ASSOCIATION OF CONSULTING ACTUARIES

Regis House, First Floor (126/7), 45 King William Street, London EC4R 9AN
Tel: +44(0)20 3102 6761 E-mail: acahelp@aca.org.uk
Web: www.aca.org.uk

3 September 2014

By Email to Pensions Policy

Dear Sir or Madam

FREEDOM AND CHOICE IN PENSIONS – draft Taxation of Pensions Bill and related documents

I am writing on behalf of the Association of Consulting Actuaries (ACA) to respond to the invitation in https://www.gov.uk/government/publications/draft-legislation-the-taxation-of-pensions-bill to comment on the draft Taxation of Pensions Bill, draft Explanatory Note (each as released on 5 August) and Draft guidance (initially released on 5 August and then updated 15 August).

(This of course follows on from the Government's decisions based on the responses to its consultation document dated 19 March 2014 on "Freedom and choice in pensions".)

We set out our comments in detail in the Appendix to this letter.

There may be areas we touch on that are to be dealt with under DWP legislation rather than the Taxation of Pensions Bill. Where this is the case, can we ask you to pass this on to the appropriate parties – the new regime has a large number of separate parts to it, and it is essential that all parties work together if it is to work sensibly for the many individuals affected.

We note for the record that there are various areas of the mechanics of new tax regime that are not covered in the Bill but will appear in the final Act (for example the disclosure requirements that you will require in connection with the new Money Purchase Annual Allowance).

We do note that these make further complex changes to an already complex system increasing the burden on administrators particularly as the changes will impact a larger number of individuals

We hope that you find our comments of assistance and would be happy to discuss them further if that is helpful. You can contact me on 020 7432 6622

(Karen.goldschmidt@lcp.uk.com) (or through David Robertson of the ACA secretariat on 020 3102 6761 (david.robertson@aca.org.uk).

Yours faithfully

Karen Goldschmidt
Chair, Pensions Taxation Committee
Association of Consulting Actuaries

About the Association of Consulting Actuaries (ACA)

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 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 private sector defined benefit pension schemes.

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

Regis House
First Floor
45 King William Street
London EC4R 9AN
Tel: 020 3102 6761
Email: acahelp@aca.org.uk
Web: www.aca.org.uk

APPENDIX 1

Rules permissive override (273B)

We note the new provision 273B and are pleased to see the provision. However:

- Exercise of the new powers given to the trustees should be subject to the agreement of relevant employers – which we suggest is defined as "such employers/entities as would be subject to meeting the cost of any new options".

- Trustees should be given the power to charge reasonably for offering such options – recognising that implementing the new options does involve costs. Our understanding is that charging is not possible here unless the law specifically allows (perhaps this is a matter for DWP legislation?). Such a power would increase the likelihood that Trustees will offer (and have the agreement from relevant employers to offer) at least some of the flexible options direct from the scheme, rather than require the member to take a transfer to another product to get such access and which may involve the member in higher charges not least because the product provider has to cover the cost of taking in the transfer.

  This would follow the precedent of allowing schemes to charge for certain aspects where a member chooses to use pension sharing for divorce settlements (and NAPF provides a recommended scale of charges for private sector pension schemes).

- Trustees should be allowed to set such constraints as they wish to apply, when they do offer payments using the new labels. It would be helpful if the legislation (here or in the DWP legislation) could say this explicitly.

- It would be helpful if the list could include "payment of PCLS in connection with Flexi Access Drawdown". This recognises that some scheme rules currently pin down when a PCLS can be paid. Again the exercise of this power should be subject to the agreement of relevant employers.

Pension commencement lump sum (PCLS) and interaction with the new uncrystallised funds pension lump sum (UFPLS)

1. For the first time under Finance Act 2004, there are situations now where several different "authorised payment" labels could be attached to the same payment.

   For example, if a member has a DB scheme pension and a DC fund within the same scheme and draws them both, and the DC is all paid as a one-off payment to the member, all within the member's residual LTA, the draft law seems automatically to apply two labels equally to the DC payment, PCLS and UFPLS.

   At worst the reading could be that a payment has two labels and is two BCEs ie LTA usage is double counted, adjustments to AA closing values are double counted etc – clearly not the intention, so we think the law may need some change.

At best the law can be read as someone having to choose which label applies. Which label actually applies can substantially change the tax due on the member's benefits (the lump sum might be 25% or 100% tax free – and it might trigger the 10K MP AA or it might not. Is it the provider's decision as to which label applies where two could do so equally? If so, we think that this needs to be stated in the law so that the tax due is unambiguous.

