



Very few retirees would benefit from the Government's current proposals to remove the requirement to annuitise by age 75...

ACA calls for Minimum Income Requirement rules to be broadened so more retirees can have option not to annuitise

20 September 2010: In their response to HM Treasury's annuity reform consultation *Removing the requirement to annuitise by age 75*, the Association of Consulting Actuaries (ACA) says that broadening the rules for pension savings that satisfy the Minimum Income Requirement (MIR), the income level below which retirees would still have to annuitise at age 75, would significantly extend the numbers of retirees who could take advantage of the new freedom. Without such a change, there is a danger the reform will be seen as a perk for the 'wealthy only'.

The ACA says that as the annuity reform proposals stand, the requirement to have a pension or annuity that is actually providing the MIR seems onerous, particularly for people who have no defined benefit pension (DB) and/or no state pension (e.g. the self-employed). They would mean someone who has no DB provision has to buy an annuity with part of his/her funds in order to be allowed to avoid buying an annuity with the rest!

The ACA suggests that there should be an extension to the items allowed (see below) to count as secure for the MIR. If this is not permitted, a significant and vocal group of those approaching age 75 will complain about the fact that they still have to buy an annuity. .

The ACA suggests that the rules should permit the following items to be added up to get a notional income equivalent to compare with the MIR.

- "Secured pension" (i.e. DB pensions and/or annuities) that carry "Limited Pension Indexation" increases in line with inflation capped at 2.5% per annum or more (Note: this item should include all Guaranteed Minimum Pensions (GMPs). While it is common for occupational pension schemes not to index-link GMPs that were earned for service between 1978 and 1988, this is because they are index-linked by the state as an addition to the individual's normal state pension.)
- 75% of "Secured pensions" (DB pensions and/or annuities) that do not increase, or increase at less than the 2.5% rate.
- 50% of the "annuity equivalent" of any pension funds that the member agrees will be 'ring-fenced', so that they will not be drawn down as cash unless and until the member asks for a further MIR assessment (this would require policing by the fund provider to ensure that the funds are not withdrawn). The member should however be allowed to use some or all of the ring-fenced funds to buy an annuity at any time.

"The non-increasing multiplier of 75% means that inflation will have to rise by a third before the MIR is threatened by the absence of indexation. The final piece with a 50% multiplier is intended to provide quite a lot of safety margin, so that even if markets fall and annuities become more expensive, the remaining assets are likely to be large enough to support a pension over the MIR," says Charles Young, ACA Pension Schemes Committee Chairman.

The ACA adds that MIR should be set at the minimum level required to keep a pensioner out of state means-tested benefits, plus a margin to allow for the possibility of this minimum rising somewhat faster than the income that covers the MIR. The ACA suggests a level of £200 per week increased annually in line with State pension increases. This provides a significant safety margin above the Guarantee Credit, where the individual would receive state support. It also compares reasonably with an individual's typical expenditure needs, based on the figure during the "normal" part of a pensioner's life.

The ACA does not believe that there is a need to ensure that there is more income shortly after retirement: while typical expenditure is higher at that age, the pensioner will typically have their retirement tax-free cash sum to finance this, so this level of expenditure does not need protecting. £200 per week is around the 20th percentile of UK earnings¹ – the ACA does not believe that it would be appropriate to require more than this.

The ACA says that the same MIR should apply to individuals and couples. It is entirely possible that the spouse has their own income, so it seems unnecessarily restrictive for a married member to be required to guarantee income up to a higher level.

On cost-effectiveness grounds, the ACA says MIR should normally be tested once only, when an individual first wants to draw down more than would be permitted under the capped drawdown arrangements. After this point, the individual would be permitted to draw down any or all funds outside those needed for the MIR, as and when the individual wishes.

The ACA paper says the current level of 120% of an equivalent annuity remains the appropriate annual drawdown limit for capped drawdown.

Currently, income drawdown is quite closely monitored, in that pension providers typically require the individual taking drawdown to take independent financial advice. This is one of the reasons why drawdown is usually only recommended for individuals with large pension funds.

If HMT wishes to make drawdown more widely used, financial advice is likely to be less thorough for those with smaller funds. The industry will need to find some way of providing information that will help individuals assess the pros and cons of drawdown, and in particular the lack of longevity insurance.

The ACA says that information for individuals must make clear that drawing down all money up to the maximum permitted may not leave the member with what he or she regards as a reasonable income for the remainder of their life.

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Note for Editors

About the Association of Consulting Actuaries (ACA)

The Association of Consulting Actuaries (ACA) is the representative body for consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body. The ACA has 1750 members working in around 75 firms. ACA Members are all qualified actuaries and all actuarial advice given by members is subject to the Actuaries' Code. The ACA forms the largest national grouping of consulting actuaries in the world.

¹ Source: Office for National Statistics: 2009 Annual Survey of Hours and Earnings: Weekly pay – Gross (£) – for all employee jobs – United Kingdom. The 20th percentile was £207 per week.