Freedom and choice in pensions

RESPONSE FROM ICAS TO HM TREASURY

11 June 2014
Introduction

The ICAS Pensions Committee welcomes the opportunity to comment on HM Treasury’s Command Paper Freedom and choice in pensions.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public and charity sectors.

Our Charter requires ICAS committees to act primarily in the public interest and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount. For example, the ICAS Pensions Committee has published two high profile reports on pensions in an independent Scotland in the context of the Referendum debate. Our reports which have been published under the banner “Scotland’s pensions future” have successfully raised important issues on the implications of independence for the State pension, public sector pensions and private pensions.

Key points

We have the following key points to raise on the Command Paper:

- We agree that there should be a statutory override to ensure that scheme rules do not prevent individuals from taking advantage of increased flexibility. However, any related regulations should be finalised in sufficient time before their effective date to enable schemes to implement them.
- Flexible retirement options need to sit side by side with the proportionate and effective regulation of decumulation products. As the paper does not deal with this aspect of Government policy it is difficult to comment more broadly on how the concept of greater flexibility may be brought to fruition.
- We support flexibility in retirement in principle but with flexibility comes complexity for individuals. Therefore, it would have been helpful if the Government’s proposals for the introduction of a guidance guarantee and accompanying monitoring framework had been scoped out in more detail in the Command Paper. The guidance guarantee is a significant part of these proposals but we are still unclear where guidance sits relative to independent financial advice and therefore how worthwhile the guidance will actually be for individuals.
- We believe that private sector DB to DC transfers should continue to be permitted in the interests of fairness, although we recognise that this could damage private sector DB schemes.
- We would like to see measures which ensure the equal treatment of pension savings for inheritance tax purposes whether these sit within a scheme or are held within an individual’s estate. In addition we would welcome the consistent application of the lifetime allowance to both DB and DC pensions.

Any enquiries should be addressed to Christine Scott, Assistant Director, Charities and Pensions, at cscott@icas.org.uk.
Responses to consultation questions and other comments

Responses to consultation questions

Question 1. Should a statutory override be put in place to ensure that the pension scheme rules do not prevent individuals from taking advantage of increased flexibility?

Response to question 1. We agree that there should be a statutory override to ensure that scheme rules do not prevent individuals from taking advantage of increased flexibility.

It is essential that regulations are published in sufficient time to enable schemes to implement them, particularly with the pace of the Government’s pensions reform agenda and the increasing preference for secondary legislation. We are aware of the following examples where regulations were published in final form, albeit by the previous Government, close to the date of implementation.

- **Tax simplification:** the Occupational Pension Schemes (Modification of Schemes) Regulations 2006 (which set out how changes to the pensions tax regime would affect all occupational pension schemes during the transitional period) were not finalised until 17 February 2006 and came into effect on 6 April 2006. The content of the regulations was crucial to scheme tax simplification and legal advisors had very little time to consider their full impact on pension schemes – market practice was therefore to execute an “elastoplast” deed and hold off implementing the full simplification changes until the effects could be considered in detail after 6 April 2006. Legal advisors had to contact all their clients during that period and the scale of the exercise across the market was immense.

- **Age discrimination:** the Government announced that the anti-age discrimination provisions applying to pensions including those in the Employment Equality (Age) Regulations 2006 needed to be re-drafted only weeks before they were due to be introduced on 1 October 2006. The re-drafted pensions age discrimination provisions were not finalised until the middle of November 2006 and came into force on 1 December 2006, again giving employers and schemes very little time to consider and implement any necessary amendments.

Question 2. How could the Government design the new system such that it enables innovation in the retirement income market?

Response to question 2. Ideally, we would have expected the Government to consult with stakeholders on options available for delivering its policy aims, including any regulatory matters, before the related tax arrangements were set out in the 2014 Budget.