2. The draft guidance suggests that "you cannot also have a pension commencement lump sum in connection with an uncrystallised funds pension lump sum". We are not sure that FA04 achieves this where the UFPLS is part of a package being drawn alongside DB scheme pension.

   For example if a member has DB pension of £40k pa (commutation rate of 20:1) and a DC fund of 200K might Schedule 29 para 3 (6) allow the following package?:

   Total lump sum of £450K of which
   £200K is DC UFPLS with 25% tax free
   £250K is PCLS (from commutation of DB) (=25% of (250K+200K+20x27.5K)
   With a DB residual pension 27.5K pa

   Similarly we note that a UFPLS can be paid to a member who has scheme specific protected lump sum rights under Schedule 36 Para 31 (unlike other situations where protection is available to members). It is not clear to use whether "ALSA" should include or exclude the UFPLS.

Trivial Commutation Lump Sum

If keeping the provisions substantially as drafted

At minimum, if the proposals are taken forward substantially as framed in the draft, we suggest the following changes

(aa) changed from "it is paid in respect of **a** defined benefits arrangement to "… in respect of **all** the …arrangement**s** ...". (Otherwise it looks as though the new TCLS cannot apply if the member has two DB arrangements in the scheme.)

(d) changed from "it extinguishes the member's entitlement to benefits under the pension scheme" to "it extinguishes the member's entitlement to benefits under **all the DB arrangements of** the pension scheme"

Now that many DC crystallisations will be BCEs (rather than TCLSs or SLSs), this change would ease administration by allowing DC benefits to be crystallised either before or after the DB.

We also query how the condition is to apply to cashing out pensions in payment. There will be some cases where some of the scheme pension may have derived from DC (eg a main DB pension plus a "scheme pension" from AVCs internally converted). To date there has not really been the concept of classifying benefits as being from DB or DC after the BCE occurred (particularly for a scheme pension). We hope that the proposed provision does not mean that such pension deriving from DC would need to be identified, and mean that it may not be possible to cash it out. In any case it is possible records will not split up the current pension into its sources.

It would be helpful if the allowed age for payment could include ill health cases (as per Pension Rule 1 in 165), to make the option available to all retirements.

Presumably the DB condition applies for a hybrid scheme to the extent that at the payment date the assessment of the benefit turns out to be DB not DC? Or would one look to the nominated date? In any case, please can this be confirmed in guidance.

We note that the consultation response document stated that *'This requirement for professional financial advice [before taking a transfer value from a DB arrangement] would not apply to small pot holders with pension savings below £30,000 as the trivial commutation rules would still apply."* Qualification for TCLS is too complex to prove, and applies in too few cases, to be the basis for setting such an exemption: we would be happy to discuss this further with you or DWP in the appropriate forum.

In fact we think the TCLS option should be substantially changed from the drafted provisions.

The TCLS is an important facility but already an unworkable facility in many cases and will get more so under the draft proposals. We would really appreciate consideration of a different change. Appendix 2 sets out some possible straw men for alternative approaches which we would be pleased to discuss further with you.

Scheme Specific ("25%+") Protected Lump Sum Rights Schedule 36 para 31+

The issue: There are a significant number of individuals who have "scheme specific lump sum rights" (SSLS) under Schedule 36 of Finance Act 2004 – the transitional easements automatically applying for individuals who had accrued benefits as at 5 April 2006 in occupational pension schemes and who, under the tax rules and scheme rules at that point, might have been able to take a higher proportion of their retirement benefits as a tax-free lump sum than under the new standard pension tax rules.

Whilst this is relatively simple conceptually, in practice they are not straightforward rights for scheme administrators to determine, and likewise they are not at all easy for the individuals involved to understand.

Currently the rules were written tightly such that, if a member transfers (totally or partially) away from the original scheme, the protection will transfer in some circumstances or will be lost or modified in others.

Proposals:

- Currently Schedule 36 para 31 requires that, when a member takes a transfer to a new scheme in lieu of all his rights under the original scheme, for protection to be maintained within a receiving scheme, the transfer must be part of a "block transfer". We suggest that this requirement is removed.

