Pensions Talk, August 2014

New Options at Retirement Detailed

The draft Taxation of Pensions Bill has recently been issued which sets out the proposals for options at retirement available from next April. This article looks at the key points under this Bill and the potential impact of these.

Going forward, options for members at retirement will increase significantly. From April 2015, individuals with money purchase pots (which include Stakeholder Pensions, Group Personal Pensions and Defined Contribution Occupational Pensions) who are aged over 55 will have the following options available to them:

Flexi-access drawdown

The existing flexible and capped drawdown will effectively be replaced with a new “flexi-access drawdown”. This will allow individuals to draw up to 25% of their fund as tax free cash. The remainder will be invested in a drawdown arrangement from which an individual can take a taxable pension income as and when they wish.

Buy an annuity

As at present, individuals will be able to take 25% of the fund as a tax free cash lump sum and purchase a lifetime annuity with the remaining 75%. However, the rules around lifetime annuities will become more flexible, allowing annuities to reduce in payment as well as increase. At the moment an annuity can be guaranteed for up to ten years. In the event that the individual dies during this period, the pension instalments can continue for the remainder of the term. Going forward it will be possible to extend this guarantee period beyond ten years.

Unsecured Fund Pension Lump Sums

An individual will be able to make withdrawals from their money purchase pots as required. From each withdrawal made, 25% will be tax free with the remainder taxed as income. This will be known as Unsecured Fund Pension Lump Sums.

There is currently a 55% tax charge on death for crystallised funds which would be avoided for those using Unsecured Fund Pension Lump Sums. However, this tax charge is in any case under review with further announcements expected in the Autumn Statement.

Annual Allowance Restrictions

The new flexibility does however bring with it further restrictions to the Annual Allowance in some circumstances. At the moment, individuals can pay up to 100% of earnings into their pension subject to the Annual Allowance. This must include contributions paid into all pension arrangements the individual may have. The value of the employer pension contribution must also be included within the Annual Allowance. The Annual Allowance is currently £40,000 but it is possible to carry forward any unused relief from the previous three years. For the majority of people this allowance will remain unchanged however in some cases this may reduce down to £10,000. This will generally apply in the following circumstances:

- Anyone utilising an Unsecured Fund Pension Lump Sum will be subject to the £10,000 annual allowance
- Anyone utilising flexi-access income drawdown will be subject to the £10,000 Annual Allowance but only if they chose to draw an income from the fund. If they use flexi-access income drawdown solely to obtain the tax free cash they will not be subject to the same restrictions.
- Anyone purchasing a short term annuity will also be subject to the reduced Annual Allowance. A short term annuity is one that pays out for a limited period of time rather than paying out for life
- Anyone who is currently in a capped drawdown arrangement (under the old rules) will not be subject to the reduced Annual Allowance so long as their income withdrawals remain within the cap.
- Unlike the regular Annual Allowance, individuals will not be able to carry forward any unused relief for the reduced Annual Allowance from previous years.
- Any benefits accruing from Defined Benefit arrangements will remain subject to the regular Annual Allowance.
- Under current rules those using “flexible drawdown” are unable to pay anything further into a pension arrangement. Under the new rules this will now be possible but they will of course be restricted to the £10,000 limit.

The new rules bring about some significant improvements to the options available to individuals at retirement. Whilst the restrictions regarding the reduced Annual Allowance are there to stop abuse of the system and the tax relief available, these do add another layer of complexity to an already complex system.

Charge restrictions and Commission Ban

The Department of Work and Pensions has published its plans for imposing restrictions on the charges and the use of commission under workplace pension arrangements. The objectives are to ensure that the arrangements used to automatically enrol employees are good quality arrangements and to avoid high and unfair charges across the membership.

The new restrictions fall into three categories:

A cap on the charges

With effect from April 2015 there will be a cap on charges applicable to default funds used for automatic enrolment schemes. The cap will be 0.75% of the fund value per annum. At present stakeholder pensions are subject to a charge cap of 1.5% of the fund value per annum for the first ten years and 1% of the fund value per annum thereafter. Whilst personal pensions are not currently subject to the same charge cap, in practice charges tend to follow the same basis.

