



**Response from the Association of Consulting Actuaries  
to the HMT/Inland Revenue document  
'Simplifying the taxation of pensions: the Government's proposals'  
dated 10 December 2003**

## **Introduction**

The Association of Consulting Actuaries (ACA) draws its membership from consulting actuaries working in over 80 consulting firms. Members of the Association are all qualified actuaries – either Fellows of the Faculty of Actuaries in Scotland or Fellows of the Institute of Actuaries – and all actuarial advice given by members is subject to the code of professional conduct of the Faculty and the Institute of Actuaries.

The major part of our members' work is as advisers to UK pension funds with assets in excess of £650 billion. The vast majority of the country's largest pension schemes are advised by ACA members and they, amongst thousands of other pension funds, companies and organisations take advantage of a wide and varied range of services offered by our members.

## **Overview**

The ACA welcomes the proposals as a whole whilst having a few reservations.

We are particularly pleased with the way in which the government has listened to submissions on the 2002 consultation, and in particular to the ACA submission and we endorse:

- The extra transitional protection route (enhanced protection)
- The use of simplified factors
- The reduced level of recovery charge
- The ability to take all benefits subject to recovery charge as a taxed lump sum
- The change in pension credit position post A-Day

We are disappointed at the further delay in referring some matters to the NAO and the inevitable planning blight that has resulted. We would be unhappy if this delay means that A-Day is put back from 2005 to 2006, as the period of planning blight would then be extended for a further year.

Whilst there may be serious concerns being expressed as to whether all necessary administration changes, consulting with employers over scheme design changes and all legal drafting of amending deeds can be completed by April 2005, we are of the view that these problems can be overcome once the timetable is known. We are of the view that all changes that are needed to be made before A-Day can be made by then, with other changes to follow.

We are disappointed that the Lifetime Allowance will only be increasing in line with the RPI, as this will inevitably bring large numbers into the “complex” area of benefit and tax planning for alternatives to pension accrual. We would not challenge the IR’s figures for the number of currently uncapped individuals who would become affected by the new Lifetime Allowance, but we are convinced that the increasing complexity of the new system over time will warrant a rethink sooner rather than later. However, the bottom line is that this is a political decision.

We are disappointed that there is no proposal for a regular review of the Lifetime Allowance in the light of improvements in mortality and consequential reductions in market annuity rates.

We are happy that accrued FURBS benefits will be protected outside the new system (apart from the increased taxation during roll-up) and will not propose that any further consideration should be given to integrating FURBS with the new tax regime.

We think that it is essential that there is a provision that enables schemes to amend existing rules so that they continue to apply after A-Day in the same manner in which they applied before A-Day, in terms of limits placed on benefits where these are currently restricted by reference to Inland Revenue limits. A general exemption from the provisions of s67 of the Pensions Act may not be sufficient if its scope is limited to those changes *required* by the Finance Act 2004. It needs to go further and to cover any changes that are made consequential to the changed taxation regime, provided that the member’s benefits would not be worse after the changes than they would have been if the regime change had not occurred. For instance, the imposition of a scheme-specific earnings cap should not be subject to a s67 certificate, which may be or may not be able to be given, depending on the extent to which the 1989 changes were explicitly written into scheme rules.

We would be unhappy if early retirements before age 55 are retained by the public sector but prohibited for the private sector – but we think that the transitional protections put in place are fair and would not want to be seen as being against the change per se.

**Our detailed comments are set out below into four sections:**

- Issues relating to the ongoing working of the new regime
  
- Transitional issues
  
- Overseas and International issues
  
- Administration issues

## Ongoing Issues

### General comments

1. There are still various proposals where DB and DC schemes and/or benefits are treated in different ways. If these differences are to remain (although we hope that as many as possible can be avoided) we believe it would be essential to define, for the purpose of simplification, when a scheme or benefit is one or the other.

The definition is important as it will feed through various parts of the proposals: valuation at vesting, valuation of protection at A Day, annual allowance etc.

For OPSs, the existing Revenue definition of a DC scheme applies only in very limited circumstances and is used only for a very technical funding issue: so we ignore this here.

