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RETIREMENT SAVINGS – FLEXIBILITY & CHOICE

AUTUMN STATEMENT - DECEMBER 2014

Over the autumn, following the March Budget, the Government announced dramatic changes to the way members can access their pension in retirement. Following the Autumn Statement on 3 December and with four months to go from when this becomes a reality the following is the latest position.

1 Flexible access to Defined Contribution (DC) funds from age 55

To confirm, members with DC savings will be able to fully access their pension as income with the first 25% of a pot tax-free and the remainder taxed at the individual's marginal rate. The Government have introduced two methods of taking income:

- You can either take your 25% tax-free cash immediately, and then pay income tax on all subsequent withdrawals (flexi-access drawdown)
- or you can have 25% of every withdrawal tax free, and just pay tax on the remaining 75% (uncrystallised funds pension lump sum).

2 Anti-avoidance measures – curbs to the flexibility

The Government realised that canny investors could use their pension scheme as an alternative method of receiving remuneration from their employer. By diverting earnings via a pension scheme, employees could avoid paying tax on 25% of their earnings, and avoid NI contributions altogether. The Government have decided that should an individual "access the flexibilities" beyond their 25% tax-free cash (i.e. receive income directly from their pension) their Annual Allowance (AA) for future contributions will be £10,000 (down from £40,000). Benefits paid from a Defined Benefit (DB) scheme would not trigger the AA reduction. People currently using capped drawdown and remaining within the existing limits would not trigger the anti-avoidance rules.

The restrictions in the AA are effective in reducing the tax-avoidance loop-hole and while would probably not impact most people are a significant step which individuals will need to address when considering accessing the drawdown route in the future.

Also those in flexible drawdown already (where the annual allowance is £0 for them) will have a Money Purchase Annual Allowance (MPAA) of £10,000 from 6 April 2015.

3 No ban on transfers from DB to DC schemes – but professional advice required

The Government consulted on the possibility of banning transfers from private sector DB schemes to DC schemes fed by the fear of a possible exodus from DB schemes and the detrimental impact on gilt markets that could follow. They have been convinced that this won't happen and so transfers can continue. The announcement does at least avoid some of the nightmare scenarios that might have arisen – such as a transfer fire-sale - had transfers been banned from next April.

However, we must place a big BUT after that where the member has pension savings (in the scheme and elsewhere) of worth more than £30,000. In these situations the Government has decided that before a transfer can proceed the member must receive advice from a FCA-regulated adviser. DB scheme trustees must check that this advice has been received (although not the quality or conclusion of the advice!). Without it the transfer will not be able to continue.

Introducing compulsory advice is perhaps not as radical as it seems - at present it is often difficult to transfer from a DB scheme unless advice has been taken, since receiving schemes will often require advice to be taken before accepting transfers. Historically, financial advisers have often been reluctant to recommend that DB scheme members should transfer – however, the new flexibilities available in DC schemes could provide a compelling and justifiable reason to transfer. This might apply to members who have good reason to want to access significant value from their retirement savings earlier in their retirement or who highly value the more favourable death benefits. On the other hand the FCA has recently issued a report that is highly critical of the transfer advice provided by regulated advisers. In practice it may become increasingly difficult (and expensive) to find an adviser prepared to actually give the advice necessary to facilitate a transfer to a DC scheme.

The Government also confirmed that they would not allow pensions in payment to be transferred to access the flexibilities. Scheme trustees should therefore make it clear to members considering drawing benefits that once they start taking their pension, they will have no further opportunity to transfer.

Transfers from unfunded state schemes will be prohibited from April 2015.

4 Guidance Guarantee – weakened further

More detail was given of the 'right to guidance'. A face-to-face guidance meeting remains as a right but alternative methods are also permitted: email, telephone, web-chat. Written follow up will also be given.

The provision of the service will initially be through the Pensions Advisory Service (TPAS) (for online and telephone queries) and the Citizen's Advice Bureau (CAB) for the face-to-face meetings. The Government has confirmed that the guidance will cover the tax implications of various decisions but fall short of recommending a course of action. Trustees and providers will be given duties to "sign-post" members on literature on how to access the guidance.

However, there remains a massive capacity issue and finding enough capable staff will be a challenge for these organisations.

People will be allowed as many sessions as they need, which is useful, allowing time to understand the concepts well in advance.

The FCA and HM Treasury continue to work on the details.

5 Relaxation on annuity rules

The post-2015 world will look very different with a slew of retirement income options available to individuals. However, the Government have thrown the annuity providers a bone with the promise to relax a number of restrictive rules to allow greater flexibility in the way annuities can be paid. The response outlined the following options:

a. Annuities that can decrease in payment
b. Annuities for a set period
c. Guarantee payment periods longer than ten years
d. Guarantees paid as a lump sum
e. Annuity purchasers can choose anyone as a beneficiary.

The Government has also announced the income from a joint-life annuity paid to the beneficiary will be paid tax free (where death occurs before 75). We are also lobbying the Government to change this for DB schemes.

