Consultation focus: What does retirement really mean?

For those with the good fortune to work in the pensions industry, consultations are nothing new. Indeed, we welcome the opportunity to comment on proposals for change before they are implemented. However, after the barrage of consultations over the last few months – including eight new Government consultations in December alone on matters related to pensions – it wouldn’t be surprising if some pensions professionals were to cry out ‘Stop, I want to get off…’ as the pensions world spins ever faster in a dizzying blur.

One of the reasons for the heady pace of developments over the last few months has been that the Government has been consulting on two fronts. First, it has been testing out some of the policies it inherited from the previous Government (such as the increase in the state pension age, automatic enrolment and restricting pensions tax relief) and making the changes to those policies that it felt appropriate. So, the increase in the state pension age to 66 has been accelerated to 2020 and the previous Government’s policy on pensions tax relief has been replaced with a simpler approach based on a reduced annual allowance. Meanwhile, it has been confirmed that auto-enrolment and NEST are to continue as planned, albeit with some minor shifts in direction.

Second, the Government has also been opening up consultations on its own new policies. Some of these policy developments had been expected from the Coalition Agreement (such as the reform of public sector pensions or the removal of annuitisation), but others have been brand new (and sometimes with the appearance of having been conjured out of thin air).

For example, the announcement of the proposed change in the inflation index used for statutory increases was both unexpected and, as has become clear from the disappointingly thin consultation on the implications for private sector schemes, not fully thought out. It is to be hoped that the same does not apply to the suggested policy to introduce a new state pension of £140 per week. Details on the latter are still sketchy and based solely on press reports, with the Green Paper promised for ‘late 2010’ yet to materialise.
Before the pensions merry-go-round starts up again, it seems an appropriate moment to look at three consultations which have the potential to change fundamentally the nature of pensions in the UK, between them challenging the three fixed ages we associate with retirement: 55, 65 and 75. Taken together, they ask the questions: “what do we mean by retirement?” and “what is a pension for?”. In a country where the DWP now estimates that over 10 million of us will live to 100, these questions are more relevant than ever.

**Early access**

The first of these consultations is a call for evidence on early access to pension funds before the current normal minimum pension age of 55. The Treasury indicates that it is considering four possible approaches:

- a loan model allowing individuals to borrow from their pension fund (and then repay the loan at a later date);
- a permanent withdrawal model, allowing individuals access to their funds in certain limited circumstances (such as hardship), with there being no requirement to repay the funds;
- early access to the tax-free lump sum (of up to 25% of scheme benefits); or
- a feeder-fund model, which would involve a more flexible savings product linking ISAs and pensions together into a single account.

The Treasury has an open mind on this issue and does not have one specific policy to recommend. The key argument in favour of early access is that it might encourage people to save more in a pension, because they know that they can still access those savings before retirement. In addition, there may be cases where individuals are faced with an immediate demand for money, such as a home repossession, for whom early access to pension savings would be very welcome. However, as the call for evidence notes, the data on early access is very limited: how many people faced with repossession actually have significant pension assets that they could use to save their home?

The consultation also indicates that the Government is planning to reconsider the trivial commutation rules, perhaps by introducing further flexibility for small personal pension pots or by making it easier for individuals to transfer small funds between pension schemes.

**Abolishing the default retirement age**

At present, employers can force their employees to retire, simply because they have reached age 65. The Department for Business, Innovation and Skills recently consulted on abolishing the default retirement age with effect from 6 April 2011 (although notifications of compulsory retirement made before that date will continue to be valid so long as the retirement happens before 1 October 2011).

This should not make too much difference to pension schemes. The existing exemptions from age discrimination legislation for many features of pension scheme design have recently been re-enacted under the Equality Act 2010 without any change and will continue to operate. So, for example, pension schemes will continue to be able to have a normal pension age of 65 for the calculation of scheme benefits even when the default retirement age is removed.
However, pension schemes are likely to see more individuals opting to work beyond age 65 and employers may therefore need to consider what pension and insured benefits to provide to employees working beyond that age. They may also need to reconsider whether the late retirement provisions in their scheme are still appropriate.

**Removing the requirement to purchase an annuity**

The third key pension age in the firing line is age 75. Until recently, individuals in a defined contribution scheme were effectively forced to purchase an annuity before age 75. The Government recently consulted on removing this requirement and its detailed proposals are contained in draft Finance Bill clauses published in December. With effect from 6 April 2011:

- There will be no requirement to annuitise funds at age 75.
- Income withdrawal (‘drawdown’) will be capped at 100% of an equivalent annuity determined by reference to standard tables and will be available at all ages, including after age 75.
- Individuals with a lifetime pension income of at least £20,000 (gross) a year will be able to withdraw their funds without any limit on the annual withdrawal under what will be called ‘flexible drawdown’. This lifetime pension income can include state pensions as well as any private pensions in payment.
- The age 75 limit on taking the tax-free pension commencement lump sum will be removed.
- Where individuals die after age 75, there will be a 55% tax charge on any lump sum death benefits.
- Inheritance tax will not generally apply to drawdown funds, whether the individual dies before or after age 75.

