News on...

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Current Pensions Issues - Spring 2014

Budget special: Chancellor unveils DC surprise

Despite rumours of a big surprise, few were expecting the Chancellor of the Exchequer to herald 'the most far-reaching reform to the taxation of pensions since the regime was introduced in 1921', when he delivered his 2014 Budget speech in the House of Commons on 19 March.

The key change will be the ending of the effective requirement to use defined contribution (DC) funds at retirement to provide a regular income. This is expected to 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.

Although the key reforms are targeted at members of DC pension schemes, some of the changes announced will also affect members of defined benefit (DB) schemes, including those who do not have any DC benefits.

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.

In a nutshell

The government's plan is to:

- from April 2015, allow retiring DC scheme members to access all of their pension savings, without limits and subject to normal marginal rate tax charges;
- increase the minimum retirement age so that, by 2028, it is no more than 10 years lower that the State Pension Age;
- ban transfers to DC schemes from public sector DB schemes with immediate effect;
- consider whether to extend this ban to private sector DB schemes; and
- as an interim measure, improve the limits on drawdown and trivial commutations.

Annuitisation

The government will amend legislation so that members of DC schemes will be able to draw down on their pension pots without any limits. If they wish to, members will not suffer penal tax charges if they withdraw their entire savings as a single lump sum.

Any funds taken will be subject to income tax at the member's marginal rate, although the ability to take up to a quarter of the fund as a tax-free lump sum will remain.

Whilst this removes the effective requirement for members to draw a regular income (for example by purchasing 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 DB schemes is not yet clear and this will be considered as part of the government's consultation.

Possible actions for DC schemes?

- Contact members who are now 'at retirement' to explain changes. Be careful not to give financial advice.
- Consider writing to all members and/or updating member communications with details of the reforms.
- Review investment strategies – for example, are default 'lifestyling' funds likely to remain appropriate?
- Discuss 'at retirement' processes with advisers. Will rule changes be required before April 2015?

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 be no more than 10 years before the SPA. The government has also suggested that the gap between the minimum pension age and SPA could reduce further still, perhaps to 5 years. The Treasury has however made it clear that members who have built up defined benefit pension benefits with a lower pension age will not be affected by the change.

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 to prohibit 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:

- removing the statutory right of all members of private sector DB schemes to transfer to a DC scheme, other than in exceptional circumstances;
- continuing to allow members of DB schemes to transfer, but requiring that any funds that have been transferred are ring-fenced and subject to the existing regulatory framework;
- placing a cap on the amount that members of DB schemes can transfer to DC schemes in any given year;
- continuing to allow transfers, but requiring the DB scheme trustees' approval before transfer; and
- maintaining the status quo (i.e. continuing to allow transfers effectively without restriction).

The government has said that a complete ban on DB to DC transfers 'must be the government's starting point unless the issues and risks around other options can be shown to be manageable'. 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.

Possible actions for DB schemes?

- If any buy-out or buy-in exercises are underway, consider whether additional flexibility to take benefits as a lump sum might be offered to members instead.
- Review any planned de-risking exercises (enhanced transfers, pension increase exchanges) with advisers.
- Consider whether to give members further information alongside transfer value quotes.
- Discuss with advisors and sponsoring employer whether rules allow for interim flexibility and whether members should be approached with an offer (for example where the new higher trivial commutation limits apply).
- Consider whether 'actuarial factors' (such as cash commutation rates and transfer value calculation approaches) should be updated.

