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News on Pensions

APRIL 2014

Budget 2014 – DC shake-up

On 19 March 2014, the Chancellor delivered his *2014 Budget* speech, in which he announced a series of significant changes to defined contribution (DC) pensions. Some of these changes will affect all schemes, and may even impact members without any DC benefits.

The key change will be the ending of the effective requirement to purchase an annuity with DC funds at retirement. This will be introduced via an Act of Parliament to take effect from April 2015. In the meantime, the Chancellor announced some interim easements to give additional flexibility to retiring members.

The Treasury, through its document '*Freedom and choice in pensions*' is consulting on some of the detail. The government has also produced a short explanatory leaflet '*Budget 2014: greater choice in pensions explained*' which may be helpful for members considering retirement options.

Annuitisation

- Legislation will be amended so that members of DC schemes can draw down on their pension pots without any limits. If they wish to, members will be permitted to withdraw their entire savings as a single, taxable lump sum.
- The ability to take up to a quarter of the fund as a tax-free pension commencement lump sum will remain.

Whilst this removes the effective requirement for members to purchase an annuity from an insurance company, members would still be able to do so if they wish.

Trustees and pension providers will be required to provide DC members with free and impartial face-to-face guidance on their choices at the point of retirement. It is not clear how this advice will be funded, although the government will establish a £20m 'development fund' to get the initiative off the ground.

The treatment of hybrid schemes and additional voluntary contributions (AVCs) within defined benefit (DB) schemes is not yet clear and this will be considered as part of the government's consultation.

Minimum pension age

The minimum age that members are able to access pension funds will increase from 55 to 57 by 2028 under the government's proposals. We understand this will affect DB schemes as well as DC arrangements.

The government intends that the minimum pension age will be linked to the State Pension Age (SPA), so in future it will always be 10 years before the SPA. However, the Treasury has also made clear that members who have built up DB pension benefits with a lower pension age will not be affected by the change.

The government has also suggested that the gap between the minimum pension age and SPA could reduce further still, perhaps to 5 years.

DB to DC transfers

To avoid large numbers of members transferring out of unfunded public sector DB schemes into DC schemes (which would create a strain on the government's finances) legislation will be enacted which stops such transfers.

The government is also consulting on how it should treat transfers to DC schemes from private sector DB schemes. The options being considered include a complete ban on such transfers, or requiring that transferred funds are ring-fenced and subject to the existing tax framework for DC pensions.

The government has said that a complete ban on DB to DC transfers "must be the government's starting point" unless the risks inherent in the alternatives "can be shown to be manageable". However, the government is open to the option of maintaining the status quo with regard to transfers, but only if "it is clear that this would not create significant risks for the UK economy".

In the meantime, private sector DB schemes are able to continue offering transfers to members.

Interim measures

In order to give members of DC arrangements additional flexibility while they wait for the new legislation, the government introduced some interim easements from 27 March 2014, including:

- Reducing the 'minimum income requirement' for members to be able to access uncapped drawdown arrangements from £20,000 per year (including state benefits) to £12,000 per year.
- Increasing the 'capped drawdown' limit of 120% of the annuity income that could be secured with the fund in the insurance market (as estimated by the Government Actuary's Department), to 150%.
- Increasing the trivial commutation limit (which applies to the combined value of an individual's approved pension arrangements) from £18,000 to £30,000. These increased trivial commutation limits will also apply to DB schemes.
- Increasing the 'de minimis' lump sum limit (for very small pension benefits) from £2,000 to £10,000. This limit applies to occupational DB and DC schemes as well as personal pensions (in respect of the latter, individuals can now use the de minimis rules on three separate occasions – previously two).

The government is also intending to review the 55% tax rate applying to some undrawn pension funds held at death to make sure taxation of pension wealth remains fair. Furthermore, the government will consult on options to simplify dependants' pension rules and will explore amending tax rules that prevent individuals aged 75 and over from claiming tax relief on their pension contributions.

