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Canada Life UK submission to HM Treasury for Spring Budget 2023

Overview and Executive Summary

The pension freedom changes introduced in 2015 have been a popular initiative amongst consumers, giving them the ability to take their pension benefits at a time of their choosing and in a manner which they decide is best for their individual circumstances.

An increasingly flexible approach to work and retirement is one of the huge benefits of pension freedom – the ability to combine the appropriate level of flexibility and certainty from a pension pot to match changing needs as people move towards and through retirement. It also allows people to access their pension pot at relatively young ages, for example 55-60, if they have a specific need, for example to pay off expensive debt, cope with the current cost-of-living crisis, or to tide people over who have been made redundant.

However, the Money Purchase Annual Allowance (MPAA) is a complex and often mis-understood rule which limits people's ability to build up further pension saving once they have flexibly accessed benefits. This may undermine the policy intention of automatic enrolment – for example, someone made redundant at age 55 accesses their pension to help their family while they seek another job. Their new employer offers a matching 5%/5% payment into the pension scheme and as the individual earns £45,000 that overall payment is above the MPAA. This may encourage people to opt-out of pension savings, or act as a barrier to returning to work, which shows the collateral damage this measure may have on ordinary people.

The UK's economic circumstances are very different to when the MPAA was introduced in 2015 and subsequently amended in 2017. We have left the EU, suffered a pandemic, a war in Europe and a cost-of-living crisis; inflation is still currently over 10%.

The UK faces an urgent need to increase productivity, level up disadvantaged groups in society and to encourage millions of older workers back into employment. Not only does the MPAA act as a barrier to achieving these aims, to date no evidence has yet been published to justify its reduction to £4,000 in 2017.

Canada Life believes we should:

1. Reset the Money Purchase Annual Allowance (MPAA) to £10,000
2. Introduce a Carry Forward provision for the MPAA, similar to the three year Carry Forward available within the standard Annual Allowance rules

3. Consider adopting a similar approach to the lump sum recycling rules, where a tax charge would not apply if an employee joined a workplace pension on the standard contribution rates available to all employees
4. HMRC data capture and reporting should be expanded to track the impact of the MPAA on savings behaviour.

Increasing the MPAA back to £10,000 would help strengthen the UK economy and boost the retirement provision of the hundreds of thousands of workers who left employment during the pandemic. We believe this is a measure which would positively impact people of all social and economic backgrounds. It would remove a barrier to help provide a pool of older experienced staff for many businesses, large or small, and whichever sector they operate in. And it will align well with other Government policy initiatives, such as the mid-life MOT and auto enrolment.

Additionally, it will help reduce complexity in pensions. Our research shows a great many people are unaware of the existence of the MPAA or, if they do know about it, they do not understand the consequences of the impact it can have on them and their families.

Next steps

Canada Life UK's CEO, Lindsey Rix, would welcome the opportunity to discuss this submission in person. We would like to work with HM Treasury to develop a new approach to the MPAA that more effectively balances off the competing policy issues explored in this submission.

About Canada Life

At Canada Life, we provide retirement, investment and protection solutions to individuals, families, and companies. We have 3.4 million customers, 470,000 pension annuities in force, and manage more than £42.2 billion of equities, fixed income, and property, as well as a comprehensive multi-asset range through our investments division. We sell products to individuals and corporate entities located in the UK through financial advisers.

We are a UK-based subsidiary of the Great-West Lifeco group of companies, which has operations in Canada, the United States, Ireland, and Germany. We have been operating in the UK since 1903 and currently have over 1,400 employees here.
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The Money Purchase Annual Allowance – MPAA: how we have ended up here

The Money Purchase Annual Allowance was introduced as part of the pension freedoms in 2015, in order to control the risk pension savers might use the freedoms to circumvent the tax system. In theory someone over age 55 could do this by having income paid into their pension and then drawing it out using the pension freedoms, thereby receiving 25% tax free. Without the MPAA, there would be nothing to stop someone 'washing' their income through the pension system up to the annual allowance every year.

