2014 Budget Consultation
Response Document

Introduction

This document has been prepared in response to the Government's proposals for the creation of a new tax framework for retirement as set out in HM Treasury's consultant paper, "Freedom and choice in pensions", issued in March 2014.

The document responds to the questions raised by HM Treasury in the same order as they appear in the Summary of Questions contained in Annex A to the consultation paper.

Equiniti

Equiniti is a market leading business process services provider. We support 1,600 of the UK's leading businesses and public sector institutions, including around half of the FTSE 100. Our core capabilities are centred around complex administration and payment solutions including money transmission, administration and customer interactions delivered by 2,700 employees in 23 UK office locations.

We are leaders in share registration and pension services markets. We also have a strong presence in HR and employee benefits. Equiniti are the private sector partner for the first mutual joint venture out of UK central government, MyCSP.

Equiniti's pension solutions division provides software and services to a total 7.3 million members in the UK

A new tax framework for retirement (Chapter 3)

A.1 The government welcomes views on its proposed approach to reforming the pensions tax framework.

We are very supportive of the Government's proposed approach to reforming the pensions tax framework.

We feel that, in particular, the proposals for members with defined contribution benefits address many of the problems inherent in the current pensions system. Giving these members other choices than an annuity, regardless of the size of their pensions pot, is a welcome development which should increase their sense of ownership, encourage pension saving and instil a greater sense of personal responsibility.

The changes to the trivial commutation limits will also be of much benefit to the industry. From members to trustees to pension administrators to annuity providers, many involved with pensions will welcome this change.

But, as is often the case with fine ideas, the difficulties may arise in the details of the implementation which have yet to be set out.

One of the key issues which underpins the new approach is the guidance guarantee. We feel that this particular proposal is crucial and will help members to make considered choices when faced with the new flexibilities. Members with defined contribution pots will be subject to greater risk than before with the variety of options becoming available to them. For these reasons, as well as the fact that the new approach starts from next April, we believe that the details of how the guidance guarantee will operate need to be set out as soon as may be possible. It will take the industry many months to gear up to providing this vital link in the chain.

Regardless of the guidance guarantee, it is extremely important that individual members acknowledge that they are ultimately responsible for the success of the new framework. The Government should take all possible steps to ensure that members appreciate their role in the process. Initiatives such as financial education for all member ages and clear guidance that members cannot subsequently fall back on the state should they extract all of their pension savings would help this process. In order to ensure that members do not and cannot subsequently fall back on the state, the Government may wish to consider a process whereby the annuity equivalent of any lump sum taken by a member is lodged as a permanent pension credit penalty against that member. Pension providers could then disclose the future potential pension credit penalty before the member makes their decision.

As the new approach represents such a radical change to the existing and well established pensions tax framework, we believe that the industry would need a minimum lead in time of at least six months before implementation. This would run from the point at which all legislation and relevant guidance is in place. In view of the deadline of next April, it may be necessary to phase in some of the changes – in particular the guidance guarantee and education for the reasons suggested above.

So, whilst we are very much in favour of these initiatives, we feel it is very important to get them right from the start. To this end, members should be provided with the correct level of support as well as maximum encouragement towards the realisation of their own responsibilities which go hand-in-hand with the increased freedom and choice on offer.

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

   In our view, whether or not the flexibility measures should be put in place using a statutory override depends on the nature of the scheme in question.

   Pure defined contribution pension schemes

   For these purposes, pure defined pension schemes are schemes providing only money purchase benefits as described in the proposed clarified definition of money purchase benefits in section 29 of the Pensions Act 2011.

   For these schemes, all of the proposed flexibilities should be put in place using a statutory override. These schemes should not be allowed to impose barriers which prevent their members from taking advantage of increased flexibility. In particular, national schemes should be required to offer all of the flexibilities from the scheme itself (including a drawdown facility).

   We are mindful however that smaller and certain older schemes will face significant challenges as regards cost and complexity if they are forced to amend their systems to accommodate the changes. In these cases, the obligation on the scheme should be to provide a no-cost transfer to another defined contribution arrangement if a member wants to take advantage of the increased flexibility and, for example, purchase a drawdown product.

   Defined contribution benefits associated with defined benefit pension schemes, i.e. defined contribution AVCs

   These are typically ancillary pure defined contribution benefits built up by a member during a period of defined benefit accrual. It is not clear whether or not these benefits are covered by the Government's proposals. We believe that they should be outside of the scope of the proposed reforms. Again, defined benefit pension schemes should be obliged to provide a no-cost transfer of the defined contribution part of the pension scheme if the member wants to take advantage of the increased flexibility in relation to these benefits.

   Defined benefit pension schemes

   Defined benefit pension schemes should not be subject to any form of statutory override in respect of the revised triviality and "small pots" limits and their adoption should remain a decision for scheme trustees (subject to scheme rules).

