In Radical Move, Britain Deregulates Retirement

By Kerry Pechter *Thu, Mar 20, 2014*

"Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, any time they want," said the UK Chancellor of the Exchequer, George Osborne (pictured with his new budget), in his annual Budget speech to Parliament.

Britain's Conservative government announced dramatic steps to deregulate retirement in the UK Wednesday, ending the country's long-standing policy of managing the way its citizens could spend their tax-deferred savings—including forced annuitization at age 75.

"I am announcing today that we will legislate to remove all remaining tax restrictions on how pensioners have access to their pension pots," said Chancellor of the Exchequer George Osborne in his annual budget address yesterday.

"Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want. No caps. No drawdown limits. Let me be clear. No one will have to buy an annuity," he added.

The move appears to have been driven as much by the low interest rate environment—which has driven down annuity rates and returns on low-risk savings vehicles—as by the Conservative government's deregulatory leanings. Some of the changes will evidently take place immediately, and some will take longer.

The retirement system in the U.K., long known as the most complicated in the world, has seen dramatic changes since the financial crisis. A national defined contribution plan, called N.E.S.T, was established for workers without access to any other workplace plan.

On January 1, 2013, commission-based sales of most financial products was outlawed. And the Labor minister has stumped for "defined ambition," a hybrid retirement plan where employers and employees share the investment risk.

Among the changes described in Osborne's budget address on Wednesday:

- Abolition of the punitive 55% tax surcharge on full withdrawals of tax-deferred defined contribution savings.
- Removal of restrictions to rates of withdrawal or access to products other than annuities.
- Elimination of the 10% tax on the first £5,000 in income from savings.
- Elimination of the requirement for non-wealthy retirees to annuitize all of their tax-deferred savings by age 75.
- Raising the contribution limits on individual retirement accounts, called ISAs.

- Issuing up to £10 billion worth of Pensioner Bonds that pay 4% a year for three-year maturities.

The government conceded that liberated consumers might struggle to navigate retirement finance markets, and promised to provide "free, impartial guidance at the point of retirement."

The reforms don't extend to defined benefit plans, but the government plans to consult with the UK pensions industry on whether to do so. The stock of assets held by DB schemes would be affected if members were allowed to take their money out. According to a government statement:

"Given that the stock of defined benefit liabilities and assets exceeds £1.1trn (€1.3trn), even relatively small changes to this stock could have a significant impact on financial markets.

"The government is concerned that a large-scale transfer (or anticipated transfer) of members of private sector DB schemes to DC schemes could have a detrimental impact on the wider economy.

"Whilst the government would, in principle, welcome the opportunity to extend greater choice to members of private sector defined benefit pension schemes, it will not do so at the expense of significant damage to the wider economy."

The reforms will require an Act of Parliament, which will be presented before the next general election and be in place by April 2015, the Chancellor confirmed.

* * *

Here is the portion of the Chancellor's speech that related to savings:

Our tax changes will help people who work. But there is a large group who have had a particularly hard time in recent years: and that is savers. And this matters not just because these are people who have made sacrifices to provide for their own economic security in retirement.

It matters too because one of the biggest weaknesses of the British economy is that it borrows too much and saves too little. This has been a problem for decades and we can't fix it overnight. It's no surprise that the OBR forecast the saving ratio falling. So today we put in place policies for savers that stand alongside deficit reduction as a centerpiece of our long term economic plan.

The reforms I am about to announce are only possible because, thanks to this government:

- We have a triple lock on the state pension
- More people are saving through auto enrolment
- And we're introducing a single tier pension that will lift most people above the means test

That secure basic income for pensioners means we can make far reaching changes to the tax regime to reward those who save.

Here’s how. First, I want to help savers by dramatically increasing the simplicity, flexibility and generosity of ISAs [Individual Savings Accounts]. Twenty four million people in this country have an ISA. And yet millions of them would like to save more than the annual limits of around five and a half thousand pounds on cash ISAs, and eleven and a half thousand pounds on stocks and shares ISAs. Three-quarters of those who hit the cash ISA limit are basic rate taxpayers.

