FINANCE ACT, 1956

THE Sessional Meeting held on 26 November 1956 was devoted to a discussion of the problems arising out of the Finance Act, 1956, sections 22–28 and section 35 (which implemented certain recommendations contained in the Report of the Committee on the Taxation Treatment of Provisions for Retirement, *J.I.A.* 81, 15).

An abstract of the evening's discussion follows:

Mr J. A. Shaljean, in opening the discussion, wished first to say a word about the old problems that had disappeared as a result of the 1956 Finance Act legislation. The old, inequitable system of taxing purchased life annuities in full, the taxation of the interest earnings on reserves held by life offices in respect of s. 379 pension schemes, and the denial to self-employed persons of tax relief in respect of provision made for retirement had all been swept away. The feeling uppermost in their minds was one of relief that so much of the Millard Tucker recommendations should have been implemented so soon. He was sure that they all felt that the new legislation represented an important step forward.

There had been a great deal of extra work for life office actuaries. They had had problems in designing new kinds of life policy, in adapting their office arrangements to the application of the new provisions to existing business, and in the purely actuarial sphere of premium rates and valuation reserves. The legislation fell into three parts to which he would refer in turn.

First, the tax concessions for the self-employed. Briefly, a self-employed person might pay, and have full tax relief on, deferred-annuity premiums for approved contracts up to a limit of 10% of his earnings, or £750, with increased limits for persons born before 1916. His premiums accumulated at a gross rate of interest, but the emerging annuity was taxed in full, normally as earned income. That was more or less in line with the majority recommendations of the Millard Tucker Committee. There was not the distinction of different percentage limits for with-return or without-return contracts; and although the 10% rate was perhaps a little on the low side, there was a great practical advantage in having one uniform rate applying to any individual for any kind of contract. No part of the annuity might be commuted for cash, whereas in the Millard Tucker recommendations it had been suggested that, in general, 25% commutation might be permitted. On the other hand, a return of premiums on death could be taken as a lump sum free of tax, whereas the Millard Tucker recommendation had been that that benefit should in general take the form of a taxable annuity.

The first problem was to design a suitable policy, and a number of questions at once arose. Should it be with or without return of premiums at death? Instead of a return of premiums, should there be a reversionary annuity to the widow? Should it be with or without profits? Should it be on an annual-premium basis or a single-premium basis? Those were largely matters of opinion, and if opinions differed it might not be a bad thing, because then the public would have the choice of a wide range of policies.

As between with-return and without-return, he felt that perhaps a contract with return of premiums with interest represented better value, because the

return at death was free of tax. If in lieu of a return of premiums on death a reversionary annuity was provided for the widow, there was the benefit of non-aggregation for estate duty, but, on the other hand, the annuity was fully taxable, and that form of benefit had the disadvantage of inflexibility. As between a single-premium contract and an annual-premium contract, at first sight it might seem that a single-premium contract was more suitable in providing for variation in premiums from year to year, but it might be that in practice many self-employed persons would wish to pay a uniform sum each year, well within the limits permissible under the legislation, and he thought that there was much to be said for an annual-premium contract so long as there was provision in it for variation of premiums on terms not too unfavourable to the policyholder. As between with- and without-profit policies, much the same arguments applied to 'self-employed' contracts as to pension schemes, which had in that connexion received a lot of attention lately.

The second problem was that of premium rates. For mortality, actuaries would, of course, all be thinking in terms of the $a(55)$ table, and in the case of 'self-employed' contracts one favourable factor was that there should be less self-selection than in the case of immediate-annuity purchases. On the other hand, they had to allow for improving mortality, for any options at pension age to substitute alternative annuities and for the option involved in the 10-year spread of pension ages. On balance it might well be thought that $a(55)$ mortality without any age adjustment was suitable.

They were experiencing a period of high interest rates. For annual-premium contracts an interest rate of 4% or a little more might be suitable. The interest rate should, however, depend on the terms to which the office was committing itself in respect of future increases and reductions in premiums. In the case of a single-premium policy, it was quite proper to use a rate of interest corresponding to the current gilt-edged rate; but few offices, he imagined, would be issuing single-premium policies without any guarantee to the policyholder as to the terms on which he could pay future premiums, and if there were any such guarantee in the contract the rate of interest should certainly not be higher than the rate used for an annual-premium contract.

For expenses, they had to take a long view. They had incurred heavy initial expenses in launching the new policies, which they could not hope to recover in a short while; so they should judge what was a reasonable expense provision to support the business in the long run.

After designing their policy and settling premium rates, the next problem was to sell the business. The Chancellor's estimate of the cost of the concessions was £7m. in the first year, rising to £30m. to £50m. in later years. Those were formidable figures, representing a large amount of business, and when he considered them in relation to the volume of business in his own office, he felt that something was wrong. It was, of course, early to judge the response. Those who were eligible would wish to consider carefully before committing themselves to a contract with important restrictions in it, and there was no incentive from the tax point of view to complete hastily; but even so, considering the exceptional publicity that the new policies had received, perhaps the initial response had not been as good as they would have liked. One deterrent might be the requirement that the annuity had to be non-commutable and non-assignable. It was understandable that no commutation could have been allowed under a Finance Act which did not provide likewise for s. 379 pension schemes; but if the tax treatment of all pension schemes were to be co-ordinated, he felt that there would be

much merit in allowing 25% commutation in all kinds of pension schemes for employed and self-employed persons. It was conceded that any such lump sum should be taxable on some reasonable basis, such as the 'top-slicing method'.