The vehicles that currently exist, that will have to fit into the new framework include:

- occupational pension schemes falling under the “DB regime of limits” but with
  - main benefits partly money purchase, partly final salary (e.g. age-banded)
  - main benefits DB but with money purchase AVCs
  - cash balance, where the final benefit will depend on annuity rates at “vesting” but growth beforehand may not, or may only partly depend on investment returns
  - main benefits DB but with a DC underpin
- buy-out policies with DB style limits, but within these the benefits depend on investment returns
- any insured money purchase arrangements with guaranteed investment returns or conversion terms
- other variations being developed to share risk between employer and employee.

We also envisage personal pension products emerging that might allow a member to lock into deferred annuity rates some time before vesting – in essence, converting this to a known (i.e. DB) benefit before vesting. It is therefore not at all straightforward to create a “scheme-based” definition.

We would propose that

- The labelling “DB” or “DC” is done by element of benefit, not by scheme.
- “DC” means that the ultimate benefit depends on investment returns or on annuity conversion, the terms of which are not pre-guaranteed.

- Where there is doubt (for example the underpin case) the individual can choose which approach to use.
2. From A-day the practice notes will cease to exist and will be replaced by legislation. We think it would be helpful if the Inland Revenue were to produce a “Guide to pension schemes” intended to be more user friendly than the legislation.
  3. The proposals appear to apply generally to both private and public sector pension schemes, with some specific comment on pension schemes for the armed forces, police and fire services at paragraph 2.15. It would be helpful if the position can be clarified in such a way that both sectors are treated consistently.
  4. We hope that the Inland Revenue will open a Q & A section of its web-site as soon as possible, to assist in the speedy implementation of the changes.

## Specific Comments

### 1.2 The simplified pensions regime

We recommend that the single lifetime allowance is subject to regular review, perhaps every five years, to check that it still meets its objectives. A simple annual indexation will not allow for changing investment conditions and will fall increasingly short of allowing for expected mortality improvements.

### 1.6 The simplified pensions regime

We hope that 25% is applied to the total benefit value, inclusive of Protected Rights, so that IR policy is in line with that of the DWP.

### 1.16 Non-standard factors

There are likely to be a large number of non-standard factors required. The ACA would be very happy to assist the Inland Revenue in formulating a policy of valuing non-standard benefits that is consistent with 20:1.

### 1.42 The simplified pensions regime

We assume that where security is provided by other than an insurance contract (e.g. a charge on assets) then such a security will not be charged as a benefit in kind.

### 1.43 Non-registered schemes

Legislation needs to be clearer on how corporation tax relief would work for non-registered schemes.

We assume that the general benefit rules for this purpose include a 25% cash limit? However, it is not at all clear what sort of annuity could be purchased to secure the excess? Would a purchased life annuity (with capital content) be permitted?

We would hope that double taxation (income and inheritance) would not be imposed on death benefits.

If cash in excess of 25% is taken (say 26%), it is not clear whether the NI is payable on the whole 26% or only on the extra 1%. We hope that it will be confirmed that it is the latter.

## **2.8 Protection of a right to draw a pension at age 50**

We are concerned that the protection that is stated will exist if the existing right is “contractual” may not cover deferred members of pension schemes who have an existing right under the scheme rules to retire at age 50. If these rights are not covered by the term “contractual”, then the term should be extended to include “accrued rights to benefit under schemes”.

## **3.10 Scheme benefits**

The definition of dependant needs to be at least as wide as at the moment. We hope that the definition could be as set out in scheme rules without too much (if any) statutory restriction.

## **A11 Annual allowance**

The AA limit is expected to impact on very few people. It is very important that the administration (in particular as it impacts on schemes) to catch those few people does not end up impacting on large numbers of people. We suggest at least a crude filter such as specifying an earnings level below which individuals are automatically exempt from checking whether the annual allowance has been exceeded. Perhaps 1/2 of the annual allowance in force at the time.

## **A12 Annual allowance**

We suggest that the increase in capital value of DB benefits should be assessed as the increase in excess of inflation. This would be consistent with the treatment of deferred DB benefits and also with DC schemes.

## **A24 Lifetime allowance**

How should temporary pensions be dealt with? A factor of 20 is potentially much too high, but this situation is too common to be dealt with as non-standard under A25.

We would recommend that a temporary pension, such as a bridging pension ceasing at state pensionable age, be valued as the annual amount of pension multiplied by the maximum term of the pension (subject to a maximum multiplier of 20).