We had been expecting the DWP’s plans to facilitate defined ambition arrangements, such as collective defined contribution arrangements, to drive change in pension regulation and through those changes to facilitate the development of a market for defined ambition pensions. However, to date the Government has not presented, for public consultation, a cohesive plan which dovetails the 2014 Budget proposals on pension decumulation with the decumulation options which could become available as a result of implementing its defined ambition policy.

We would envisage that insurers will seek to develop new draw down products as the Budget proposals will increase the demand for these. However, insurers would need to be confident that any new products they brought to the market would be able to operate without change over the long-term and that the regulatory underpinnings minimised the risk of products being deemed to have been mis-sold.

We made similar comments about the absence for proposals on how products would be regulated and how providers may respond to new opportunities in our submission to the DWP on its consultation ‘Reshaping workplace pensions for future generations’ which was published in November 2013.

In terms of specifics, we would support any plans to make the open market option for annuity purchase the default position. We recognise that this could increase demand for independent financial advice which is generally viewed as expensive. Therefore, value for money and the capacity for financial advisors to meet any increased demand will be key to whether people seek independent financial advice, or not.
While supporting flexible retirement options and recognising that the annuity market could be more efficient, we note that the Government is likely to benefit through increased tax receipts. However, as a consequence, annuity providers have experienced share price falls and possibly a permanent fall in demand for annuities. It is therefore vital that the prime objective of the Government’s approach to flexible retirement is to benefit pensioners and not to benefit Treasury coffers.

Question 3. Do you agree that the age at which private pension wealth can be accessed should rise alongside the State pension age?

Question 4. Should the change in the minimum pension age be applied to all schemes which qualify for tax relief?

Question 5. Should the minimum pension age be increased further, for example, so that it is five years below State pension age?

Response to questions 3 to 5. We do not believe it is appropriate for us to comment on what the minimum pension age should be. However, proposals to increase the minimum pension age appear contrary to the principle of increased flexibility for people.

Question 6. Is the prescription of standards enough to ensure the impartiality of guidance delivered by the pension provider? Should pension providers be required to outsource delivery of independent guidance to a trusted third party?

Response to question 6. We agree that standards should be prescribed to ensure that guidance is delivered consistently to all at ‘the point of retirement’, albeit that guidance may be required earlier in the lead up to retirement and that advice may be preferable to guidance at any stage in the accumulation and decumulation stages. However, it is difficult for us to comment further on this aspect of the guidance guarantee as neither proposed standards nor proposals for the accompanying monitoring framework have been drawn up.

Standards are normally associated with quality and this will certainly be an important feature of the guidance offered to retirees. However, the Command Paper hints that the standards address the scope of the guidance and its content. We believe this approach is appropriate as developing standards for the guidance guarantee will be as much about setting out what the guidance is not expected to deliver as what it is expected to deliver. The Government has been at pains to emphasise the guidance is not the same as independent financial advice which does seem to us to give it an image problem from the outset, making clarity over its scope an important feature alongside its perceived quality.

Increased flexibility introduces more complex tax considerations for individuals and it is not clear from any of the Government’s proposals how it envisages individuals will evaluate the tax consequences of the flexible retirement options available to them. It would be helpful to know whether it is the Government’s intention for tax matters to be covered by the guidance guarantee in some way.

The term ‘monitoring framework’ is used with reference to the delivery of the guidance guarantee. Therefore, monitoring compliance with the framework will be a regulatory activity. As it is not yet clear who will provide the guidance, it is not clear what authorisations these providers will be required to have. Regulation needs to be both proportionate and effective, and most importantly pension products need to be regulated. Therefore, in some respects the focus on regulating the guidance guarantee is only part of the story, with the regulation of products being absolutely key to the success of the Government’s policy on flexible retirement.

The use of the term ‘impartial’ rather than ‘independent’ highlights that the Government has not taken a policy position on who should provide the guidance. We have not arrived at a view on whether the guidance should always be provided by a third party but we are aware that other commentators have expressed concerns that guidance provided in-house cannot be viewed as genuinely impartial guidance.

