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The *Rights of Savers Bill*

Bill 15 of 2005-06

Sir Malcolm Rifkind, currently the Shadow Work & Pensions Secretary, won second place in the ballot for Private Members' Bills held on 26 May 2005. His Bill is designed to encourage pension saving by introducing Savings and Retirement Accounts (SaRAs); providing a further alternative to the purchase of an annuity at 75; removing the age 75 limit on annuity protection lump sums; and tackling "high proliferation and low persistency" in pension saving. The Bill extends to the whole of Great Britain and is due to have its second reading on 28 October 2005.

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Summary of main points

The Rights of Savers Bill 2005/06, published on 25 October 2005, is sponsored by the Shadow Work and Pensions Secretary Sir Malcolm Rifkind MP. Its aim is to encourage people to save by making it easier for them to do so.

The Bill will:

- Introduce Savings and Retirement Accounts (SaRAs). These would be a cross between a stakeholder pension and an Individual Savings Account (ISA), but governed by pension legislation. However, it would be possible to withdraw capital from the account before minimum pension age to buy a first home or to fund lifelong learning. Such withdrawals would need to be repaid into the account or tax relief would be forfeited.

- Remove the requirement that pension funds must be converted into an annuity by age 75 by introducing the optional alternative of a Retirement Income Fund.

- Allow the return of capital on death after age 75 on value protected annuities.

- Require employers to offer payroll deduction for personal pension contributions to a wide range of schemes so that individuals are able to continue paying into an old scheme on change of employer.

The third and fourth of these proposals have been actively promoted by the Association of British Insurers (ABI).

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I Introduction

Sir Malcolm Rifkind was appointed Conservative spokesman on Work & Pensions after the General Election in May 2005. On 26 May 2005, he won second place in the ballot for Private Members' Bills and on 22 June 2005, he introduced his *Rights of Savers Bill* "to make provision about the rights and choices of savers in relation to pensions and pension schemes, annuities and savings and for connected purposes".[1]

Following a period of consultation about the precise contents of the Bill, the Bill itself was published on 25 October 2005. Sir Malcolm explained the aim of his Bill in a press release:

> These practical proposals are aimed at providing much more flexibility in our pension system with reform of existing pension rules such as changes to annuity rules, but also a new savings vehicle. These changes would bring about much needed simplicity in pension products and help restore the savings culture which is currently in crisis in this country. Young people these days want to save, but also want to be prepared for a change in circumstance during their working life. A single pension pot would make life much easier.[2]

The Bill is a response to the serious concerns expressed about the lack of long-term saving in the UK. For example, in its 2004 preliminary report, the Pensions Commission, chaired by Adair Turner, highlighted the inadequacy of current pension saving to meet future need. It found that the underlying level of private pension saving is now in decline and that actual private pension contributions will fall from 3.8% to about 2.9% of GDP over the next 15 years.[3]

The Bill is designed to encourage long term saving by introducing Savings and Retirement Accounts (SaRAs); removing the requirement that pension funds must be converted into an annuity by age 75 by introducing the optional alternative of a Retirement Income Fund; allowing the return of capital on death after age 75 on value protected annuities; and requiring employers to offer payroll deduction for personal pension contributions to a wide range of schemes so that individuals are able to continue paying into an old scheme on change of employer.

It is envisioned that SaRAs would be a cross between a stakeholder pension and an Individual Savings Account (ISA), but governed by pension legislation. However, it would be possible to withdraw capital from the account before minimum pension age to buy a first home or to fund lifelong learning. Such withdrawals would need to be repaid into the account or tax relief would be forfeited. This is in line with the conclusions of the July 2004 report by the Treasury Select Committee into restoring confidence in long-term savings. One of the report's recommendations was that the Government look at

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1 Bill 15 of 2005-06, long title
2 Conservative Party press notice, "Flexible savings plan to boost retirement income", 24 October 2005
3 *Pensions: Challenges and Choices*, 12 October 2004, chapter 4: http://www.pensionscommission.org.uk/publications/2004/annrep/chapters/ch4.pdf

introducing more flexible access to pensions as a means of making saving more attractive.[4]

Although the Government has not yet formally commented on the Bill, it may make similar objections as it has done to like proposals in the past: namely that the generous tax relief given on pension contributions, investment income and growth and lump sums is intended to encourage people to save for a regular income in retirement not for any other purpose, such as the accumulation of capital to buy a house, fund education or pass on to one's heirs. There are other tax-relieved savings vehicles, such as Individual Savings Accounts (ISAs), which could be used for these purposes although the tax relief is not so generous.

However, press reports indicate that Sir Malcolm is hoping to have talks with Pensions Minister Stephen Timms before second reading of the Bill, with the aim of winning all-party backing for his proposals.[5] A further report quotes a Conservative Party source as stating that "the time the Bill needs may be provided by the Government, or the Bill could be folded into Government legislation".[6]

II Savings and Retirement Accounts (SaRAs)

Part 1 of the Bill is designed to introduce Savings and Retirement Accounts (SaRAs). Sir Malcolm explained how he sees these accounts in an article in the *Sunday Telegraph*, prior to the publication of the Bill. He argued that two of the key benefits of the scheme were that, firstly, they would allow money to be withdrawn at important, predetermined stages of people's lives:

> It makes sense to permit withdrawals at key stages, such as when you are buying your first home, or to meet the costs of career development.