Requiring the maximum lump sum to be calculation to be based on the value of post-commutation benefits results in a complicated calculation. The maximum lump sum is equal to

$$20 * P * C / (3C + 20)$$

where C is the scheme commutation factor, and

P is the pre-commutation pension

In the spirit of simplification, it would be more straightforward if the maximum tax-free lump sum were to be 5 times the value of the pre-commutation pension. See also our comment on C13.

**A26 Lifetime allowance**

The permission for across the board increases to pensions in payment needs careful definition to encompass reasonable “catch up” exercises but to minimise abuse.

**A27 Surpluses**

We suggest that surpluses that have built up due to current restrictions on benefit payments should be allowed to be paid out as a lump sum, subject to suitable taxation.

**A34 The recovery charge**

In practice, because of other issues impacting on the factors used by schemes to commute pension for lump sum (for instance rules expressed otherwise), existing factors may not be actuarially justified. We suggest, rather than require all three bullets to apply, that either the first bullet or (both the second and third bullets) apply. We also suggest, to avoid the interpretation that the same factor should be used for everyone (for example, even when the benefit given up has different increases attaching), that “equivalent” in the second bullet be changed to “consistent”.

**A42 Transfers between schemes**

It needs to be clarified whether transfers after vesting are prohibited (as at the moment, other than for reconstruction), or not. Earlier IR consultation on flexible annuities appeared to indicate that transfers during drawdown would be permitted.

**A49 When and how pensions must be paid and taxed**

Trivial commutation should presumably be included as an exception here.

## **A56 Types of pension benefit**

We are unhappy with the conditions for determining the amount of the payments. The maximum income is proposed to be 70% of the annual amount of the flat rate single life annuity which could be obtained on the open market for a person aged 75 (or an earlier age if ASI commenced before 75). Thereafter the amount is reviewed at least annually but basis for determining the maximum remains unchanged i.e. 70% of maximum annuity for a person aged 75 even though the retiree is now aged more than 75. This basis of valuation is unduly restrictive compared with what could be obtained from an annuity as can be seen from the following:

Age	Ratio of Maximum ASI to maximum annuity
75	70%
80	55%
85	43%

Clearly the Government is keen to ensure that people using ASI do not erode their pensions savings too quickly and hence have recourse to social security but the basis proposed is far too penal and discriminates unfairly against those who do not wish to buy an annuity on religious grounds. The requirement to undertake an annual review and a restriction of the maximum to 70% of the maximum flat rate single life annuity at the retiree's then age should be more than sufficient to ensure that the retiree continues to receive an adequate income from ASI for the rest of his or her life.

Under the last bullet, could not the ASI funds be transferred to a provider willing to provide ASI?

## **A61 Death benefits**

What right would the personal representatives have to recover the recovery charge from the recipients of the death benefit lump sum?

## **A65 Death benefits**

There is no provision, as now, for the guaranteed payments following the death of a pensioner to be paid as a tax free lump sum if the guarantee period is no more than 5 years. We would encourage this provision to be maintained as it is extremely common and popular with current pension schemes. If the provision is removed, the likely result is for a complicated term assurance arrangement to be put in place to replicate the provision as it will commonly need to be provided as an accrued right.

Guarantees of up to 5 years payable as a lump sum for retirees up to age 75 are currently written into many, if not most, scheme rules. The removal of this benefit would probably breach the Human Rights Act, particularly for pensioners over age 70 whose benefits came into payment after age 70, and probably for deferred pensioners and active members who have the right to draw pension up to age 75 with a 5 year guarantee. We do not think that converting these lump sum rights into dependants' pensions is adequate, as these would be less valuable (due to the time value of money) and there may not be any dependants.

The current regimes also allow for a "funeral grant" of not more than £2,500 to be paid as a lump sum on death at any age. We would encourage this provision to be maintained as it is a potentially very useful benefit to have at a time that may be very difficult to cope with.

#### **A70 Death benefits**

We are unhappy about the restriction on death benefits after age 75 for individuals using drawdown under the Alternatively Secured Income route. This inflexible approach will remain contentious and we think it should be addressed now. We have not been told what happens on the death of an individual with ASI after 75 where there are no dependants (we do not think such funds should necessarily be refunded to charities). We recommend those surplus funds are taxed and the balance returned to the member's family.

