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Corporate

The 2014 Finance Bill Consultation

Freedom and choice in pensions

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Introduction

1. The Institute of Financial Accountants (IFA) and the Federation of Tax Advisers (FTA) welcome the opportunity to comment on the draft Finance Bill 2014 clauses on HM Treasury's consultation on 'Freedom and Choice in pensions' published in March 2014.

2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. Information about the IFA and the FTA is given below.

Who we are

4. The IFA is an internationally recognised professional accountancy membership body whose members work for small and medium-sized enterprises (SMEs) or who run or work in small and medium-sized accounting practices (SMPs) that advise SMEs.

5. At the IFA, we put small and medium enterprises (SMEs) first, recognizing their role as vital wealth-creators, as employers to more than half of the UK's private sector workforce and as the power behind vibrant urban and rural communities. We hold the interests of small and medium practices (SMPs) in the accounting profession in equal regard.

6. The FTA is the Tax Faculty of the IFA and is the modern membership body for agents who provide tax compliance and planning expertise to SMEs and entrepreneurs. It is the tax representative for IFA and FTA members.

7. We are proud of our unique relationship with our members, who predominantly come from a SME/SMP background. As a professional accountancy body, we aim to provide the very best support and guidance to our members who operate within this arena, frequently tailoring policies and recommendations to meet the unique challenges and trading relationships associated with smaller business.

8. Founded in 1916, the IFA supports over 10,000 members and students in more than 80 countries with a programme of professional qualifications and education. As well as resources, events, training and seminars. IFA members uphold high standards of conduct, confidentiality and ethics and undertake annual continuing professional development (CPD) activities.

9. The IFA is a full member of the International Federation of Accountants (IFAC), the global body for the accountancy profession. As such, the IFA takes its place alongside the UK and Ireland's six chartered accountancy bodies, as well as 135 national and regional accountancy organisations representing 125 countries and jurisdictions.

10. The IFA is formally recognised as an awarding organisation by Ofqual, the public body responsible for monitoring standards, exams and qualifications (other than degrees) in England, underlining the quality of the IFA's work and the integrity of its qualifications; and is authorised by HM Treasury for Anti Money Laundering supervision.

General Comments

11. We are generally supportive of the proposed changes to the way individuals can access their pension funds on retirement as long as this freedom incorporates sufficient guidance and safeguards so that individuals understand the choices they are making and the impact that these choices will have on their income and lifestyle during retirement.

12. However, based on the evidence of countries where greater flexibility has been introduced, we believe that where individuals receive comprehensive retirement advice there may, in practice, be little impact on the type of product invested in on retirement; we anticipate that most individuals will choose to convert their pension savings into a guaranteed income stream. For example, in the 2012 Blackrock US pension survey 77% of retirees interviewed said that knowing what they knew now about retirement, they would have chosen to receive a steady stream of income on retirement.

13. Evidence from the USA also shows that only circa 19% of individuals take advice on their options at retirement and, as a result, individuals exhaust their pension savings by the age of 83 on average.

14. Furthermore, based on the experience of our members in the UK, we expect that, even after the introduction of the proposed changes, when retirement planning advice has been received the only individuals who will choose to drawdown significant proportions of their pension fund on retirement are either:

    a. Those who have accumulated large pension pots or alternative sources of income which they can use to provide for their retirement; or
    b. Those with small pension pots where the annual income it would produce in retirement is negligible.

15. Both these groups of individuals can already access their pension funds under the “flexible drawdown”, “trivial commutation” or “small pots” legislation.

16. That being said, individuals with small pension pots but which exceed the trivial commutation threshold (as well as those who may be seriously ill) will benefit from the potential new pension legislation as it will allow them to manage their money more effectively – for example by paying off existing debts.

