FINANCIAL SECRETARY TO THE TREASURY

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Dear Andy

INCOME DRAWDOWN

Thank you for your open letter of 15 September concerning the Government's changes to income drawdown arrangements as part of the reforms to remove the effective requirement to annuitise pension savings by age 75.

The Coalition Government is committed to applying its principles of freedom, fairness and responsibility to pension savings. This led us to include in this year's Finance Act measures to give people new freedoms over the use to which their pension savings can be put.

We have consistently opposed compulsory annuitisation at age 75, which meant that people, who had used an income drawdown product and had some flexibility about the amount they could draw down, would have to buy an annuity. We have changed that to give people more freedom.

As you know, before April this year the tax rules allowed individuals in an income drawdown arrangement to withdraw up to 120% of the value of a comparable annuity (based on the Government Actuary's Department (GAD) rates) every year before age 75, while after age 75 this limit was 90%. There were also different tax charges on lump sums left in income drawdown at death before and after age 75, with the latter subject to tax changes of up to 82%. These rules made income drawdown very unattractive to individuals after the age of 75.

The Government's reforms have removed these arbitrary age-based rules, allowing those individuals who wish to enter or remain in income drawdown arrangements until much later in life to do so with fewer constraints. The change in the drawdown withdrawal limit to a single rate of 100% of GAD rates at any age (now known as 'capped drawdown') was integral to ensuring that this product was suitable for use over a much longer period. In particular, the reduction of the annual maximum reflected evidence received during the public consultation about the increased risk of running out of funds if capped drawdown is extended beyond age 75.

While it is unfortunate that other factors are also affecting the income calculations for individuals in drawdown arrangements having their reviews at the present time, including wider economic factors, this does not change the rationale for the new withdrawal limit, which is based on longer-term considerations.

The fact that volatile markets mean individuals could be at risk of investment losses which further reduce their fund value only reinforces the potential risks a higher withdrawal limit would pose to individuals in terms of exhausting funds prematurely in later life. Increases in life expectancy, which are reflected in the new GAD rates, also demonstrate that an individual's income level from their pension fund needs to be sustainable.

You also mention the change in the required frequency of investment reviews, to at least every 3 years before age 75. One benefit of this change is that should an individual's fund value improve significantly, or gilt rates rise again, these factors will be reflected sooner in an individual's new level of income. Individuals can also choose to have another review earlier than this if they wish.

However, income drawdown is by its nature an investment related product, and this means a degree of risk is inherent in the product. Accordingly, individuals should only enter such arrangements if they are able to cope with fluctuations in the level of income they receive from it.

In reforming pensions we have to balance freedom, fairness and responsibility, we believe that the new freedoms given to people under the reformed system achieve this balance and in the long term will lead to better outcomes for pensioners and those saving for retirement. While in the short term the Government appreciates these reforms may affect the incomes of individuals under 75 who are presently in income drawdown, the Government continues to believe the reforms will improve flexibility and safeguards for savers in the longer-term.

Yours sincerely,

MARK HOBAN MP
FINANCIAL SECRETARY TO THE TREASURY