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Briefing note

New Pension Flexibilities

From 6 April 2015 individuals have greater flexibility over how they can access their defined contribution (DC) pension arrangements. Individuals are now able to take all of their pension savings as a lump sum, draw them down gradually over time or buy an annuity (or a combination of these). 25% of the fund can be taken tax free, as previously, while the remainder is subject to income tax.

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This note looks at the implications for defined benefit (DB) pension schemes. We hope that the information will be useful to employers in helping them formulate a benefits strategy which not only fits with its' business objectives, but will provide favourable outcomes for employees and pension scheme trustees.

DB to DC transfers

Members of DB pension schemes are only able to access these new flexibilities if they transfer their benefit entitlement to a DC pension arrangement. The Government has previously signalled its intention to consult on whether to allow withdrawals directly from DB arrangements, but it is not clear when the consultation will take place or what the outcome will be. It is therefore possible that a greater proportion of a DB scheme's members will request a Cash Equivalent Transfer Value (CETV). The members most likely to request CETVs are those who are either at or close to retirement.

Many schemes' rules will not permit transfers within twelve months of retirement. In light of the new flexibilities, DB scheme sponsors could ask the pension scheme trustees to consider granting such an option and reminding members of their option to take a CETV when they reach retirement age. This could be included as standard as an additional option within the member's retirement illustration, either by referring to the option and inviting the member to request a CETV quotation, or by including the CETV amount in all retirement illustrations.

Members who elect to take a CETV of more than £30,000 from a DB scheme will be required to have received independent advice from a regulated financial adviser before they do so. In order to facilitate transfers, employers may want to consider offering to either meet or contribute towards the cost of this financial advice.

Benefits of offering members CETVs at retirement

There are a number of benefits to both members and employers of offering this option. These include:

- Increased flexibility for members over how they access their pension benefits. For example, they could take a higher proportion of their benefits as a cash lump sum.
- Enables members to provide themselves with more appropriate benefits. For example, they may not require an attaching spouse's pension or pension which increases in payment.

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- Benefits settled at less than the cost to the scheme of purchasing an annuity with an insurance company. This could improve the solvency funding position and move the scheme closer to buy-out, if desired. However, the potential reduction in liabilities is likely to be smaller the closer a member is to retirement age.
- Reduction in size of the scheme relative to the sponsoring employer reduces risks (longevity, inflation, investment etc.) and hence the likelihood that the employer will not be able to meet future contribution requirements, improving the security of benefits for the remaining members.
- Reduction in expenses associated with long-term pension payments and benefit administration.

Drawbacks of offering members CETVs at retirement

However, there are also a number of potential drawbacks to offering this option:

- Members could potentially end up being worse off, which could result in potential claims against the trustees of the scheme and/or the employer, and the associated reputational risk. This is mitigated by the requirement for members to take independent financial advice on amounts of more than £30,000 before transferring – although trustees are not required to check that a member has followed the advice given.
- Formally offering members this option at retirement may cause some ‘selection’ against a scheme, i.e. members in poor health and/or with no spouse electing to transfer out to a DC plan if they feel they can achieve a better outcome. The potential for such selection has always existed, but the likely increased interest in pension transfers generally may make this more of an issue going forward.
- Increased cost of retirement quotations as CETVs will need to be calculated and communicated to members if this approach is agreed. The employer could offer to meet the cost, in part at least, of taking independent financial advice.
- The increased complexity of retirement quotations will need to be carefully communicated to members. This may lead to additional queries, such as comparison of the CETV with the scheme’s usual retirement cash option.
- Disinvestments may be required at inopportune times (i.e. when asset values are low) to pay CETVs. This may have implications for the scheme’s investment strategy.

Partial CETVs

From 6 April 2015, all members will have a statutory right to a partial transfer, but only in respect of the entirety of their rights in any of the three categories (money purchase benefits, other flexible benefits, and non-flexible benefits) and only where the member has stopped accruing benefits in that category (at least one year before normal pension age). It could also be used as an option for legacy DC arrangements such as Additional Voluntary Contributions (AVC). However, there is the possibility for schemes to go further.

Members could be offered the option to transfer a portion of their benefits out of a scheme, whilst leaving the remainder of their benefit entitlement in the scheme. This would remove some risk from the scheme, with members benefiting from the additional flexibility whilst still retaining some of the

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All members retiring from DC arrangements have access to 'free and impartial' guidance on their choices by way of the new government-backed service, *Pension Wise* >

security provided by DB benefits. It is important that employers offering this option consider carefully which tranches of benefits are transferred as some may offer greater savings relative to the annuity cost than others.

While there would be increased administration fees in dealing with partial transfers, and possibly in helping to meet the cost of advice to members, there may be the opportunity for a saving in long-term cost.

Accessing pension savings

All members retiring from DC arrangements have access to 'free and impartial' guidance on their choices by way of the new government-backed service, *Pension Wise*. The guidance is generic and individuals may require further advice from an independent financial adviser. In particular, not all DC arrangements will offer all flexibilities and there may be minimum fund requirements so members may find it difficult to access their money in the way they wish.

Individuals who access their pension flexibly will have a reduced annual allowance of £10,000 as a tax avoidance measure. Higher earners may require specialist support to enable them to make informed decisions.

Finally, with the new freedoms come new risks and it is essential that all parties are aware of potential pension scams.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

corporateconsulting@barnett-waddingham.co.uk
020 7776 2200
www.barnett-waddingham.co.uk