17. The proposed changes may also lead to an increase in the number of individuals saving for their retirement through contributions into a pension scheme. This is because a common reason cited for not making pension contributions whilst an individual is in employment is the concern that the funds are ‘locked up’ and cannot be accessed if necessary. The introduction of greater flexibility at the point of retirement may alleviate some of this concern and may encourage greater pension saving. In particular where individuals are approaching retirement age it will be far more tax efficient to save into a pension than an ISA, for example, by virtue of the tax relief available on pension contributions.

18. To summarise, therefore we expect to see phased retirement and more product blending as a result of this new flexibility and that more than ever individuals will need even more advice and guidance on their options for saving for and accessing their pension savings.

Specific answers on the questions raised in the consultation

19. In addition to our general comments, our answers to the questions raised in the consultation document are given below.

A new tax framework for retirement

Q1: Should a statutory override be put in place to ensure that pension scheme rules do not prevent individuals from taking advantage of increased flexibility?

20. We do not believe that a statutory override is necessary. When an individual joins a pension scheme they currently receive detailed information on the scheme rules which they will be bound to comply with. It is then up to them to decide whether they wish to restrict their options beyond those contained within pension legislation.

Q2: How could the government design the new system such that it enables innovation in the retirement income market?

21. From the perspective of our members, the design of the system in itself is unlikely to result in innovation in the retirement income market.

22. Annuities will continue to have a place within the new retirement income landscape as many clients will still want the certainty and guaranteed income that these type of products provide, although we appreciate that other options should also be given consideration. Recent press coverage has focused on the negative outcomes received by a segment of customers in the annuity market, but it is important to note that these concerns primarily relate to standard conventional annuities where the customer fails to shop around and has not taken advice. Enhanced annuities, investment-linked annuities, fixed term annuities and drawdown will all be key products in constructing the income individuals need in retirement. There is still a valuable place in retirement planning for enhanced annuities; representing good value for money and providing a secure guaranteed income for life for those who cannot afford fluctuations, ie the individuals have no capacity for loss.

23. That being said, one of the biggest problems in the retirement market is the fact that many individuals accumulate a number of pension pots with different providers as a result of changing employment during their working life. These pension pots are costly for the pension provider to operate. As a result of the recent reduction in the cap on management fees that can be charged to 0.75% of the fund value, several of the larger pension providers have recently increased the monthly minimum pension contributions required in order for an individual to participate in a scheme, as anything less is not cost effective. This reduces choice within the pension market.

24. To counter this and increase innovation in the retirement market software could be developed which could be available to all employers to allow them to allocate pension contributions to an individual's pension provider on an employee by employee basis. The employee would then have a single transferable pension pot throughout their lifetime. This larger 'combined employment pot' would offer economies of scale to both the pension provider and individual resulting in lower fees overall.

Q3: Do you agree that the age at which private pension wealth can be accessed should rise alongside the State Pension age?

25. We see no reason why the age at which private pensions can be accessed should not rise alongside the State Pension age since the reality is that very few individuals can afford to take their personal pension earlier than state retirement age and that where individuals fully understand the long term financial consequences of accessing their funds as a lump sum in the early years of retirement, most choose not to draw down any more than the 25% tax free lump sum. Consequently the minimum age acts as a failsafe mechanism to safeguard against individuals accessing their funds early thereby denying themselves income during retirement.

Q4: Should the change in the minimum pension age be applied to all pension schemes which qualify for tax relief?

26. Yes for the reasons cited in para 25 above.

Q5: Should the minimum pension age be increased further, for example so that it is five years below State Pension age?

27. We do not believe that any change is necessary as the minimum age an individual can access their funds in practice has little bearing on when they actually choose to, as explained in para 25 above.

Supporting choice

Q6: 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?

28. Whilst in theory we agree with the proposal that individuals should be able to access free independent advice at the point of retirement and, additionally, when considering drawing down on their pension fund at any stage during retirement, the provision of independent, impartial face to face advice is one of the biggest challenges in the proposed legislation.