In its response to the pension freedoms consultation, published in July 2014, the government said:

'The government will be closely monitoring behaviour under the new system and will work closely with industry to ensure the system remains fair and proportionate.'[1]

The government subsequently announced in 2016 its intention to reduce the MPAA from £10,000 to £4,000. At the time it stated:

> 'The current MPAA of £10,000 is more than three times median DC contributions made by men aged 55+ and five times median DC contributions for women in the same age group. Only 3% of individuals aged 55+ make DC contributions of more than £4,000 a year. Setting the MPAA at £4,000 would ensure that where a person remained in, or returned to, employment having drawn benefits flexibly, pension savings could be made at a level that is above those required under automatic enrolment. The maximum legally-required savings under automatic enrolment are currently £743, rising to £2,974 from 2019.
>
> Where additional support is offered for saving after a pension has been accessed flexibly, the government wants to focus it on those who genuinely needed, rather than simply chose, to draw on savings and who subsequently find themselves able to re-build some pension. People in this situation might include individuals who
>
> - have divorced or separated
> - have been made redundant
> - have been declared bankrupt'[2]

Monitoring and evaluation

When publishing its policy paper introducing the reduction in the MPAA, in March 2017, the government stated its policy objective:

[1] Freedom and choice in pensions: government response to the consultation (publishing.service.gov.uk)

[2] Reducing the money purchase annual allowance consultation (publishing.service.gov.uk)

> 'The government believes that an MPAA of £4,000 would be fair and reasonable and should allow individuals who need to access their pension savings to rebuild them if they subsequently have opportunity to do so. The reduction in allowance from £10,000 to £4,000 will limit the extent to which pension savings can be recycled to take advantage of tax relief, which is not within the spirit of the pension tax system.'

Costing the policy change, the Treasury stated:

> 'The static costing is estimated as a proportion of the current amount given relief at the £10,000 MPAA. The costing includes a behavioural effect to account for the reduction in incentive for individuals to divert their earnings through pensions. As the MPAA limit is being lowered the costing also accounts for individuals who make use of the higher MPAA before it is reduced (forestalling).'

The Exchequer impact was estimated at £70 million a year, rising to £75 million by 2021/22.[3]

The government also committed to monitor, the change, stating:

> 'The measure will be kept under review through the monitoring of information collected from tax returns and existing tax records.'

Both at the time of the proposed change in 2016/17 and subsequently, the industry has repeatedly spoken out against this measure on behalf of investors, arguing the change was arbitrary unnecessary and disproportionate (see below).

Repeated recent FOI requests seeking information on the impact of the MPAA have been declined; in spite of the government's commitment at the time to monitor the impact, to date no information has been published to provide evidence of the impact of the original policy decision.[4]

How the MPAA works

Anyone limited by the MPAA has an annual pension allowance of £4,000 a year. If they make pension contributions in excess of this (or contributions are made on their behalf by their employer), they are liable for income tax on the excess.

So for example, someone earning £40,000 a year who is auto-enrolled into a defined contribution pension scheme with an annual employer contribution of 15% will receive a pension contribution of £6,000. They would have to pay income tax on the excess contribution of £2,000, meaning a tax charge of £400.

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[3] Autumn Statement 2016: policy costings (publishing.service.gov.uk)

[4] HMRC doesn't know how many people face MPAA fines (citywire.com)

Govt figures on impact of MPAA cut a 'best guess estimate' | Money Marketing

HMRC unable to tell MPAA breaches - FTAdviser.com

Who is affected by the MPAA?

It has been argued the MPAA only affects higher rate taxpayers, given the allowance of £4,000 equates to an income of £50,000 when using an 8% pension contribution rate (the default for auto-enrolment). However, this doesn't tell the whole story, for two reasons.

Firstly, just thanks to economic growth and inflation, salaries are higher today than they were when the MPAA was introduced. When the MPAA was first introduced in 2015, median full-time earnings were £27,456[5]; today that figure has risen to £30,472 for regular pay and £32,708[6] for total pay, increases of 11% and 19% respectively.

Secondly, for many people, as a result of employment breaks, contribution holidays and other disruptions to their savings journeys, the default auto-enrolment contribution rate is insufficient to deliver a good standard of living in retirement. The Pensions Quality Mark sets a minimum standard of 12% and a target rate of 15% of salary[7]. For a further comparison, the average contribution rate for private sector defined benefit pension scheme, the gold standard of pension provision, is currently 25.6%[8].

For an employee with a 15% contribution rate, the MPAA limits contributions on salaries of £26,667 – below national average earnings.

