LCP's response to HMRC's consultation on the Abolition the Lifetime Allowance

8 September 2023

This document sets out LCP's response to draft tax legislation on abolishing the pensions lifetime allowance published on 18 July 2023 for technical consultation and the pensions schemes newsletter 152 published on 20 July 2023. Alongside removing references to the lifetime allowance (and any related features), the drafts revise the taxation of some lump sums.

Who we are

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have around 1,000 people in the UK, including 160 partners and over 300 qualified actuaries.

The provision of actuarial, investment, covenant, governance, pensions administration, benefits advice, and directly related services, is our core business. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements, including the application of the pensions tax regime to benefits. The remaining 20% relates to insurance consulting, energy, health and business analytics. LCP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Our overall comments

The project to remove the Lifetime Allowance from pensions tax legislation (and replacement with a regime focussed solely on what levels of lump sum are taxed) is a huge undertaking, as the Lifetime Allowance is so embedded into the current regime. The speed at which such significant changes are being made is concerning, as the changes are intended to take effect in only seven months' time.

The draft legislation released on 18 July represents significant progress towards the intended aim, and in a number of areas simplifies the pensions tax rules. However, key policy decisions on the changes are yet to be confirmed and the draft legislation has important gaps, and some key drafting is already stated as not being in line with policy so needs to be changed, in unknown ways. This makes it very difficult for pension schemes to check whether the drafts make sense, or to start to prepare for the changes at this time, which will inevitably impact pension scheme members planning for upcoming retirements (many schemes typically start issuing illustrations and quotations four to six months before a planned retirement date, meaning quotations for retirements after 6 April 2024 would normally start to be issued next month).

To minimise the amount of disruption that will be caused, it is essential that key policy decisions and meaningfully complete draft legislation is produced as soon as possible – by October at the latest. This is to allow sufficient time to allow further consultation to make sure it works as you intend, and to allow time to prepare ahead of the changes being introduced. If this is not possible, then it is essential that the implementation date is deferred.

Overall we are extremely concerned about the burdens on industry, the possibility of unintended and inappropriate changes and consequences out of line with policy intent, and members not being able to make informed decisions. Of top level concern we are concerned that in the rush, and against stated intent, this legislation may open/force new DB cash-out flexibilities without any time for a proper framework of member protection from scams or scheme/PPF protection from a "run on the bank".

We have set out further high-level comments below.

Clarity on the remaining gaps is required as soon as possible, with full opportunity to review

It is essential that the pensions industry is given a further opportunity to carefully review the draft legislation, and that the changes are not rushed through without further engagement with the industry. We have already seen that the initial draft legislation contains a number of unintended outcomes, and further errors are possible as the draft legislation is developed further. Other unintended outcomes may only be identified once it is possible to see the full picture of the changes, including looping back on how new elements/changes impact reviews of earlier drafting.

To allow proper consideration by the industry ahead of implementation on 6 April 2024, HMRC will need to confirm key areas of policy intent and publish further draft legislation as soon as possible, and much earlier than would typically be the case for an ordinary Finance Bill.

The consultation on the measures already released closes on 12 September. We believe that revised draft legislation, and confirmation of remaining policy decisions, is required in October for the industry to be able to adopt the changes on 6 April 2024 – see below for further details on the timescales.

Policy intent (and ideally draft legislation) can, and should, be provided earlier for the areas not covered in the initial drafts.

Concerns about the timescales for implementation

A key challenge will be for pensions administrators to implement the systems, processes and communications changes required to comply with the new tax rules. This is because the drafts introduce technical changes at the detailed level even where the big picture mostly remains the same - for example on collecting information in respect of benefits drawn from other pension arrangements, cashing out small benefits and on the range of protections. This will be a significant task, which is likely to take months to fully implement, and will increase costs for pension schemes.

The material released to date does not cover two areas which are key to the administration of the new lump sum limits – the transitional rules for how benefits drawn before 6 April 2024 will impact the future, and the requirements to provide information to members. This, alongside the key policy details remain unknown – particularly the scope for taking taxed cash lump sums at retirement (see below) – means that pension scheme administrators are unable to start significant work on the changes at the current time.

Scheme administrators might typically issue retirement quotations 4 to 6 months in advance of a member's chosen or assumed retirement date. This means that schemes need to be in a position to issue appropriate detail to an April 2024 retiree by November 2023. If this is not the cases members will not be able to make decisions about their impending retirement, which could cause delays, hardship or inefficient outcomes.

Clarity of the legislative changes is required as soon as possible to allow administrators time to understand and implement the necessary changes.

In any event, implementation of the changes on 6 April 2024 will inevitably mean that member retirement decisions around this time will be impacted. Where members do not have a full picture of their retirement options, it will be very difficult for financial advisors to be able to provide suitable advice and for members to make any decisions. Clarification of the new rules as soon as possible will help minimise the amount of disruption.

Given the above, implementation from 6 April 2024 will be a challenge even if the necessary draft legislation and guidance are published in good time, and will be impossible if they are not. If they are not published by October at the latest then it is essential that implementation is deferred, potentially to 6 October 2024.

Uncertainty regarding taxed retirement lump sums for defined benefit pensions

At present, members of defined benefit schemes who have reached normal minimum pension age are routinely allowed to take a "tax free cash sum" at retirement of up to 25% of the value of their benefits being "crystallised". Once a member reaches the Lifetime Allowance there is scope for a further taxed lump sum.

The draft legislation as released would change this: quoting the Background Notes "*there will be no limit on the size of authorised lump sums …. only a limit on the amounts not subject to income tax*". Such tax law would put defined benefit pensions on a par with the 2015 "Freedom and Choice" reforms introduced for money purchase schemes.

We welcome the subsequent clarification by HMRC in their newsletter that "*it is not the government's intention to significantly expand pension freedoms*". However, at the current time we do not know how the legislation will change for paying lump sums from defined benefit schemes, even for members who have benefits that are below the new allowances.

We are concerned that this key policy area has not yet been addressed, the detail could be very important to individual members and there remains a risk that new pension freedoms may be introduced to some extent for DB schemes without suitable member protections and with a material impact on pension scheme funding and investment. A major policy change would in our view merit a formal consultation all of its own, including proposals to extend the important member protections that are in place when members wish to transfer pension from a DB scheme to a DC scheme and measures to ensure trustees can take suitable steps to protect scheme funding and investment positions.

There are various other policy changes that have not been consulted on. These include well publicised changes to tax on death benefits before age 75, and the treatment of small benefits paid as a lump sum. Again, if there is to be a policy change, we are of the view that a consultation should be undertaken to ensure that the impact can be properly considered.

We recognise that there is a significant amount of work for HMRC in delivering the new regime. We welcome the approach that has been taken in the first six months of this project, engaging with the industry, holding workshops and publishing newsletters to disseminate information quickly. We hope that our comments will be helpful to you. We are happy to discuss any of these points further with you.

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