This space for innovation is excellent news for those who are interested in structured income options in retirement.

6 Reduction on "death taxes"

For those in "drawdown" (i.e. taking an income from their pension pot) any fund that remains invested is currently taxed at 55% when paid to the deceased's beneficiaries. The Government has announced that where death occurs before 75 this rate will now be 0%. Tax-free! Any income paid on death after 75 will now only be taxed at the beneficiary's marginal rate. Also where a pension fund is inherited from a pension member who dies before age 75 there is no tax payable on income from the fund. This is a significant advantage of DC funds over DB income.

7 Further consultation – DB flexibilities

The Government have also (enticingly) left the door ajar with the promise of a further consultation on how far to allow DB schemes to pay benefits in a flexible manner, without having to transfer to a DC scheme. This could be an acceleration of income or increased lump sum (appropriately taxed). How any advice would work when giving options to members would need to be addressed but this is an interesting development for trustees and employers to monitor.

This is to be welcomed, since this may allow DB schemes to offer members more flexible access to their pension without the need to give up a lifetime pension guarantee entirely.

8 DC to DC transfers – statutory period extended

The existing rules on transfers stipulate that the statutory right to a transfer falls away when the member is within 12 months of retirement. To allow greater flexibility up to retirement the Government will grant the right to transfers up to the scheme's Normal Retirement Age. We are lobbying the Government to extend this to DB Schemes.

9 Permissive statutory override

The Government will also lay legislation which will mean that should a trust based DC scheme (or possibly DB schemes with DC benefits, AVCs for example) wish to allow members to access the new flexibilities the scheme will not need to change their rules to allow it. Instead they can circumvent the scheme's rules and pay the benefits in line with the tax rules.

The operation of this will depend on the precise wording.

10 Minimum Pension Age – 55 rising to 57 in 2028

The Government have confirmed that their proposed change to the Minimum Pension Age will proceed as originally specified.

11 Trivial Commutation DB

As previously announced the new triviality limits will remain for DB schemes from April 2015. So, the new £30,000 limit, for the trivial commutation limit assessed across all pensions wealth, will apply. Also, the scheme specific de minimis limit of £10,000 will apply when paying a lump sum. The Government have confirmed that the minimum age to access a trivial commutation lump sum will also reduce to 55 (from age 60) from 6 April 2015.

Actions

There is much for trustees, employers and individuals to consider with these changes. While further clarity is welcome the devil is, as always with pensions, to be found in the detail. The simple concept of direct access to DC pension saving is already being complicated and we have now seen HMRC's draft guidance on the flexibilities which introduces more complication. We will be following up this document with a technical briefing when the regulations have been finalised.

However, in the meantime you may want to consider the following:

DB Schemes

- Now that there is some clarity over future transfer policy, trustees should review their transfer option communication policy. Quoting transfer values (or possibly the option of partial transfers) as part of a retirement benefit statement is likely to become common, and some trustees might go further and start issuing annual statements – including transfer value details – to all deferred members. Compulsory advice means that trustees should be less worried about members making flawed decisions. Meanwhile, employers keen on reducing pension risk might want to think about offering advice for any member considering a transfer, to ensure that the advice requirement does not act as a major impediment to future transfers

- Monitor developments and impact of the anti-avoidance powers and the impact on scheme members and individuals to limit exposure to unexpected tax charges. Annual Allowance is going to get more complicated
- Communications will need to be reviewed to ensure appropriate sign-posting for individuals to access the Guidance Guarantee
- Employers and trustees of DB schemes should monitor the Government's further consultation on permitting similar flexibilities for DB schemes as if permitted may dramatically change the way DB benefits are taken
- Trustees should consider adopting a policy to write to any member who at age 55 is (or potentially is) eligible for trivial commutation, following the increase to triviality limits.

DC Schemes

- All DC schemes should monitor changes to the retirement income market (annuities and drawdown products) where we are expecting a dramatic rise in products on offer
- DC scheme trustees should also review the permissive statutory override and determine to what extent they will adapt the benefits they pay to comply with the flexibilities permitted by the tax rules
- Pensions, while on the one hand are becoming simpler, the growth in options to individuals means that there is increased complexity. Future focus will be on the quality of member communication and support throughout the member's tenure within the scheme which will be key to getting the right outcome
- As 90% plus of members of defined contribution (DC) schemes are in the default strategy, this could mean the end of traditional lifestyling for many in DC schemes. With lower volatility diversified growth funds being used to extend the period of growth in a controlled way, this could have two benefits of improving 'good member outcomes'. Firstly enabling a larger retirement pot to be built up and secondly not reducing this pot by converting to an annuity. Trustees and employers should start to consider how they might build these features into their schemes. As the members' long term intentions for their pension pots will be unknown this may mean members will have to take much more responsibility for their own investment strategies.

Contact us

DAVID BROOKS
Technical Director
T: +44 (0)20 7893 2262
E: david.brooks@broadstone.co.uk

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