BROADSTONE™

2015 BUDGET – PENSIONS GUIDE

FOR TRUSTEES AND SPONSORING EMPLOYERS

With effect from 6 April 2015 the way pension benefits will be accessed for millions across the country will change. Primarily the change has an impact on Defined Contribution (DC) benefits but will also have implications for members of Defined Benefit (DB) pension schemes.

1 New: Lifetime Allowance reduced to £1m

The Chancellor announced that from April 2016 the Lifetime Allowance (LTA) will reduce to £1m, from its current level of £1.25m. It was also announced that with effect from 6 April 2018 it will increase in line with inflation.

This will have implications for members of pension schemes who have not previously applied for a form of protection but have pension savings in excess of £1m. For defined benefit (DB) members this will be a pension, at April 2016, worth more than £50,000 p.a.. It is likely to affect a small proportion of the scheme membership and is something that should be checked and communicated with them.

It is expected that some new forms of protection will be introduced in a similar vein to Fixed Protection 2014 and Individual Protection 2014 when the Lifetime Allowance was previously reduced from £1.5m to £1.25m.

Affected members will need to look at their pension savings to take the appropriate action.

It is worth noting that the Annual Allowance (the limit on contributions to a pension scheme) remains unchanged at £40,000.

2 New: Lifetime Allowance and Automatic Enrolment

The reduction in the Lifetime Allowance to £1m could mean some of your employees could be at risk of tax bills when they are automatically enrolled. While individuals are ultimately responsible for managing their own tax affairs, you may wish to notify your workforce of the changing rules so they avoid falling foul of the tax man. Many have tax protection in place which is only maintained with the provision they do not make any further pension contributions.

Currently the Pensions Regulator allows members who are at the Lifetime Allowance limit, or have exceeded it, to opt out after being automatically enrolled within 30 days as if nothing has happened. The good news is that in the future individuals will be able to withdraw from the cycle beforehand to avoid going through this administrative process.

Employers should also consider that group life assurance payments can also end up being included in LTA calculations. When dealing with large multiples of salaries and pension payouts, beneficiaries could end up with a nasty tax bill at a difficult time.

3 New: Secondary Annuity Market

The Government have announced a consultation on the construction of a secondary market to allow people to sell their annuity to a third party. This will work by those in receipt of an annuity assigning that benefit to a third party, in return for a one off lump sum. The consultation will cover a number of important areas:

- Whether the existing annuity provider could buy back the pension
- Whether assignment of an annuity would be subject to the agreement of an annuity provider, who might be able to charge a fee.

Consumer Protection is clearly a concern for the Government and to address this they are consulting on:

- The levels of advice, guidance and risk warnings that should be in place
- Whether the sale might be subject to compulsory advice, as per DB to defined contribution (DC) transfers
- Creating a flow of information to enable people to compare costs and requiring them to shop around
- The requirement to have written consent from dependants before selling.

DB scheme implications:

- Government is not keen to allow DB scheme trustees to assign annuities held within DB schemes
- There is no mention of the idea of assigning or surrendering pension rights in a DB scheme.

Previously announced

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

Members with DC savings will be able to fully access their pension as income with the first 25% of a benefit taken tax-free and the remainder taxed at the individual's marginal rate of income tax. 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 – UFPLS).

5 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 National Insurance 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 money purchase 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 they 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.

There is no ban on transfers from DB to DC schemes – but professional advice must be taken.

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 the 6th April.

However, we must place a big BUT after that where the member's Cash Equivalent Transfer Value is more than £30,000 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. Receiving schemes will often require advice to be taken before accepting transfers and this approach may continue.

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 to a DC scheme will be prohibited from April 2015.

6 Pension Wise

The Government has launched Pension Wise to provide the promised Guidance Guarantee. Through Pension Wise individuals considering accessing their DC pension savings are entitled to a face-to-face guidance session to discuss their options and the potential repercussions of a certain course of action. The face-to-face sessions will be held at specified Citizen Advice Bureaus across the country. For people unable/unwilling to attend a face-to-face session there will be web based information and the option for a telephone session which will be managed by the Pensions Advisory Service.

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 have been given the duty to "sign-post" members on how to access the guidance.

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

7 Relaxation on annuity rules

The post-2015 world will look very different with a wide range 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 see "Reduction on "death taxes" below). 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.

8 Reduction on "death taxes"

For those in "drawdown" (i.e. taking an income from their pension pot) any fund that remains invested would have been 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.

9 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.

10 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.

11 DC statutory partial transfer right

Members of schemes with DB and DC benefits (AVCs for example) now have the statutory right to transfer the DC tranche of their benefits while leaving any DB benefits behind. As a statutory option this will need to communicated to affected members.

12 Permissive statutory override

Should a DC scheme (or possibly DB schemes with DC benefits, Additional Voluntary Contributions 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.

13 Minimum Pension Age – 55 rising to 57 in 2028

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

14 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 trivial commutation assessed across all pensions wealth will apply. Also, the scheme specific de minimis limit of £10,000 will apply when paying a lump sum from DB or DC schemes. 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.

15 Pension liberation and scams

With change and complication comes the opportunity for people to mislead members into making bad decisions. Employers and Trustees are at the front line of the battle against the pension "liberators" and scam artists and they will be expected to protect members as much as possible. This will require verification of advisers (when considering DB to DC transfers) and due diligence on receiving schemes when paying transfers (of all kinds). The quality of member communication will be the big difference between good and bad outcomes for members.

16 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.

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 this is a statutory right for DC benefits) 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, the 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 Pension Wise service
- 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 widening of 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. The loss of the trivial commutation option means that some schemes will want to allow the payment of some UFPLS to pay small funds larger than £10,000 to members, schemes will need to consider any further risk warnings required.

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.

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