The restrictions in 'self-employed' policies had led to the advocacy of endowment assurances with guaranteed annuity options, which had, of course, become much more attractive because of the improved tax treatment of ordinary purchased life annuities, and in some cases the latter would be more appropriate contracts; but it would be a pity, he felt, if the new 'self-employed' contract did not become the normal vehicle for pension provision by a self-employed person.

He thought that the carry-forward provision contained some anomalies. A person earning £7500 a year could have relief on £750 each year, but a person earning £5000 and £10,000 in alternate years was at a disadvantage because of the inadequate carry-forward arrangements. Those anomalies were currently not important because the limits were high, but limits of that kind had a way of remaining in the legislation even though the value of money fell and they became out of date.

His second main heading was annuity fund taxation. Annuity funds were to be split into two parts for taxation purposes. One part, the pension annuity fund, was to represent the reserves for the new 'self-employed' contracts and for s. 379 pension schemes, and that was to be taxed on a profits basis. It would be relieved of liability to tax on interest. The other part, the general annuity fund, representing reserves for purchased life annuities and for s. 388 pension schemes, was to be taxed on the old complicated basis. He thought that the retention of that basis would be regretted even by those who fully understood it. The problem of balancing annuity payments and interest, although reduced, would remain in the case of the general annuity fund, and actuaries could not assume a gross rate of interest in calculating premiums for s. 388 pension schemes because a large volume of that business would cause a disadvantageous tax position.

For premium rates under s. 379 pension schemes, as well as for 'self-employed' contracts, it had become correct to assume a full gross rate of interest, and he imagined that the same rate of interest of 4%, or even a shade more in current circumstances, might well be used for s. 379 pension schemes. For s. 388 deferred annuity schemes they would have to use a lower rate to allow for the possibility of tax on interest, and the difference depended upon the circumstances of the office's annuity fund. Either the premiums could be calculated accurately, using the same interest rate after the deferred age as was used for s. 379 schemes and a lower rate up to the deferred age, or for convenience the rates could be based on the s. 379 rates with a flat percentage addition.

The split of the annuity fund produced valuation problems, and the first point that he wished to make was that it would in any event be necessary to bring the valuation bases into line with current mortality and interest rates. They would all, he thought, be turning over to $a(55)$, as indeed many offices had already done; but, on the other hand, they could justifiably increase somewhat their valuation interest rate. For the pension annuity fund they would be able to increase the valuation interest rate to something approaching the rate assumed in the premiums; but, bearing in mind the fact that market interest rates were currently high, they would probably feel it wise not to relax the basis too precipitately. For the general annuity fund they should value at a lower rate to allow for the possible liability to tax on interest.

The Millard Tucker recommendations favoured an extensive tidying-up of the tax treatment of pension schemes for employees. The distinction between s. 379 and s. 388 schemes was to be removed and one set of rules for approval would have applied to both. Although that matter had not been dealt with in the 1956 Finance Act, except to the extent of giving gross interest to s. 379 schemes, they might yet hope that it was intended to give fuller effect at a later date to the Millard Tucker proposals on the subject of pension schemes for employees, and in one respect that had become rather urgent. The Financial Secretary to the Treasury had suggested that it might be as well for schemes not to be changed too hastily from s. 388 to s. 379, but the fact was that currently there was an undoubted advantage in changing, and they were faced with the possibility of numerous requests for switches and a great deal of work that might be unnecessary. That danger would be removed if the whole annuity fund were taxed on a profits basis only, as the new pension annuity fund was. Not only would that remove the danger of mass switches of pension schemes, but the reform would also greatly simplify annuity taxation; and, if 25 % commutability were introduced for all pension schemes, then the distinction between s. 379 and s. 388 pension schemes might well be removed altogether.

His third heading was the taxation of annuities. In the case of purchased life annuities, a fixed proportion of each payment—the consideration divided by the expectation of life—was to be regarded as capital, and only the balance was to be taxable. That was in accordance with the Millard Tucker recommendations. It was a long overdue reform and one that was very welcome to them. No longer would offices have to issue 'split annuities' to overcome the disadvantages of the old tax system, and the reformed tax basis, together with the alleviation of the problem of balancing their annuity funds for tax purposes, meant that they could look forward to the development of their annuity business on more natural lines. They could determine their rates on normal principles, with comparative freedom from the worry of having to stimulate the business merely because of the tax position of the annuity fund.

It was the case, he thought, that on any normal immediate annuity rate basis, assuming the same table of mortality was used as in determining the capital content, the interest content would be practically constant in relation to the consideration for all ages, for both sexes, and for all modes of payment. They had endured an unjust tax basis for many years, and he was wondering whether the new basis was not perhaps a little over-exact, and whether it would not be reasonably fair and save much trouble if on any given rate table a flat percentage of the consideration were subject to tax. He had in mind that the Revenue might be empowered to approve a flat rate, say 3 % at that time, in relation to scales of rates falling within suitable limits.

