Low Incomes Tax Reform Group

A voice for the unrepresented

Financial Conduct Authority (FCA), CP17/16
Advising on Pension Transfers
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We appreciate the opportunity to contribute to this important consultation on pension transfer advice. We are concerned that a future mis-selling problem could arise in this area, as people may be attracted by the selling points of accessing pension freedom which they cannot do from a defined benefit (DB) scheme.

1.2 Citing a range of possible examples, this response highlights the difficulties of explaining to the low-income and unrepresented individuals we come across all the factors they need to take into account in getting to the right decision for them. We agree that pensions transfer advice is nigh on impossible to automate and that individual recommendations should be given, as generic advice or guidance is unlikely to be of great assistance to many people.

1.3 In giving such advice, it is important not to overplay the potential future benefits of pensions freedom. Who can guarantee that today's policy will stand the test of time? Pensions and what you can do with them are, after all, regulated by what is permitted under tax law – which changes from one year to the next.

1.4 Indeed, the fact that pensions are subject to complex and ever-changing rules is a key reason for people preferring to save in other simple and accessible ways. To encourage a person in their mid-thirties, say, to transfer from a DB scheme to a defined contribution (DC) scheme to take advantage of future pensions freedom therefore seems entirely inappropriate, unless there are other factors to take into account. The FCA therefore must ensure this point is stressed in guidance to advisers.

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1.5 Although we commend the FCA for ensuring that the tax consequences of transfers and proposed means of taking benefits are mentioned at 4.12, we would like to see this stressed more clearly. With pensions freedom, the risk of creating a large, unexpected tax bill (not only through an obvious direct income tax charge, but also through loss of other reliefs and benefits) is much greater than when someone invests their pension for an annual income. Clearly advising on this area is an uncertain business, as it does involve an element of crystal ball-gazing – for example, assumptions about what the future tax and welfare benefits regime might look like. Nevertheless, it is essential that advisers highlight any such assumptions made – even if it is simply that they have assumed that the regime of the future will be the same as it is now (in itself, a highly risky assumption, given the rate of change of tax law!).

2 About Us

2.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

3.1 We welcome the opportunity to respond to the questions in this consultation document relevant to our professional interest in taxation and those on low incomes. It was pleasing to note that you acknowledge the particular needs and difficulties of those of limited wealth or income in your reference to the Financial Advice Market Review (FAMR) in 3.5. Our comments are a continuation of our previous responses to consultations by you, HM Treasury and HMRC on pensions advice, financial guidance and similarly related themes.

3.2 We draw much evidence from enquiries received to our suite of websites,[1] and from our 'sister' tax charities,[2] especially Tax Help for Older People,[3] who have extensive experience of these topics in their daily hands-on dealings with clients who cannot afford to pay professional advisers' fees.

4 General

4.1 Tax and its impact on tax-related benefits are an integral part of almost all financial decisions. No financial adviser can give sound advice without taking into account what effect tax would have on any course of action. Pensions are no exception to this but now under pensions freedom, it becomes a major consideration. Under the previous regime, annuity purchase was the only route available (except for those with substantial pension pots who could risk the drawdown option), and therefore tax choices were limited to whether to take a tax-free lump sum or a higher taxable income, and the timing of starting to draw retirement benefits when ceasing or cutting down work. The potential for triggering a large and unexpected tax bill (or loss of means-tested benefits entitlement) was limited. Now a transferred pot has a much wider range of destinations which offer a variety of tax situations, both in life and at death.

4.2 For example: a part-time worker may wish to top up her income to the personal allowance limit by a series of UFPLS[4] withdrawals; someone with a poor health prognosis may wish to leave his beneficiary a tax-free inheritance should he die before 75; the pensioner may wish to place the proceeds of a pension pot within the ISA shelter to benefit from tax-free income and potential tax-free growth, not to mention the recently acquired ability to pass ISA holdings within their tax shelter on to their spouse outside the estate; those still working but winding down may wish to use income drawdown to allow them to take variable income to top up their earnings without propelling them into a higher tax band. And so on.

4.3 We mention these common examples because the average pension saver, especially those on modest incomes and with small pension savings, is unlikely to have the knowledge and skills necessary to understand the impact of tax on their decisions, let alone the full financial consequences and impact on wider personal circumstances (which are not within our remit). It is therefore essential that financial advisers and pension transfer specialists have a thorough grasp of the tax implications of transfers.

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[1] LITRG operates four websites. In particular, we refer here to our main website www.litrg.org.uk, through which we regularly receive enquiries relating to pensions together with their associated tax treatment and welfare benefits interactions.

[2] TaxAid and Tax Help for Older People

[3] See www.taxvol.org.uk for full details

[4] Uncrystallised Funds Pension Lump Sum

4.4 We now answer the specific questions asked.

5 Q1: Do you agree with our proposal to require all advice on the conversion or transfer of safeguarded benefits to be a personal recommendation? Please provide the reasons for your response.

