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Making the new pension flexibilities easier

April 2016

Introduction

Since 6 April 2015, individuals have had far greater choice about what they do with their defined contribution (DC) pension savings on retirement. This is a break from the past, and it will take some time for the full consequences to sink in. In the meantime, trustees and employers need to ensure they are up to speed.

9 steps to understanding the new pension flexibilities

1. Before 6 April 2015, most individuals used their DC pension savings to buy an annuity. Those who could demonstrate a certain level of pension income were able instead to draw down funds from their DC pots flexibly. But for the majority of DC savers, the amount they could draw down was capped, and the cap had to be reviewed regularly. Now new pension flexibilities apply to all DC pension savers, irrespective of their pension income, as long as they have reached normal minimum pension age (usually 55) or suffer from ill-health.

2. So what are the new flexible retirement options? DC savers now have access to "flexi-access drawdown" – a form of drawdown without restrictions, irrespective of the member's pension income. And, instead of entering drawdown or buying an annuity, DC savers have the option of cashing out some or all of their DC pot. The cash sum is known as an "uncrystallised funds pension lump sum".

3. Whether or not a particular scheme offers any of the new flexibilities will depend on what the trustees are willing and able to provide. If a scheme does not offer the desired retirement option, members may be able to exercise that option by first transferring out to another scheme.

4. Trustees need to adopt a policy on what retirement options should be made available to members on retirement. They should discuss with their scheme administrators and the sponsoring employers what is possible and at what cost. Many scheme administrators are unable to offer drawdown at all, and others may only be able to offer it at a cost and following a renegotiation of the scheme administration agreement. However, most occupational pension schemes are likely to wish to offer uncrystallised funds pension lump sums. This will require an appropriate policy to limit costs. For example, trustees could restrict these lump sums to just one per member per year, or decide that a lump sum would be paid only where members cash out their entire DC pot.

5. Trustees need to consider carefully how best to communicate retirement options to members. DC savers approaching retirement now have the right to free and impartial guidance from Pension Wise. Schemes must signpost members to that guidance and provide certain other information to members about their retirement options. From April 2016, trustees will need to provide risk warnings when members are looking to take flexible benefits.

6. Schemes must inform members when the new money purchase annual allowance is triggered. Once a member has triggered that allowance, a tax charge applies if the annual level of his future contributions to any DC arrangements exceeds £10k. An individual triggers the money purchase annual allowance when he receives certain benefits from his DC savings (such as a flexi-access drawdown payment or an uncrystallised funds pension lump sum).

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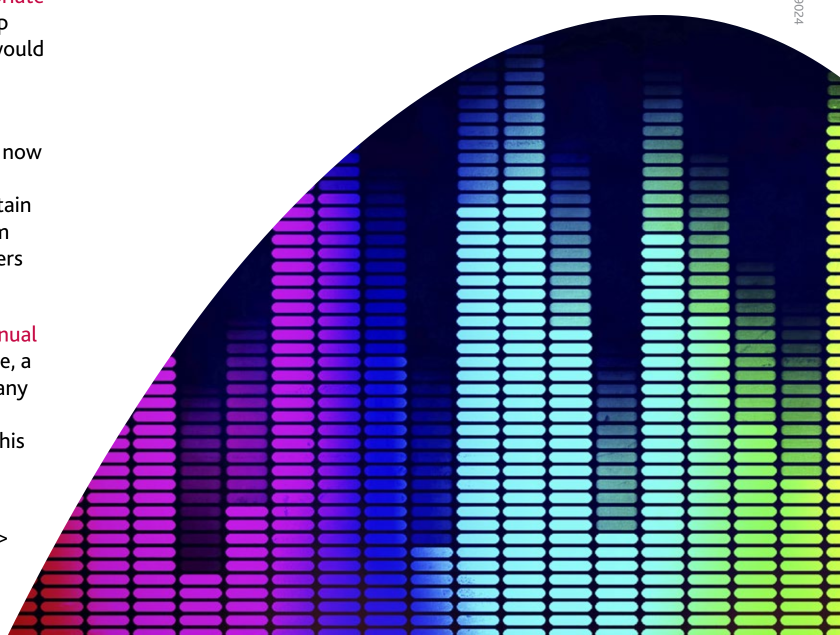
7. Members now have a statutory right to transfer funds from their DC scheme to another scheme provided that they have stopped contributing and have not yet started taking a pension or designated funds for drawdown. Previously, individuals with DC savings lost their statutory right to transfer once they were within a year of their normal pension age. Trustees need to ensure members are aware of their rights.

8. The government expects some DB members to transfer to a DC scheme to take advantage of the new DC flexibilities, but has recognised the risk of members being worse off as a result of the transfer. Consequently, it has introduced legislation requiring DB members to take advice from an independent financial adviser before a transfer to a DC scheme can be made (unless the transfer amount is under £30k). The employer must pay for the advice if the transfer is from a DB section to a DC section within the same scheme, or the transfer follows an employer-led incentive exercise. Guidance from the Pensions Regulator specifies, among other things, what trustees must do to check that a member has received appropriate independent advice, and when the check must be carried out.

9. The taxation of death benefits under DC arrangements has radically changed since 6 April 2015. If a DC saver dies under age 75, death benefits are now tax free. If he is 75 or over on death, pension benefits are taxed at the recipient's marginal rate, and lump sums are taxed at 45% (or the recipient's marginal rate from April 2016). An individual can now nominate anyone he chooses to inherit a drawdown fund or benefit from a joint lifetime annuity - previously only spouses, civil partners and dependants could receive these death benefits. Trustees will need to consider the impact on their scheme and communicate any new options to members.



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Further reading

The Pensions Regulator has produced an essential guide to communicating with members about pensions flexibilities

Pensions law can be tricky… but it doesn't have to be. These 'making it easier' guides explain key issues in simple terms, giving practical help to trustees and employers.

The series is growing; additional copies can be downloaded from www.pinsentmasons.com

Current topics include: Using advisers; Scheme changes and Becoming a trustee

Comments and ideas for further topics are welcome…

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