Interim measures

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

- Reducing the minimum income requirement for members to be able to access 'flexible drawdown' arrangements. Before the Budget, an individual was required to demonstrate a guaranteed retirement income of £20,000 per year (including state benefits) before being able to use a flexible drawdown arrangement. From 27 March, this requirement has been reduced to £12,000 per year.
- Where the minimum income requirement is not met, it is still possible for members to access drawdown arrangements instead of purchasing an annuity. However, under 'capped drawdown', the amount that could be drawn each year was limited to 120% of the annuity income that could be secured with the fund in the insurance market (as estimated by the Government Actuary's Department). This limit has been increased, from 27 March, to 150% of the equivalent annuity.
- Before 27 March, where the combined value of all of an individual's approved arrangements was less than £18,000, these could be taken as a taxable 'trivial commutation lump sum'. The trivial commutation limit has been increased to £30,000, and this new limit will also apply to DB arrangements.
- If the value of a pension arrangement is less than £10,000 at retirement (£2,000 before 27 March), regardless of total pension wealth, this can be taken as a 'de minimis' lump sum. The limit applies to occupational DB and DC schemes as well as personal pensions, although in respect of personal pensions, individuals are restricted to using 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 pension contributions.

Next steps

The initiatives 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 their usual Barnett Waddingham consultant.

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

"Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want."

George Osborne, 19 March 2014

Our services

Barnett Waddingham provides professional services spanning pensions, life and general insurance.

Our services include:

- Scheme Actuary and associated services to the trustees and employers associated with defined benefit pension schemes.
- Advice in relation to defined contribution schemes.
- Pension accounting for UK and international companies.
- Administration and management services including pensioner payroll, preparation of annual accounts and secretarial services.
- Investment strategy reviews and advice on scheme evolution strategy.
- Management of closed schemes, wind-ups and reconstructions and schemes in PPF assessment.
- Employer risk management through buy out options, transfer exercises and PPF levy management.
- Advice on group personal pensions, stakeholder schemes and personal accounts.
- Group risk advice including group life assurance, private medical benefits and income protection benefits.
- Advice to individuals and employers on pension provision for executives, including pre-hire, advice upon early termination and tax efficiency in the lead up to retirement.
- Analysis and modelling of mortality and longevity risk for insurance companies, reinsurance companies, investment banks and pension schemes.

Barnett Waddingham is also a leader in the provision of self -invested personal pensions (SIPPs), small self- administered pension schemes (SSASs), specialist executive pension plans (EPPs) and other retirement arrangements.

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:

- Introducing 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. The updated directive does not impose a Europe-wide solvency regime, but also does 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 further details from the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR).

VAT on pension fund management costs

Two recent rulings by the Court of Justice of the European Union (CJEU) could mean that some schemes are able to reclaim VAT paid on investment manager fees in certain circumstances:

- DB schemes: HM Revenue & Customs (HMRC) has issued *a briefing* for DB schemes, setting out its updated policy on the recovery of VAT on pensions investment management costs. This follows a CJEU ruling last summer (see *Current Pensions Issues – Summer 2013*). As a result of the briefing, there are circumstances where employers may be able to reclaim input tax in relation to pension funds where they could not before. However in practice such circumstances are expected to be very limited.
- DC Schemes: A further preliminary *judgement* by the CJEU could allow wider recovery of VAT on management costs for some DC pension schemes. DC pension schemes investing through insurance wrappers are not likely to be affected by the ruling since there is currently already an exemption for VAT on management costs in these cases. However, DC scheme trustees should 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 UK's approach.

Employers may wish to obtain specialist taxation advice and review schedules of contributions to maximise the level of VAT recovery in future.

Equality: Civil partnerships and same-sex marriages

Under the Civil Partnership Act 2004, occupational pension schemes must treat civil partners in the same way as married couples. In particular, spouses' benefits that would be payable on the death of a member must also be payable to civil partners. At present, schemes are only legally obliged to do this in respect of post 1988 GMP (Guaranteed Minimum Pension) and non-GMP benefits earned after 5 December 2005 (the date the Civil Partnership Act came into force) although many schemes opted to extend the rights to civil partners for all service.

A member of the Innospec Limited pension scheme took his employer to an Employment Tribunal to argue that limiting his civil partner's benefits post-2005 service was discriminatory. Although the tribunal originally agreed with the member, the decision was recently *overturned* by the Employment Appeal Tribunal.