And, secondly, that the scheme would be transferable when people change jobs:

> Many people end up with lots of little pensions that have acquired as they move around. With a SaRA these can all be put into a single wrapper.[7]

The briefing accompanying the publication of the Bill goes into more detail:

> Stakeholder pensions have failed in their attempt to stimulate long-term saving at the bottom end of the market. At the time of introduction, it was estimated that there were approximately 5m people not in an occupational pension scheme with earnings between £10,000 and £20,000 per annum. Concerns have been raised by the ABI and PMI suggesting that while there are 1.45m stakeholder members, much of the money now in Stakeholders has merely been transferred from other pension arrangements. Stakeholders are not stimulating additional pension savings but are just displacing other pension vehicles.

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4 Treasury Committee, Restoring confidence in long-term savings, (8th report of session 2003-04), HC 71-I, 19 July 2004, para 96: http://www.publications.parliament.uk/pa/cm200304/cmselect/cmtreasy/71/71.pdf

5 "Tories unveil savings plan", *Sunday Telegraph*, 23 October 2005

6 "Tory grandee calls for new pensions era", *Mail on Sunday*, 23 October 2005

7 "Tories unveil savings plan", *Sunday Telegraph*, 23 October 2005

> The main advantage of SaRAs is their simplicity; in that regard, we expect them to be far more marketable than Stakeholders.
>
> The possibility of drawdown for house purchase and life-time learning would make them very attractive to the younger end of the market.
>
> We expect take-up, in particular at the bottom end, to be an improvement on Stakeholders because a far greater range of providers will offer them; this will likely result in the active promotion by providers as opposed to manner in which many firms passively offer Stakeholder schemes.[8]

This could be seen as a variant of the Conservative proposals during the 2005 general election campaign for a new Lifetime Savings Account (LiSA). Their manifesto, *Action for Older People,* said:

> Better incentives for saving. We will provide better incentives to save with a new Lifetime Savings Account (LiSA). To encourage people to get into the savings habit, we will use the simple principle of 'buy one, get one free': when people put money into a LiSA, the Government will put money in too. People save for other things as well as retirement, so putting money into a LiSA need not mean locking it away until the end of working life. A decision on the exact structure and funding will follow completion and analysis of the current 'Savings Gateway'.[9]

Private Members' Bills cannot have as their main object the creation of a charge upon the public purse, so this Bill could not propose that the government contribute matching funding to SaRAs, but the idea that money need not be locked away until the end of working life is retained. David Willetts, Conservative spokesman on Work & Pensions before Sir Malcolm, argued the case for a more flexible approach to the release of pension savings in a speech to the Institute for Public Policy Research on 13 December 2004. The *Financial Times* reported:

> High house prices, growing student debt and changes to tax rules that made it easier to contribute more money to pensions later in life meant "we need fresh thinking on the design of savings products", he told a conference held by the Institute for Public Policy Research.
>
> Asking young people to put aside money for a pension, which they would not be able to get at for 40 years, was "pretty heroic", he said, when "high house prices, the new tax regime for pension saving and graduate debt are going to have a massive impact on patterns of saving across the life-cycle. I'm not sure that politicians or the savings industry yet realise how big this could be".
>
> What was needed was encouragement for saving that could be used for a variety of purposes - "rainy day" saving - which could become the saving used to finance retirement.

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8 Press notes, *Rights of Savers Bill*, October 2005.
9 Accessed via http://www.conservatives.com/tile.do?def=manifesto.index.page

> Reflecting a point made by the employers taskforce, he said that if people were able to access their money they might be willing to save more.
>
> In France, he noted, official statistics showed low saving for pensions but in practice the French saved a lot more in more flexible vehicles such as mutual funds and insurance. As a result, "a French pensioner gets almost as high a proportion of his or her income from funded saving as a British pensioner".[10]

The acronyms LiSA and SaRA could lead to some confusion. The present Labour Government has, in the past, tried to launch a new pension wrapper, variously described as a lifelong individual savings account (or Lisa),[11] pooled pension investment (ppi),[12] an individual pension account,[13] or a savings and retirement account (SaRA).[14] These products were not stand alone pension products but wrappers for existing products. The individual pension account has not been a success. Financial experts believe this is because of their complexity and the fact that they are not stand alone products.

The Investment Managers' Association, in a response to the Government's Green Paper on Pension Reform published in December 2002, said;

> Individual Pension Accounts (IPAs) were introduced by the Government in April 2001 in order to allow for mutual fund based personal pensions, as an alternative to the traditional life insurance based products, in view of the success of such products in the US and in parts of continental Europe. In the event, however, the IPA regulations have failed to allow the development of such products because their structure introduced complexity which rendered IPAs uneconomic for providers to offer other than in special circumstances.[15]

The Association of Investment Trust Companies, in their response to the Pensions Green Paper, argued that IPAs had failed because they were not stand alone products, but wrappers for existing products:

> The AITC believes the failure of Individual Pension Accounts to command support from product providers is because they are not stand-alone products in their own right. Instead, the AITC feels there is already the perfect structure in Individual Savings Accounts (ISAs) which with a few minor changes, could help create an active, informed savings market that the 401k product helped to stimulate in the US.
>
> The AITC recommends that legislation for Individual Pension Accounts should be abolished and instead the ISA model should be used to form a new Individual Pension Account. This would help transform competition in the pensions industry

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10 "Tories call for flexible approach to savings across various stages in life", *Financial Times*, 14 December 2004

11 HM Treasury press notice, 3 February 1999, "Helping to deliver stakeholder flexibility in pension investment" and "Mixed reception for enigmatic Lisa", *Times*, 6 February 1999

12 HC Deb 22 February 1999, c 162W and HC Deb 2 March 1999, c 642W

13 HM Treasury press release, 11 July 2000, "Individual pension accounts helping more people save for the future", http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2000/press_88_00.cfm