Salary levels at which the MPAA is relevant, for different MPAA levels and contribution rates

	Contribution rates - % of salary			
MPAA levels	8%	12%	15%	25.60%
£4,000	£50,000	£33,334	£26,667	£15,625
£10,000	£125,000	£83,333	£66,667	£39,063

Notes

8% is the default auto-enrolment contribution rate
12% is the minimum required for the Pension Quality Mark
15% is the rate required for the Pension Quality Mark+
25.6% is the average contribution rate for a private sector defined benefit pension scheme

This illustrates the fact a £4,000 MPAA can impinge on the retirement saving capacity even of those on average earnings, whilst a £10,000 limit would focus

[5] Annual Survey of Hours and Earnings - Office for National Statistics (ons.gov.uk)
[6] Average weekly earnings in Great Britain - Office for National Statistics (ons.gov.uk)
[7] Pension Quality Mark (plsa.co.uk)
[8] Occupational Pension Schemes Survey, UK - Office for National Statistics

the policy back squarely on those at whom it was originally aimed, the higher earners.

These contribution rates are not as exceptional as might be expected. The ONS confirms there are 428,000 employees aged 55-64 who are currently receiving employer contributions of 8% or more.[9]

There are also 248,000 employees (possibly the same people, the data doesn't show) who are making member contributions of 7% or more. [10]

The pandemic and economic inactivity among the over 50s

Employment patterns have evolved significantly in recent years. Since the MPAA was reduced in 2017, we have seen the pension freedoms bed in and then more recently, we have seen significant disruption as a result of the COVID 19 pandemic.

According to the FCA, in the period April 2018 to March 2021, over 800,000 pension plans were fully encashed for the first time. The data doesn't distinguish between plans taken using the <£10,000 small pot exemption and those taken using either drawdown or UFPLS rules.[11]

Nevertheless, even stripping out encashments of less than £10,000, so we eliminate the possibility they are covered by small pots, still leaves over 300,000 encashments. We can also add in plans paying a regular withdrawal, as at April 2021 there were 131,000 of these, all held by people aged 55-64.

So we can say with some confidence there are around half a million people of working age who have accessed their pensions and who are now restricted by the MPAA – it could be as many as nearly 1 million people.

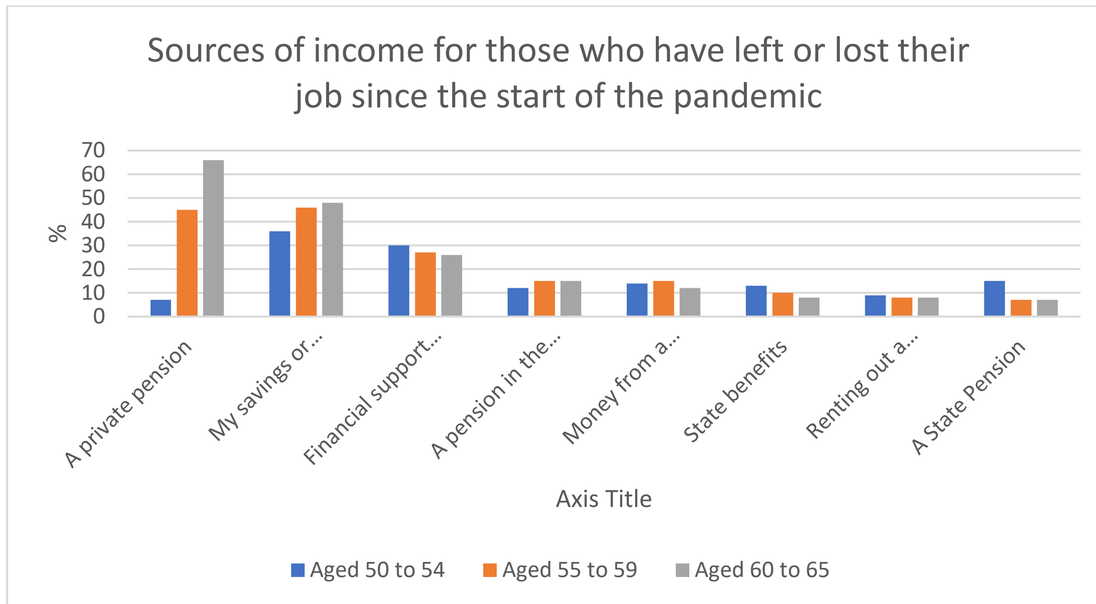
This is borne out when looking at ONS data on the over 50s leaving employment since the pandemic. A large proportion of the hundreds of thousands of working age people who have left the workforce are currently relying on their pensions to provide them with income.