In summary, increased flexibility means more complexity for individuals and we believe that there is an increased risk that individuals may make sub-optimal decisions due to a greater need for both independent financial advice and tax advice without any increase in the means of individuals to pay for it.
Question 7. Should there be any difference between the requirement to offer guidance placed on contract-based pension providers and trust-based pension schemes?

Response to question 7. We envisage that the planned introduction of Collective Defined Contribution (CDC) arrangements will mean that for some trust-based schemes, at least, additional guidance will need to be provided on retirement options. However, over and above any differences arising from an administrative perspective, it is difficult for us to comment on any potential differences between guidance for DB and DC schemes until we see the proposed guidance standards.

Question 8. What more can be done to ensure the guidance is available at key decision points during retirement?

Response to question 8. Until we know what form the guidance will take, who will provide it and who will bear the costs, it is difficult to suggest other points, if any, at which it should be mandated. Financial education and financial advice are desirable at points in a person's life but it is difficult to envisage how the introduction of an extended guidance guarantee would work. However, we believe that individuals with defined contribution pensions do need to review how their funds are invested in the last few years before retirement.

Question 9. Should the Government continue to allow private sector defined benefit to defined contribution transfers and if so, in which circumstances?

Response to question 9. This is a difficult issue given the potential for damage to private sector defined benefit schemes. However, we believe that it would be untenable to prohibit DB to DC transfers as doing so may be discriminatory and could be challenged from a human rights' perspective. Therefore, we would support leaving the existing flexibilities in place.

There are circumstances where a DB to DC transfer is the most appropriate option for an individual, for example, for someone who is terminally ill and/or has no dependents. Therefore, making transfers subject to trustee approval could have consequences for the trustee body or the PPF. For example, if a transfer was refused by the trustees, what would happen if the scheme entered the PPF and the individual's retirement income was reduced as a result? Would there be a potential liability arising in relation to any loss suffered and where would it lie?

The complex rules around transfers mean that it is already difficult for individuals to find an independent financial advisor who is willing to recommend that an offer is accepted on the basis that it is difficult to assess whether the cash transfer value represents a good offer.

We fully recognise that any increase in DB to DC transfers as a result of the planned reforms will make cash flow forecasts more uncertain. Uncertainty could lead to increased scheme funding requirements which in turn could create a risk of overfunding, for example, if in reality the demand for transfers from a scheme is largely limited to small pots only.

Some DB scheme trustees may consider a more innovative approach to scheme funding, for example, they may move to asset-backed funding and reduce investment in gilts. On the other hand, the prospect of more transfers out, and the greater uncertainty about cash requirements this creates, could mean that the trustees decide to place more of the fund in lower risk realisable assets i.e. bonds.

Question 10. How should the Government assess the risks associated with allowing members of private sector defined benefit schemes to transfer to defined contribution under the proposed tax system?

Response to question 10. It's not clear if this question is about the risks to DB schemes or the risks to individuals transferring their pension pots or both.

In respect of DB schemes, the most obvious approach would be to discuss the risks with the schemes themselves. Smaller schemes should be included in any discussions as they are likely to be disproportionately affected by transfers out.

The risk faced by an individual is that they could be worse off in retirement as a result of transferring their pot from a DB to DC scheme. Obtaining independent financial advice before making a decision to transfer would be highly desirable.

Response to question 11. See our comments on asset-backed funding in our response to question 9.

Other comments

We understand the Government intends to address the inheritance tax aspects of these reforms and we welcome this: we also welcome the retention of the tax free lump sum. However, we believe that the treatment of pensions savings which are held in someone’s estate on death should be treated consistently with pensions savings which have not been drawn down.

Another issue which requires attention is the measurement of the lifetime allowance which currently favours those with defined benefit pots. We believe this is another area where the treatment should be consistent for both defined benefit and defined contribution pensions.