14 "Government to slash pensions red tape", *Sunday Telegraph*, 14 November 2004

15 Investment Management Association press release, 17 December 2002, "IMA reaction to government pension proposals", http://www.investmentuk.org/press/2002/20021217.asp

> by incorporating product providers who have traditionally been excluded from the market, including a range of well-diversified, collective equity products (including investment trusts), as well as bond and cash funds.
>
> Daniel Godfrey continued: "Building on the already well-established model of the ISA, as opposed to introducing an altogether new pensions product, would reduce confusion and help create the kind of active, informed savings market that we need to see developed as a matter of priority. Crucially, it would also remove one of the many barriers to competition in the pensions market and integration between ISAs and IPAs could encourage more people to save for their future." [16]

SaRAs, as proposed by Sir Malcolm, are similar to the American Individual Retirement Accounts (IRAs). The Association of British Insurers, in their report, *UK pension reform – lessons from abroad?*, published in April 2005, describe IRAs as follows:

> A third of the USA's households save in personal pensions known as Individual Retirement Accounts (IRAs). They are very liquid and may be cashed in at any time for a number of specified purposes, for example, higher education or purchasing a first home. IRAs can also be offered through the workplace with employer sponsorship in a manner similar to Group Personal Pensions in the UK. The standard IRA was introduced in 1974. The current limit on contributions is £1,058 plus £132 for a non-working spouse or £2,116 per household. However, tax deductibility is limited to those who are not members of an occupational pension or who are on low earnings. During the 1980s, when this rule was removed it led to a surge in higher pension saving by those on higher incomes and a fall when the rule was later reapplied. Following an announcement in 2004, the Bush administration plans to consolidate the wide range of existing IRAs (each with slightly different rules) and to create a new form of personal pension product, the Retirement Savings Account (RSA). Unlike most IRAs they will operate on a TEE basis [contributions are made after tax but returns and benefits are free of tax]. Decumulation will be somewhat stricter than at present as the 10% tax charge can only be avoided once the account holder is 58 or has become disabled or died. Previously, as outlined, IRAs could be used before retirement for a wide range of uses. Contributions will be limited to £2,645 per year provided this is less than 100% of salary.[17]

The ABI does not draw any "lessons for the UK" from this particular form of savings account, though it does express some concern about the ability to remove savings from 401K schemes on a change of job:

> Unlike the UK, in the USA, both occupational and personal pensions are easy to access prior to retirement. In the USA, 401(k) plans can be decumulated at the end of each employment. Government figures suggest that, of those who decide to unlock their fund on changing jobs, only a fifth intend to roll over their funds into another pension. Moreover, all private pensions can be cashed in at any age at the cost of a modest 10% tax-charge (in addition to paying income tax). (…)

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[16] Association of Investment Trust Companies press release 29 April 2003, "AITC calls for increased competition and greater transparency in the pensions market" http://www.aitc.co.uk/press_centre/default.asp?id=1904

[17] http://www.abi.org.uk/BookShop/ResearchReports/UK%20Pension%20reform%20lessons%20from%20abroad.pdf

> The fact that only a fifth of those in the USA who opt to unlock their pension fund on changing jobs plan to roll their pension savings into a new pension suggests that there are real risks in abandoning the UK's approach of preventing decumulation until 50 years of age (later rising to 55 years of age).[18]

III Annuities

Part 2 of the Bill is concerned with the current rule which requires people to convert pension savings into an annuity by the age of 75.

A. Retirement income reform

It has long been Conservative policy to abolish the requirement that people should convert their pension savings into an annuity by the age of 75. Their manifesto, *Action for Older People,* published before the 2005 general election said:

> Reforming annuities. At the moment, people with private pension schemes have to use their savings to buy an annuity when they reach the age of 75, even if they do not think they are being offered a good deal for their savings. Conservatives believe that people should not be forced to buy an annuity which might not be the best use of their hard-earned savings. We will therefore abolish this requirement provided people do not become dependent on means-tested benefits.[19]

The purpose of clauses 9-11 in Part 2 of the Bill is to provide, with a Retirement Income Fund, an optional alternative means for holding and investing pension funds on retirement, and would be an alternative to compulsory purchase of annuities at age 75. It will not 'abolish' the 75 year rule *per se*. The briefing accompanying the publication of the Bill goes into more detail:

> Under the current legislation, an individual can take up to 25% of his pension pot as a tax-free lump sum after retirement age. With the remainder of the pot, an individual is compelled to purchase an annuity by the age of 75.
>
> Such legislation needlessly reduces an individual's choices over what he does with his retirement fund. While there is a commendable view that a degree of compulsion is required to ensure that an individual does not fall back on state benefits to provide retirement income, it is perverse that such a large chunk of one's retirement fund is considered necessary for preventing people falling on state benefits.
>
> It is suggested that the result of these unattractive annuity rules is to turn people away from pensions altogether. Simple changes to these rules could stimulate interest in pension saving and increase flexibility for those reaching retirement age.
>
> Although many individuals choose annuitisation and from April 2006, the government will introduce Alternatively Secured Pensions (ASPs) both options

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[18] Ibid

[19] Accessed via http://www.conservatives.com/tile.do?def=manifesto.index.page

still do not give individuals flexibility and choice over the investment of their retirement fund and the level of income to be taken from it during retirement.

Some individuals will have different income level requirements at different stages of their retirement.