45% of those aged 55 to 59 are relying on their pension, rising to 66% for those aged 60 to 64.

[9] Employer contribution bands by age group and pension type: Table P9 - Office for National Statistics (ons.gov.uk)

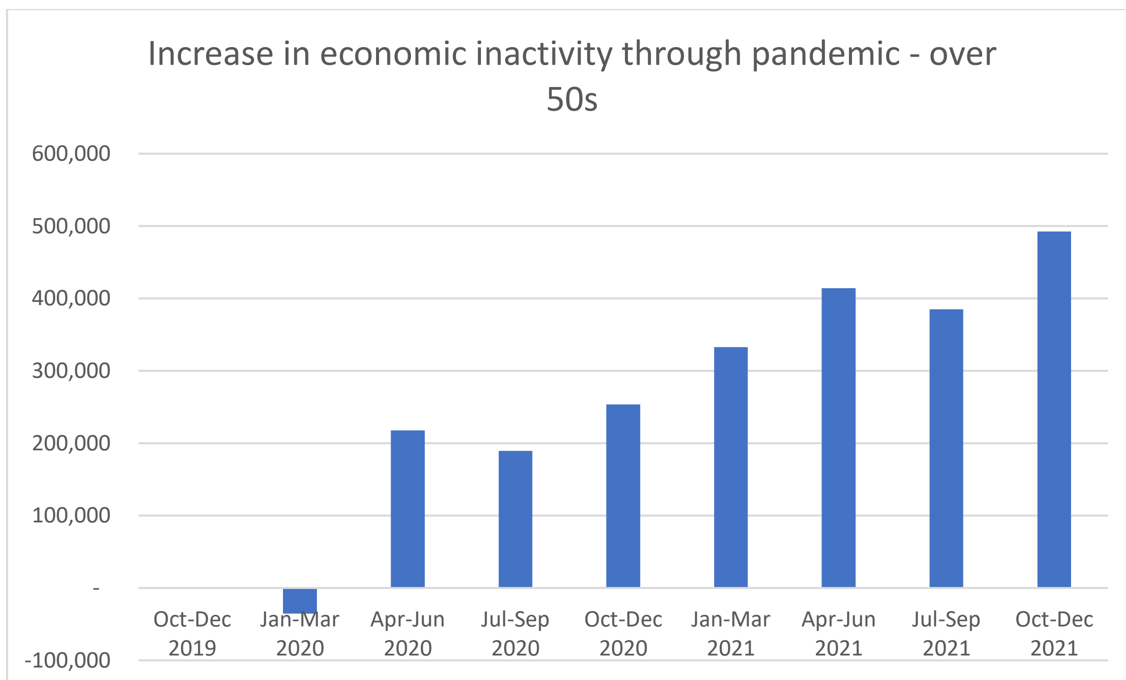
[10] Employee contribution bands by age group and pension type: Table P5 - Office for National Statistics (ons.gov.uk)

[11] Retirement income market data 2020/21 | FCA



Source: Office for National Statistics (ONS) – Over 50s Lifestyle Study (OLS)[12]