He felt that the exclusion of annuities arising under wills and settlements from the application of the new basis involved an injustice, particularly where the annuitant had the right to take cash and buy the annuity but did not in fact do so. No doubt regard had been had to the case where the annuity was paid by the executors or trustees, and in that case was wholly taxable, but where capital was raised to buy an annuity from a life office, capital was also released representing the value of the reversion and that capital would produce taxable income; he thought there would be little loss to the Revenue in applying the new basis to all such purchased life annuities.

He felt also that the clause regarding the exclusion of annuities purchased for employees, etc., might in a few cases operate harshly. As it stood, such annuities

were excluded even though there had been no tax relief of the build-up. Would it not be preferable for the new basis to operate in all cases except where there had been tax relief on the consideration?

Mr N. Benz began by extending a wholehearted welcome to the new legislation, for which, he felt, they should be grateful for many reasons.

He wished to make two preliminary points. As the opener of the discussion had indicated, inflation of the type with which they had become familiar over recent years might well undo a lot of their work. That was rather a saddening thought. He would also like to make a reference to s. 35. He was left very much puzzled as to how members of the profession, who presumably would be concerned, would cope with the problems of ascertaining the market value of annuities which by definition had no market. It seemed a very odd thing to him. But that was not the end of the oddity of the situation. They had to place a market value on a life annuity which might be guaranteed for as long a period as 10 years. Those were novel circumstances which might well call for a note in the *Journal* if they could ever get round the first and very difficult problem.

As to purchased life annuities, he thought that, in spite of the word 'actuarial' in the relevant section of the Act, there was not much for comment compared with what there was elsewhere in the Finance Act. After all, it was a little difficult to get excited over something when interest was excluded and Regulations specified the mortality table to be used. In applying the relief to existing purchased life annuities there was, however, considerable scope for interesting exercises in drawing the line between different categories of annuity.

With regard to the taxation of offices, the point of greatest interest was that, in spite of the apparently sweeping nature of the changes that had been made, many of the old problems remained. Perhaps the most important point of all was the sub-section of s. 24 which said that the business of life assurances and annuities was to remain one business; in other words, the pension annuity fund and the general annuity fund might better be known as the pension annuity computation and the general annuity computation. Even the pension annuity fund would not be entirely free from difficulty in the future because there was still the problem of their old friend, realized profits and losses; there might be two offices which looked very much alike, but whose latent tax liabilities might be very different because of the general levels at which existing assets had been bought. The general annuity fund was as much a matter for speculation as in the past, and some fresh thinking might be required, although he thought that the principles laid down in the paper by Rowland and Wales of twenty years earlier (*J.I.A.* **68**, 447) would still be found to hold good. He thought that the splitting of the existing business into the two funds would cause some practical difficulty, not least in relation to s. 379 business, because of sub-section (7) which required that premiums referred to the pension annuity fund must be on business relating to trusts which were fully approved; that sub-section might also raise problems in relation to the costing basis of new s. 379 contracts.

With regard to 'self-employed' contracts, as the opener had indicated, there were many problems of considerable actuarial interest. There were great opportunities for issuing contracts with a wide variety of guaranteed options if so required by the public, and he thought it was up to offices to provide them. He thought it would be a pity if they were to be provided too generously, without some cost to the individual concerned. Perhaps it was fortunate, in looking at the paid-up value problem, to take one example, that proportionate paid-up

values contained a wide margin of safety for the offices; to achieve consistency, however, would not be easy as between annual-premium, limited-premium and single-premium contracts with and without guarantees of the paid-up annuity, even leaving aside the question of guarantees of rates for future increments of annuity. The basis of participation in profits was a matter which would be of major moment to the offices. He did not think there was the same flexibility to the offices as in employees' schemes for determining the costing basis. Finally on 'self-employed' contracts, there was one problem, namely, the comparison with endowment assurances, which he thought was essentially an actuarial problem, because he did not think it had any precise answer!

One point that he had not referred to was the question of trust schemes. He felt that the President's remarks in his recent Address should be very much in the minds of those called upon to advise on problems arising from those schemes. They were as yet uncharted territory, and he thought that a clear exposition of the problems to people who were not particularly well versed in actuarial matters would be of the utmost importance.

Mr M. E. Ogborn said that problems of taxation were apt to be discussed from the point of view of what was fair, but he had the impression that in law there were no principles of equity connected with taxation. What was needed was a close consideration of the new legislation, as it was in fact.

He welcomed the 1956 Act as a step forward and a belated measure of justice for policyholders, but he felt that it was a step forward on to difficult and dangerous ground for the life offices. The life offices gained some measure of freedom from uncertainty on a part of their business, but personally he dreaded the dangers inherent in the taxation of the two parts of the annuity fund in two different ways, with the consequent possibilities of switching. He felt that the possibilities were for loss rather than profit for the life offices.

The lower scale of premiums for deferred annuity contracts in the pension annuity fund was conditional on the contracts' continuing to be eligible; the office had to have power to refuse premiums. That suggested to him that in dealing with actuarial problems of valuation, and perhaps especially of distribution of surplus, it was simplest to approach them from the single-premium rather than from the annual-premium point of view, i.e. to consider what had been purchased at the time of valuation (and in that connexion he was reminded of Mr Redington's 'triangular bonus' (*J.I.A.* **81**, 295)).

