Decumulation proposals

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The above-named organisations were consulted in developing the proposals and recommendations in this report. None of the proposals should be assumed to be the individual policies of any of these organisations and listing of the named organisation should not be interpreted as meaning their unconditional support of all proposals. They do, however, represent significant thought and debate and whilst not all organisations have had the same level of involvement, they all welcome the opportunities these proposals provide for a constructive dialogue with government, regulators and other financial services stakeholders.

1. Managing longevity/mortality risk (FCA and DWP)

Approaching retirement communications should prompt individuals to consider the length of their retirement to help reduce the number of individuals extinguishing their pots before death

FCA statistics show that in 2019/20 the most popular regular withdrawal rate for all age groups and pot sizes below £250,000 was 8% or more.

The latest ONS Wealth and Assets survey shows the median combined DB and DC pension wealth for someone approaching retirement is £91,200. This is heavily skewed by DB which has an isolated median of £181,000 compared to DC of £28,500. As accrued DB wealth continues to decline in the private sector (almost non-existent for younger employees), we can expect the combined median to reduce as the ongoing reduction in DB will not be adequately offset by the expected increase in DC. To achieve a moderate retirement of £30,000 net, then even with full state pension, a withdrawal rate of 8%+ would be required based on expected fund values at retirement.

It may also help people who underspend to increase income to experience better retirement outcomes, and those who fully encash to consider if that is appropriate.

Research shows at least 67% of people underestimate their life expectancy. Understanding mortality is crucial to decision making in the Pension Freedoms landscape.

Drawdown propositions are becoming far more prevalent in Master Trusts. However quinquennial wake up packs from age 50 until full crystallisation are not a requirement for Occupational DC schemes, despite these members needing the same support and guidance with retirement decisions as contract-based scheme members. We have seen considerable growth in the membership of Master Trusts - legislation implemented to help members achieve better retirement outcomes should span across both regulatory regimes to ensure a consistent consumer journey.

Members of Trust Based and Contract Based DC schemes need identical help and support with their retirement decision making. However, regulatory changes are not aligned between the two regimes which results in different consumer journeys. We need more strategic alignment to ensure all scheme members are provided with the same levels of protection, support and opportunities.

The most popular average withdrawal rate according to FCA retirement income data 2019/20 is 8%+ for all age groups and all pot sizes up to £249,000. Whilst we do not know the personal circumstances of these individuals, clearly this is an unsustainable rate for the typical length of retirement.

Age	Withdrawal less than 2%	Withdrawal 2 - 3.99%	Withdrawal 4 - 5.99%	Withdrawal 6 – 7.99%	Withdrawal 8% +	Total number
55-64	11%	15%	16%	11%	48%	124,315
65-74	**10%**	**16%**	**21%**	**15%**	**38%**	**180,137**
75-84	9%	14%	16%	14%	47%	47,480
85+	**5%**	**10%**	**12%**	**11%**	**62%**	**1,491**

Pot size	Withdrawal less than 2%	Withdrawal 2 - 3.9%	Withdrawal 4 - 5.99%	Withdrawal 6 – 7.99%	Withdrawal 8% +	Total number
Less than £10,000	**6%**	**4%**	**6%**	**6%**	**78%**	**16,280**
£10,000 - £29,000	**3%**	**5%**	**10%**	**11%**	**71%**	**50,319**
£30,000 - £49,000	**4%**	**8%**	**15%**	**13%**	**60%**	**49,745**
£50,000 - £99,000	**6%**	**13%**	**20%**	**16%**	**45%**	**78,984**
£100,000 - £249,000	**11%**	**19%**	**24%**	**16%**	**30%**	**89,023**
£250,000 and above	**24%**	**29%**	**22%**	**11%**	**14%**	**70,447**

Where an ad-hoc income is taken in addition to regular income, this is included

With most DC members opting for Drawdown, how can we help individuals consider the length of their retirement before making withdrawal decisions?

Proposal

Extend the age-related wake-up pack requirement to Trust Based DC pension schemes. Include a life expectancy summary section based on outputs from the ONS calculator, specific to the individual.