#### **A72 Death benefits**

Dependants' pensions should be able to cease on other contingencies, such as cohabitation.

#### **A73 Death benefits**

We would encourage the continuing provision of dependant's benefits after the age of 23 if still dependent for any reason (e.g. in full time education) and not just on account of disability.

#### **A79 Trivial commutation**

We suggest that the requirement to make all trivial commutations within 12 months is removed. The requirement may cause difficulty for people with several potential commutations and the 1% requirement will prevent abuse. Very small benefits in schemes that the member had forgotten he had may turn up after the 12 month limit and it would be the trustees of those schemes who would be penalised

by the 12 month rule.

We also strongly request that schemes, as well as members, are able to trivially commute pensions, although this may need to be tied into a 1% overall limit. Schemes cannot administer efficiently large numbers of small benefits – the cost of administration can easily outweigh the value of the benefit itself.

**A83 Trivial commutation**

We assume that there is still a 25% tax free element, as implied by A94. Assuming so, the Revenue may wish to impose controls to prevent a one off payment into the scheme being immediately vest and worth up to £1,400 for higher rate taxpayers.

**A103 Other tax charges**

How is £10,800 arrived at and how will it be indexed in the future?

**A113 Other tax charges**

This should refer to pensioner trustee, not pensioner.

## Transitional Issues

### General comments

1. We welcome the Revenue's new twofold approach to dealing with transitional issues. We would hope that these tools will, between them, be effective in delivering accrued expectations.
2. However, it will be important to have more details on the operation in particular of the new option, Enhanced Protection (EP). This will crucially affect its usefulness and is urgently needed, as, although there is a 3 year window to register calculated rights, members wishing to operate EP effectively only have 12 months before having to opt out of accrual. In that time they will need to explore the option, take advice and negotiate with their employer regarding options instead of future pension accrual. We highlight some areas below.
3. Naturally the whole area of transition is complex. Our comments focus on the high level issues we have identified so far, but we hope that we could contact you after the close of the consultation period to raise any issues that arise that require resolution..

### Specific comments

Points are addressed generally in the order they appear in the technical appendices.

#### **1.43/A151 UURBS**

The proposal newly introduces an NI charge on cashing-out in excess of 25% of an UURBS (this is how we have been led to believe the reference to "general benefit rules" is to be read). It would be consistent with the principle of no retrospective taxation to ringfence any pre-A-day accrued right in an UURBS and allow this to be cashed-out 100% without attracting NI.

(Presumably, for flexibility, the facility to roll over UURBS into registered schemes will be available for fragmented UURBS.)

#### **C4/C37/38 Enhanced Protection (EP) – accrual or augmentation**

It will be key that everyone knows what constitutes accrual/augmentation that loses EP. It would be consistent with the principles behind the whole structure that the following post-A-day "changes" do not count as accrual/augmentation:

- Vesting at an age other than NRA (for example, payment of the benefit earlier than the normal retirement age without reduction). This is consistent with the simplified DB approach focusing on amount of pension without regard to payment age, and is also

consistent with the current limits approach. Clearly payment of a reduced benefit amount (i.e. with an early retirement factor applied) should also not count.

- Uplift to a benefit amount if enforced by legislation or if scheme rules require it, e.g. a late retirement actuarial uplift enforced by preservation legislation or an uplift required by contracting out legislation.
- Changes to commutation factors, where these are not fixed before A-day but are subject to discretion and review, so long as the factors used satisfy the same principle as A34 (as modified).
- Loss of enhanced protection should not occur if, in the event of a scheme wind-up, surplus is distributed to the member with EP if this is in accordance with normal scheme provisions.
- We hope that aggregate benefits under protection (in particular, EP) would not be lost on transfer to another scheme. (C39 implies no loss.) Presumably on transfer, the benefits from transfer must be actuarially equivalent.
- There are real risks of an employer or Trustee granting a scheme-wide improvement on accrued benefit. One of its members (say a deferred pensioner) may, unknown to the employer, have EP. The improvement would inadvertently lose him EP on all his retirement benefits – a huge financial risk. We need legislation that gives an individual subject to EP the power to refuse (possibly in retrospect) any improvement that might otherwise be granted. We hope that Scheme-wide improvements may be ignored in the same way that post-vesting Scheme-wide pension increases will be ignored.