Our Proposals :

The Retirement Income Fund will be an optional alternative means for holding and investing pension funds on retirement and furthermore will be an alternative to compulsory purchase of annuities at age 75.[20]

1. Private Members' Bills

A succession of Private Members' Bills designed to achieve this or similar ends have been introduced by Conservative Members who had done well in earlier Private Members' ballots:

David Curry's *Pension Annuities (Amendment) Bill 2001/02*, Edward Garnier's *Retirement Income Reform Bill 2002/03* and Adrian Flook's *Retirement Income Reform Bill 2003/04* all had this as their purpose. They provided that people with pension funds large enough to buy an annuity providing a Minimum Retirement Income above the level of means-tested support should be able to re-invest any residual funds in a Retirement Income Fund which they could use as they liked.

None of these Bills was successful. David Curry's Bill (which was fifth in the list of Private Members' Ballot Bills in 2001/02) was talked out on Report;[21] Edward Garnier's Bill (which was fourth in the list of Private Members' Ballot Bills in 2002/03) was also talked out on Report;[22] and Adrian Flook withdrew his Bill (which was ninth in the list of Private Members' Ballot Bills in 2003/04) arguing that it "would better continue its parliamentary life as an amendment to the Pensions Bill in Standing Committee and Report. Doing so will force the Government to consider its many merits instead of relying on their Back Benchers to talk it out."[23]

The Liberal Democrats have consistently supported the principle of these Bills.

2. Pensions Bill 2003-04

Nigel Waterson, the Conservative spokesman on the *Pensions Bill 2003/04*, did, indeed, move an amendment designed to incorporate the provisions of the *Retirement Income Reform Bill* into the Bill on 27 April 2004. He summarised the reasons for and the effect of the amendment during his speech:

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[20] Press notes, *Rights of Savers Bill*, October 2005.

[21] The Bill's provisions are described in Library Research Paper 01/118 and the Parliamentary debates are summarised in section II, C, 2 of Library Research paper 03/19

[22] HC Deb 11 July 2003, cc 1566-1574. The Bill's provisions are described in Library Research Paper 03/19

[23] HC Deb 26 March 2004, c 1192

During my experience of representing Eastbourne I have received many letters from constituents who bitterly resent the fact that, whether they want to or not, by the age of 75 they must purchase an annuity—an annuity that is probably giving them a return of not much better than half of what it would have done a few years ago. The Conservative party has felt strongly for some time, hence that string of private Members' Bills, that we badly need to bring more flexibility and fairness into the system. The most recent of my colleagues to introduce such a Bill was my hon. Friend the Member for Taunton (Mr. Flook), who is a doughty campaigner on those issues. His Bill was in danger of being talked out a couple of Fridays previously and the business was collapsed. We have recreated the Bill in large measure in the two new clauses. (…)

[The Treasury] does not want people to fall back unnecessarily on the state system when in their earlier years they have made provision for a pension fund. That is why the proposals, which I think have much cross-party support, are designed to allow people to have maximum flexibility in their choice of retirement income and to create a minimum retirement income—MRI—so that people need not fall back on state benefits if things go wrong. We say that the MRI level should be set each year by the Chancellor and it is intended to be at a level above pension credit. The sense of having it fixed each year is to allow the Chancellor at any given time to take into account changes to pension credit, to means-testing or to any other relevant factors, to ensure that it remains relevant and effective in carrying out its function. (…)

The intention is that those retiring in future could purchase an increasing annuity that would provide sufficient income to maintain them above the level of state benefits. At the same time, the intention is to create a retirement income fund—an RIF. Individuals with pension funds in excess of those required to meet the MRI would be able to reinvest those savings in an RIF, and there would be no restrictions on when and how much income could be drawn.

It will be of interest to many Committee members that the amendments would also introduce gender equality requirements. Annuities could be used to purchase the MRI without regard to the sex of the annuitant.[24]

Steve Webb, then Liberal Democrat spokesman on pensions, supported the principle of the amendment although he had some doubts about the precise way in which the Minimum Retirement Income was to be calculated:

The Liberal Democrats in general support the principle behind the new clauses and we have supported the series of private Members' Bills that have attempted to implement something along the same lines. We restate that support now.

(…)

The state should not require people to do things that it does not need them to do. It seems that the taxman's interest would be satisfied if two conditions were met. First, having given tax relief on the way in—in the fund, except on dividends, and, potentially, on a lump sum of one quarter—the tax man must expect to tax that income once. If someone indefinitely defers buying an annuity and eventually dies, there needs to be a tax take. Indeed, I believe that there is one, at a special rate of 35 per cent. Such a structure seems to work. The Inland Revenue

[24] SC Deb (B) 27 April 2004, cc 798-799

> argument that the Treasury should receive its tax therefore falls. The Treasury indeed receives its tax, although, admittedly, it has to wait for it. We can cope with that. I am not worried that there is a tax issue, because the tax ultimately gets collected in respect of the money that was given earlier in life. The first condition is therefore met.
>
> The second condition is dealt with in new clause 28, which tries to put the floor in place. We do not want people to have tax-relieved savings all their lives, blow the lot on a foreign cruise, ring the pension credit line and say, "Hello, I'm poor and I'd like some Government money." That would be unfair, but, even if we leave aside the inherent implausibility of that scenario, a floor needs to be put in place.
>
> I am concerned about new clause 28, however, because the floor is astonishingly high.
>
> (…)
>
> In principle, if the taxpayer's interest is protected in terms of getting his tax take and not calling on means-tested benefits, there is no reason why there should be any requirement to buy annuity at a particular age. Once those two requirements are satisfied, people should be able to do what they want. The way in which this is drafted seems remarkably restrictive: it has to be bought at 65, has to be indexed and has to replace the whole of pension credit. All of that undoes most of the good that the new clauses aim to do. We support the principle behind the new clauses, but do not think that, when the next great Liberal Government come to implement the changes, we will do it like this. [25]