Example wording age 50 pack:

For males – "Did you know you have a 1 in 4 chance of reaching age 93?"

For females – "Did you know you have a 1 in 4 chance of reaching age 95?"

For further details please visit the ONS Life Expectancy calculator at ons.gov.uk

Whilst the individual cannot do anything with this information immediately, it may help them consider how long they will live and factor this into their thinking when they are ready to make retirement decisions.

Wording will be conditional on scheme member characteristics which could include gender and age, although gender neutral communications might also be considered. Whilst not being prescriptive with the exact wording, it needs to prompt members to consider how long their retirement might last and provide some sort of indication as to how long this might be.

Understanding longevity risk is an essential part of retirement planning in today's world, so firms should consider embedding this within their online consumer journeys, where this does not already exist.

2. Level up the MPAA to £10,000 across all DC pension schemes

The MPAA was introduced with Pension Freedoms with the intention to restrict the recycling of pension savings. The level was initially set at the level of £10,000 in 2015/16 and reduced to £4,000 from 2017/18.

HMT stated an MPAA of £4,000 was a fair and reasonable level and would not impact disproportionately on any groups. A commitment was made in 2017 to keep this under regular review.

Anyone who accesses their pension savings flexibly will be impacted by the MPAA. It has become commonplace for individuals to phase in retirement by gradually reducing work and supplementing reduced pay through pension withdrawal.

Conversely, individuals can access Defined Benefit pots of any size and subsequently maintain or commence contributions to a Defined Contribution plan without triggering the MPAA. Inequalities therefore exist across consumer groups.

HMRC do not collect data on MPAA breaches so there is no way for government to measure who is breaching the limit. This prompts the question how do they intend to keep the limit under "regular review" as stated in the HMT March 2017 consultation without this data?

Nevertheless, there is plenty of research that has been undertaken in this area to conclude that the number of people who are impacted by the MPAA has increased and the likelihood of some of this group exceeding the limit, often unknowingly has also increased.

According to FCA, the final 3 months of 2020 saw a 10% increase in the number of individuals who flexibly accessed, compared to the same period last year. This could be an impact of COVID on household finances.

LV= estimated in January that more than 150,000 55–64-year-olds have been pushed into early retirement due to COVID. Reasons include redundancy, pay cuts, a wish to reduce exposure to COVID and a general reassessment of life priorities. This will result in the group flexibly accessing their pensions earlier than originally anticipated.

Data contained in the HMRC report 'Commentary for Personal and Stakeholder Pension Statistics: September 2021' shows that Personal Pension contributions have risen by circa 25% between 2017/18 and 2019/20. The same report also shows the number of individuals flexibly accessing their pension, and therefore subject to the MPAA has risen by 38% from 2018 to 2020.

In 2017/18 minimum AE contributions were 2% of banded earnings. This has since risen to 8% and will increase further when the lower earnings limit is removed during the mid-2020s.

Industry research and HMRC statistics show that there have been significant increases in DC pension contributions and the number of individuals who have flexibly accessed their pensions since the MPAA was reduced to £4,000. This could not be anticipated when the MPAA proposals were implemented, however these increases which materially impact on the appropriateness of the MPAA limit have prompted no review to date.

A workplace pension is considered an important part of an employment proposition with competition in certain sectors driving up the average level of employer contribution. We see average DC employer contribution levels in the Finance and Insurance industry of 9.5% of whole salary according to 'Profile Pensions' research. Similarly, employers in the Education sector contribute on average 9.3% of salary.

If we consider the contribution level needed for a median earning employee to breach the MPAA, we arrive at a total contribution of between 13% and 14%. Given many employers operate a contribution structure on a matched basis, we can expect it likely that median earning employees who are receiving employer contributions of 7% or above, will be contributing in total over £4,000 per annum.

