Comments on behalf of

The Association of Corporate Treasurers

in response to:

***Simplifying the taxation of pensions**: increasing choice and flexibility for all,* HM Treasury and Inland Revenue; and

***Simplicity, security and choice**: Working and saving for retirement,* CM 567, Department for Work and Pensions, HM Treasury and Inland Revenue

(December 2002)

I. Introduction

The Association

The Association of Corporate Treasurers was formed in 1979 to encourage and promote the study and practice of finance and treasury management and to educate those involved in the field.

Today, it is an organisation of professionals in corporate finance, risk and cash management operating internationally. It has over 3,000 fellows, members and associate members. With more than 1,200 students in more than 40 countries, its education and examination syllabuses are recognised as the global standard setters for treasury education.

The ACT welcomes the opportunity to submit views on this important topic.

We would be pleased to expand further any point made herein or to assist the Department for Work and Pensions, HM Treasury or the Inland Revenue in any other way.

March 2003

II General comments

We are pleased to present our views on the Government's proposals.

The ACT welcomes the Government's attempt to simplify the taxation of pensions and its proposals to replace the numerous complex existing regimes by a single unified approach. We fully support the declared aim to encourage individuals to save more for their retirement by giving them clearer simpler choices and the intention to make it easier to set up and run good pension schemes.

III Specific points

We confine our remarks to the following specific issues.

A. Simplifying the taxation of pensions

1. The lifetime cap

1.1 The lifetime cap represents an enormous potential simplification of the current regime.

However, we believe that as currently structured the cap fails to meet the Government's declared aim to give individuals clear choices as to how they save for their pensions.

The main problem is that the cap is a limit on the value of the benefits at retirement (currently set at £1.4m) rather than a limit on the total amount of contributions into schemes.

1.2 The value of benefits is entirely unpredictable for money purchase type schemes. Individuals saving for their retirement cannot have clear choices if they do not know *in advance* how their investments will be taxed. This uncertainty complicates and potentially confounds choices in a manner directly contrary to the Government's declared aim.

The Government's aim – which we believe to be right - can only be achieved with a lifetime limit if it is based on contributions made into the scheme.

1.3 It would of course be necessary for the Government to provide assumptions in order to enable employers to calculate the amount of contributions for a defined benefit scheme but this is no more difficult than the requirement for them to provide assumptions in order to be able to calculate the value of benefits as is currently proposed.

1.4 Similar assumptions may be needed to be provided as a practical matter to establish notional value of past contributions into defined contribution schemes where records are incomplete.

2. The annual contribution limit/limit of annual relevant earnings

2.1 If the lifetime limit were changed from a benefits to a contribution limit then there would be no need for an annual contribution limit, currently proposed to be £200,000. This would represent a significant additional simplification.

2.2 The consultation paper also proposes that there should be an annual limit on an individual's relevant earnings for the year. Again the need for this would be nullified by having a lifetime contribution limit – additional simplification.

2.3 Removal of the annual limit would also mean that those taking a career break, perhaps following redundancy or education or other purposes, could continue to make tax effective contributions during a year when they received little earned income but may have significant investment income. They should be able to use other savings similarly to contribute to pension savings.

3. Number of people affected by the lifetime limit

3.1 A current point of debate is how many people would be affected by the lifetime limit.

3.2 We believe that there is an inconsistency in the Government's argument on this point. The Government's declared aim in setting the limit at £1.4m was to produce a figure which, at today's annuity rates, would buy a pension roughly equal to the maximum pension payable under a defined benefits scheme for someone whose earnings were equal to the current earnings cap of £97,200. It follows then that most people earning more than the earnings cap are potentially affected by the £1.4m limit. Figures for this number should be easily available from the Inland Revenue, but it is undoubtedly more than the 5,000 currently being quoted.

4. Adequacy of the £1.4m limit

4.1 As noted above, it is the Government's stated aim in arriving at the £1.4m lifetime limit to produce a figure which would buy a pension roughly equal to a two-thirds pension based on earnings of £97,200. Such a pension may be considered to include LPI indexed increases plus a surviving spouse pension of 50% of the annual pension payable.