The Government has always maintained that tax relief is given on pension contributions to encourage people to secure an income for themselves in retirement, not to enable them to build up a large capital sum to be used for whatever they like. Malcolm Wicks, the Pensions Minister, made this point when responding to Nigel Waterson's amendment:

> The debate is interesting and I am sure that the House will return to it, as has been promised—or threatened. However, the essential matter is that pension schemes are pension schemes. They are designed to give people a secure income to last the whole of their retirement. The annuity is, virtually by definition, such a guarantee to pay an income for life, no matter how long that life turns out to be. Over the decades, successive Governments have brought forward fiscal tax advantages for such arrangements.
>
> What is being proposed is that over and above a certain level something intended to be a pension will become simply a capital sum for the individual to use as he or she likes. One can argue about the pros and cons of that, but I have no doubt that the fiscal arrangements would have to be rather different. I repeat that a pension is a pension, not a way of accumulating a large capital sum. There is a fundamental difference.[26]

[25] SC Deb (B) 27 April 2004, cc 802-804
[26] SC Deb (B), 27 April 2004, c 805

The Opposition continued the campaign against compulsory annuitisation in the Lords with debates in the Lords Grand Committee,[27] and on report stage.[28] The Government was defeated (by 198 votes to 144) in the Lords on Third Reading on an amendment moved by Lord Higgins which would have removed the requirement to take an annuity at age 75 "provided that the pensioner can demonstrate that he has the resources to ensure that he will not become dependent on means-tested benefits".[29] This was overturned in the Commons by 292 votes to 203.[30]

When the issue returned to the Lords, they again defeated the Government (by 207 votes to 136) on Lord Higgins' new amendment that the age limit should be increased from 75 to 85.[31] This amendment was also reversed in the Commons – by 265 votes to 155.[32]

On the very last day of the session, Lord Higgins proposed another amendment, raising the age limit from 75 to 80 but this time the Government won the division by 119 votes to 96 and the *Pensions Bill 2003-04* Bill went forward to Royal Assent containing <u>no</u> provisions on compulsory annuitisation.

During the many debates on the issue, the Government did promise to revisit the issue once the Pensions Commission under Adair Turner had presented its second report (due on 30 November 2005).[33] On 16 November 2004, Malcolm Wicks repeated the arguments against compulsory annuitisation and promised the review:

> The present rules on annuities mean that members of personal pension schemes and small defined contribution occupational schemes must purchase an annuity with their pension fund by the time that they reach the age of 75. Members of occupational pension schemes are required to receive a pension, rather than purchase an annuity at the age of 75.
>
> The intention behind these rules is to ensure that pension pots are used to provide a stream of income in retirement. Personal pension schemes will purchase an annuity and occupational schemes usually, but not always, provide a pension from the scheme rather than for the purchase of an annuity. Members of pension schemes benefit from more favourable tax treatment than other savers. Tax relief is provided at the pension scheme member's marginal income tax rate so that, in effect, he saves the gross amount and not the net amount of income into his pot. (…)
>
> The contributions grow in a tax favoured environment when invested. There is also the tax-free lump sum on vesting a pension, which adds to the favourable treatment. That can be up to 25 per cent of the value of the fund and is a recognition by the Government that people need encouragement to lock away

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27 HL Deb 18 October 2004, cc 156-163
28 HL Deb 8 November 2004, cc 717-728
29 HL Deb 15 November 2004, cc 1224-1238
30 HC Deb 16 November 2004, cc 1220-1243
31 HL Deb 17 November 2004, cc 1535-1551
32 HC Deb 17 November 2004, cc 1430-1441
33 http://www.pensionscommission.org.uk/

> their money for a considerable period until they are ready to draw retirement benefits.
>
> Those tax reliefs are then only recovered when the pension fund is converted into an income stream either by taking a pension or purchasing the annuity. That can happen as early as age 50 under present rules but must happen once the member reaches the age of 75. I recognize that there will be a debate about the cost-benefit tax analysis of that against other savings vehicles but our argument would be that this is tax-privileged area for savings for retirement. (…)
>
> The Government recognise the underlying issues of greater longevity and demographic shifts in this country and, indeed, across the developed world, both of which have profound implications for the way in which our pensions policies are put into effect. The Government are taking action through the Bill and in other ways to meet those and other challenges. We set up the Pensions Commission under Adair Turner to review the regime for UK private pensions and long-term savings. Its first report, published last month, provides a mine of detailed and valuable information on the demographic challenges that we face. It is a singular fact that we are debating whether to preserve one of the few elements of compulsion in our pensions structure, but the Pensions Commission was set up specifically to look at the effectiveness of the voluntary approach to pensions and whether there is a case to move to greater compulsion. The commission is considering whether the level of compulsion within the UK pension system is appropriate. For people investing in a pension, the requirement to purchase an annuity at 75 with tax-privileged saving is a compulsory element in the existing system. *Once the commission has reported on the wider issues relating to compulsory saving, the Government will wish to consider key issues, including annuitisation at the age of 75, with particular care and urgency, and decide whether they remain fit for the purpose.*[34] (Emphasis added)

3. Finance Act 2004

Compulsory annuitisation was also debated during the passage of the *Finance Act 2004*. This Act, which in Part 4, introduces an entirely new tax system for pensions which is due to come into force in April 2006, does, in fact, relax the age 75 rule. It allows people to take an "alternatively secured pension" (ASP) at 75. Effectively this permits income drawdown to continue after age 75.