## **C6/C8 EP and salary linking**

A lot more detail is needed as to how salary linking post-A-Day will work. We set out our interpretation in the Appendix to this response covering the most straightforward case. There will need to be appropriate rules where schemes mix DB and DC benefit, for underpins etc.

We assume that permitted salary linking stops when the member leaves the service of the sponsoring employer: we would ask that the concept of “continued service” still applies so that salary linking can continue where a transfer is part of a company or scheme reconstruction and so not of the member’s making.

## **1.17/C7 Capped salary linking**

For capped employees, leaving service benefit is based on day before A-Day, so on 2004/05 cap expected to be £102,000 under current law. The effective cap on pensionable salary in 05/06 (except for pre 89 regime members) appears to be £100,000 (=1.4m/14) which would mean a loss of one – or even two- year’s RPI. The 14 divisor needs to be appropriately lower.

## **C13 Tax-free lump sum**

If the proportion of tax-free lump sum to total benefits at A-Day is  $k$ , then under enhanced protection the formula shown at A24 above becomes

$$20*k*C*P/[C(1-k) + 20k]$$

We would hope that something simpler could be achieved. If our proposal at A24 above is accepted, then the formula would simplify to

$$20*k*P$$

## **C17 Lump sum protection**

The protection relates to members’ pre-A-day “lump sum entitlements”. Some schemes leave the amount of lump sum permitted in the Scheme “to Trustee discretion up to the maximum allowed by the Inland Revenue” (with appropriate IR limits rules then embedded elsewhere in the Rules). We assume that “lump sum entitlement” for protection would here mean the Inland Revenue maximum under the current regime, whatever the Trustee current policy: otherwise many schemes would need to change their rules before A-day just to preserve a holding position.

We assume that this section means that protection of any tax-free lump sum above 25% is lost on transfer (although it is not clear if this relates to just C16 to C13-C15 as well). This impacts on high and low paid employees, with the latter potentially losing the ability to commute all their pension in some cases and also having a real block on transfers at a time when security in OPSs is of concern. Is this necessary, particularly in the case of enforced transfers? (It is currently a feature of transfers from OPS to PP, but not of transfers from OPS to OPS or S32.)

We would ask that protection is certainly preserved where a transfer is part of a company or scheme reconstruction and so not of the member's making.

**C22 Primary protection –  
Leaver benefits at A-day**

The 20:1 factor will apply to the accrued benefit at A-day, with, we understand, retained benefits relating to early exit dates first being revalued to A-day. Currently deferment revaluation is generally defined as a cumulative figure at NRA. We suggest the revaluation be defined as the revaluation had NRA (and where there are GMPs, SPA) been equal to A-day.

Who will be carrying out this calculation? Will it be the Trustees of the scheme holding the retained benefit? Only they will be familiar with revaluation particular to their scheme. The demand for updates of leaver information to enable individuals to decide to opt out and eventually to register EP or PP values could be onerous.

**C23 Limit testing /  
establishing at A-day**

Many members will have paid AVCs that overfund early leaving, because they intended to fund early retirement on the scales expecting to apply. Trustees are currently required not to permit AVCs that are likely to lead to overfunding. For A-day checking against Inland Revenue limits, we suggest that the test ignores AVCs, on the assumption that early retirement at A-day or age 50 if later would justify them on reasonable assumptions; then the leaver test just applies to non AVC benefit.

OPS limits are currently employer-based (aggregating benefits from all employer service. The protection tests will be scheme-based. There will need to be some clarifications on how limits – e.g. lump sum rights - are to be “shared out”.

The test refers to limits on leaving pensionable service. We assume that for post 89 regime members, the limits considered should be those applying on leaving service (i.e. not the less generous approach applied on opting-out but continuing in service). There may be other clarification/modifications needed of current limit rules for A-day checking of benefits and establishing protected lump sum rights.

**C37 EP and personal contributions to a DB scheme**

The structure of EP will create a new sort of DB pension scheme member: one who accrues no further fraction but does get salary linking. It may be that for such members, employers wish to continue to charge an employee contribution. This is consistent with the structure of several current schemes where a member may reach maximum accrual before NRD but continues to be charged employee contributions, again to access continued salary linking.

