Budget 2014—Pension Reform

The Government proposes to reform the rules that affect how and when benefits are withdrawn from defined contribution (DC) pension schemes. The changes may have repercussions for defined benefit (DB) schemes.

Immediate Changes
With effect from 27 March 2014:

- the minimum income requirement for flexible drawdown will drop from £20,000 to £12,000 per annum;
- the capped drawdown limit will increase from 120 per cent of the 'basis amount' (an estimate of the annuity that the member could purchase) to 150 per cent of that amount;
- the £18,000 'trivial commutation lump sum' limit will increase to £30,000; and
- the £2,000 limit on the various other 'small lump sums' that can be paid without considering registered pension scheme rights in their entirety will increase to £10,000, and it will be possible to take such payments from up to three (rather than two) personal pension arrangements.

April 2015
The preceding list of changes is a prelude to more fundamental reform, which will take effect in April 2015. The proposals include:

- complete removal of the caps and limits on income withdrawal;
- obliging DC scheme trustees and providers to offer a guarantee of free, impartial, face-to-face guidance about retirement choices; and
- allowing lump sum withdrawals at retirement in excess of the usual 25 per cent tax-free lump sum, subject only to tax at the member's marginal rate (i.e. replacing the unauthorized payments charge, unauthorized payments surcharge, and scheme sanction charge combination that would currently apply).

Payment of trivial commutation and the other small lump sums will be possible from 'normal minimum pension age' (NMPA), which is generally the earliest age at which benefits can be taken in circumstances other than ill health (currently, those lump sums cannot be paid prior to age 60). However, the Government also proposes to increase the NMPA, to take account of scheduled increases in State pensionable age (SPA). This could mean that NMPA will be age 57 with effect from 2028, maintaining a ten-year gap between it and SPA thereafter, but the Government is considering other options, such as closing the gap to five years. We assume this will also apply to the LGPS but this has still to be confirmed.


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Defined Benefit Schemes
The proposed reforms will have implications for DB schemes. The Government proposes to prevent transfers from public sector DB schemes to DC schemes in most circumstances (DB-to-DB transfers, including those under the Public Sector Transfer Club, will be unaffected by this Budget). Funded public sector schemes such as the LGPS may be subject to a similar ban, in the interests of fairness and consistency, but the decision could be influenced by the treatment of private sector schemes. The Government says that it may permit DB-to-DC transfers from private sector DB schemes if the risks and issues around doing so can be shown to be manageable. There is also likely to be no requirement to use money purchase AVCs to buy an annuity if tax-free cash limits are exceeded, as they may in future be used to increase cash at retirement (although in practice most currently get taken as cash anyway).

Pension Liberation
Her Majesty’s Revenue and Customs (HMRC) is being given new powers to tackle pension liberation. From 28 March 2014:
- the main purpose of a registered pension scheme must be provision of authorized payments;
- HMRC will have extensive information-gathering powers to support registration investigations;
- surrender of pension rights to facilitate payment of surplus to the employer will be an unauthorized payment; and
- surrender of rights in favour of dependants will be unauthorized unless the resulting dependants’ benefits are created within the same pension scheme.

From 1 September 2014:
- the scheme administrator—in Finance Act lingo this generally means the trustees—must be a fit and proper person; and
- if the Pensions Regulator or court order reverses a liberation transfer, the member and scheme administrator of the transferring registered pension scheme will be able to claim relief from unauthorized payment charges.

Conclusions
The government’s preferred approach is to treat all public service schemes equally. However, to be consistent, the impact on the funded LGPS of the April 2015 reforms could be more influenced by the approach adopted for non-public sector defined benefit schemes. Despite having reservations about extending these freedoms to members of defined benefit schemes generally, the government is still open to leaving the existing flexibilities in place. For the LGPS this would mean the continuation of CETVs from the LGPS to DC schemes. This is not all a done deal yet as it is still subject to consultation but the direction of travel is clear.

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For more information, see Combating Pension Liberation—Changes to Finance Act 2004

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APPENDIX 12
(continued)