Following the Budget the Treasury has announced that individuals who have already taken a tax-free lump sum from their DC scheme will be given 18 months (instead of the usual 6) to decide how to draw their remaining benefits – by which time it is expected the new regime will be in place.

Next steps

The announcements in the 2014 Budget will have a significant impact on members of DC pension arrangements and some DB schemes. Trustees and employers should consider the actions outlined above and discuss them with your usual Barnett Waddingham consultant.

For further information, email us on *budget2014@barnett-waddingham.co.uk*.

PPF update

PPF-specific insolvency model

The Pension Protection Fund (PPF) has *published* a document setting out progress on the change in insolvency risk provider from Dun and Bradstreet (D&B) to Experian. In particular, the PPF intends to use a measure of insolvency risk designed specifically for them ('the PPF-Specific Insolvency Score') rather than Experian's existing Delphi Score.

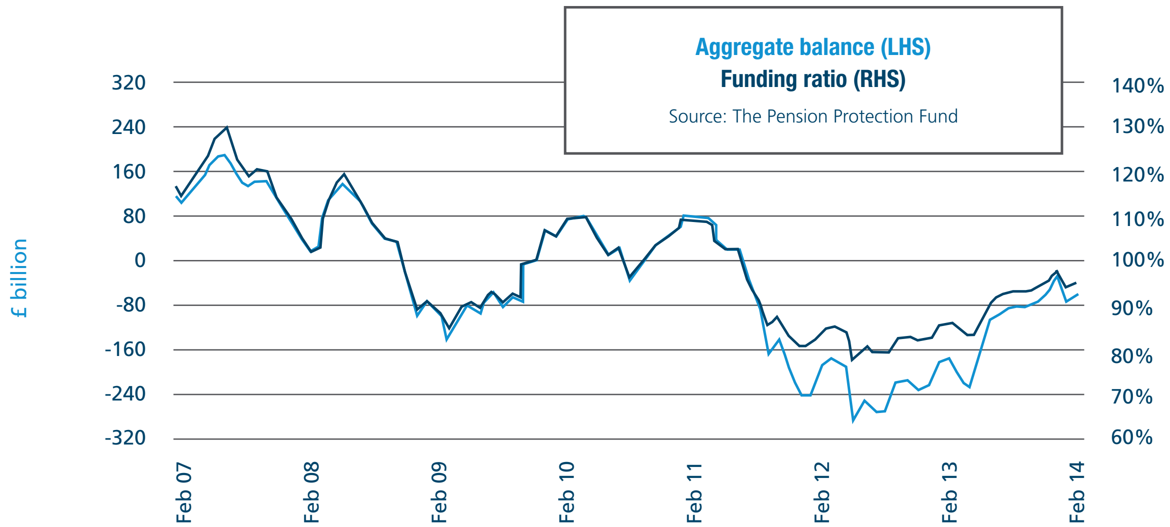
At the end of May, the PPF will publish a consultation which will include details about how its proposed new model will work, how the existing ratings will change and how levies may be affected accordingly. The consultation will also cover other aspects of the PPF's plans for the next three levy years (2015/16 – 2017/18).

In the meantime, the PPF has confirmed that the new ratings will not be used until October 2014 to allow schemes to verify their own data and address any individual issues they may have. The PPF's document also includes a list of actions for schemes ahead of the switch to Experian.

PPF 7800 Index

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 index is estimated to have decreased over the month from a deficit of £76.5bn at the end of January to £61.2bn at the end of February 2014. The funding ratio increased from 93.7% to 94.9%.

There were 3,947 schemes in deficit and 2,203 schemes in surplus.



DWP: DC schemes – charges and governance

New measures have been *announced* by Pensions Minister Steve Webb, intended to ensure that DC pension schemes 'deliver value for money for savers'. From April 2015, charges for default funds in DC schemes used for auto-enrolment will be capped at 0.75% pa.

These measures are outlined in a Department of Work and Pensions (DWP) Command Paper – '*Better workplace pensions: further measures for savers*'. The paper forms the government's response to the DWP's earlier *call for evidence* on quality standards in workplace DC schemes, the *consultation on charges* in DC workplace schemes and an Office of Fair Trading *market study*.