5.1 We have no hesitation in supporting your proposals to require all advice to be a personal recommendation. It is not merely the tax implications adumbrated above which are both beyond the grasp of most people and also applicable to each person in different ways, but also, as you say throughout, the aims, expectations (whether realistic or not), longevity, health, family commitments and other sources of income and capital. The long-term needs of, say, a single person with no family will obviously differ hugely from a remarried widower with a second family, yet the adviser must delve deeply to discover that the single person is guardian to his orphaned nephew while the former widower's first family are now well-established adults. It may be more useful for a terminally ill man to leave his teacher wife with earning capacity and her own pension a lump sum to pay off the mortgage. We sketch these three small outlines by way of illustrating the myriad different aspects which must be considered for each client.

5.2 Add to these considerations the not entirely predictable benefits of a DB scheme – a surviving spousal pension has no value when the spouse predeceases the saver – and what might be potentially sacrificed should the pension be transferred to a DC scheme and we have a farrago of information and suppositions which can only be resolved for one individual. Generalist advice or guidance would leave the client in no better position to understand their choices than when they started.

6 Q2: Do you agree with our proposals for new guidance on assessing suitability? If not, what guidance do you think would be helpful?

6.1 Again we agree strongly that assessing suitability must depend on what is right for the client, not an assumption that the status quo is automatically the correct answer. We have illustrated above how circumstances can affect the needs of the client in ways not foreseen – or at least catered for – by pension scheme trustees and administrators. As suggested, the adviser should start from a neutral position and assess, on the whole of the evidence available, what would be the best outcome for the client and beneficiaries.

6.2 Bearing in mind the difficulties of predicting the future, any recommendation is bound to depend on a raft of 'what-ifs' on both sides of a transfer, e.g. the current apparently confirmed bachelor may subsequently marry and procreate. Thus the benefits of his DB scheme double almost overnight. On the other hand, the needs of the unexpected widower in the last paragraph have also changed overnight. The unpredictability of a DC scheme reliant on investment growth may not necessarily be inferior to a DB scheme that fails and leaves the pensioner to fall back on the Pension Protection Fund.

7 Q3: Do you agree with our proposals to add guidance to the Handbook to clarify what a pension transfer specialist is expected to do when checking advice on transfers or conversion of safeguarded benefits?

7.1 This is largely an "in-house" question but we comment that we would expect a second opinion to check whether the original adviser had demonstrated satisfactorily that the recommended course of action was in the client's best interests.

8 Q4: What are your views on how the current qualification requirements for pension transfer specialists operate in practice?

8.1 No comment.

9 Q5: Do you have any comments on our explanation of the responsibilities of advice firms and pension transfer specialists?

9.1 No comment.

10 Q6: Do you have any comments on our explanation of the responsibilities of advice firms and independent pension transfer firms?

10.1 No comment.

11 Q7: Do you agree with our proposals on the introduction of an appropriate pension transfer analysis? If not, how could we amend it?

11.1 This question naturally follows on from Questions 1 and 2. Clearly the financial aspect of a potential transfer must be core to the argument but no longer the sole determinant. To take an extreme example, the adviser might point out that the transfer would mean giving up an indexed pension of £10,000 a year with surviving spouse benefits for a level single life annuity of £5,000 a year, but a full appropriate pension transfer analysis (APTA) might make the choice less blindingly obvious if the client was unmarried with six months to live and wanted to fit in a world cruise before he died. As you say in 4.10, the advice must distinguish between the objectives and the needs of the clients. Many, perhaps most, clients will have a limited grasp of their own longevity, of the effects of long-term inflation, of a sound investment strategy, of investment risk and who carries it; nor can the client predict future imponderables such as their health – a car accident or Alzheimer's can have life-shattering effects.

11.2 In particular, we would strongly reinforce your statement in 4.12 that "taxation consequences should be an inherent part of the consideration of crystallising funds benefits and accessing funds". Incidentally, we note with some regret that the word "tax" only

appears a couple of times in your text outside the somewhat specialised area of overseas transfers. Something with an impact ranging between 0% and 60% should surely rate a higher level of importance.

11.3 To stress this even further, examining obvious income tax consequences is not sufficient – i.e. advisers must not overlook knock-on effects. For instance, our website commentary on pensions freedom looks at how one might incur not only a straight tax charge of perhaps 20%/40% on the taxable element of a pension lump sum, but also that they might trigger a High Income Child Benefit Charge and clawback of the marriage allowance,[1] tax credits overpayment,[2] or impact on other means-tested state benefits.[3] Also, a pension withdrawal taking a person into a different rate of tax might result in the loss of other tax 'breaks' such as the 0% savings rate or a reduction in the so-called 'personal savings allowance' (which is in fact another nil rate of tax on savings income).

11.4 So advisers must present and examine the wider and possibly unpalatable outcomes of a potential transfer beyond the "this is what it is worth in cash". Apart from the transfer value from the ceding scheme, the destination of the transfer must play a major role. Is it heading for a FTSE 100 pension company and if so, how will the benefits be derived – impaired life annuity, flexible drawdown, etc. – or is it heading for an unbeatable investment in snake oil wells in Ruritania sold by a stranger over the phone? This consideration is paramount for consumer protection.