The charge cap will only apply to the default fund for automatic enrolment schemes. This means that employees will still be able invest in specialist and external funds which bear higher charges if they choose to do so.

Ban on commission

With effect from April 2016, there will be a ban on commission payable through any automatic enrolment schemes. There is already a ban on commission being paid from any new arrangements set up since 2012. This new restriction takes this a step further and effectively imposes a retrospective ban on commission, impacting on any automatic enrolment scheme, regardless of when the scheme itself was set up.

The commission ban will force many companies to either pay for pension consultancy and advice for perhaps the first time or else receive no advice or support at all.

Ban on the use of Active Member Discounts

With effect from April 2016 there will also be a ban on "Active Member Discounts" being used on an automatic enrolment scheme. "Active Member Discounts" are a method of providing a lower annual management charge for those who are contributing to the pension, which is in effect paid for by placing higher charges on those who are no longer paying into the pension. For example, someone who is an employee of the company and paying into the pension each month may benefit from a charge of 0.5% of the fund value per annum. Once they leave service (and therefore are no longer paying into the pension) the charges may increase to 1% of the fund value per annum.

From April 2016 onwards this will no longer be possible and the charges imposed on both active and inactive members must be equal.

We welcome the changes introduced. This is clearly good news for members of pension arrangements and will hopefully improve clarity and transparency in pension scheme charging.

Retirement “guidance” proposals clarified

In the March Budget, the Chancellor announced that free, face to face advice would be provided for everyone in order to help with the choices available at retirement. Within 24 hours, “advice” was quickly altered to “guidance” once it transpired that advice could not be delivered in such a manner. Details of this new “guidance” have now been published.

The guidance will come into force from April 2015 and will be delivered via a range of partners including The Pensions Advisory Service and the Money Advice Service. It will be paid for by a fee on regulated financial services firms.

The guidance will be delivered via a number of channels including web-based, phone-based and face-to-face sessions. However it is expected that all those reaching State Pension Age will be signposted to a telephone and online service and they will then be able to select which method they would like to use to obtain the guidance.

Although the basic details and delivery channels have been announced, how effective the new “guidance” service will be remains to be seen. With the plethora of new options available to individuals at retirement, the guidance will need to be concise and well delivered in order to avoid further confusion. The fact that only those reaching State Pension Age will be targeted also raises some concerns. Individuals can currently take benefits at any age from 55 (although due to increase in future) which is ten years before the current State Pension Age. It may well be that the new guidance reaches many people too late to be of use.

State Pension changes

A new State Pension system will take effect from April 2016. New rules regarding the increases applicable for those who defer taking their pension at their State Pension Age will also apply.

With effect from 6 April 2016, anyone reaching State Pension Age will be entitled to a new flat rate pension set at around £148 per week. In order to receive the full entitlement, individuals must have paid, or been credited with paying, National Insurance contributions for at least 35 years. No benefit will be payable unless an individual has paid, or been credited with paying, National Insurance contributions for at least ten years.

At present if someone chooses to defer taking their State Pension, the pension will be increased by 10.4% for each complete year they delay drawing the benefit. For anyone retiring after 6th April 2014, the rate will significantly reduce to a rate of approximately 5.8% for each year the pension is deferred.

In addition, a new system has also been announced that will allow existing pensioners and those reaching the State Pension Age before 6th April 2016 to top up their State Pensions by up to an additional £25 per week. This will be gained by paying Class 3A voluntary National Insurance Contributions. For a 65 year old an extra £1 of pension a week will cost £890, whereas for a 75 year old this will cost £674.

One Pension Consultancy LLP

Reading office

One Pension Consultancy LLP
Sunfield Business Park
New Mill Rd
Finchampstead
Berks
RG40 4QT

Tel: 0118 9734420

Southampton office

One Pension Consultancy LLP
2 Venture Rd
Chilworth
Southampton
Hants
SO16 7NP

Tel: 02380 762590

Birmingham office

One Pension Consultancy LLP
Lonsdale House
52 Blucher Street
Birmingham
B1 1QU

Tel: 0121 222 2300

London office

One Pension Consultancy LLP
1 Cornhill
London
EC3V 3ND