HMRC: Countdown to ending of contracting-out

Her Majesty's Revenue and Customs (HMRC) has published the first issue of its '*Countdown to ending of contracting-out*'. HMRC intends to publish these bulletins on a regular basis to cover topics relating to the end of contracting-out in April 2016.

In the first issue, HMRC explains the background to the end of contracting-out on a salary-related basis, and includes a timeline setting out the various contracting-out activities for schemes and company payroll operators before and after 2016.

One such activity will be for schemes to reconcile their Guaranteed Minimum Pension (GMP) records with HMRC. For further information, please see *our information sheet*.

Latest from Europe

European Commission: IORP II

The European Commission has published a draft revision of *the Institutions for Occupational Retirement Provision (IORP) Directive* 'IORP II'), with stated aims that include:

- Improving pension scheme governance and risk-management. Included in the proposals are the introduction of a 'fit and proper' person test for trustees and managers of schemes and a requirement for them to hold professional qualifications.
- Removing certain restrictions on cross-border pensions activity. As widely expected, the updated directive does not impose a Europe-wide solvency regime. However, despite an early leaked draft suggesting otherwise, the revisions do not relax the existing requirement that cross-border schemes remain fully funded at all times.
- Providing 'clear and relevant' information to members, including standardising annual benefit statements across Europe

The Directive is expected to come into force by 31 December 2016. In the meantime, we await details of how the DWP and The Pensions Regulator (TPR) intend for the UK to implement the Directive.

CJEU - VAT on DC management costs

Some DC pension schemes may have greater scope to reclaim VAT in respect of management costs following a preliminary judgement in the Court of Justice of the European Union (CJEU).

In *ATP PensionService A/S v The Skatteministeriet*, the CJEU took the view that a DC pension scheme could be considered a 'special investment vehicle' because the members of the scheme bear the investment risks.

However, DC pension schemes that invest through insurance wrappers are unlikely to be affected by the ruling as there is currently already an exemption for VAT on management costs in these cases. Nevertheless, DC scheme trusts should want to monitor the situation as the case returns to the Danish national courts. It is not clear when (if at all) HMRC will provide clarification of the approach in the UK.

Research round-up

ONS: 2013 Annual Survey

The ONS has published its '*2013 Annual Survey of Hours and Earnings: Summary of Pension Results*'. Key points from the survey include:

- In 2013, 50% of employees (85% of public sector employees, 36% of private sector employees) belonged to a workplace pension scheme – representing a year-on-year increase for the first time since 2006.
- 51% of employees in large private sector companies (with 5000+ employees) were members of a workplace pension, up from 36% in 2012.
- 75% of full-time public-sector employees earning £100 – 200 per week were members of a workplace pension, up from 59% in 2012.

TPR: Auto-enrolment

Research published by TPR show that 47% of small employers (with 5 – 49 employees) still do not know when they will need to act on auto-enrolment. TPR is urging employers to check their staging date.

TPR has also announced that *three million employees* have now been auto-enrolled into a workplace pension scheme. The three millionth worker is said to be an employee of West Ham United Football Club.

Further information

We are hosting a series of seminars on 'The Health and Wealth of your Workforce' during September and October 2014. The seminars will consider how companies can align employee benefit provision with their corporate objectives, and will include industry insights and views from our expert speakers Damian Stancombe – Head of Employee Benefits and Carl Chapman – Head of Wellbeing.

In addition, the seminars will include a short update from Bhargaw Buddhdev our Head of Executive Pensions, who will be commenting on changes from 6 April 2014, when the reduced lifetime and annual allowances came into force.

Further details, including information on registering for these free courses, please visit *our website*.

You may also find our recent publications on the following topics interesting:

- *Buy-outs, buy-ins and longevity swaps*
- *Current Issues in Pensions Financial Reporting-31 March 2014*
- *Single-Tier State Pension - Implications for defined benefit schemes (updated)*

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

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