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Legal Update
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DC pensions flexibility: Government consultation response published

In the 2014 Budget, the Government announced what it called "the most fundamental reform to the way people access their pensions in almost a century". The most significant change announced was that, from April 2015, members with money purchase or cash balance rights (here called **"DC members"** for short) would be able to draw down all their benefits as cash from age 55.

The Government consulted on a number of related questions and has now published its response. It will not stop DB to DC transfers in the private sector so the new DC flexibilities will be available indirectly to all. A relatively low level of transfers is expected, but schemes will be able to use the protections in existing law to reduce transfers if there is a "run on the scheme".

Background: the 2014 Budget announcements and consultation

The 2014 Budget announced that the restrictions on drawdown of pension benefits would be removed, so as to let DC members draw down all their benefits as cash from age 55 and effectively removing the requirement to annuitise. The current tax-free cash would continue to be available and members would pay tax on amounts drawn down above the tax-free cash limit as extra income, even where they withdrew all their benefits. (Currently a 55% tax charge applies if a member does this.)

In addition, it announced that all DC members – whether of contract or trust-based schemes – were to be offered free and impartial face-to-face guidance at the point of retirement (the "guidance guarantee").

The Government consulted on a number of questions relating to these announcements, including:

- whether a statutory override should be put in place to ensure that scheme rules did not prevent individuals from taking advantage of the new flexibilities (for example, where scheme rules require annuitisation of funds above the tax-free cash limit);
- whether differing approaches to the "guidance guarantee" should be taken for contract and trust-based schemes, and whether the guidance needed to be provided by an independent third party;
- whether transfers from private sector DB schemes to DC arrangements should be banned (they were to be banned from public service schemes); and
- whether the earliest age at which individuals can take their pension benefits without incurring tax penalties (i.e. normal minimum pension age) should increase to 57 by 2028 (with a phased transition before then) and then rise in line with the state pension age so that it was always 10 years below state pension age.

The Government has reached the following conclusions on these points.

Offering the new DC flexibilities

The Government has decided that new legislation will ensure that all schemes providing money purchase or cash balance benefits are able to offer the new flexibilities, but are not required to do so. There will be a statutory power to allow schemes to offer all or any of the new flexibilities without needing to amend their scheme rules. We assume the power will apply to DC sections in hybrid schemes.

In addition, the transfer legislation will be changed to allow members to transfer from one DC scheme to another up to the point of retirement. Currently the statutory transfer right generally only applies until one year prior to the scheme's normal retirement age. The Government has said that transfers will not be permitted once a pension is in payment.

The "guidance guarantee"

The guidance will be provided by independent organisations to ensure that there are no potential or actual conflicts of interest, with delivery partners including The Pensions Advisory Service (**"TPAS"**) and the Money Advice Service (**"MAS"**). The FCA will be given statutory responsibility for setting standards for the guidance and for monitoring compliance with those standards. The guidance service will be funded via a levy on FCA-regulated financial services firms.

The guidance will be available through a number of different channels, and "face to face" guidance will not be required, as long as it is offered. Individuals will be able to choose the channel, or mix of channels, that they find most convenient. The guidance will be tailored to individuals' personal circumstances, but will not recommend specific products or providers. Pension providers and trustees will have a statutory duty to make members aware of their right to impartial guidance and to direct them towards the guidance service as they approach retirement.

The distinction between "guidance" and "advice" may not be self-evident to members and there is a lot of work to be done to establish industry consensus on what should be said. Using TPAS and the MAS for delivery on a mass scale should help to streamline and standardise the process.

DB to DC transfers

Transfers from private sector DB schemes to DC schemes will not be banned. However, members who wish to transfer from a private sector DB scheme to a DC scheme will be required to obtain independent financial advice from an FCA-authorised financial adviser before doing so. In this context, it is generally the member who will be required to pay for the advice. However, if the transfer is to a DC section within the same scheme or is part of an employer-led incentive exercise, the employer will have to pay for the advice. Further work will be required to define what constitutes "employer-led", especially as the options will have to be publicised to members.

In addition, the Government will produce guidance to ensure that trustees of DB schemes are aware of their powers to delay transfer payments where the scheme is at risk, and to reduce transfer values to reflect scheme underfunding.

The Government also plans to consult on allowing direct withdrawal of benefits in lump sum form from DB schemes. Given all the other initiatives, it may be unlikely that this exercise will be of sufficient priority to be completed during this Parliament.

Transfers from unfunded public service DB schemes to DC schemes will be banned. However, transfers from funded public service DB schemes (e.g. the Local Government Pension Scheme) to DC schemes will be permitted, subject to similar safeguards as will apply to transfers from private sector DB schemes.

Consultation response: other aspects

Normal minimum pension age will rise from 55 to 57 in 2028 and will then be pegged to 10 years below state pension age. The Government is giving further consideration to the nature and extent of any protection to be given to individuals who have built up benefits with a right to a normal minimum pension age earlier than that. Subject to the result of next year's General Election, the Government will legislate for this change in the next Parliament. A Government of any political persuasion would be perhaps likely to carry this change forward.

The small pots and trivial commutation rules will continue to apply to DB schemes, but the age at which benefits can be commuted using those rules will be reduced from 60 to 55.

Lastly, the Government has concluded that it should reduce the current 55% tax charge on funds held in drawdown products at death or uncrystallised after age 75. However, it notes that this is a complex area, and has therefore decided to consider the implications further with a view to confirming its intentions in the Autumn Statement later this year.

Comment

The announcements in the 2014 Budget on DC flexibility represented a fundamental change in the Government's approach to private pension saving, and raised concerns throughout the pensions industry about the potential implications both in terms of cost and in terms of whether individuals would make the right choices when given absolute freedom in how they access their DC benefits. The Government's consultation response goes a significant way towards allaying some of those concerns.

Trustees of DC schemes will welcome the fact that schemes will not be required to offer members the new flexibilities (and incur the attendant costs), but will have an option to do without having to amend their rules first. Employers of DC schemes will be glad that the cost of the "guidance guarantee" is to be met through a levy on regulated financial services firms rather than by employers. Both trustees and employers of DB schemes are also likely to welcome the decision to continue to allow transfers to DC schemes, though it remains to be seen whether significant numbers of members will choose to transfer out, and employers will want to be clear about what constitutes an employer-led exercise. As for the guidance guarantee itself, only time will tell whether it achieves its aim of ensuring that members make informed, and as far as possible the right, choices.

The Government intends to legislate this autumn to introduce the new DC flexibilities, and the Pension Schemes Bill that is currently before Parliament will be amended to include provision for the guidance guarantee. Exactly how the statutory override enabling DC schemes to offer the new flexibilities will work will be clarified when the relevant legislation is published. In the meantime, however, trustees and employers of DC schemes will need to think about what options they will offer members at retirement.

If you have any questions about this update, please get in touch with your usual Mayer Brown contact or:

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