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

   We believe that the Government could encourage more providers to enter the annuity market by relaxing the financial conditions applicable to providers and broadening the circumstances in which the level of a lifetime annuity can decrease allowing, for example, payment levels to rise and fall in line with the value of underlying assets. Variable annuities of this type have become part of the retirement plans of many Americans. Having said this, a projected reduction of 75% in the individual annuity market may discourage many from entering as any market needs buyers as well as sellers.

   In addition, any annuity products that don't offer a lifetime rate guarantee should be required to offer a transfer to an alternative annuity product on a cost neutral basis.

   The Government has tried to encourage the development of insurance/annuity-based products in an attempt to alleviate some of the pressures associated with long-term care costs. The industry has, however, been slow to take this up and this may be an area for development.

   Changes of this nature would need to be accompanied by increased scrutiny of the annuities market by both the FCA and TPR.

   Whilst we wholeheartedly support the aim of bringing innovation into the retirement income market, care needs to be taken to ensure that this innovation does not become a double edged sword. An influx of new products will mean more choice (and possibly confusion) for members. This will in turn lead to an increased demand for advice and will make the provision of good quality and impartial guidance critical going forward.

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

   We feel that the answer to this question depends very much on the long-term plan for defined contribution pension saving in the United Kingdom.

   If the intention is that this form of pension saving is kept separate from other more general types of saving, then it seems appropriate that the minimum pension age should be retained with a ten year gap between it and the later State Pension Age.

   On the other hand, perhaps the long-term plan is for the current distinction between defined contribution pension saving and other types of saving (e.g. ISAs) to be gradually blurred and then removed. In this event, it may well be appropriate to remove the minimum pension age altogether at this point in time which would give members even greater flexibility.

   Because of the uncertainties mentioned above, our vote would be for maintaining the minimum pension age but as a threshold rather than a limit. This would allow defined contribution members to take their benefits before they reach that age but subject to a small, additional, freestanding tax charge, e.g. 15%. This 'early crystallisation charge' would be payable by the scheme administrator and deducted from the benefit.

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

   We cannot think of any compelling reason for not applying a change in the minimum pension age across the board to all defined contribution pension benefits. Having said that, we do understand that there will be a good case for some exceptions to this rule. For example, those with 'protected rights' to take pension at an earlier age (as mentioned in this document) as well as those in special occupations.

   But, as referenced in previous answers, we feel that defined benefit pensions should be dealt with on a different basis. For these members, the issue of alignment with ISAs does not apply and the new flexibilities will not be available. It therefore seems sensible to leave the normal minimum pension age as it is for this category of benefit, unless the only change is to increase it to maintain a ten year gap with State Pension Age.

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

   In line with our response on question 3 above, we feel strongly that any move to reduce the gap between the minimum pension age and State Pension Age would be counter-productive. In our opinion, it would only serve to turn people away from the idea of saving in a pension scheme and it would act against the expressed intent for the new framework as set out in this document "Freedom and choice in pensions" and potentially stimulate short termism.

Supporting choice (Chapter 4)

A.2 The government welcomes views on its proposed approach to supporting consumers in making retirement choices.

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?*

   In our view, the provision by the Government of "robust standards" should be sufficient to ensure the impartiality of guidance given by pension providers and, as such, we can see absolutely no reason why they should be required to outsource the provision of guidance to a third party.

   In the command paper, Better workplace pensions: Further measures for savers (March 2014), the DWP has proposed that, with effect from April 2015, pension providers will be required to operate independent governance committees to assess the value for money delivered by contract-based schemes and report on how they meet the minimum quality standards set out in that paper. They will also have a key objective to act in the members' interests. We believe that such compliance governance can and should play an important role in monitoring guidance so as to ensure that it is both impartial and compliant with prescribed standards. We would go further by saying that external validation is key.

7. *Should there be any difference between the requirements to offer guidance placed on contract-based pension providers and trust-based pension schemes?*

   The Government's intention appears to be to make the same degree of increased flexibility available to members of both contract-based and trust-based pension schemes. As such, we can see no reason why the guidance requirements relating to these schemes should be different.

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

   Any standards that the Government provides must not only specify what information must be included in the guidance, but also when that information must be provided.

   In our view, guidance should be provided no later than three to six months before retirement and be followed up by a detailed written statement confirming all of the options available to the member. This statement should be in a standard form approved by the FCA and serve as confirmation that the individual has received the guidance to which they are entitled. Thought will need to be given as to the timing of guidance where a member elects to take either early or late retirement.

   It is not clear from the proposals whether the requirement will be for a "one-off" offer of guidance when the individual first accesses his defined contribution pot or for an offer to be made on every such occasion. This is an important issue as increased flexibility could result in individuals accessing their defined contribution pots several times over a lengthy decumulation period and guidance given at the start of that period may be outdated by the end. For example, guidance given to a member taking his tax-free lump sum at age 57 may well have been overtaken by developments in the market and in personal circumstance when he decides to use the balance of his pot to buy an annuity on reaching age 66 for example.

