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News on Pensions

August 2014

DC Pensions: Freedom and Choice

Treasury announcement

Following an earlier consultation on 'Freedom and Choice in Pensions' (see *News on Pensions – April 2014*), the Treasury has issued an *announcement* and written *ministerial statement* confirming that it will press ahead with plans to allow members of defined contribution (DC) schemes full flexibility in accessing their pension savings from April 2015.

The Treasury also confirmed that transfers from private sector defined benefit (DB) schemes to DC schemes will continue to be allowed in respect of benefits not yet in payment, although two new restrictions have been announced:

- Transferring members will be required to take independent financial advice, unless the transfer value is less than £30,000. Members will be expected to pay for this advice themselves.
- New guidance will be issued for trustees on the use of their existing powers to delay transfer payments and their ability to take account of scheme funding levels when determining transfer values.

The ban on transfers from unfunded public sector arrangements will remain in place.

Non-pensioner members' statutory right to a transfer will be extended all the way up to Normal Retirement Age (NRA) for transfers between DC schemes. Schemes do not currently have a legal obligation to offer a transfer once a member is within 12 months of a scheme's NRA.

Within the *consultation response*, the government confirmed that:

- It will consult in due course on whether to allow full or partial withdrawals directly from DB schemes, rather than first requiring individuals to transfer to a DC arrangement.
- The guaranteed guidance on pension choices announced in the Budget (for members retiring from DC schemes) will be provided free of charge by independent organisations rather than pension schemes or pension providers. It is expected that guidance may be provided face-to-face, over the phone or via the internet, and will be funded by a levy on regulated financial services firms.
- The statutory minimum pension age will increase from 55 to 57 in 2028, and will remain at 10 years below State Pension age thereafter.
- A 'permissive' statutory override will allow DC schemes to override rules in order to give members access to the additional flexibility.
- The Chancellor's Autumn Statement will include more detail on changes to inheritance tax rules (in particular the effective 55% charge that currently applies to undrawn pension savings in a drawdown fund).

Legislation

HMRC has published *draft clauses* for the Taxation of Pensions Bill, which is to be introduced to Parliament in the autumn. The draft legislation contains no big surprises, but plenty of new terminology, in particular in setting out the ways in which savers can access DC funds from next year:

- Drawdown: From 6 April 2015, individuals will be able to access their DC funds flexibly via a new 'flexi-access drawdown fund' with no caps on the amount withdrawn and no minimum income requirement. Those who currently have 'capped' drawdown funds will be able to convert these to a new flexi-access drawdown fund if they wish. Existing flexible drawdown funds will automatically convert to flexi-access drawdown funds on 6 April 2015.

  Payments from flexi-access drawdown funds will be taxable as a pension, however individuals can take a tax-free lump sum of up to 25% of their pension fund when their remaining funds are designated to a flexi-access drawdown fund.

- Lump sums: As an alternative to flexi-access drawdown, individuals may take a single or series of lump sums from 'uncrystallised' funds from age 55. 75% of each such lump sum will be taxed as income with the remaining 25% paid tax-free. It is not possible to take a tax-free lump sum of 25% of the fund in conjunction with this option.

- Annuities: Individuals may still purchase an annuity with their DC funds. Such annuities will now be allowed to reduce as well as increase in payment. The current maximum period of 10 years for guaranteed annuities will be removed, allowing annuities to continue to be paid after the member's death until the end of any given term. There will also no longer be a requirement for the individual to have been given the opportunity to select the insurance company.

To ensure that the new system is not exploited, a new 'money purchase annual allowance' of £10,000 will apply for any new money purchase savings by individuals who have withdrawn any money under flexible access. However, a tax-free lump sum taken under flexi-access drawdown will not trigger the money purchase annual allowance rules. The Treasury's intention is to limit the scope for individuals to have salary paid into pension funds and then withdrawing immediately (thereby avoiding tax income tax on 25% of the amount).

Individuals will retain an overall allowance of up to £40,000 including in relation to defined benefits pensions savings.

The draft legislation includes a scheme rules override in order to allow trustees or managers to make payments within the new framework without having to change the scheme rules. However schemes will not be obliged to make these payments if they do not wish to, in which case members would need to transfer to another arrangement in order to access the flexibility.

Finally, *amendments* were incorporated into the *Finance Act 2014* setting out transitional arrangements in relation to the DC reforms, including:

- A temporary extension of the time allowed between taking a pension commencement lump sum (PCLS) and deciding what to do with the remaining pension benefits. For example, individuals who took their PCLS between 19 September 2013 and 5 April 2014 will have until 6 October 2015 to decide what to do with their remaining pension benefits.
- A temporary relaxation of the rules on transferring pension rights once a PCLS has been paid. Certain individuals who have taken their PCLS will be allowed to transfer their remaining pension rights.
- The rules on repaying a PCLS have also been relaxed.

Draft guidance on the transitional arrangements is available on HMRC's website.

Definition of 'money purchase'

TPR: Immediate action required!

On 23 July 2014, the new statutory definition of money purchase benefits came into effect with retrospective effect from 1 January 1997. Schemes such as those offering hybrid benefits, cash balance benefits and/or those which internally annuitise could be affected.

The Pensions Regulator (TPR) has published a *Statement* with further information, in which it urges trustees to review their scheme's trust deed and rules, seeking legal advice if necessary, to determine whether their scheme is affected. If the trustees find that, despite historic treatment, the benefits offered have the potential to result in a funding deficit they must notify TPR immediately.