The pension annuity fund ought, he thought, to start with the value of the benefits granted in that fund on a basis appropriate to the new conditions, whereas offices were asked to transfer the old valuation liability less a proportional part of the notional loss. There was scope for thought there. Further, offices were not able to transfer part of the notional loss when a s. 388 scheme was switched to s. 379 form, and he thought, therefore, that it was not practicable to transfer the relevant part of the old valuation liability. In his view all that was available for transfer was the premiums accumulated at a net rate of interest.

Another simple consideration was that offices would, in future valuations, have contracts carrying what were effectively gross rates and contracts carrying net rates, and it was not reasonable to value all the contracts at one rate of interest—as did some offices that still valued their immediate annuities and their life assurance contracts at the same rate of interest.

In the consideration of margins in actuarial calculations, the probability distribution of the expected rate of interest could be thought of in terms either of net

or of gross rates of interest. If the rate of tax was constant, the distribution was the same for both, so that the margin should be proportionately greater when dealing with the gross rate of interest than when dealing with the net rate. For example, with income tax at 7*s.* 6*d.* in the £, the probability distribution was the same for the range 6%, 5%, 4%, 3% gross, as for $3\frac{3}{4}$%, $3\frac{1}{8}$%, $2\frac{1}{2}$%, $1\frac{7}{8}$% net. The margins needed to be very much larger for the gross rate, and he wondered whether that had been forgotten in some of the premium rates that were quoted.

Another consideration was that when the liabilities of a gross fund were valued at a gross rate of interest, the surplus brought out was gross and provision would have to be made out of it for tax. Provision could be made through the accounts, but it would not be convenient to keep the accounts open until the valuation was settled. In general, when the surpluses from the two funds were being amalgamated the tax would have to be reserved before the surplus from the gross fund could be brought in.

Another point to consider was that when paid-up benefits were being valued, as they would be, at different rates of interest, they could be valued all together at one rate of interest with a simple adjustment. The difference between v^t at two rates of interest (say 4% and a lower rate i) would be roughly proportional to tv^t at 4%. Thus tabulation of a simple constant would enable the whole business to be valued at the new level of 4%.

Again, when there were with-profit contracts in the pension annuity fund, he wondered what the computations of profit and loss for tax purposes would mean, particularly when the whole of the contracts were with-profits. If the policyholders' profits absorbed exactly the amount of surplus, the tax account would yield the expenses as the taxable profit, but it would be necessary to remember the treatment of profit on realization. He would not elaborate on that, but it seemed to him that there were some difficulties in the concept.

Since annuity funds were growing at a greater rate than life funds, the current method of taxation of profits on sale and realization of securities meant that effectively the growing annuity fund purchased the assets of the life fund at cost and not at market prices. That was, he felt, wrong in principle. It was necessary to bring in an adjustment for the difference in prices. Another thought arising out of it was that during a period of low interest rates and high values, such as had been experienced some time previously, tax was paid on the profits on realization of securities which were exchanged. In current conditions, exchanges of securities tended to disclose losses on realization—and it might be wondered whether the office would ever get the tax back.

Mr F. H. Wales pointed out that the Act did not require the separation of the assets of the life fund, and that raised an interesting point in connexion with the issue of with-profit pension annuities. In order to determine his profits, the insurer would require to set up a notional fund to which would be carried a proportional part of the investment income of the office. Most offices carried their investments in their books at prices below the current market price, and the margin of undisclosed appreciation could be very large, particularly for an office holding a large proportion of ordinary shares, although the crises of the current year would probably have wiped out much of that appreciation. The growth of the pension annuity fund was invested, therefore, not at current market prices, but at the average written-down price of the portfolio as a whole, modified, of course, because the increase in the total funds of the office had been

invested at current market prices. As far as equity between the various classes of business was concerned, that would not matter if the growth of all funds were at the same proportionate rate. That, however, would not be so since the new annuity fund was starting from scratch.

The point had been much in his mind for many years, because his own office operated two closed funds and two entirely separate types of with-profit policy. The assets of his company were common to all the funds. Therefore they had four with-profit funds each increasing or decreasing at a different rate, and each having a share in the common pool of undisclosed investment margin. With their with-profit pension annuity business they would have five. In theory the closed funds should be selling investments each year at current market prices and the active funds, one of which in the case of his office was increasing much faster than the other, buying at current prices. What happened in practice was that the closed funds had a smaller part of the total margin each year and had, in effect, sold some of their assets to the active funds at book prices much below the market prices. It was necessary, therefore, to arrange an equitable transfer each year from the active funds to the closed funds and, indeed, between the two active funds. That meant that the active funds had a strain on their surplus each year, and that strain could be regarded as the cost of immediately writing down the new assets in those funds to average book prices of the total assets.

Mr A. W. Joseph remarked that the legislation on purchased life annuities was a topic that had excited violent discussion and difference of opinion for many years, and yet it had passed through Parliament almost without comment. To him that was extraordinary. No amendments had been made to the original clause as it appeared in the Finance Bill.

There would, of course, be points of difficulty in regard to s. 27 of the Finance Act. One such concerned the calculation of the capital element of a purchased annuity in some of the less common contracts. S. 27 (3) (*c*) provided that calculations should be made at the date when annuity payments began to accrue, not at the date when the contract started. The calculation of the capital element, therefore, ignored mortality in the period, if any, between the start of the policy and the date when annuity payments began to accrue, and that could cause anomalies. Thus, under a deferred joint life and survivor annuity without return of premiums on death in the deferred period there would be a different capital element in the annuity payable to the survivor according to whether the death of the first life occurred during or after the period of deferment.