According to ONS statistics, circa 15% of employers contribute at least 8% of salary to their employees DC scheme. A median earning employee with a total contribution of circa 13% will breach the MPAA limit

In 2020 the ONS median salary was £31,500. Calculations based on the below DWP AE statistics for 2020 show that the average gross personal contribution of whole salary to AE for an 'eligible employee' was 6.75% and employer was 8%. Based on these figures, the average employee would be contributing in total £4,650 per annum and would be breaching the MPAA limit. The average employee contribution has increased by over 270% since the MPAA limit was reduced.

TISA

Trends in workplace pension saving

Total pension saving of eligible savers 2009-2020

By employer and employee contributions, sector and gender*

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Public sector												
Total saved (£ billions)	**38.7**	**41.7**	**39.6**	**38.2**	**39.8**	**38.7**	**39.9**	**40.2**	**40.1**	**40.6**	**41.4**	**47.1**
Employee contributions	7.9	8.6	8.1	8.4	9.5	9.8	9.9	9.8	9.7	9.7	9.5	10
Employer contributions	28.2	30.2	28.6	26.8	26.8	25.3	26.4	26.8	26.7	27.1	28.2	33
Tax relief	2.6	2.9	2.9	3	3.5	3.6	3.7	3.6	3.6	3.7	3.7	4
Per eligible saver (£s)	***6,256***	***6,457***	***6,330***	***6,374***	***6,453***	***6,639***	***6,782***	***6,685***	***6,719***	***6,723***	***6,848***	***7,140***
Per male eligible saver (£s)	*7,465*	*7,792*	*7,495*	*7,686*	*7,635*	*8,260*	*8,447*	*8,385*	*8,443*	*8,545*	*8,805*	*8,966*
Per female eligible saver (£s)	*5,589*	*5,781*	*5,731*	*5,774*	*5,919*	*5,973*	*6,055*	*6,040*	*6,046*	*5,997*	*6,217*	*6,406*
Per eligible employee (£s)	***5,708***	***5,873***	***5,709***	***5,718***	***5,933***	***6,149***	***6,250***	***6,155***	***6,239***	***6,273***	***6,405***	***6,703***
Per male eligible employee (£s)	*6,880*	*7,103*	*6,811*	*6,941*	*7,046*	*7,661*	*7,908*	*7,801*	*7,849*	*8,129*	*8,199*	*8,482*
Per female eligible employee (£s	*5,046*	*5,220*	*5,177*	*5,209*	*5,438*	*5,565*	*5,661*	*5,591*	*5,678*	*5,692*	*5,849*	*6,071*
Private sector												
Total saved (£ billions)	**41**	**39.2**	**38.9**	**39.3**	**41.6**	**44.1**	**45.7**	**45.3**	**48**	**53**	**59.1**	**58.9**
Employee contributions	8.4	7.9	7.7	7.9	9.1	10	10.6	10.5	11.4	13.7	16.5	15.9
Employer contributions	29.2	27.9	27.8	28	28.4	29.7	30.4	30	31.6	33.4	35.6	36
Tax relief	3.4	3.3	3.4	3.5	4.1	4.4	4.7	4.7	5.1	6	7	7
Per eligible saver (£s)	***4,348***	***4,229***	***4,303***	***4,275***	***3,911***	***2,444***	***1,815***	***1,484***	***1,170***	***1,572***	***2,125***	***2,059***
Per male eligible saver (£s)	*5,090*	*4,866*	*5,023*	*4,878*	*4,429*	*2,754*	*2,073*	*1,690*	*1,331*	*1,754*	*2,408*	*2,293*
Per female eligible saver (£s)	*3,387*	*3,333*	*3,341*	*3,470*	*3,228*	*2,075*	*1,524*	*1,236*	*1,005*	*1,306*	*1,752*	*1,749*
Per eligible employee (£s)	***0***	***0***	***0***	***0***	***0***	***457***	***518***	***531***	***634***	***1,237***	***1,786***	***1,713***
Per male eligible employee (£s)	*0*	*0*	*0*	*0*	*0*	*514*	*593*	*608*	*711*	*1,399*	*2,031*	*1,912*
Per female eligible employee (£s	*0*	*0*	*0*	*0*	*0*	*376*	*408*	*415*	*509*	*1,014*	*1,454*	*1,453*
All employees												
Total saved (£ billions)	**79.7**	**80.9**	**78.4**	**77.5**	**81.4**	**82.8**	**85.7**	**85.5**	**88.1**	**93.6**	**100.4**	**105.9**
Employee contributions	16.3	16.5	15.8	16.3	18.5	19.7	20.5	20.3	21.1	23.4	26	26
Employer contributions	57.4	58.1	56.4	54.8	55.2	55	56.7	56.8	58.3	60.5	63.8	69
Tax relief	6	6.3	6.2	6.5	7.6	8.1	8.4	8.3	8.7	9.7	10.6	11
Per eligible saver (£s)	***5,411***	***5,503***	***5,465***	***5,426***	***5,219***	***4,148***	***3,585***	***3,242***	***2,743***	***2,492***	***2,999***	***3,061***
Per male eligible saver (£s)	*6,113*	*6,112*	*6,090*	*6,004*	*5,600*	*4,107*	*3,339*	*2,855*	*2,245*	*2,176*	*2,913*	*2,840*
Per female eligible saver (£s)	*4,775*	*4,957*	*4,933*	*4,956*	*4,863*	*4,169*	*3,782*	*3,500*	*3,178*	*2,864*	*3,119*	*3,276*
Per eligible employee (£s)	***1,778***	***1,673***	***1,373***	***1,203***	***1,642***	***1,741***	***1,555***	***1,410***	***1,489***	***1,840***	***2,419***	***2,457***
Per male eligible employee (£s)	*1,230*	*1,030*	*292*	*0*	*859*	*1,147*	*1,064*	*1,009*	*1,105*	*1,705*	*2,381*	*2,294*
Per female eligible employee (£s	*2,190*	*2,154*	*2,046*	*1,939*	*2,350*	*2,423*	*2,208*	*1,962*	*2,027*	*2,082*	*2,483*	*2,696*