   The provision of guidance at multiple points in time would be costly for both pension providers and trust-based schemes alike. In our view, an individual should only be entitled to receive free guidance when they first access their defined contribution pot. Further guidance should be offered as and when they access any remainder, but pension providers and trust-based schemes should be able to charge for this. In addition, many members ask for several quotes as they approach retirement. Is it the Government's intention that each such request would trigger the requirement to offer guidance?

   As well as "what" and "when", there is also the question of who has to offer guidance. Where an individual has multiple defined contribution pots with different pension providers and/or trust-based schemes is the intention that all these arrangements will be required to offer individual guidance? Where guidance is given elsewhere, will schemes be required to seek confirmation of that guidance before they can put a member's benefits into payment? Any such requirement would complicate and delay the retirement process. Our suggestion is that members are required to self certify that they have received guidance either from the scheme or elsewhere at the point of drawing benefits.

Defined benefit schemes (Chapter 5)

A.3 The government would welcome views on the options outlined in point 5.15, including their likely complexity, and the burdens they might place on scheme sponsors and HMRC.

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

   Members of defined benefit schemes do not face the same risks as members of defined contribution schemes as regards the pension that they will receive at or in retirement and do not have to purchase an annuity to secure that pension. Because of this and the possible risks to both the UK economy and members of defined benefit pension schemes, we do not think that private sector defined benefit to defined contribution transfers should be allowed unless real safeguards are included.

Our views on the options set out in point 5.15 are as follows:

- If transfers were to be allowed in "exceptional circumstances", there would need to be clarity as to what those circumstances are. We would suggest that the following might be regarded as exceptional (although this is not intended to be an exhaustive list):
    - Transfers to an overseas defined contribution pension scheme where the individual concerned is currently living abroad and has done so for a prescribed period of time.
    - Transfers of pension credit rights created following a pension sharing order on divorce.
    - Deferred members who find themselves in ill-health may benefit from being able to take their benefits as cash under a defined contribution scheme.
- Ring-fencing would represent yet another form of transitional protection and result in further complexity and cost.
- An annual cap has the potential to create a considerable amount of additional work for those administering defined benefit pension schemes (with a corresponding cost for the scheme sponsor). Not only could it lead to an increase in the volume of transfer-related work, but every transfer-out made by a particular member would mean the recalculation of that member's benefits. Defined contribution schemes would also see a corresponding increase in transfer-in activity.
- Allowing these transfers to continue subject to the consent of the defined benefit scheme trustees would place a burden on those trustees who have an overriding duty to act in the best interests of the member. Decisions would have to be taken on a case-by-case basis and it is not clear on what criteria they would be based. Conversely, there is also a risk that less conscientious trustees may see such requests as an opportunity to "de-risk" and approve transfers without proper regard to the interests of the members concerned – this is a treating members fairly issue.
- As already stated, we do not think that private sector defined benefit to defined contribution transfers should be allowed to continue due to potential risks both to the UK economy and to defined benefit members who make poor decisions in relation to their benefits. We believe that, until these risks have been assessed and (if possible) mitigated, the ability to transfer should be withdrawn.

10. *How should the government assess the risks associated with allowing private sector defined benefit schemes to transfer to defined contribution under the proposed tax system?*

As stated in question 9, we believe that there are serious risks in allowing these transfers. In order to assess these, the Government must talk to defined benefit pension scheme trustees and scheme actuaries to try and determine the extent to which defined benefit pension schemes might move towards more liquid types of investments when faced with the possibility of more transfers out. Members of defined benefit pension schemes should be asked if they would (if allowed) transfer their benefits to a defined contribution scheme. They could also be asked when they might make such a transfer and in what form they might take their eventual retirement benefits.

Financial markets and investment (Chapter 6)

A.4 The government would welcome views on any potential impact of the government's proposals on investment and financial markets.

- Defined contribution pension schemes will need to redesign their investment policy so as to provide both cash and income generating options. Members will need to give serious thought as to how they want to take their retirement benefits and choose their options accordingly. The proposals spell the end for default lifestyling funds which reduce opportunities for fund growth and are geared to annuity purchase at retirement.
- A decline in the annuities market will not only have a direct impact on the providers themselves, but will also affect the wider UK economy as annuities are largely backed by gilt and bond investment and provide funding for Government, local authorities and businesses alike.
- As mentioned in our response to question 10, defined benefit pension schemes might switch funds away from longer term asset classes to more liquid investments when faced with the possibility of more transfers out (as will defined contribution pension schemes as their members look to take their retirement benefits as cash.) A move away from longer-term asset classes by UK pension schemes will mean a reduction in the long-term investment available to both UK businesses and infrastructure projects.
- There will be an increased need for advice to enable individuals to take their benefits in the most tax efficient way. The proposals will also lead to an increase in the number of pre and post-retirement financial products available in the market, e.g. retirement-orientated ISAs.

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