C37 states that EP in a DB scheme would be lost unless the member "has paid no personal contributions to the scheme since A-Day". This would appear to prohibit schemes from charging for the salary linking. We would propose that the phrase is extended to "has paid no personal contributions to the scheme since A-Day except where this is a condition of continued DB salary linking".

**C38 Death cover before vesting**

We would ask for consistency between DC and DB, and the general terms, in relation to any dependants.

There must be a common policy so that, for example, premiums for death benefits in either a DB or a DC scheme can continue without the member losing EP. At a minimum, death-before-vesting benefits should be able to be provided under the same rules as apply for those without protection (i.e. whether the benefits are proceeds of insurance policies, return of fund or defined in

a DB scheme): unlimited dependant's pension; and unlimited lump sum, taxed (at 55%) only to the extent that they are above LTA); and anything within these limits should not trigger loss of EP.

If higher, we would suggest it would be reasonable if transitional arrangement to continue cover at the same amount as applied immediately before A-day (under current limits) tax-free and without losing EP.

**C53**

There appears to be an error in Table C3 (either the £220K should be described as being a whole-service (i.e. pre and post A-Day combined) value, or the £100K x 1.2 should not be deducted from it when applying the 25% factor.

**Operation in the 3 years before registration is complete?**

How will the tests operate where a member wishes, after 3 years, to register primary protection but has in the meantime taken some benefit from a scheme? Will there have to be a catch-up or delayed retirement? See earlier comment re difficulties of getting appropriate restatement of retained benefits.

**Corrections**

Protection is clearly complex. We hope the Revenue will be sympathetic to valid corrections to registered benefits emerging after registration.

## **Overseas and International Issues**

### **Corresponding Acceptance**

We welcome the statement by the Pensions Simplification Team in its response of 18 December 2003 to Hewitt Bacon & Woodrow that employees who have corresponding acceptance in respect of an overseas retirement benefits scheme at A-day will automatically be granted migrant relief from A-day, even if the employee or the scheme would not meet the strict requirements for migrant relief required for new applications.

### **Migrant Relief – Scheme Design**

There is no detail of the tests on scheme design that would be applied to non-EEA schemes for migrant relief (paragraph A124). While a minimum definition of a retirement benefits scheme is necessary it is important that the tests are sensitive to the range of designs found outside the UK. A number of overseas schemes provide lump sums on retirement in excess of 25% of the fund, and the lump sum benefit can often be 100%. Examples are Australian superannuation funds or retirement and provident funds found in parts of Asia. Equally, life expectancy in foreign countries may not be as great as in the UK and an overseas scheme may reasonably permit retirement before age 55, as UK schemes currently do. We would suggest that:

- An overseas scheme must be a retirement benefits scheme within the meaning of section 611 of the Income & Corporation Taxes Act 1988 but resident outside the UK.
- It must not allow retirement benefits before age 50 except on the grounds of death, incapacity or unless earlier benefits are permitted in the country where the scheme is established.
- It may provide 100% lump sum at retirement if that is a feature of the scheme.

A person who has migrant relief but who, while UK resident, joins another foreign retirement benefits scheme because of reorganisation of the company's schemes, or because of a takeover of the business etc should be allowed migrant relief in the new scheme even although he would have joined it while resident in the UK. This would be similar to the circumstances in which a member of a UK retirement benefits scheme who is currently uncapped may continue to be uncapped, as set out in appendix III of IR12.

### **Migrant Relief – Scheme Administration**

The administration of overseas retirement benefit schemes will not be set up to meet the UK regulatory framework and in particular there may be practical problems in:

- Valuing the accrued benefits at A-day (6 April is not an obvious valuation date for an overseas scheme);
- Splitting a member's benefits into pre-A day and post A-day elements, particularly in defined contribution arrangements.

Some flexibility in when benefits can be valued, e.g. at an adjacent scheme anniversary date and not exactly on A-day, would be a practical help.