Number of eligible employees participating 2009-2020 (thousands)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Public	5,102	5,350	5,167	4,812	4,885	4,667	4,763	4,784	4,820	4,864	4,816	5,174
Private	6,338	5,988	5,804	5,899	6,580	9,118	10,610	11,180	12,855	13,879	14,427	14,261
Overall	11,440	11,338	10,972	10,711	11,465	13,785	15,373	15,964	17,675	18,743	19,243	19,435

The combination of:

- The increase in those flexibly accessing due to Covid-19
- The increase in those flexibly accessing due to working for longer and phasing in their retirement
- The increase in contribution levels

means that there is an increasing group who fall into these categories and cannot benefit in full, from their employer workplace pension scheme.

It is not only members of workplace pension scheme who are restricted by the MPAA. The self-employed are another group who will be particularly impacted. There are circa 5 million s/e individuals, with the highest percentage falling into the 50-59 age group. This group did not qualify for any furlough pay during the pandemic and receive no sick pay. Consequently, during periods of inactivity, financial difficulty or low earning fluctuations, those of minimum pension age will often flexibly access their pension pots, with a view to replenishing it when circumstances improve.

For everyone impacted, access to money during times of hardship will overshadow any consequential impact of flexibly accessing and given the low levels of engagement that exists within pensions, many will not even be aware of the implications and the future contribution restriction they are triggering. There is a very real risk that for thousands of savers who have the ability and inclination to invest for their futures, they run the risk of unknowingly incurring tax bills for doing so.

The current level of the MPAA does not align to the government initiative of encouraging and enabling people to work for longer. Research shows the number of individuals aged over 70 who are still in work has doubled over the last decade.

The government also needs to recognise the impact that Covid-19 has had on withdrawal behaviour, the significant increase in contributions since 2017 and the contribution and access flexibility needed to reflect the nature of self-employed work.

As economic expectations rise as we emerge from the pandemic, the MPAA limit needs to be levelled up and future proofed with regular reviews.

Proposal

The MPAA limit needs to be levelled up to the previous limit of £10,000.

This is required due to the changes since 2017 in respect of working/retirement patterns, contribution increases, the impact of Covid on withdrawal behaviour and reflects the government expectation of a rising economic backdrop.