- In order for the receiving scheme to be able to identify those rights correctly, they need to know two numbers "VULSR" and "VUR" under Schedule 31. These are not straightforward to calculate – they are based on data up to 5 April 2006 and require knowledge and understanding of the 2006 scheme's rules and tax law at 5 April 2006, as well as how they all interact under FA2004. We suggest that on transfer it is a requirement for the transferring trustees to provide either these figures, or else an underestimate of VULSR and overestimate of VUR based on such simplifications as they feel is appropriate, given the nature of the data they hold, their policy for allowing commutation for lump sum before 5 April 2006 and the potential complexity of the calculation and costs involved.

Reason for proposals:

As the consultation document response notes, "the current system is complicated, inaccessible and rewards those who have only saved a small amount, or a very large amount, by providing them with flexibility and choice over how they take their pension savings". Furthermore the new regime recognises that in many cases an annuity is an inappropriate product for an individual.

The regime will not require schemes to provide the new flexibilities to members – recognising that this can substantially increase the burden of administration and create costs. Where a scheme does not offer the flexibilities, an individual with protected lump sum rights has a very difficult choice to make - remain in the scheme and potentially be required to take benefits in a shape inappropriate to their circumstances, or else transfer but suffer significantly more tax without the 2006 easement. (A third option – acknowledged by HMRC as available albeit perhaps not the original policy intent of the law when written - is to find a "transfer buddy" i.e. someone who can transfer to the same scheme at the same time. However, whether or not there is actually an extant appropriate buddy is pure happenstance). This matter has already been raised in the press (See Sunday Times 10 August 2014) with encouragement - possibly inappropriate - for individuals to take advantage of a limited temporary window arising from Finance Act 2014 that lifts the block transfer requirement for those who transfer before 5 April 2015 provided they draw their pension benefits by 5 October 2015.

We acknowledge that these individuals are benefiting from an old more generous regime already, from a regime which did require the balance of the fund to be drawn as pension - should HMRC really be perpetuating the transitional easement PLUS new flexibilities? But if HMRC does not the consequence could be to:

- Effectively to put a real block in the way of individuals for whom the flexibility is appropriate. An individual with a fund of say £60K would need to choose perhaps between: taking a transfer to take all as cash with 25% tax free; or being able to take 30K tax free but being obliged to buy an annuity with £30K losing perhaps £3,000 to £6,000 in tax so as to avoid being forced to spread 30K to a low lifetime income

- Result in individuals' decisions being skewed by the wrong drivers

- Keeping individuals in policies that are not really appropriate for them

- Add a real burden of complexity and risk to advisers

We are very aware that the protection involves complex management and in fact quite a burden for the schemes that hold these rights. But our conclusion is that it is better that matters are arranged so that they are preserved, rather than individuals having to face complex decisions to which no answer is particularly satisfactory.

(As an aside we note that the concept of "block transfer" raises wider issues - it is a major stumbling block to scheme tidy-ups. Our proposal would solve this too.)

Trivial Commutation Lump Sum Death Benefit Schedule 28 para 20

We were pleased to see the proposed new level for the above benefit, of cash out value up to £30,000. This is appropriate recognition that small pensions can cost disproportionate amounts to pay; and that a one-off cash payment can be much better help to the recipient.

However, we hope that you can change the draft so that the level applies for all payments made after Royal Assent, rather than all deaths after the Act is passed. This would enable schemes to do "sweep up exercises" ie offering cash out, to all dependents pensions now in payment in the scheme, using the £30,000 level.

If the draft is left as written, such future exercises will still have to use a £18,000 level if the member death was before Royal Assent .There seems to be no need for this block/extra complexity if £ 30,000 is now accepted as the appropriate measure of "triviality" for such a facility.

(While these changes are being made, it would be very helpful if the resulting rules can apply **in their entirety** for all TCLSDB **payments** after Royal Assent. At the moment if the "originating member's" death was before 6 April 2011, a Trivial commutation LSDB can be paid now only if the member died before reaching age 75 – and if so, that payment must be made before the date the member would have reached their 75th birthday. So the TCLSDB option in respect of a current dependent pension may not exist or may be time limited – again making "sweep up exercises" complex.)

Recycling provisions

We note the decision to maintain the recycling provisions but with a revised trigger level of £10,000. We are not sure why this level is being chosen (it seems to achieve little). We do note that to date schemes do generally warn members not to recycle so the provisions perhaps act as a "put-off" – but if a member does recycle, it is unlikely to be identified and unlikely that the due sanctions will apply.