PPF: Updated guidance

Following an earlier consultation, the PPF has *responded* and called for schemes to consider the effect of the amended money purchase definition on their section 179 levy valuations. Schemes should consider whether they are affected and, if their scheme actuary considers the change in definition of money purchase to have a material impact on the s179 funding position, carry out an out-of-sequence s179 valuation by 31 March 2015.

Arcadia: RPI vs CPI

The High Court has handed down its latest *judgement* in the ongoing saga of the switch in statutory pension increases to the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). Arcadia Group Limited approached the High Court to determine whether the rules of two schemes of which it was Principal Employer conferred a power to select an index other than RPI.

Broadly, the rules of both schemes defined the 'Retail Prices Index' used to determine pension increases as 'the Government's Index of Retail Prices or any similar index satisfactory for the purposes of the Inland Revenue / HM Revenue & Customs'. The judge found that this wording allowed the selection of an index other than RPI. There was no requirement for RPI to be discontinued or replaced before CPI could be considered a suitable alternative. The judge found that the power of selection rested jointly with the employer and the trustees.

Schemes with a similar rule may wish to revisit any decisions that have been made over whether to use RPI or CPI, after taking legal advice on how this case may affect them.

PPF News

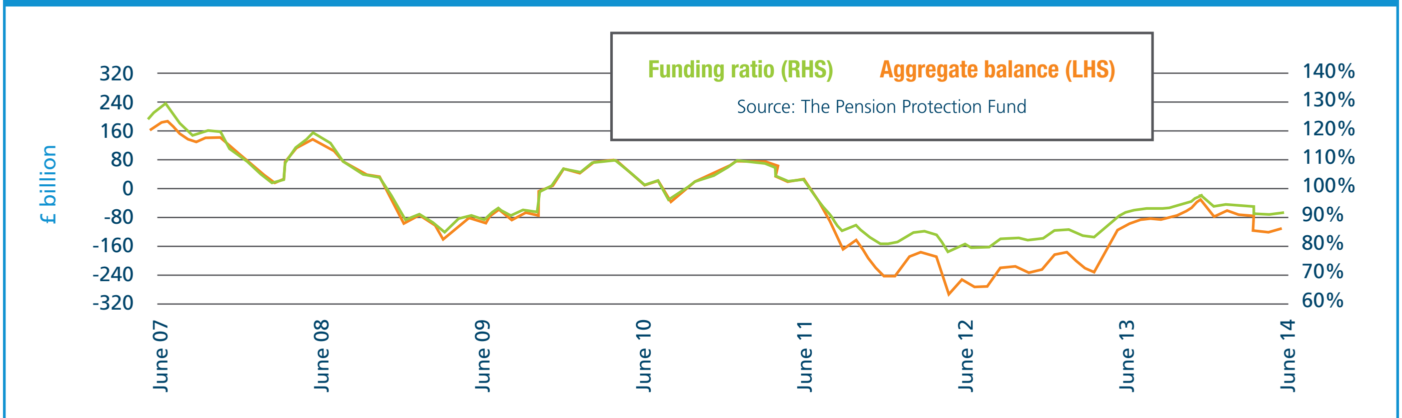
PPF 7800 Index update

The *latest update* of the PPF's 7800 Index of schemes' funding (on the s179 basis) has been published.

The aggregate deficit of the 6,150 schemes in the PPF 7800 index is estimated to have decreased over the month to £109.0 billion at the end of June 2014, from a deficit of £118.2 billion at the end of May 2014.

The funding ratio increased from 90.8% to 91.5%. There were 4,308 schemes in deficit and 1,842 schemes in surplus.

ESTIMATED AGGREGATED BALANCE (ASSETS LESS S179 LIABILITIES) AND FUNDING RATIO OF SCHEMES IN THE PPF UNIVERSE



Accounts and Funding Strategy Update

The PPF has issued its *2013/14 Annual Report and Accounts* and the latest version of its *Funding Strategy Update*. The documents demonstrate that the PPF is 'firmly on track' to meet its goal of self-sufficiency by 2030.

The accounts note that £1.2 billion has been paid out in total PPF compensation (with payments of £445 million in 2013/14). At 31 March 2014, the fund was assessed to have a £2.4 billion funding surplus.

Other News

HMRC: End of contracting-out

HMRC has published the latest edition of its *Countdown* to ending of contracting-out bulletin. The publication confirms that HMRC's Scheme Reconciliation Service is now live and provides details of how HMRC is working with industry ahead of the abolition of contracting-out in April 2016.

BT longevity swap

The BT pension scheme has entered into a longevity swap by setting up its own insurance company and then reinsuring 25% of its longevity risk in the biggest deal of its kind, covering £16bn of the Scheme's liabilities. The BT scheme has approximately 320,000 members and over £40bn in assets.

TPR 2013/14 Report and Accounts

TPR has published its *Annual Report and Accounts for 2013 – 2014*, together with an overview of its activity during the year. The report focuses on TPR's involvement in *auto-enrolment*; raising standards of administration and trusteeship in *DB* and *DC schemes*; and stepping up 'the fight against *pension scams*'.

TPR is also updating its *Trustee Toolkit* over the summer to reflect recent changes to the pensions landscape.

Further Information

Impact of pension schemes on UK business

For many years we have read about the ever-increasing pain that DB pension schemes have piled onto employers, be it additional funding requirements or unwelcome volatility on the balance sheet. However, Barnett Waddingham's *4th annual report* on the FTSE350 shows more positive signs than previous editions and the past year seems to have been a good one...

To discuss these issues in more detail please contact your usual Barnett Waddingham consultant or use the following:

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