11.5 We are also concerned about pensions freedom being used as a selling point to encourage DB scheme members to transfer in entirely inappropriate circumstances. We must remember that pensions freedom is permitted by the tax legislation of today. The law as it stands might permit that freedom at age 55, but we know that this is already promised to go up to age 57 by 2028. Beyond that, who knows? Perhaps in five or ten years' time, a review of pensions freedom policy might deem it to be an unmitigated disaster and withdrawn? Perhaps it will be deemed a partial success, but the government of the day might decide that it is acceptable for people to have freedom over only 50% of their savings and that withdrawals from the balance must be restricted to spread them over one's anticipated lifespan, or to pay for care? For a DB scheme member aged, say, in their mid-30s now, encouraging a transfer out to a DC scheme on the basis that they will be able to take advantage of pensions freedom in 20-odd years or more is therefore likely to be extremely poor advice.

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[1] See http://www.litrg.org.uk/tax-guides/pensioners-and-tax/what-tax-position-when-i-take-money-my-pension-flexibly#toc-could-taking-money-out-of-my-pension-affect-my-child-benefit-claim-

[2] See http://www.litrg.org.uk/tax-guides/pensioners-and-tax/what-tax-position-when-i-take-money-my-pension-flexibly#toc-will-taking-money-from-my-pension-affect-my-tax-credits-claim-

[3] See http://www.litrg.org.uk/tax-guides/pensioners-and-tax/what-tax-position-when-i-take-money-my-pension-flexibly#toc-what-is-the-effect-of-taking-money-out-of-my-pension-on-other-state-benefits-

11.6 In 4.13, the first bullet notes that “appropriate mention [may be made] of the existence of and benefits provided by the Pension Protection Fund”. We would stress the use of **appropriate** in this context, as we are concerned that those seeking to offload the future liabilities of DB schemes may use the lack of 100% protection of guaranteed benefits as a means of encouraging scheme members to take a transfer value. For example, mention of members being likely to receive **only** 90% of their scheme benefits in the event of the scheme’s sponsoring employer running into financial difficulty could be interpreted as a veiled ‘threat’, particularly when coupled with the selling points of pensions freedom and promised control over one’s own savings. That is, both the risks of staying with the DB scheme and the potential benefits of a DC scheme/pensions freedom might be overplayed so as to make a transfer appear attractive overall.

12 Q8: Do you agree with our proposals on preparing and presenting the client with a mandatory transfer value comparator within the appropriate pension analysis? If not, how could we amend it?

12.1 We are not convinced that the mandatory transfer comparator as shown in the document is the best route. To show that the client needs an extra £20,000 to purchase an equivalent value annuity is pointless unless the chart can also show any differences in benefits which make that extra £20,000 worth paying. Asking someone if they want to buy an identical house for £300,000 or £350,000 is a waste of breath unless you add that the second one is in an excellent school catchment area and five minutes’ walk from the station. A useful transfer value comparator (TVC) must surely include at least some of the financial considerations of an APTA, although we recognise that this would not be easy to construct.

13 Q9: Do you agree with the proposed changes to the assumptions for the rolling annuity interest rate, non-annuity mortality, the growth rate and the inclusion of charges?

13.1 No comment.

14 Q10: What are your views on the use of stochastic tools within appropriate pension transfer analysis? How could the outcomes be presented in a way which results in good consumer understanding, given the format and outcomes presented in other mandated documents?

14.1 No comment on the first part of the question. On the second part, we would merely observe that only a small minority of clients would understand a word of sections 4.30, 4.31 and 4.32.

15 Q11: Do you have any comments on our explanation of the responsibilities of advice firms in relation to software?

15.1 No comment.

16 Q12: Do you have any views on the assumptions for CPI and for benefits with caps and collars?

16.1 No comment.

17 Q13: Do you agree with our proposal for the application of the additional requirements for pension opt-outs to be restricted to opt-outs where there are potential safeguarded benefits available?

17.1 No comment.

18 Q14: Do you agree with our proposal that the new TVC analysis should not be required for any pension opt-outs?

18.1 No comment.

19 Q15: Do you have any thoughts on the impact of these proposals on overseas transfers?

19.1 We do not consider that there is any essential difference in the proposed safeguards and analysis regardless of whether the transfer is domestic or overseas. There is merely the added financial aspect of the new 25% charge.

20 Q16: Do you have any comments on our expectations for the provision of streamlined advice when advising on safeguarded benefits?

20.1 We have serious doubts that the area of pension transfers is suitable for any form of streamlined advice. The extensive facts and possibilities to be taken into consideration for a major financial decision affecting the whole of one's future life require far closer examination on a personal level than is possible with an automated programme.

21 Q17: Do you have any comments on our cost benefit analysis?

21.1 No comment.

LITRG
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