Income drawdown is a facility, introduced in 1995, whereby people can take a tax free lump sum from their pension fund but postpone converting the remainder of the fund into an annuity and take a taxable income direct from the fund instead. This reduces the fund and could lead to a lower annuity in the end but is popular with those who want to retain their capital or who hope that annuity rates will rise. At present there are minimum and maximum limits on the amount of the fund which can be taken as drawdown and drawdown must cease at age 75 when an annuity must be purchased with the remainder of the fund. From April 2006, people will be able to take an alternatively secured pension instead of an annuity at age 75. The minimum income withdrawal will be £1 and the maximum income withdrawal will be 70% of a single life annuity for a 75 year old. This

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[34] HC Deb 16 November 2004, cc 1221-1223

amount will be reviewed annually and the member will be able to change the income received each year. Although introduced to provide an option for people, such as the Christian Brethren, with a religious objection to annuities, it is thought that it will prove attractive to people who do not want to be forced to take an annuity at age 75.

Plans for the ASP were announced in the Treasury's second consultation document on its proposals for a radical simplification of the pension tax system, published in December 2003.[35] The consultation document argued that it would not be an attractive proposition for anyone without theological objections to annuities:

> **Age 75**
>
> 3.4 The previous chapter discussed the Government's proposal to move the minimum age for taking benefits to 55. The Government intends to retain the existing rules, which require all pension savings to be used to provide an income either to the member or, on death, to his or her survivors, by age 75. This reflects the fact that pension savings are intended to be used as income in retirement.
>
> 3.5 Conventional pensions and annuities are likely to remain the most popular and suitable means of securing benefits. However, some religious groups have principled objections to the pooling of mortality risk and need to be accommodated by the new rules. The Government, therefore, proposes to allow pension income to be delivered after age 75 through Alternatively Secured Income (ASI).
>
> 3.6 The pension scheme must at all times remain responsible for delivering ASI. All income payments to the member must be paid via the scheme whether or not the administration and investment of the funds underlying the ASI have been placed with a financial institution. ASI will need to satisfy the general benefit rules but there will be additional controls in place to ensure that funds are used for their proper purpose. The maximum income that can be taken in any year will be 70 per cent of that which could be generated by applying to the fund an annuity rate for a person of the member's age and sex up to age 75. From 75, the annuity rate for a 75 year old will be used. The minimum income to be taken from the product in any year will be £1 or any greater DWP minimum income requirement. If at any point the scheme is to be wound up, the ASI funds standing to the member's credit must be used to purchase an annuity for the member.
>
> 3.7 The maximum income will have to be reviewed annually. On the member's death any remaining funds underlying the ASI must be used first to provide dependants' pensions. If there are no dependants, any remaining pension fund must revert to the scheme, where it may be re-allocated to provide pension benefits for other scheme members or possibly be paid to a registered charity. Otherwise, funds will revert to the employer.

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[35] HM Treasury/Inland Revenue, *Simplifying the taxation of pensions: the Government's proposals*, December 2003, http://www.hm-treasury.gov.uk/media//8692C/simplifying_pensions_421.pdf. The first was published in December 2002, HM Treasury/ Inland Revenue, *Simplifying the taxation of pensions: increasing choice and flexibility for all,* http://www.hm-treasury.gov.uk/media//5E3E9/simppencondoc02.pdf

3.8 ASI is likely to be an inferior choice for pension savers without dependents and who do not have a principled objection to the pooling of mortality risk. The product may be converted to a guaranteed pension for life or an annuity at any time at the member's discretion.[36]

However, financial commentators still believe this will be a popular choice.[37]

The introduction of ASP does not, however, meet all the objections to compulsory annuitisation at age 75 and the Conservative Opposition moved amendments to the *Finance Bill* 2004 which were intended to remove the requirement to buy an annuity altogether. Ruth Kelly, for the Government, argued that this would be unfair to the majority of pensioners and extremely costly for the public finances:

Ruth Kelly: We have again heard a speech about whether there should be a requirement to take an annuity at the age of 75; I have heard the argument many times. When I first heard it made relatively persuasively by the Opposition and the Retirement Income Reform Campaign, I was persuaded that there was a case to consider and I considered it in great depth. I listened to their representations favourably but decided that it was impossible to accommodate them without severe detriment to 95 per cent. of the population.

The argument is not about whether it is possible to accommodate wealthy people in their retirement choices. It is about whether it is possible to accommodate them without doing damage to the 95 per cent. who remain in the previous system. Every proposal that I have heard from the Opposition and outside interests has been framed in such a way that the vast majority of the population would be forced, for the first time, to take out an index-linked annuity at age 65 to enable the top 5 per cent. of the population to have freedom for any surplus income that they may have available above the level which would see them float off means-tested benefits. Requiring the vast majority of the population to take out index-linked annuities at 65 would be a huge restriction on individual choice and would have untold consequences for the gilts market, which could not accommodate people being forced to take out index-linked gilts at 65.

(…)

The second argument against the policy is that, given the amount of unused tax relief in the system, particularly for higher rate taxpayers, any additional incentive for higher rate taxpayers to pass their pension funds down through the generations could have significant behavioural effects and would mean that more was saved in pensions than is currently the case. Inland Revenue estimates suggest that that could cost hundreds of millions of pounds.