The £10,000 Money Purchase Annual Allowance

The proposed operation of the Money Purchase Annual Allowance is not straightforward for individuals to understand, particularly with its use of PIPs and the way pension input amount is proportioned for the tax year of first triggering the reduced Allowance. However in general we do not have alternative suggestions and can simply ask that any burdens on schemes to support the operation of the Money Purchase Annual Allowance is kept as limited as possible.

However we do particularly note the proposed draft provisions on how the operation of the Money Purchase Annual Allowance applies to **hybrid arrangements**. We have separately sent you an email with our detailed comments in this area. We have highlighted to you that there are a significant number of schemes that already have hybrid arrangements – and many of them were specifically set up in connection with the contracting-out facilities allowed by Government. The contracting-out in many cases has stopped or is coming to an end – but the hybrid arrangements still create Pension Input Amount. These arrangements are clearly not set up to abuse or avoid the new Money Purchase Annual Allowance. We have therefore separately suggested carve outs to mean that the hybrid provisions in the draft legislation apply substantially more simply for such schemes and similar.

Deduction by the provider of tax on flexi-access drawdown payments or UFPLS

We have separately sent you an email of our detailed comments in this area, but note here:

We hope that you can continue the current deduction approach for SLS and TCLS, ie for the provider to deduct basic rate tax.

For FADD and UFPLS, we appreciate that this is unlikely to be acceptable to you as it may mean too little tax is deducted. From a provider's point of view, it is most important that the tax deduction process chosen is straightforward and unambiguous; and that it is easy for us to explain to members how the tax we physically deduct is calculated (albeit recognising that this deduction may not match the correct tax due on the payment).

Miscellaneous

We are not sure that the new 8B(2) works.

> (2) The sums and assets that make up the fund immediately before the payment is made become newly-designated funds "immediately before the payment is made (so that the payment is made out of the member's flexi-access drawdown fund in respect of the arrangement and therefore is not part of the total capped by pension rule 5)."
>
> It seems to require a recalculation just before payment? (similar for dependants). And does it tie in with 8C?

In s57 we are not sure that the proper offset applies where a member pays little or no MP contributions after drawdown. Guidance is clear that if £8,000 only is paid, DB input can be £32,000 without Annual Allowance charge. Does the legislation pick this up?

In example 7 (page 13) of the draft guidance, it might be helpful to explain that the test for whether Lifetime Allowance charge applies, and the actual deduction of that charge, will have already happened at age 75.

In example 9 of the draft guidance, our understanding is that Isobel can "carry-forward" £2,000 to assist with Annual Allowance in future years (based on DB PIA of £28,000 and MP PIA of £11,000, of which she pays tax in respect of the £1,000 excess over £10,000). It would be helpful if that was explicitly stated.

APPENDIX 2 - alternatives to the proposed "DB only" Trivial Commutation Lump Sum

The Government has indicated that "direct" DB flexibility will be consulted on some time in the future, but we appreciate that this may be delayed because of other urgent priorities. One aspect of DB flexibility is changing which we would like to try to hone to be as effective as possible.

Under the Bill proposals, there will be two means to cash out small DB benefits for a member who has attained NMPA:

- The Small Lump Sum (SLS), available when
  - (for benefits in an occupational pension scheme OPS) all the benefit for an in respect of a member in the scheme (whether DB or DC or a mixture) can be cashed out for a sum of less than £10K
    subject to some anti-abuse measures limiting scope for fragmentation (eg there must not have been a transfer from this or a related scheme in the last 3 years);
  - (for benefits from a personal pension PP) all the benefit in an arrangement can be cashed-out for £10K – for up to 3 personal pensions in a lifetime and with very little other constraint;
- The Trivial Commutation Lump Sum (TCLS), now to be available
  - (newly) only in respect of benefits from a DB arrangement,
  - extinguishing all benefit from the scheme
  - when the member has, at the start of a nominated 12 month window,
    a total benefit "value" (HMRC rules) of all past BCEs and current uncrystallised benefits (DB and DC), of (newly since March 2014) less than 30K.
    As before, this valuation ignores benefits that at nominated date have already been drawn as SLS.

We appreciate the increase from March 2014 in TCLS limit from £18K to 30K - and in cases where a member has benefits only in a single scheme that will be very helpful. However we think that the TCLS is a very difficult to operate for other individuals so as to achieve the full policy intent and will get more so – we set out why later.

We would appreciate consideration of an alternative, before schemes have to set work bedding in systems to manage a 30K TCLS in the new regime as it is currently proposed.