Defined contribution schemes which already have income drawdown options in place are likely to be most significantly affected and will have to decide whether they wish to offer the new ‘flexible drawdown’.

**Time to slow down?**

It feels as if just about every aspect of pensions policy has been thrown into the melting pot over the last few months. However, the consultation roundabout looks set to continue until well into the New Year, with the Green Paper on the state pension expected imminently. As well as setting out the Government’s policy for state pensions, this is likely to have implications for contracted-out defined benefit schemes in both the public and private sectors – if the state second pension is to be combined with the basic state pension to create the £140 per week pension, what will happen to contracting out from the state second pension? And, perhaps more significantly, what happens to contracted-out benefits that have already built up?

Two major Bills are expected too – most of the clauses for the Finance Bill 2011 have already appeared in draft, but the Pensions and Savings Bill (due in January) could well contain a few surprises (as well as the anticipated legislation on state pension ages, the proposed changes on automatic enrolment and some consequential amendments implementing the switch to CPI). We are also awaiting the publication of the final Hutton Report with its recommendations for the long-term future of public sector pensions.

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**Behind the scenes**

Liz is Head of Actuarial Tools. She also advises trustees in her role as Scheme Actuary and provides actuarial advice to corporate clients.

Liz uses her experience of client needs to provide strategic direction to a team involving around 20 staff developing actuarial tools. These are both for use by actuaries when advising clients and for use by clients (or members) directly via the internet. The tools use clear graphics designed to assist clients in understanding various pension issues, especially funding risk.

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“Clients have found Punter Southall Impact, our tool for understanding the effect of changing funding assumptions, especially helpful for making quick progress through the triennial valuation process. Punter Southall Pulse, our internet tool for monitoring the ongoing funding position of a pension scheme on a daily basis, then enables clients to take appropriate action between valuations in response to a changing funding position.”

Liz Rye
Other recent developments

Payments to employers
As we have highlighted in previous Pensions Bulletins, section 251 of the Pensions Act 2004 appears to require trustees to make a resolution before 6 April 2011 in order to retain the power to make any future payments to an employer. The Department for Work and Pensions (DWP) has now indicated that it intends to extend the deadline for doing this by five years and also to clarify that the scope of this section is much more limited than had been feared. The amending legislation has not yet been published, so it remains to be seen whether it will achieve what the DWP intends.

Abolition of DC contracting out
There was alarm earlier this year when it became apparent that transfers from contracted-out defined benefit (DB) schemes to defined contribution (DC) schemes would no longer be possible after April 2012 (when DC contracting out is abolished). Effectively, this would have left individuals tied to their DB schemes – and unable to access any of the new flexible drawdown arrangements. The Government has thankfully seen sense, and we are now expecting legislation in the New Year to allow members in contracted-out DB schemes to continue to be able to transfer to DC schemes after 2012.

Pension protection levy consultations
The PPF has now confirmed its proposals for the 2011/12 pension protection levy. As proposed, it aims to collect £600 million (reduced from £720 million for 2010/11, mainly because of the switch in inflation index from RPI to CPI). The scaling factor for the risk-based levy will be 2.07 and the multiplier for the scheme-based levy 0.000135.

The PPF’s other recent consultation on its plans for the longer term development of the levy framework (including an allowance for the riskiness of a scheme’s investment strategy) has recently closed.

Disclosure requirements
Under regulations which came into force on 1 December 2010, pension schemes will now be able to provide information to members electronically either by email or on a website. In order to do this, pension schemes must tell existing members that they intend to provide future communications electronically and members must have the opportunity to opt for written communications if they prefer.

Electronic communications must be in a format that can be either stored or printed and must be accessible to disabled members. Where information is provided on a website, individuals must be told when new information has been added.

New guidance from the Pensions Regulator
The Pensions Regulator has now produced final versions of its guidance on monitoring employer support, withdrawing from multi-employer schemes and incentive exercises. There are no significant changes in emphasis from the draft versions discussed in our last Pensions Bulletin.

The Regulator has also published a statement on employer-related investments, which covers the fact that employer-related investments via a Collective Investment Scheme are no longer exempt from the 5% self-investment rule and also deals with the more innovative funding mechanisms (including some limited partnership structures) that are being employed to fund DB schemes.

New data on pension schemes
The Pensions Regulator has recently published the Purple Book (jointly with the PPF) and DC Trust, which provide useful sources of data on DB and DC schemes respectively. The Regulator has also produced an analysis of recovery plans submitted to it over the last year.