Since 13 March 2014, same-sex marriages have been legal in England and Wales. Trustees and employers will need to consider whether they are required to extend the rights of same-sex spouses to benefits earned before 5 December 2005 and obtain legal advice where appropriate. There may be yet further developments in this area. In particular, the Equality Act 2010 is currently under review by the government and a report is due to be published by July 2014.

TPR: Record-keeping update

TPR has published the *results of its 'thematic review'* of pension schemes' record-keeping, noting that many schemes were demonstrating good practice with regular measurement and reporting on the presence and quality of 'common' and 'conditional' data. Record-keeping is also being flagged in schemes' risk registers and featuring as a regular agenda item for many trustee meetings.

However, TPR noted areas of concern that included a 'lack of action on record-keeping until prompted by the regulator' and 'insufficient focus on conditional data'. Furthermore, some schemes' record-keeping activities are limited to measuring and addressing the presence of data rather than its accuracy. Following the review, seven separate detailed case investigations were opened. The schemes involved may face enforcement action.

News in brief

TPR: DC governance statement

TPR's DC *code of practice* and *regulatory guidance* were launched last November, setting out the quality features the regulator expects of all DC schemes.

TPR has since launched *a tool* to help trustees assess their scheme against TPR's DC quality features and has published a *standardised governance statement* to enable trustees to confirm that their scheme complies with the code of practice. TPR expects trustees to publish an initial governance statement by the end of their 2014/2015 scheme year.

TUPE: Auto-enrolment

The DWP *has confirmed* that, with effect from 6 April 2014, employers who take on staff subject to the Transfer of Undertakings and Protection of Employment (TUPE) regulations will no longer be required to pay matching contributions up to 6%, if the transferring company contributed at a lower rate to meet auto-enrolment requirements.

PPF Levies : West of England Ship Owners

The High Court has *overturned a decision* by the Deputy Pensions Ombudsman to award compensation to the trustees of a scheme where out-of-date data was used in a scheme's PPF levy calculation.

The High Court ruled that there is no scope in the levy determination for the PPF to depart from a failure score provided by D&B where this is based on information used by D&B in the ordinary course of its business. In particular, D&B Luxembourg had used data from an older set of company accounts as it does not routinely seek updated reports.

DWP: Standards for DC schemes

Following an earlier consultation, the DWP has released a paper on '*Better workplace pensions: further measures for savers*' in relation to charges and governance standards for occupational DC schemes.

From April 2015, a charge cap on default funds of 0.75% and a ban on consultancy and commission charges will apply in occupational DC schemes used for auto-enrolment. There will also be mandatory disclosure of costs and charges in a standard format.

Abolition of contracting-out

The DWP has *published* its response to a consultation on the abolition of contracting-out.

The government has decided that employers in certain former nationalised industries (such as electricity and rail) should not be allowed to use a statutory override which would have enabled them to offset their increased National Insurance bills resulting from the end of contracting -out. For further information visit our *website*.

Forthcoming Events

Trustee Training

All pension scheme trustees are legally required to have a minimum standard of knowledge and understanding. Our one-day Trustee Training courses are aimed at both new trustees and those seeking a reminder of the basics of trusteeship.

London - Thursday 5 June | Leeds - Thursday 18 September | Bromsgrove - Wednesday 26 November

For further information on the course please visit our *website*.

Funding update and PPF update seminars

TPR's *revised Code of Practice* on Scheme Funding is due to come into force in the Summer. Barnett Waddingham will be hosting a series of seminars in July to discuss the new code and other developments relating to funding DB pension schemes.

Amersham - Tuesday 8 July | London - Wednesday 9 July | Leeds - Thursday 10 July | Birmingham - Tuesday 15 July

The PPF's delayed switch of insolvency risk provider to Experian and levy management techniques will be on the agenda for Barnett Waddingham's PPF update seminars in June:

Bristol - Tuesday 10 June | Leeds - Wednesday 11 June | London - Thursday 12 June | Amersham - Tuesday 17 June
Birmingham - Wednesday 18 June

Further details on these seminars will be on our *website* shortly.

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:

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APRIL 2014
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