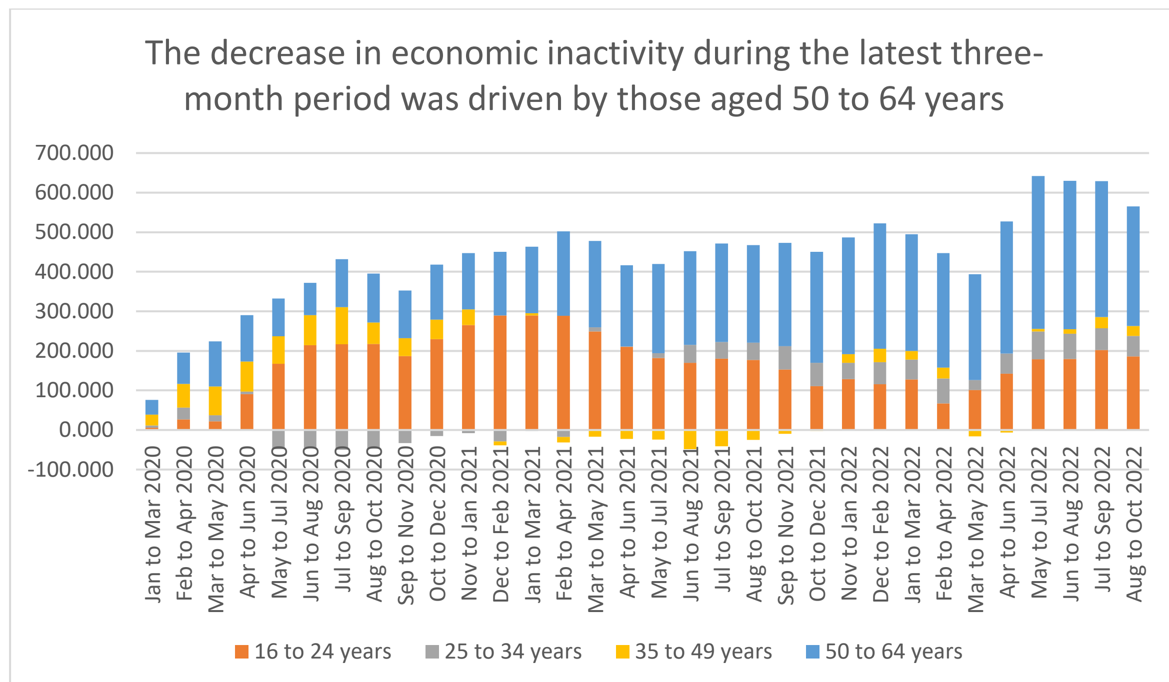
The numbers of people involved are no longer trivial. Around half a million workers over the age of 50 became economically inactive during the pandemic



Source: Office for National Statistics – Labour Force Survey

[12] Reasons for workers aged over 50 years leaving employment since the start of the coronavirus pandemic - Office for National Statistics

As the following chart shows, over the past 3 months we've also seen tens of thousands of 50 – 64 year olds return to economic activity. This illustrates that for many of them, accessing their pensions during the pandemic was just a temporary measure to get them through a situation not of their choosing. These are exactly the kind of people the Treasury originally said it didn't want to see affected by the MPAA.



Source: Office for National Statistics - Labour Force Survey

This uncertainty over work and retirement plans is further reinforced by the ONS data showing that among adults aged 50 to 65 years that left work since the start of the coronavirus pandemic and not returned, just under one-fifth (18%) said they were currently on an NHS waiting list for medical treatment.

While among those who left or lost their job since the start of the pandemic and not returned nearly 6 in 10 (58%) adults considered returning to work, over half (55%) of these had not looked for a job since leaving the labour market.

Among those who would consider returning to work:

- 41% said they weren't sure when they would like to return
- 16% said they would like to return in the next three months
- 12% said they would like to return in three to six months
- 8% said they would like to return in 6 to 12 months
- 4% said they would like to return in one year or more
- 19% said they were currently looking for work, which was more likely for those aged 50 to 59 years (21%) than those aged 60 to 65 years (15%)

The situation today is very different to 2017, when Treasury policy anticipated only small numbers of those who had experienced, divorce or separation,

redundancy or bankruptcy. Today there are hundreds of thousands of workers, possibly as many as a million, who are now held back either from resuming employment, or who have re-joined the workforce and are unable to rebuild their retirement savings.

Awareness of the MPAA

A further problem is that many are unaware of either the existence of the MPAA, or if they do know about it, they don't know important details.

A survey of working adults over 55 by Canada Life[13] revealed that more than one in ten (14%) of them have flexibly accessed their pension over the last year. However, two fifths of all respondents are unaware of any restrictions, such as the Money Purchase Annual Allowance (MPAA) on the amount they can continue to contribute to their defined contribution pension pot.

Worryingly, 40% are aware of the restriction but are uncertain about the detail. Many overestimated the allowance as almost £7,000 a year. Almost double the real MPAA limitation of £4,000.

An alternative approach: Recycling

The Treasury also has rules to prevent pension savers from recycling their tax free lump sum into a pension.