Additional safeguards could be put in place to ensure that recycling abuse does not occur.

3. Removal of the Block Transfer rules and restrictions (HMRC)

Block transfers were introduced in April 2006 and formed part of the pension simplification package of change. The rules introduced a mechanism enabling an individual to retain a pre-2006 protected retirement age (PRA) or tax-free cash (PTFC) on transfer. However, in order for a transfer to meet these requirements, it is necessary for the individual who wants to transfer to find another scheme member or ‘buddy’ who agrees to transfer their benefits to the same destination scheme at the same time. Furthermore, all the benefits must be taken in one go, otherwise the protection is lost and unauthorised payments may be made with associated tax charges.

However, consider the pensions landscape back in 2006 and where we are now. Significantly:

- Automatic enrolment didn't start until 6 years later
- Pension freedoms were not introduced until 9 years later
- Annuity purchase was by far the dominant form of pension access
- People are encouraged and are working for longer now – we are in the era of phased retirement
- There is now a strong government focus on Value for Money and a desire for smaller DC schemes to consolidate into larger Master Trusts

The decumulation landscape has changed almost beyond recognition, with a primary focus on enabling flexibility in work and retirement. The decision to retire is no longer the cliff-edge decision it once was.

The decumulation landscape was very different in 2006 when the Block Transfer rules were introduced.

So what about those individuals who have a protected tax free cash or retirement age? The rule to find a transfer 'buddy' is a little peculiar whether we are in 2006 or 2021. But the real impact these changes have had surround the crystallisation and receiving scheme membership rules.

We know that back in 2006, annuity purchase was the only DC decumulation option considered by almost everyone. It was not until 2014/15 that we saw a real shift towards Drawdown with the introduction of pension freedoms. Retirement was for most a one and done decision – those who wanted to gradually reduce their working hours as they moved towards retirement often found they could not live on reduced pay. So what did they do - stop work and buy an annuity. The crystallisation rules linked to Block Transfers did not materially impact on retirement decisions given the retirement options available and the general attitude towards retirement.

Fast forward 15 years, we are now in a world where the government are encouraging us to work for longer. It is not unusual to see people working into their 70's – the number has doubled over the last decade. As such, the transition into retirement can take years, with a gradual reduction in working hours or even a change of career. During this period and often up until state pension age or beyond, the lost income is supplemented through a partial Drawdown or UFPLS.

Unfortunately, the Block Transfer rules have not moved with the times – if they had they would have been removed by now. This means that for those individuals who hold PTFC or PRA, it is not possible for them to enjoy the benefits of pension freedoms to their fullest extent – they have to crystallise all of the benefits held within the pension scheme in one go. The introduction of Auto Enrolment compounds the issue as many who hold this protection will have (subject to finding a buddy) moved a protected arrangement into their more modern and flexible workplace scheme. It is commonplace for an individual to accrue several pension pots through Auto Enrolment. This can often be with the same pension provider (GPP or Master Trust) and this will become even more typical as we see the DC market contract with the ongoing government thrust towards DC consolidation.

The problem this creates is that whilst individuals may hold several AE pension pots in respect of different employers, if they are with the same provider they are held in the same overarching scheme.

As the Block Transfer rules requires all benefits held within a scheme must be crystallised to retain protection and potentially avoid tax charges, this means an individual will have to crystallise all their pension pots held with a provider at the same time – even an active pot they are currently contributing to. This is clearly not a good outcome. The benefits and tax planning opportunities that Pension Freedoms provides are severely compromised for this group of individuals.

Government encourages us to work for longer. The introduction of pension flexibility has played a major part in this cultural shift to a gradual phasing of retirement for many. However, Block Transfer rules have not moved with the times, so individuals impacted by these requirements cannot benefit fully from the flexible options available to everyone else. Retirement decisions become restricted and some will be unable to even move from their scheme to benefit from better value for money.