S. 22 had been framed, as he thought rightly, so as not to allow a non-taxable lump sum benefit during the lifetime of the annuitant. The only non-taxable benefit allowed was a return at death, and that was subject to estate duty. He did, however, agree with the opener of the discussion that lump sum benefits by way of surrender values or commutation of annuity should be allowed if properly taxed.

It would be seen that the income tax advantage that accrued to a person effecting a 'self-employed' pension consisted in income of one period being allowed to be transferred to a later period, carrying with it all its attendant income tax liabilities. In other words, 'self-employed' pension policies were a means of redistributing income over working life and retirement so as to make it more uniform than it was before and thus reduce the impact on the individual of the United Kingdom's highly progressive income tax scale. When it was understood that that was the only income tax advantage provided by the new

legislation, questions immediately sprang to mind. What need was there for the numerous limitations and restrictions embodied in the Act? When the Chancellor stated that the cost of self-employed pensions would rise to between £30m. and £50m. a year, had account been taken of the tax payable on the benefits? His own guess was that in that, as in some other estimates provided by the Chancellor's advisers, the cost to the Exchequer of the new policies had been exaggerated.

Some of the restrictions seemed to him to be, speaking mildly, highly inconvenient. Why should annuities be allowed to start only at ages between 60 and 70 (but between 50 and 60 for jockeys)? Why the limitation on amount of qualifying premiums? After all, if a man transferred too large amounts of income to a later period, he stood a chance of increasing his total tax rather than decreasing it. Why the obsession with occupation, leading to exhaustive inquiries to make sure at the start and ever afterwards that the policyholder was in non-pensionable employment? Did it really matter if a man also got the benefit of an employer's pension? Such pension schemes were frequently quite inadequate. Why the complicated, and in extreme cases inequitable, arrangements for carry-forward of unused qualifying premiums? All those restrictions and many others stemmed from the Revenue's fixed idea that the scheme was to apply, with little exception, to providing retirement pension for the individual who obtained income tax relief on premiums. That was quite unnecessary when the limited nature of the income tax concession was grasped. It would be quite different if there were a non-taxable benefit payable in the lifetime of the person obtaining income tax relief on contributions.

The income tax concession implicit in the 'self-employed' scheme would be very helpful in overcoming other income tax inequities. For example, the man with a fluctuating income who was exposed to heavy surtax in some years with little or no relief in years when his income was low might effect, in exchange for a single premium, a policy providing for an annuity-certain for, say, seven years. If the premium were granted the relief of s. 23 and the annuity payments were treated in full as income when received, a useful and equitable lightening of the income tax burden would be achieved.

To his mind, the legislation of ss. 23–26 opened the way to a fundamental reform of income tax law when, with the mellowing of time, the current restrictions were seen to be unnecessary and harmful.

Mr R. Ll. Gwilt had sent the following written comments, which were read to the meeting:

'I would have liked very much to take part in the discussion. Unfortunately, I am unable to be in London on the day and can but tender my apology for absence. Had I been there, I would have liked to draw attention to some points concerning mortality which may not be generally known outside actuarial circles and possibly only to a minority even there.

I refer to the not inconsiderable chance of major reductions occurring in the mortality at the older ages in future and to the fact that in other parts of the world the mortality actually being experienced by the male population over age 60 is already considerably lighter than the experience among British male life annuitants—a select group of the population.

To take Norway as an example, the mortality actually being experienced now by the male general population at ages 60, 70 and 80 is only about 60%–70% of the experience of the male population of England and Wales. The present Norwegian population experience at these older ages is actually as light as the

projected mortality 20 years hence for British male life annuitants at durations 5 years and over on the basis used for the $a(55)$ tables. These tables were introduced as suitable for immediate annuities commencing in 1955, and for annuities commencing in later years lighter mortality would be appropriate. The difference between the experience of the Norwegian male population and British male life annuitants is owing mainly to the higher mortality in Britain from cancer and the cardiovascular diseases, and the much more highly industrialized character of Britain as compared with Norway may well mean that there will always be a difference. However, the fact remains that much research is being devoted here to finding means of reducing the mortality from these causes and this suggests that spectacular reductions in mortality at the older ages may be achieved by new discoveries perhaps sooner than some are inclined to assume.

The possibility of major reductions in mortality at the older ages, combined with the fact that interest rates at present are historically high, may mean that some of the terms offered for deferred annuities will eventually prove to have been too cheap.

It is interesting to note that the reductions in the rates of mortality per 1000 of the male population over the past 100 years have been significantly different in Scandinavia and the Netherlands from the reductions in England and Wales and figures are given below (*vide T.F.A.* **24**, 76–81) to illustrate this fact:

Reduction in past century in rates of male mortality per 1000

	Age	
	60	70
Denmark	18·6	39·1
Norway	15·0	26·5
Sweden	20·5	37·7
Netherlands	22·8	34·8
England and Wales	8·7	10·8

What has happened elsewhere can presumably happen here!

One further point which may be worth mentioning is that at age 65 the value of an annuity on the basis of *current* Norwegian population mortality for male lives is about 5% more than the value on the $a(55)$ Table for durations 1 and over.'

Mr William Phillips wished to mention an anomaly.