The recycling rules offer a relevant comparison with the MPAA. These rules are relatively light touch, with sequential tests being applied, all of which must be met for recycling to be deemed to have occurred.

Recycling of a pension commencement lump sum involves using that lump sum as the means to increase contributions significantly to a registered pension scheme. The recycling rule is intended to prevent the systematic exploitation of the tax rules for registered pension schemes to generate artificially high amounts of tax relief by using the pension commencement lump sum to make a further, tax-relieved, contribution to a registered pension scheme.

When the recycling rule applies all or part of the pension commencement lump sum is treated as an unauthorised member payment for tax purposes.

When does the recycling rule apply?

The recycling rule applies in respect of all pension commencement lump sums paid on or after 6 April 2006, where those lump sums are used as part of a recycling device, regardless of when the significantly increased contributions are

[13] Two-fifths of working over-55s unaware of MPAA restrictions (canadalife.co.uk)

actually paid. The recycling rule applies when all of the following conditions are met:

- the individual receives a pension commencement lump sum
- because of the lump sum, the amount of contributions paid into a registered pension scheme in respect of the individual is significantly greater than it otherwise would be.
- the additional contributions are made by the individual or by someone else, such as an employer
- the recycling was pre-planned.
- the amount of the pension commencement lump sum, taken together with any other such lump sums taken in the previous 12-month period, exceeds
  - £7,500 for events on or after 6 April 2015, or
  - 1% of the standard lifetime allowance for events before 6 April 2015

and

- the cumulative amount of the additional contributions exceeds 30% of the pension commencement lump sum.

It should be noted that very few lump sum payments will be affected by this recycling rule. Pension commencement lump sum payments will not be caught if they are paid as part of an individual's normal retirement planning.

A significant increase in contribution might be deemed to have occurred when contributions increase by more than 30% relative to previous years.

A similar, light touch approach could be adopted in relation to the MPAA:

For example, someone leaves employment and takes flexible benefits, thereby triggering the MPAA.

They subsequently take up employment and join a pension scheme, for example through the auto-enrolment process.

An MPAA could be set at £10,000, with the additional provision that a tax charge would only apply where their pension contributions represent a significant departure from the standard contribution rates for that scheme, or from their previous pension contribution history.

What do others think?

There is widespread demand to get older workers back into employment. For example, in August 2022, Dame Sharon White, the Chair of John Lewis, said:

> 'I guess I would encourage any government to really think much more about how do we encourage more people back into work," she said.

> “Maybe it is flexible retirement to allow more people to combine more time outside work but more time in work. One million people out of the labour market has profound long-term implications and I’d like there to be more of an open debate.’ [14]

In November 2022, commenting on the Older Workers Week, Employment Minister Guy Opperman said:

> ‘Older workers are a huge asset to our country and our economy. I want to support them to get into work.
>
> An age-inclusive workforce makes business sense too. Our 50 PLUS Champions will work with leading employers across the country to connect job-ready people with the vast number of opportunities out there.’[15]

It seems extraordinary that we have one government department launching policies to get older workers back into employment, while at the same time another government department is hitting them with a tax penalty for doing so.

In October 2019, the Office for Tax Simplification published a report: Taxation and Life Events: Simplifying tax for individuals.[16]

The report says:

> ‘In relation to the Money Purchase Annual Allowance, the effects of the rules on taking certain amounts out of a pension pot can have an ongoing and disproportionate effect, beyond the policy objective of preventing inappropriate recycling.
>
> The government should review the operation of the Money Purchase Annual Allowance, gathering better evidence, considering whether it meets its policy objectives, is set at the right level and is sufficiently understood, given the present potential for disproportionate outcomes.’

Many others across the pensions industry are calling for reform:

Scrap the Money Purchase Annual Allowance to help financial resilience | ABI

Govt must scrap MPAA, Quilter says - FTAdviser.com

Treasury must relax MPAA rules to allow savers to rebuild pensions - Webb - Pensions Age Magazine

[14] Get over-50s back to work to tackle UK labour shortage, says John Lewis boss | Sharon White | The Guardian

[15] Government drive to help those aged 50 and over re-join the jobs market - GOV.UK (www.gov.uk)

[16] Taxation and life events (publishing.service.gov.uk)