The Opposition's proposals would not only be to the detriment of the vast majority of ordinary pensioners, but cost the Exchequer hundreds of millions of pounds. We have had a quick run through of the arguments. I do not think that now is the time to develop them further. [38]

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[36] http://www.hm-treasury.gov.uk/media//8692C/simplifying_pensions_421.pdf

[37] See, eg, Aegon UK press release, 10 August 2005, "Advisers predict healthy future for Alternatively Secured Pension says Scottish Equitable", http://www.aegon.co.uk/media/press_releases/lp_20050810.htm

[38] SC Deb (A) 8 June 2004, cc 489-490

B. Annuity protection

Clause 12 in Part 2 of the Bill would remove the age limit for annuity protection lump sum death benefit. Annuity protection is a new option to be introduced under the new pension tax regime in April 2006. The aim is to offer people who are concerned that they will die shortly after taking their annuity a method of ensuring that their heirs receive some benefit from the pension fund accumulated over their lifetime. A taxable lump sum equivalent to the pension fund used to buy an annuity, minus the income already received, is paid to the estate or beneficiaries. The Treasury consultation documents on the new regime originally described this option as "value protected annuities". The December 2002 document said:

> **Value protected annuities**
>
> 5.53 The feedback on *Modernising Annuities* showed some interest in value protected annuities. This kind of annuity could make a residual payment on the death of the annuitant before age 75, equal to the difference between the amount paid for the annuity and the stream of payments made under the annuity before death. Of course, some annuitants will stand to get no such payment because they survive longer than average. And anyone using this kind of annuity will receive a lower income because of the cost of buying the implied insurance. So value protected annuities may not suit everyone.
>
> 5.54 After pension simplification, the new benefit rules will allow this kind of annuity too. Where someone below age 75 dies in circumstances which mean that a residual payment is made, there will be a 35 per cent tax charge on the residual, as for drawdown and limited period annuities.[39]

The December 2003 document said on value protected annuities:

> **Value protection and guarantees**
>
> 3.15 Secured pensions may offer value protection. Value protection is the repayment on the death of the member before age 75 of an amount representing the initial capital value of the pension less any pension instalments paid before the date of death. All value protection payments will be taxed at 35 per cent.
>
> 3.16 Pension schemes may offer a guarantee that the pension will continue for a period not exceeding 10 years from the date of vesting.
>
> 3.17 Value protection and a guaranteed period of pension payments are mutually exclusive options.

The *Finance Act* 2004 has introduced this option but calls it "annuity protection". HM Revenue & Customs is producing an online *Registered Pension Schemes Manual*. This describes annuity protection as follows:

> **A lifetime annuity contract and annuity protection**

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39 http://www.hm-treasury.gov.uk/media//5E3E9/simppencondoc02.pdf

> [s168(1)][Para 16, Sch 29]
>
> A lifetime annuity contract may provide a member with annuity protection. This means that the annuity contract guarantees that if the member dies before their 75th birthday and they have not received a certain total amount of annuity payments by that time, the balance will be paid as a lump sum on the member's death.
>
> This lump sum is called an annuity protection lump sum death benefit and is taxable at 35%.
>
> Whether or not a contract provides this protection will be decided on purchase, and be expressly provided for in the contract. This protection will be costed into the annuity price.[40]

The Conservative Opposition tried to remove the age limit of 75 on annuity protection lump sums during the passage of the *Finance Bill 2004*. George Osborne, the Conservative spokesman, said:

> One of the biggest obstacles to people taking out a pension is the fact that when it is annuitised the pension pot dies with the member, although in some cases a dependant's pension can be paid. The Government partly recognise that. The Bill is striking in that it recognises that people are discouraged from taking out pensions and annuities because they cannot pass on lump sums when they die. That is why it introduces the concept of value-protected annuities, which, in return for the member's taking a reduced income, will allow any remaining pension pot to be paid to the member's dependant—with the tax charge—provided that the member is not over 75. I concede that that measure is likely to be very popular, and my amendments do not seek to remove it from the Bill.
>
> Last week, the Financial Secretary brandished her report on annuities. I went away and found a different report to brandish, one produced by the Association of British Insurers. Its research found that 47 per cent. of annuitants would be interested in the option of a value-protected annuity and would be willing to give up a reasonable amount of income for one. In fact, one fifth of those whom the ABI surveyed were prepared to give up 20 per cent. of their annuity income in order to be able to pass on something after their death. However, the problem with value-protected annuities—this welcome new product that the Government will allow to be offered—is that they pay out only if the member is under 75. Why is that? What is the Government's argument for such an arbitrary cut-off? If people want to pass on a pension pot after their death, and they are prepared to have a reduced income while they are alive to pay for that option, they should be free to choose that and the market should be free to provide products that allow it to happen.[41]

The Government response was, as Mr Osborne had predicted, that pension tax relief was intended to encourage saving for an income in retirement not to assist the transfer of wealth between the generations:

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[40] http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM09101790.htm

[41] SC Deb (A) 15 June 2994, cc 518-519

> As the hon. Member for Tatton has sought to anticipate my argument, I repeat that pension saving is designed to provide an income in retirement to the member, which on death may continue to be paid to any survivors. It is not a route for conserving or preserving capital, regardless of whether it is properly taxed.
>
> The hon. Gentleman may ask why we allow the passing on of capital before 75 while a person is in income draw-down. We want to ensure that pensions remain a vehicle for securing an income in retirement in later years, but we recognise that those taking their benefits using income draw-down bear mortality and investment risk. For that reason the rules allow that, when a member dies before 75 having taken benefits but without having secured income, any undrawn funds in the pension fund may be repaid as a capital sum, subject as now to tax at 35 per cent. [42]

The Association of British Insurers (ABI) continues to press for a relaxation of the age 75 rule. Its report, *Serious about saving. The ABI agenda for action on state and private pension reform*, published in June 2005, pointed out that one way to reduce the savings gap was to encourage people to work longer and take their pensions later. Current rules requiring people to convert pension savings into annuities at age 75 and preventing money back on annuities where death occurs after age 75 militate against this:

> The First Report of the Pensions Commission reminded us that one of the options for dealing with the savings gap is for people to work longer. As life expectancy rises, many people will want or need to take advantage of job opportunities later in their careers.
>
> This raises big questions for the Government and others about the state pension age and how best to reduce discrimination against older workers. For its part, the pensions industry has already taken some important steps to increase pension flexibility and enable people to work longer.
>
> New retirement income products which can adapt to different income needs at different times, together with flexible retirement arrangements, will allow people to combine part-time work and a gradual move towards retirement.
>
> The time is now right to add to these innovations by raising the age at which it is compulsory to turn pension savings into a secure income. The Government should do this by either raising the age from 75 years to 80 years or by linking the increase to the amount of time that people work, for example by requiring an annuity, or other pension income, to be secured within 20 years of the date of retirement, or by linking the increase to predicted life expectancy.
>
> This change would have significant benefits for those deciding when to secure their income and what type of product to buy. It would encourage and reward people who have longer working lives. And it would remove a major inflexibility for some in pension savings – the requirement to turn a pension into an income in retirement by 75 years of age.

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[42] Ruth Kelly, SC Deb (A) 15 June 2004, c 523

> A key concern that people have about annuities is that, because their annuity dies with them, they will not have received value for money if they die soon after purchase. Our research found that many consumers are willing to meet the small cost of a money back guarantee so that any unused capital can be returned to their estate on death.
>
> The Government has addressed some of these concerns by allowing new types of retirement income products, such as value protected annuities.
>
> But further simplification and innovation is now needed. The Government should simplify further the socalled decumulation regime. This could be achieved by applying the same tax treatment to all lump sum death benefits, and by allowing any money back (purchase price less income received) after the age of 75.[43]

According to the Government Actuary's interim life tables, a man aged 75 can expect to live for a further 9.62 years, while a woman of the same age can expect a further 11.68 years.[44]

IV Proliferation and persistency in pension saving

Part 3 of the Bill is designed to tackle problems highlighted by the Association of British Insurers in their report, *Serious about saving: reducing proliferation and increasing persistency in long-term saving*, published in August 2005. These are the problems caused when people collect a large number of small pension pots (known as "high policy proliferation") and when people stop paying into their main pension arrangement after a short period (known as "low persistency"). This was also highlighted as an issue for younger people when thinking about saving for retirement in a 2003 survey by the National Consumer Council. It found that: "Confusion can be exacerbated by having a number of pensions from different employers. The value of these can be uncertain to an individual, to the point that one even questioned whether he still had access to his pension rights from previous jobs".[45]

The briefing accompanying the publication of the Bill states:

> Companies that currently have to designate a stakeholder pension should additionally offer payroll deduction for pension contributions into any personal or stakeholder pension. This would help to tackle the twin problems of high policy proliferation, whereby individuals' pension arrangements become bewilderingly complicated, and low persistency, whereby people end up having pension funds which are insufficient to provide a comfortable retirement. Companies with existing occupational or Group Personal Pensions would not be affected by this change and neither employers nor employees would be compelled to make private pension contributions.[46]

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43 http://www.abi.org.uk/BookShop/ResearchReports/Seriuos%20about%20Savings.pdf
44 based on data for the years 2001-2003, http://www.gad.gov.uk/Life_Tables/Interim_life_tables.htm
45 NCC, *No nest egg*, October 2003: http://www.ncc.org.uk/moneymatters/no_nest_egg.pdf
46 Press notes, *Rights of Savers Bill*, October 2005.

It is assumed that, in conjunction with SaRAs, "this proposal could be very beneficial. If individuals can request that when they change firms, their new Stakeholder scheme is paid into their SaRA, then it will be possible for people to keep *all* their accumulated pension funds in one simple and accessible vehicle".[47]

The ABI summarised their proposals in a press release issued on 29 July 2005:

> People in work are saving too little. But the ABI (Association of British Insurers) says that they also lose out because they often collect a number of small individual pension pots during their working lives as they move jobs or change their pension provider.
>
> The ABI is today calling for action from pensions providers and the Government to make it easier for savers to consolidate their savings into fewer, but larger, individual funds. In a new policy paper which is being sent to the Pensions Commission for consideration, the Association argues that this 'proliferation' of pensions makes saving more complicated and costly for consumers, while also making administration more difficult for companies. The result is lower savings and incomes in retirement than would otherwise be the case.
>
> New data released by the ABI in its report shows that:
>
> · 21% of people aged over 50 in paid employment have three or more private pensions;
>
> · 62% of employees say that they stopped paying into their first pension because they changed jobs;
>
> · changes to pensions legislation and increased labour mobility mean that the number of people with these complicated pension arrangements is likely to grow unless action is taken to reverse this trend.
>
> To help remedy this situation, the ABI is proposing three new measures:
>
> · the ABI is leading an industry initiative to develop a single pensions transfer process for the pensions industry, with a common transfer form and standardised transfer arrangements. First results are expected to be available before the end of this year;
>
> · the ABI is calling on the Government to reform pensions legislation so that employees can require employers who do not provide pensions to pay their employee pension contributions into a specified stakeholder pension scheme of their choice;
>
> · the ABI is proposing a new Workplace Advice Credit, particularly aimed at small businesses, to encourage the provision of financial advice via the workplace.[48]

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[47] *Ibid.*
[48] http://www.abi.org.uk/Newsreleases/viewNewsRelease.asp?nrid=11840