Triplets—three sons—born in the year 1900, joined the same firm and became members of the firm's pension scheme. Soon the eldest son warned his brothers that, since he intended to secure control of the company for himself eventually, they had better leave, which they did. One took a cash refund of his contributions—the very thing that actuaries had been taught was to be deprecated; the other took a frozen benefit—necessarily a very small one. Those two gentlemen thrived exceedingly and at last were able to start again providing for their old age. They were both old enough to be entitled to maximum uplift, except, of course, that the one who had done the thing that was to be encouraged—namely, taken a small frozen benefit—got no uplift. He was limited to 10% of earnings and £750. The man who had taken cash got his uplift to 15% of earnings and £1125.

What about the eldest triplet? He had gone on piling up actuarial interest in the original pension scheme until he got so high in the business that he had to come out of the scheme—which he did with a very handsome frozen benefit; but he did not lose his uplift because Part II of the Third Schedule of the Finance Act, 1956, said *This Part of this Schedule shall not apply in relation to any year of assessment in which the individual, in respect of his past services in any office or employment formerly held by him.....*, and he had no 'office or employment formerly held by him', because he was still in the same office or employment.

Mr F. M. Redington said that the 1956 Finance Act introduced three major reforms. He used the word 'reforms' advisedly, since they were more than changes; they were matters of justice and equity which they must all welcome, whether as professional men or as citizens. He had heard from Mr Boss, the Secretary of the Life Offices' Association, who was present, that they had excited considerable interest in the United States. They had set a pattern.

Those three major reforms had been required to bring consistency into the situation. It was true that they were not the only things that had to be done, for there were still inconsistencies and anomalies. Furthermore, any change, however beneficial, brought its own new problems. He would say, however, that anybody who wished to remedy the situation should try to see it as a whole. Tax arrangements were bound to contain a certain measure of rough justice; they could not be individual and precise. A corollary was that it was always possible to claim that case A was less favourably treated than case B. Often case A would have advantages that case B had not got, but even if that was not so, it might well be that the tax arrangements under consideration, taken as a whole, were more advantageous than otherwise. It was no good cavilling at the roughness of rough justice if the alternative was no justice at all.

Funding was perhaps not directly relevant to the immediate problem, but the Finance Act had created many new opportunities, and he thought that some of the fundamentals should be examined. It was possible to under-fund or to over-fund a pension arrangement. In his opinion, the danger in the United Kingdom was of under-funding, i.e. funding at too slow a pace. He had had an illuminating instance of a particular scheme which in the United Kingdom had to be defended against a charge of funding too fast, whereas the same scheme in Canada had to be defended against the charge that it was not being built up quickly enough. Taking the widest possible view of the national interest, he had more sympathy with the Canadian view than the British. He had little fear that in any serious sense pension schemes in the United Kingdom were, or were likely to be, funded too rapidly. The dangers of perhaps over-ardent salesmanship on some occasions were that funding of schemes might be at too low a level.

He wished to refer to a point that Mr Benz had made concerning a particular item in the Finance Act. Personally, he had been delighted to see s. 22(5) enabling private trust funds to be set up for the self-employed. He felt that it would have been undesirable if one section of the business had been given a virtual monopoly. Nevertheless, such a fund would set extremely severe problems for an actuary who had to deal with it.

Turning to premium rates, he entirely shared Mr Gwilt's views about mortality. He thought that perhaps the five or ten years' guarantee might moderate the dangers a little; nevertheless the dangers were considerable. They were launching 'self-employed' contracts at a time when interest rates were extremely high, and he could only hope that offices were not placing too much reliance

on the possibility of long-term immunization. He would say that the possibility of profit or loss for some of the quotations which were currently being made, especially at the younger ages, were strongly in favour of a loss. Mr Dow, in Edinburgh, had shown that in the past they had often lost on deferred annuities. He thought that they were probably repeating the mistake.

Finally, if they launched those contracts at 4½%, with relatively heavy mortality, at what rate of interest would they value them, especially annual premium contracts? And at what rate would they value them in five years' time, if the market rate should then be 3½%?

Mr J. K. Scholey said that, as a self-employed person, he wished to take up one or two of the points that Mr Redington had put forward. He wondered whether, in the discussion of pension schemes, they were not being too obsessed by the question of investments, and whether insurance companies as a whole were not making difficulties by stressing the investment side rather than the mortality side. He believed that in the United States proportionately much more pure insurance was written than in the United Kingdom. If they were intent on putting money aside and giving 4½% interest on it, then they had to earn the 4½% interest; but if they had some pure life assurance in the contract, then they had some possibility of profit, provided they had made their calculations properly, to offset the difficulties of perhaps having to go down to a 3½% basis.

With regard to the self-employed people, Mr Redington had said that the difficulties were in calculating the premiums, but would it not be possible for a combination of a 'self-employed' pension scheme and a unit trust to be set up? In the past, many self-employed people had helped the economy by investment in equity shares, and it might be that there was the possibility there for associations, institutions, and so on, to set up trusts which would enable self-employed people to set aside a portion of the permitted 10% or 15% of earnings, which would then be invested in equity shares. They would gain the advantage of tax relief on their contributions, and, if indeed equity shares did give help against inflation, they would gain in that respect also. He wondered whether, when talking about setting up trust schemes for the self-employed, they emphasized too much the need to quote so much premium for so much annuity, and whether it might not be better to say 'Put in what you like within the Revenue limits, and then use what you have got at pension age to buy yourself an annuity'.