Draft guidance on default DC funds
The Department for Work and Pensions is consulting on draft guidance on the design of default options in DC pensions used for automatic enrolment. This sets out the standards which should be met when governing, designing, reviewing and communicating the default option.

Levy freezes
The Government has confirmed that the PPF Administration Levy and the General Levy (which pays for the Pensions Regulator and Pensions Ombudsman) will be frozen again for the 2011/12 year. The FRC has also indicated that its pensions levy (which pays for the regulation of pension scheme actuaries) is not expected to increase in 2011/12.
Pensions briefing note round-up

Here are details of the pensions briefing notes we have published over the last quarter. If you have missed any, all our briefing notes can be found on our website: www.puntersouthall.com/briefing-notes

**Pensions briefing notes:**

**Government consults on CPI switch**

An overview of the Government’s consultation on the implications of the CPI switch for private sector schemes, which does not propose to introduce modification powers to allow schemes with RPI specified in their rules to make the change to CPI with retrospective effect.

**Making automatic enrolment work**

An update on the recommendations made by an independent panel of reviewers into the automatic enrolment regime, which included a raising of the income threshold before employees need to be automatically enrolled and a simple certification mechanism for defined contribution schemes.

**The pension protection levy: a new framework**

An overview of the PPF’s proposals for a wide-ranging overhaul of the pension protection levy framework which is intended to provide greater stability in the levy faced by pension schemes.

**2011/12 pension protection levy consultation**

A summary of the PPF’s proposals for the 2011/12 pension protection levy, including the setting of the total levy to be collected at £600 million and the scaling factor at 2.07 (both of which have now been confirmed).

**EC pensions green paper**

A briefing note summarising the European Commission’s views on the priorities for future pensions policy across Europe, in particular the possible introduction of a solvency regime for pension schemes.

**Hutton review of public sector pensions**

An analysis of the interim report of the Independent Public Service Pensions Commission, which concluded that the case for reform was clear, and that changes to public sector pensions would be needed both in the short and longer terms.

**High earners & contributors survival guides:**

**5: More detail on the tax changes emerges**

A review of some of the developments on the tax changes since 14 October, including the publication of draft Finance Bill clauses, which provide more detail on the operation of the reduced lifetime allowance, and the consultation on mechanisms for pension scheme benefits to be used to meet members’ tax liabilities.

**4: Annual allowance approach confirmed**

An update summarising the 14 October announcement that the Government intends to proceed with a £50,000 annual allowance and a £1.5 million lifetime allowance.

**Punter Southall Investment Consulting briefing notes:**

**Changes to self-investment regulations**

An update on changes to the self-investment regulations, in particular the fact that employer-related investment through a Collective Investment Scheme is no longer exempt from the 5% self-investment rule.

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**Where can I get further information?**

To discuss any of the issues covered in this edition, please get in touch with Jane Beverley on 020 7839 8600 or by email to jane.beverley@puntersouthall.com or your usual Punter Southall contact.

www.puntersouthall.com

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Dates for your diary

Key dates (January – April 2011):

7 January  Closing date for consultation on 'scheme pays'
January  Draft regulations on annual allowance information requirements
          Publication of Pensions and Savings Bill
9 February  Closing date for consultation on draft Finance Bill clauses
25 February  Closing date for consultation on early access to pension savings
2 March  Closing date for consultation on CPI switch
7 March  Closing date for consultation on default funds for defined contribution schemes
23 March  Budget
31 March  Publication of Finance Bill 2011
          Deadline for (re)certification of contingent assets for 2011/12 pension protection levy
1 April  Technical Actuarial Standards on Pensions and Modelling in force
5 April  End of transitional period for A-Day modification regulations
6 April  Annual allowance reduced to £50,000
          Default retirement age abolished
          Requirement to purchase an annuity at age 75 abolished
7 April  Deadline for certification of deficit reduction contributions for 2011/12 pension protection levy

Events:

• Employer Masterclass
  Getting ready for your next pension scheme valuation
  • 20 January, London
  • 5 April, London
  • 20 September, London
  • 27 January, Birmingham
  • 7 April, Birmingham

• Pension Trustee Breakfast Seminar
  • 25 January, London

• High Earners & Contributors Power Hour
  • 23 February, London

• Investment Conference
  • 1 March, London

• Auto-enrolment: in action or inaction?
  • 15 March, London & Aberdeen
  • 17 March, Edinburgh & Birmingham
  • 23 March, Cardiff
  • 24 March, Bristol

• Surrey Pensions Conference
  • 30 March, Guildford

• London Pensions Conference
  • 6 October, London

Trustee training:
A full range of courses available throughout the year for trustees, ranging from courses for newly appointed trustees to courses for experienced chairmen of trustees.

Event booking:
To find out the latest dates for all our events or to enquire about other locations throughout the UK, please contact Jenny Gallagher:
Tel: 0118 977 2277
Email: events@puntersouthall.com

Find out more at www.puntersouthall.com