## **Recovery charge and members retiring overseas**

We would welcome confirmation that the operation of the recovery charge on schemes and members where the member retires outside the UK would be consistent with the UK's obligations under double tax treaties. In particular, the UK's treaties containing a pensions article almost invariably give the taxing rights on pensions to the country of residence of the pensioner. In other words, subject to the exact wording of each treaty, we are not clear how the UK could levy the recovery charge when there is a double tax treaty in force.

We presume that the Inland Revenue has sought and obtained legal confirmation that where a citizen of an EU member state retires to an EU country other than the UK the proposed recovery charge is compatible with the rulings emanating from the European Court of Justice.

## **Section 615 schemes**

Section 615 schemes meet a specialised need and this need remains. Employers do not necessarily wish to use UK registered schemes after A-day for employees outside the UK because:

- Companies, particularly those with their head office in the UK, wish to run retirement benefit schemes from this country but for the benefit of employees unable to join or unsuited for local foreign schemes. In some countries there would be no suitable retirement benefit scheme.
- The facility in a section 615 scheme to pay the benefit entirely as a lump sum is important. In a number of countries a pension is an uncommon retirement benefit and a retirement lump sum or gratuity is customary.
- Employees retiring outside the UK often do not want a sterling-based pension and the scheme does not want to pay a pension in foreign currency. The cost of remitting funds abroad and foreign exchange risks usually make a UK-sourced sterling pension unattractive.
- The minimum retirement age of 55 in UK registered schemes may be too high for countries where life expectancy is lower than in the UK.
- Registered schemes will no doubt be subject to current UK social security law on matters such as member-nominated trustees. This law is designed to meet UK needs and with the UK operating environment in mind. Companies and trustees with substantial numbers of non-UK members or deferred scheme members who remain non-UK residents would find some elements of UK social security provision, such as conducting elections for member-nominated trustees, onerous where the membership was scattered throughout the world.

Keeping section 615 schemes would also benefit the UK.

Multi-national companies typically would like a retirement benefits vehicle for cross-border and internationally mobile employees that ideally does not attract a benefit in kind tax charge in the host country, that has investment roll-up in a tax-deferred environment and, other things being equal, would prefer to site such a vehicle in a developed country with a good tax-treaty network. The benefit in kind tax charge in host countries and a culture of defined benefit schemes have to date made such vehicles quite hard to operate. (Defined contribution makes it easier to price the cost of retirement provision to each operating unit within the business.) Both taxation and benefit design are changing.

If an effective and efficient cross-border retirement benefits vehicle can be achieved then significant funds may flow into such vehicles. For the UK to abandon its existing framework for section 615 schemes now, just as benefit in kind positions are starting to change, would be a boon to other countries, such as Luxembourg, Ireland and the Netherlands, all of which have the infrastructure to operate funded retirement benefit schemes and would welcome the opportunity to develop their financial services sector at the expense of the UK.

In the absence of a suitable UK fiscal and regulatory regime (i.e. allowing lump sums and minimal social security provisions), the schemes that presently exist for internationally mobile employees would be more likely to move to other jurisdictions, either within the EU or offshore. We note in passing that the countries and tax authorities in the EU with large and well-developed cross-border retirement benefit scheme structures would be more experienced and better placed to exert influence on EU tax-policy in this increasingly important area than equivalent sized countries that lacked such a base.

### **Remaining in a UK registered scheme while overseas**

Paragraph A31 of the consultation document says, "Contributions by non-residents that have not received UK tax relief do not need to be tested against the lifetime allowance." Does this apply to contributions and investment return (i.e. ring-fencing the overseas element) or only the contributions themselves? If exemption from the lifetime allowance were only in respect of the latter then this would encourage funds to move offshore for expatriates.

## Administration Issues

In this section we comment on the cost of implementation and the cost savings as a result of the simplification. We have taken account of the following administration work involved in implementing the simplification proposals, and have not attempted to estimate the cost of legal work, consultancy work or investment work that will be needed in addition:

- Amendment to calculation routines to reflect new lifetime limits
- Amendment of routines to deal with exchange of information to test lifetime allowance usage, assess and collect tax and modify benefit appropriately
- Amendment to systems to provide what is required to assist annual allowance tests
- Amendments to scheme documents and booklets
- Benefit quotes for members close to LT allowance.
- Additional member (general) queries on rights, options and benefits.
- Unless the trivial commutation approach is changed, long-term administration of the many members with trivial benefits who would otherwise come off the scheme's books.
- Changes to admin/payroll records re cessation of dependants' benefits at fixed age.
- Dual status records for members who opt for phased retirement - new status codes required, and possibly member references.
- It will be much harder to reconcile movement of member statistics if a member can have more than one status.
- All member communications must be reviewed or re-written.
- Accurate recording of both types of member protection.
- Changes to the structure of the death in service benefits may result in additional correspondence and underwriting issues.