Mr G. F. M. Mayo thought that the reaction among actuaries to the entirely new 'self-employed' business had been, to tread not warily but unwarily. They had seen offices giving policies bristling with every kind of option.

There were three main options—the option of a guaranteed period, the option of the pension age and the option to the widow. The first two, he thought, could very largely be minimized by use of a policy with return of premiums. An option remained but not of any great extent. The third option, however, that to the widow, seemed to him to be distinctly dangerous and they did not know to what extent it was likely to be exercised. On a group pension scheme they could say with fair certainty that not a great many people would take a widow's option because their pensions were usually small—and they were content to let the State look after their widows. He had found, however, that a larger proportion of the members of private funds took advantage of a widow's option. He felt that s. 22 schemes would go even further in that direction and that they would be dealing with a class of people who were even more likely than those in a private fund to exercise the widow's option.

Mr R. J. Kirton wished to comment on Mr Scholey's point that trustee funds might be invested in equities as a hedge against inflation to provide pensions, which he thought was sound in one way but not in another. He had in mind two points. First, there was a mild danger that, just as their forefathers had believed that they could preserve wealth by investing in trustee securities, so might they fall into the error of thinking they could preserve wealth by investment in equities. The second point was that a person might take the lump sum at retirement age and purchase an annuity, but he might find that if he retired in 1967 he would get £100 and if he retired in 1968 he would get £65. That would be quite a reasonable fluctuation in equities in 12 months, and it was not very satisfactory. Or if a person took a fluctuating annuity based on equities for the pension, he might get that sort of fluctuation in yearly income. He felt that investment in equities for pensions had only a limited applicability.

Mr W. H. Clough said that he was one of the actuaries who belonged to the self-employed, with no frozen benefits and plenty of uplift. He was very glad that the flexibility for the self-employed of funding their benefits in a privately administered fund had been touched upon, although the difficulties of the actuary who would handle such funds had also been mentioned. He had seen what the life offices were prepared to offer him as a self-employed person and he had to admit that, as time had gone on and their views had become more generous, he had been pleased to see the advantageous terms which were being given. As a with-profit policyholder of the same life offices, he was not sure that he took quite such a good view of the situation! If he had been a shareholder, he felt that he would have been even less satisfied with the position.

Nevertheless, on the terms offered, the self-employed were being given very generous contracts by the life offices, but he felt that they were rather rigid, inflexible contracts. Quite apart from the question which had been raised of investing a private fund in equities—and those who had had something to do with private funds had seen at least the advantages of a spread of investments, including equities—he found that, if he were the actuary of a professional institution which took an interest in providing a fund for its self-employed persons, he could, without any risk, reinsure his benefits with a life office on considerably more flexible and generous terms than he could obtain as a member of the public. He could not help feeling, therefore, that professional bodies would be well advised, for a number of reasons, to explore the possibility of providing pensions for themselves through their parent institution.

First, he was surprised that the life offices had adhered in so many cases so rigidly to annual premium contracts rather than offer the flexibility of a series of single premiums. As a self-employed person, he wanted to make his pension arrangements when and how he could to the best of his ability, and he might therefore prefer to pay a series of single premiums into a private fund. Secondly he might want to provide something for his widow and there again he found a certain diffidence on the part of the life offices, or many of them, in issuing individual contracts to the public, giving reversionary pensions for the benefit of widows, whereas such benefits could be provided by a self-administered fund. Perhaps life offices might in the end grant the same benefits.

Mr A. G. Simons, in closing the discussion, said that it was a rare event for any new tax legislation to find complete favour with any but a small minority of the persons interested. First, each individual had his own views as to how the

thing should have been done; secondly, different individuals had different interests to consider; and finally, Parliament sometimes altered a Bill, which had been very carefully thought out, and introduced anomalies of the sort that Mr Phillips had mentioned.

The Act had been no exception to that, except perhaps for s. 38, which was outside the discussion, probably because everybody liked it. The object of the 1956 Act, quite obviously, had been to cure some of the anomalies from which they had been suffering in recent years. It did not cure them all, but it did cure some of them, although at the same time it introduced new anomalies not so much in principle as in details.

But let them consider where they stood compared with where they had stood previously. Then there had been five main ways in which a pension in due course could be provided out of income: first the s. 379 insured scheme; secondly, the s. 379 private fund; thirdly, the s. 388 deferred annuity insured scheme; fourthly the s. 388 endowment assurance scheme; and fifthly, for the self-employed, either personal endowment assurances with or without annuity option, or saving out of net income. Three of those five had been brought together by the new Act—the s. 379 private fund, the s. 379 insured scheme, and the self-employed—and that surely was a great achievement. In bringing those three together the Act had not also brought them in line with the other two, but at least getting rid of anomalies for those three sections was a great step forward.

Probably the biggest anomaly left was the question of lump sums, and nobody would attempt to defend completely the current position that an employed person could have perhaps a very large lump sum and a self-employed could have no lump sum. On the other hand, it had to be remembered that there were points the other way. Many self-employed had a business or a practice that they could build up and sell, and even barristers sometimes received late fees free of tax on retirement, which was more beneficial to them than their benefits from the pension annuity fund.