4.2 Experience suggests that the availability of such a pension for £1.4m at present is contingent upon circumstances including not only annuity rates but, importantly, the negotiating leverage of the person negotiating the transaction. For individuals making such a purchase and not backed by a large company it does not seem that £1.4m would achieve the result.

Comparable effects would be seen under a regime of lifetime contribution limit.

4.4 Thought should be given to how this discrimination against those who do not work for large companies could be reduced. Similar concern about negotiating powers are reflected in Chapter 4, (para. 77 ff) of *Simplicity, security and choice,* of course. The centralised "clearing house" arrangement considered there could be applied here too.

B. Simplicity, security and choice

5. Amending the priority order of creditors

5.1 We note that generally there is no requirement for an employer to make good any deficit in a pension scheme funding due to inability to meet its (the scheme's) liabilities to scheme members. Thus in this respect pension schemes are not creditors of the company.

5.2 We assume, therefore, that the sums concerned in the discussion in Chapter 4 (para. 73 ff) are amounts payable by the company re contributions due but not paid at the time of insolvency. They will include sums deducted from wages and salaries in respect of employees' contributions and the related relevant amounts in employer's contributions.

5.3 Trustees should not permit undue delay in payments to the scheme, but perhaps this duty of trustees could usefully be spelt out very clearly. Trustees may be reluctant to trigger insolvency by insisting on prompt payment of employers' contributions and sums deducted from wages and salaries although forbearance may be hazardous and potentially a form of abuse.

5.4 Some of our members have observed that pensions may be seen as deferred employee remuneration and so should have similar protection to unpaid wages, but should not in any case be ranked below secured creditors. Unless there has been abuse of sums due to pension schemes, the impact on other creditors should be small.

5.5 Other members have expressed concern that there may be some implied intention relating to general pension scheme deficits (rather than just contributions due but not yet transferred to the scheme trustees). The sums involved in such a case could be much larger and so affect other creditors more. We would like to make more comments if such a change were contemplated.

6. Central clearing house

6.1 See 4 above. We believe that this could be a useful arrangement. It is wholly compatible with insurance arrangements as discussed below.

7 Insurance arrangements

7.1 Insurance arrangements (or a Central Discontinuance Fund) would give a desirable stability to pensions arrangements. We note the Pension Benefit Guaranty Corporation in the US which gives very limited protection to scheme members and is generally funded by contributions from insured schemes.

7.2 In general, insurance could usefully cover not 100% of benefits but, to avoid moral hazard, say 80-90% of benefits, including limited indexation and survivor's pension. Small pensions, up to say £20,000 p.a. (indexed) could perhaps be paid in full with a taper above that level.

7.3 Insurance should not be compulsory but once elected for by a scheme would be a long-term arrangement.

7.4 The insurer, properly established, would require appropriate review of pension scheme internal arrangements including prudential rules. It may require small schemes which find difficulty in achieving sufficient internal controls or investment diversification to subscribe to multi-company schemes which it approves. This oversight would provide an important safeguard to pensions schemes.

7.5 Regarding transition arrangements, the insurer should only provide cover in respect of such proportion brought forward scheme liabilities which it believes are fully funded although such cover could be upgraded as schemes receive further funding. The insurance basis of cover would be destroyed if the insurer were expected to cover prior funding deficits[*]. As regards scheme liabilities in respect of new contributions, cover should only be provided to the extent that current contributions are considered adequate.

7.6 Long-stop government backing to the credit standing of the insurance scheme or CDF would be important in case of systemic problems with pension schemes.

7.7 In order to reduce the risks of systemic problems, there should only be minimum restrictions on scheme investments both as regards type of investment or geographic distribution of investment.

7.8 Consideration should be given to bringing into cover personal, but not self-invested, schemes for those not able to participate in employer sponsored schemes.

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[*] Any funding or insuring of inadequately funded brought forward liabilities to scheme members would be a matter of public policy, not insurance.

March 2003

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