shortcomings/risks with the pension growth protection proposal:

- It effectively assumes that an individual can opt out of a pension scheme without (in gross-of-tax terms) financial loss – ie that the employer will offer an alternative form of remuneration (subject to tax and therefore in tune with the Government's overall regime target). If an employer does not so offer, or makes an offer of lesser personal value, the individual has a very complex decision to make (potentially retrospective tax loss, versus loss of part of a remuneration package).

- Some individuals will be dropping out of salary-linking at a time when their salaries may have been frozen for a while but might – when the climate changes – be reviewed with retrospection; the proposed protection's requirement to opt-out now means such individuals' giving up the corresponding 'retrospective' improvement in pension.

If the Government were to offer the (additional) option of an alternative approach based on a personal LTA and allowed continued accrual, this would avoid these two issues. It would however require considerable extra upfront administration, and a multitude of options does not conform to the principle of simplicity.

- It is important that the definition of "opting out" of a pension scheme (albeit still continuing in employment) is a clear and sensible concept that is future proofed. (It may be that the definition to be used should be similar to that used for the "deferred pensioner carve-out" for the main AA provisions – which, for example, would need to accommodate uplifts imposed by legislation in relation to GMP equalisation, without prejudicing the carve out). The requirement to opt-out should nevertheless permit the individual to continue to be covered for a death and incapacity benefits through a registered pension arrangement. Transfer of rights between schemes, and from DB to DC, etc should be accommodated.

- If an individual chooses to revert to unprotected status – which is a key option under the protection proposal - there may be real complexities. For example, we assume there would be no untangling of crystallisations since registration (in line with EP currently). Unwinding protection will not be a trivial issue for an individual, as it could trigger a one-off LTA charge of £75,000 (25% of 300,000).

Overall the decision to opt for this protection will, of course, not be a simple decision for an individual to make (it is a very different protection from those in 2006), and it will have to be taken on the assumption of no further changes to the tax system as it impacts on pension provision – which whilst perhaps not a given is becoming an increasing necessity.

Individuals with existing primary and/or enhanced protection

We agree that it important that the existing 2006 protections should continue with their effect entirely unchanged by the reduction in the LTA.

As well as constituting retrospective taxation (on savings that had been made more than some five years ago), any changes that impact these protection regimes could lead to significant administrative complications and the need for the individuals concerned to re-visit costly financial advice they had received in the past.

Where such individuals have registered 'over £375,000' lump sum protection as part of their primary or enhanced protection registration, this should not be compromised for similar reasons.

DB valuation factor for LTA purposes

We strongly agree with the Government's provisional view that the existing 20:1 valuation factor should continue to be used, as indicated in B.11. Any change would be extremely disruptive in relation to the existing and proposed new protection regimes; in dealing with any calculations involving tax-free lump sums (PCLSs) at retirement; and indeed with fundamental administration processes that have had to be set up as part of the "A-day simplifications". Any change could also be regarded as retrospective legislation, as it would affect the tax-status of benefits already accrued, and conflicts with the other principles set out in B.2.

We believe the LTA is unlikely to be the main tax yield measure (albeit that it is now a more significant part of the measures than anticipated) and, as such, it should be left to operate as a fallback mechanism and so kept as simple as possible.

LTA excess charges

We agree that the existing rates of 55% and 25% should continue to apply where excess benefits are taken respectively in lump sum and pension form. Any change in the relationship between these two would either be complex or would affect some individuals in an unfair way.

Trivial commutation

We agree that the £18,000 limit should not be reduced in line with the LTA – and, ideally now that the link with LTA is broken, it should be possible for Government easily to make provision for this figure to be indexed in future, so that the triviality provisions reflect real money terms. Similar considerations apply to other authorised lump sum payments, including winding–up lump sums that are defined by reference to the LTA. These options are not used as mechanisms for mitigating tax (indeed they produce tax in most cases) but as very powerful ways of "clearing up" small pension pots in a simple way and they are valued as such.

Tax-free lump sums on retirement

All other things remaining unchanged, when the standard LTA drops, this would also reduce ‘the 'available portion' used in PCLS calculations – the overall cap on tax-free cash sum at retirement (just a cap – the actual permitted amount is also limited by rules relating to how much related pension is being drawn).

Our view is that, both for EP/PP registered cases that have no “over 375K lump sum” protection registered, and for the individuals who opt for the new pension growth protection, the available portion should reflect a £1.8 standard LTA as this seems to be consistent with the overall aim of the protection and avoiding changes with retrospective effect (on benefits that had been accrued on previous assumptions/previously been understood to be protected).

'Pipeline' benefits/special cases

Transitional provisions will also be required to deal with 'pipeline' cases, where the event giving rise to the benefit (e.g. a member's death or retirement) occurs shortly before the date of the LTA reduction, while payment of benefits cannot be finalised until after that date. Lump sum death benefits and retirement lump sums (PCLSs) seem particularly likely to be affected.

Other cases where special provisions will be called for include those where funds have already been or are designated for drawdown before the reduction but where a second LTA test (BCE 5A) is required on reaching age 75, if the funds have not yet been annuitised (although this may change when the annuitisation requirement is abolished). For those already in drawdown changes should not impact so as to in an way interfere with the investment and drawdown strategy embarked upon ahead of the BCE 5A test, as again this would be a breach of the terms on which monies were initially invested.

Response by:

Association of Consulting Actuaries
St Clement’s House
27-28 Clement’s Lane
London EC4N 7AE
Tel: 020 3207 9380
Fax: 020 3207 9134

3 November 2010