A number of speakers had referred to the rates now being quoted for self-employed contracts and also the variety of contracts on offer. He was very glad to find that there was such a variety of contracts because in 1954, when answering a question in which it was suggested that if the self-employed were given merely deferred annuities every office would quote the same thing and that that would encourage nationalization, he had suggested that the ingenuity of actuaries would ensure that such a situation did not arise. It was a pity that the Act had been passed at a time when, as Mr Gwilt had indicated, the future of mortality rates at older ages was so uncertain and also at a time when they had for a few years been experiencing extremely high interest rates because, certainly for annual premium contracts, deferred for 10, 20 or 30 years, the two things that mattered most were not the current mortality rates and interest rates, but the rates of mortality and interest in future years, the most important rates of interest being those in the last few years of the deferred period.

One of the most interesting things from an actuarial point of view which might come out of the Act was something which they had not yet reached, although it had been referred to briefly by Mr Ogborn, namely the question of the valuation rates of interest in the future. In 1955 the most common rate of interest for a life fund valuation had been $2\frac{1}{2}\%$, or perhaps $2\frac{1}{4}\%$, and grossing up $2\frac{1}{2}\%$ at 7*s.* 6*d.* in the £, 4% was obtained. He used 7*s.* 6*d.* because he thought that was the proper rate for grossing up and not the rate of tax that the revenue account showed after allowing for rebate of tax on expenses. For the annuity fund

valuation, perhaps the most common rate of interest in 1955 had been 3%, although there was the curious phenomenon that the life office which was 'in the red' on its annuity fund probably tended, if anything, to value a little above the rate, and the life office 'in the black' tended to be a little below. When that fund had been split into its parts, one of those parts would earn gross interest in the future, a thing they had never had before as a certainty. The other part might, for the time being at any rate, earn a gross rate, but in many cases it would not. Assuming that the new general annuity fund was treated in the same way as the old annuity fund, he would expect to see again a valuation at 3%. On the other hand, for the pension annuity fund there ought correspondingly to be a valuation at, say, 4%, which was the 3% of the general annuity fund grossed up at something less than 7*s*. 6*d*., because of the set-off of the annuities against the interest income. If that were done, immediate annuities would be valued in the pension annuity fund at 4% and in the general annuity fund at 3%, but in reality they were both earning a gross rate of interest. It would be quite a problem therefore for life office actuaries to decide whether in the past they had been wrong in using one rate of interest in valuing the annuity fund and whether they should have used a gross rate greater than 3% on annuities in possession and a rate lower than 3% on deferred annuities.

Leaving the valuation question, they had also to consider what they were going to do about existing s. 379 insured schemes which were to be put into a fund where the rate of interest was gross. Some of them had had a gross rate of interest in effect in the past, but some had not. It might be that they all thought that it was quite easy to deal with future premiums, but they were also concerned with past premiums. They had seen a variety of rates quoted by life offices in the last twenty years since s. 379 schemes had first been put into effect, and it would not be easy to decide whether all those or only the most recent of them should have an allowance given them for the new gross rate of interest. After all, most offices were 'in the black' twenty years ago, so presumably they were then thinking in terms of gross rates.

He asked whether s. 35 was the beginning of double taxation. An annuity which was to be fully taxable as each payment was made would also, before it started, be subject to estate duty. In other words, the poor widow had to pay duty when her husband died and she had to pay tax afterwards for so long as she lived. Perhaps Mr Benz had answered the question by asking what was the market value, when there was no market, for a non-commutable and non-assignable annuity. No market value implied no duty.

The Act would take a little while to settle down and really be appreciated, and it was a pity, therefore, that some of the younger members of the Institute had not given their views, because they were the ones who would have to handle it in the future. Mr Mayo had spoken about the question of options. He had entirely agreed with what he had thought Mr Mayo was going to say, namely, that the options being offered, if they were fully guaranteed, could be dangerous; but towards the end of his remarks Mr Mayo had put the point that, the more widow's options that were exercised, the more dangerous the thing was. Surely it was the other way round—the fewer that were exercised, the more dangerous it was.

The President (Mr C. F. Wood) said that at the end of a Sessional Meeting it was usual for the President to propose a vote of thanks to the author of the paper. Two years previously Mr Bunford had wittily taken advantage of the

custom by proposing a vote of thanks to a visitor at the meeting, Mr Millard Tucker as he then was, who was the author of the Report which had been discussed. If that excellent precedent were to be followed, he presumed that for the authorship of the Finance Act he should give credit to the Chancellor of the Exchequer. In the same way that Mr Millard Tucker had acknowledged the work of the members of his Committee, he felt sure that the Chancellor, had he been present, would have acknowledged the help which he had received from the members of Her Majesty's Civil Service. It was therefore a great pleasure to them that Mr J. P. Strudwick, Assistant Secretary of the Board of Inland Revenue, who had been Secretary of the Committee on the Taxation Treatment of Provisions for Retirement, should be present.

Although they were not favoured with the presence of the author of the paper, they had been privileged to listen to the opening of the discussion by Mr J. A. Shaljean, who had given them a thoughtful and carefully prepared assessment of the provisions of the Finance Act, an outline of the problems with which the life office actuary had to contend, and a comparison with the recommendations of the Millard Tucker Report. He asked them to accord to him a hearty vote of thanks.