Furthermore, the government desire to encourage occupational DC consolidation will see an increase in larger AE schemes holding several pension pots for an individual. However, where an individual with a PRA or PTFC exists and they have already held benefits in the destination scheme for longer than 12 months, the bulk transfer cannot take place for these individuals as they will lose the protection.

Block Transfer rules will impact occupational DC scheme consolidation exercises, which have become a firm focus for government.

Whilst the percentage of members who hold these protections are fairly low, they are also not insignificant. One TISA member has circa 90,000 scheme members who hold these protections.

With the NMPA moving back to 57 in 2028, a new protection regime is being introduced to enable some individuals to retain a protected retirement age 55. The Block Transfer restrictions which would also apply to this group have been recognised and addressed.

The new protection regime for the increase in NMPA to 57 recognises the restrictions that Block Transfers create and has brought in relaxations for this group to allow partial crystallisation and transfers into a scheme to which an individual has already been a member of for 12 months or more.

Why is this relaxation not being extended to individuals who are currently impacted through existing forms of protection?

Government is keen to promote innovation in decumulation, but must realise that some of the archaic rules which may have been appropriate at one point also need to move with the times.

Proposal

The Block Transfer rules need to be abolished or at the very least, the relaxations which will apply to the new protected retirement age of 55 need to be extended to cover this group. Anyone with a PRA or PTFC should be able to benefit in full from the pension flexibility introduced to improve retirement planning and outcomes. This will also enable larger scale full consolidation exercises designed to improve value for money to proceed without adverse impact to those who hold a protection.

4. Operation of PAYE on income withdrawals (HMRC)

Pension payments are taxed on the 'Pay as you Earn' basis. This means the first income payment withdrawal from a scheme is taxed on a Month 1 basis, which results in an overpayment of tax for most individuals. The larger the withdrawal, the larger the overpayment and as guidance or advice is often not taken, individuals are often not aware of the overpayment until the net income payment is received.

Even then, some may not be aware and will not take proactive action to complete the necessary forms to request the repayment. In these instances, the rebate will be made automatically, however not until the following tax year, so this takes over a year to receive the overpayment.

Circa £500 million in tax has been overcharged by HMRC since the introduction of Pension Freedoms in 2015.

Receiving a smaller net payment than anticipated can result in further withdrawals being made to bridge the shortfall, which then reduces the pension pot even further. It is possible to mitigate this overpayment by taking a small initial payment which bears the overpayment and once HMRC issue the correct tax code to the pension administrator, take the remaining balance.

The Office of Tax Simplification has made recommendations to review the way in which the tax system works for pension payments to make this fairer, but it has not been taken on board by HMRC to date.

HMRC consider it more consumer detrimental to under tax a payment as the individual may not be aware of the underpayment and struggle to pay the HMRC reclaim once received. However, given the mistrust that exists in the UK pension system, the current system of over taxing is a clear example of why this mistrust exists.

Trust in pensions is very low. Reasons include perceived lack of control, transparency, inability to easily access information and scam activity. The huge amounts of overpayments in tax resulting from PAYE adds to this mistrust.

The PAYE system which is designed for regular payments needs to be changed to recognise the impact that pension freedoms have on withdrawal behaviour. It cannot be acceptable to make changes to pensions without updating the associated systems and processes where consumer detriment is incurred on an ongoing basis.

The correct tax outcomes can be achieved through Dynamic Coding – whereby a pension provider notifies HMRC of an intended income payment and HMRC return in real time the correct tax code to use.

In 2020, the government announced its 10-year tax administration strategy, through the publication of 'Building a trusted, modern tax administration system'. This set out a strategy to improve the resilience and effectiveness of the UK's tax administration system over the next decade, keeping pace with rapid social, economic and technological change. These improvements will underpin **a trusted and modern tax system**, which works closer to real time.

A pensions tax system which results in over £500 million of overpayments since 2015 cannot be considered as "trusted and modern".

PROPOSAL

HMRC should update the PAYE process for pension withdrawals using dynamic coding to ensure accurate tax deductions are made and large-scale overpayments are not made. This should form part of their 10-year administration strategy and will bring pensions into the objective of operating 'a trusted and modern tax system'.