29. The additional competency and qualification requirements introduced in the Retail Distribution Review ('RDR') have already led to a significant reduction in the number of financial advisers and the limitation of the ability of banks to offer face to face advice to customers. As a result, there are simply not enough financial advisers to provide the advice proposed.

30. In addition, since multi-product financial services institutions are prohibited from subsidising their pension business from their other business lines, the provision of such advice will further erode the profitability of pension providers. At present, on average, pension providers only start to generate profits from managing an individual's pension fund when the individual has held the fund and contributed to it for 13-15 years dependent upon provider. If profitability is reduced further there is a risk that pension providers may demand higher minimum monthly contributions or withdraw from the market, thereby reducing freedom and choice in the market place.

31. It is also unclear in the proposals what recourse an individual may have if they felt that they had not received adequate advice at the point of retirement. Pension providers will be reluctant to assume liability when the provision of the advice is already a real cost to them.

32. The only form of independent advice that we believe can be realistically provided free of charge to all those reaching retirement age is a decision tree, or some other form of written document, which sets out the options available to them and the pros and cons of each of the ways in which they can access their retirement fund. This could be produced by an independent not for profit body, such as the pensions regulator or the Citizens Advice Bureau.

33. In addition, an interactive tool could be made available on the pension regulator's website to allow individuals to model basic scenarios and gain a better understanding of the financial impact of accessing their pension in various ways at various stages at the point of and during retirement.

34. That being said, we fear that the lack of availability of good qualify affordable advice may result in people acting against their long-term best interests.

Q7: Should there be any difference between the requirements to offer guidance placed on contract-based pension providers and trust-based pension schemes?

35. With the advent of master trust arrangements such as Nest, The Peoples Pension and Now Pensions these schemes offer a trust based guidance to help with what could be perceived as the more vulnerable end of society (lower and more transient earners), thus guidance here could possibly be more beneficial than those having earnings large enough to qualify for Group personal Pension plans (contract based plans).

Q8: What more can be done to ensure that guidance is available at key decision points during retirement?

36. The pensions market is already one of the most highly regulated financial markets and pension providers are already legally required to provide significant amounts of literature and guidance to those approaching retirement age. Consequently we do not believe that additional legislation is required in this area. Often too much information is counter productive as it is never read.

37. The final legislation should also be clear on what is meant by 'key decision points'. Is this when you first access your pot? Is it state retirement age? Is it a certain amount of funding ultimately taken etc.

38. In addition, the most suitable pieces of advice that we believe will be most appropriate and feasible at the key decision points are the aforementioned decision trees and pros and cons table. Any more than this would require a comprehensive review of the individual's personal circumstances akin to the current requirements of paid independent financial advice. This would mean full income and outgoings information would need to be calculated, alternatives considered and a robust document reporting process put in place to cover against complaints. Whilst the concept of the provision of guidance is simple, the implementation is likely to be considerably more problematic.

Defined benefit schemes

Q9: Should the government continue to allow private sector defined benefit to defined contribution transfers and if so, in which circumstances?

39. We recognise the real financial risk to defined benefit pension schemes from allowing individuals to transfer to defined contribution schemes and the desire to ensure that schemes with a funding shortfall do not become insolvent.

40. Transfers from defined benefit schemes to defined contribution schemes are, however, already highly regulated and, in our members' experience, transfers are extremely rare as they will rarely be in the individual's best interests. In addition, finding an adviser who is prepared to advise and administer a transfer from a defined benefit to a defined contribution scheme will be difficult.

41. Consequently, we believe that individuals should continue to be allowed to transfer into a defined contribution scheme, where scheme rules permit them to do so, subject to having received the necessary financial advice. After all, the trustees could provide a low transfer value, thus removing any advantage of transfer and thus saving any ultimate increase in liability to the scheme that would arise upon transfer.

Q10 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?

42. See above, we believe that any transfers will be rare, however we would support further consultation with the pension industry prior to the introduction of legislation relating to defined benefit schemes.

Should you wish to discuss our responses further, please contact AdamL@ifa.org.uk in the first instance.