It is difficult to frame an alternative without understanding HMRC's key criteria but we have considered two straw men to start the discussion. At this stage we have not attempted to analyse them fully, but note they all have their pros and cons, with different implications for HMRC, for the scheme operation and for the members concerned:

Possible alternatives

Approach 1: Instead of a "DB-arrangement-only TCLS" and the (all types, whole scheme) "SLS", solely have SLS broken down into two types:

- The **"DC only" SLS** applies when all the benefits in the scheme are DC
  but it works exactly as now
  ie it has a limit of £10K
  with one set of rules for OPSs and one set of rules for PPs

- The **"Not all DC SLS"** applies if any of the benefit in the scheme are not DC ie where there is any element of DB or hybrid
  its operation would match the current OPS SLS rules
  but with a limit of **30K**.

As now, payment of an SLS would not trigger the 10KMPAA

Approach 2: Instead of a "DB-arrangement-only TCLS" and the (all types, whole scheme) SLS, have three types of SLS

- The **"DC PP" SLS** applying exactly as now, 10K limit, 3 PP arrangements

- The **"DC OPS" SLS** applying in respect of all the arrangements in a scheme that are DC, similar rules to the current OPS SLS but in respect of the arrangements that are and can only be DC, treated in aggregate, at £10K

- The **"non DC OPS" SLS** applies in respect of all the arrangements in a scheme that are not DC and cannot be DC ie DB and relevant hybrid in aggregate] at 30K

These proposals are based on the fact that the SLS rules for OPSs already have many measures in them to stop schemes being set up or manipulated to take advantage of the SLS facility. Our aim of any approach would be:

- To avoid the complex consideration of how the new "DB arrangement only" rules might work, together with the existing full complexity of the TCSL conditions

- To minimise the work involved in looking "across schemes"

- To be easy for a scheme and a member to apply.

- To have little scope for abuse.

Reason cash out of smallish benefits is needed for DB schemes/OPSs

Managing the payment of small pensions causes a disproportionate cost to DB schemes, which cannot be charged to the member. We have explored this with HMRC many times , but to point out just some of the issues: a scheme can have very many small pensions because of the long tail of past leavers with deferred pensions; each pension might, once in payment involve annual reviews; each pension has to be accounted for in scheme valuations and in any project in which a scheme tries to de-risk and achieve an endgame of buyout - or if it is forced to wind up in which case every penny matters. The more small benefits can be cashed out efficiently at retirement, the better for the scheme and its members.

The Small Lump Sum facility was set up to help deal with this - and the move to its new £10,000 level will be very helpful.   However, a £30,000 limit realistically available to help extinguish DB benefits would be a useful tool too.

Reason why the TCLS is difficult to operate, cost too much, can be operated in much more limited circumstances than intended, and many errors will arise

Before 2006 the TCLS rules were scheme-centric – they were designed to be simple from a "one-scheme" point of view. From 2006, the rules became "member centric" – tests had to be done across all the schemes in which a member had accrued benefits, involving complex information collection and valuation; potentially several loops when timing went wrong; and with the test passed or failed according to complex considerations of order and timing of drawing benefit. Where a member has benefits in just one scheme checking whether TCLS is possible is relatively easy. Where the member has benefits in more than one scheme, these tests are generally beyond the capabilities of many individual (schemes are beginning to try to devise flowcharts to assist members to do the check but they are challenging); and onerous or maybe even impossible for a scheme to do for a member. TCLS has been offered by many schemes only where a member confirms he has benefits only in that scheme.

If the rules continue as drafted, these problems will continue but be more complex (more schemes to look at, the complexity of incorporating tests for SLSs and UFPLS, the fact that it will be even more dependent than before on how the member draws other benefits). The 30K DB TCLS will be a policy intent that in real life barely can be used practically (generally only for those with benefits accrued in just one scheme).

PAYE considerations

One aspect of TCLS and SLS is that currently these are paid out net of basic rate tax – and HMT have indicated in workshops that they are minded to continue this.

We appreciate that the change we propose above changes the dynamics of the cases involved; but we hope that HMT could nevertheless continue with the principle that if our proposal were adopted, the two SLS types both have basic rate tax deducted by the provider, with adjustments to the correct rate applied by other means direct between the member and HMRC.

Other considerations

As noted in the main body of the response, it would not be appropriate to use these provisions as part of the conditions (or exemptions) for requiring a member to take advice on transferring DB benefit out of a scheme. The TCLS as it is framed in the draft Bill is clearly too complex and onerous a basis for setting such an exemption: we would be happy to discuss this further with you or DWP in the appropriate forum.