So we will make ISAs simpler by merging the cash and stocks ISAs to create a single New ISA. We will make them more flexible by allowing savers to transfer all of the ISAs they already have from stocks and shares into cash, or the other way around. And we are going to make the New ISA more generous by increasing the annual limit to £15,000.

£15,000 of savings a year tax free – available from the first of July. And I’m raising the limits for Junior ISAs to £4,000 a year too. But the £15,000 New ISA is just the first thing we are doing for savers. Second, many pensioners have seen their incomes fall as a consequence of the low interest rates that Britain has deliberately pursued to support the economy.

It’s time Britain helped them out in return. So we will launch the new Pensioner Bond paying market leading rates. It will be issued by National Savings and Investments, open to everyone aged 65 or over, and available from January next year. The exact rates will be set in the autumn, to ensure the best possible offer—but our assumption is 2.8% for a one-year bond and 4% on a three-year bond.

That’s much better than anything equivalent in the market today. Up to £10 billion of these bonds will be issued. A maximum of £10,000 can be saved in each bond. That’s at least a million pensioner bonds. And because 21 million people also invest in Premium Bonds I am lifting the cap for the first time in a decade from £30,000 to £40,000 this June, and to £50,000 next year – and I will double the number of million pound winners.

But I still want to do more to support saving. And so, third, we will completely change the tax treatment of defined contribution pensions to bring it into line with the modern world. There will be consequential implications for defined benefit pensions upon which we will consult and proceed cautiously. So the changes we announce will not today apply to them.

But 13 million people have defined contribution schemes, and the number continues to grow. We’ve introduced flexibilities. But most people still have little option but to take out an annuity, even though annuity rates have fallen by a half over the last 15 years. The tax rules around these pensions are a manifestation of a patronizing view that pensioners can’t be trusted with their own pension pots. I reject that.

People who have worked hard and saved hard all their lives, and done the right thing, should be trusted with their own finances. And that’s precisely what we will now do. Trust the people. Some changes will take effect from next week. We will:

- Cut the income requirement for flexible drawdown from £20,000 to £12,000
- Raise the capped drawdown limit from 120% to 150%

- Increase the size of the lump sum small pot five-fold to £10,000
- And almost double the total pension savings you can take as a lump sum to £30,000

All of these changes will come into effect on 27 March. These measures alone would amount to a radical change. But they are only a step in the fundamental reform of the taxation of defined contribution pensions I want to see. I am announcing today that we will legislate to remove all remaining tax restrictions on how pensioners have access to their pension pots. Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want.

No caps. No drawdown limits. Let me be clear. No one will have to buy an annuity. And we're going to introduce a new guarantee, enforced by law, that everyone who retires on these defined contribution pensions will be offered free, impartial, face-to-face advice on how to get the most from the choices they will now have.

Those who still want the certainty of an annuity, as many will, will be able to shop around for the best deal. I am providing £20 million over the next two years to work with consumer groups and industry to develop this new right to advice. When it comes to tax charges, it will still be possible to take a quarter of your pension pot tax free on retirement, as today.

But instead of the punitive 55% tax that exists now if you try to take the rest, anything else you take out of your pension will simply be taxed at normal marginal tax rates – as with any other income. So not a 55% tax but a 20% tax for most pensioners. The OBR confirm that in the next fifteen years, as some people use these new freedoms to draw down their pensions, this tax cut will lead to an increase in tax receipts.

These major changes to the tax regime require a separate Act of Parliament – and we will have them in place for April next year.

Mr. Deputy Speaker, what I am proposing is the most far-reaching reform to the taxation of pensions since the regime was introduced in 1921. But there is one final reform to support savings I would like to make. Mr. Deputy Speaker, There is a 10 pence starting rate for income from savings. It is complex to levy and it penalizes low-income savers. Today I am abolishing the 10 pence rate for savers altogether. No tax on those savings whatsoever. And we will almost double this zero-pence band to cover £5,000 of saving income.

One and a half million low-income savers of all ages will benefit. Two thirds of a million pensioners will be helped.