In **question D2** you request an estimate of the cost to industry of making these changes. One major consultancy has estimated that the costs of the above items will total between £6 million and £10 million. We would estimate that total industry costs in relation **to non-insured occupational pension schemes only** would be crudely 25 times this figure, i.e. between £150 million and £250 million. The costs of making changes to systems will be proportionately higher where administration is done in-house. We would expect that the costs for insured schemes would be proportionately lower, as economies of scale are likely to be larger.

In **question D4** you ask about potential long term savings in administrative costs. We estimate that savings in day to day administration will be of the order of 3% - 5% of current costs of administering occupational pension schemes. For some schemes, where there is a large number of members potentially affected by the Lifetime Allowance, it is anticipated that costs may increase. There will also be increased costs where schemes permit partial drawing of occupational pensions. The overall savings figure may therefore be nearer 3%.

We estimate that current costs of administering such schemes are crudely 0.5% of pensionable payroll. From Table 2.15 on page 27 of "Employers' Pension Provision 2000" published by the DWP, 61% of employees are members of occupational pension schemes. From page 65 of "Living in Britain" published by The Stationery Office in 2002, around 54% of full-time male employees and 58% of full-time female employees were members of their current employer's pension scheme in 2001. The balance of around 6% may be assumed to be deferred members only of occupational pension schemes. From the Pension Pocket Book 2004 published by NTC, on page 7 an employed population of 25.8 million is shown, and from page 4 average weekly earnings were £464.60 in 2002.

The total pensionable payroll of all employees in pensionable employment is therefore around £350 billion, giving pension administration costs of around £1.75 billion. On this basis, savings of around £50m a year may arise.

## APPENDIX

### Salary linking for Enhanced Protection – paras C6/8

There is a lack of detail on how max final pensionable salary will be calculated.

As regards what has already been released, C6 and 8 are unclear and the categories do not seem to cover all cases. Is the following an accurate restatement of what is intended?

- **Schemes will be able to continue to operate whatever FPS definition they currently have in respect of the accrued right in question (a change [giving rise to a higher figure] could constitute a breach that results in EP loss).**
- **However, the following will apply as overrides**

	<b>If the FPS according to this formula at vesting:</b>	<b>then FPS must be limited by:</b>
<b>a</b>	<b>is less than the “earnings cap” (i.e. LTA/14):</b>	<b>The best total taxable earnings in any one of the last three years</b>
<b>b</b>	<b>would otherwise be more than the “earnings cap” AND the member had been subject to the post-89 regime at A-day:</b>	<b>the “earnings cap”</b>
<b>c</b>	<b>would otherwise be more than the “earnings cap” AND the member had NOT been subject to the post-89 regime at A-day</b>	<b>a last-three-year average of total taxable earnings</b>

If this is not the proposal, we need clarification.

If it is a correct statement of the proposal, we would suggest the following modification.

The FPS caps should have, as an underpin, the FPS actually used at A-day to calculate the protected benefit. This is to protect against an overnight drop just because of the new test and not because of any change in member circumstances. Even so it may mean that in some schemes the member sees no increase in benefit for a while despite an increase in pensionable salary.

There is a need for an ongoing underpin for part-timers, where there should be no drop in FPS purely as a result of bringing part of a pension into payment and working part-time.

**Background note to ensure understanding:** OPSs currently have clear separation of two earnings terms, Final Remuneration and scheme-defined Pensionable Salary (the latter being a very varied term). Current IR limit operation is just that

Scheme FPS x scheme fraction	must be limited to	Inland Revenue Final Remuneration x Revenue permitted fraction
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The constraint is on the outcome not on the components (except that Scheme FPS is restricted for post 89 regime members)

*We accept that the IR will want careful rules to minimise the abuse that can be made of this facility, but these should be minimised if simplicity is to be achieved.*

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