Institute
and Faculty
of Actuaries

Interactive Legal Update

Ian D'Costa (Sacker & Partners LLP)

19 June 2014

Institute
and Faculty
of Actuaries

Implications of the Budget

Thought leadership Progress Community Sessional Meetings Education Working parties Volunteering Research Shaping the future Networking Professional support Enterprise and risk Learned society Opportunity International profile Journals

10 June 2014

Institute and Faculty of Actuaries

Agenda

- Background
- What's new
- What's next?

ertise onsorship Thought leadership Progress Community Sessional Meetings Education Working parties Volunteering Research Shaping the future Networking Professional support Enterprise and risk Learned society Opportunity International profile Journals Suppor

The Budget 2014

- Delivered on 19 March 2014
- Provided a number of reforms to the tax regime
- A focus on DC flexibility

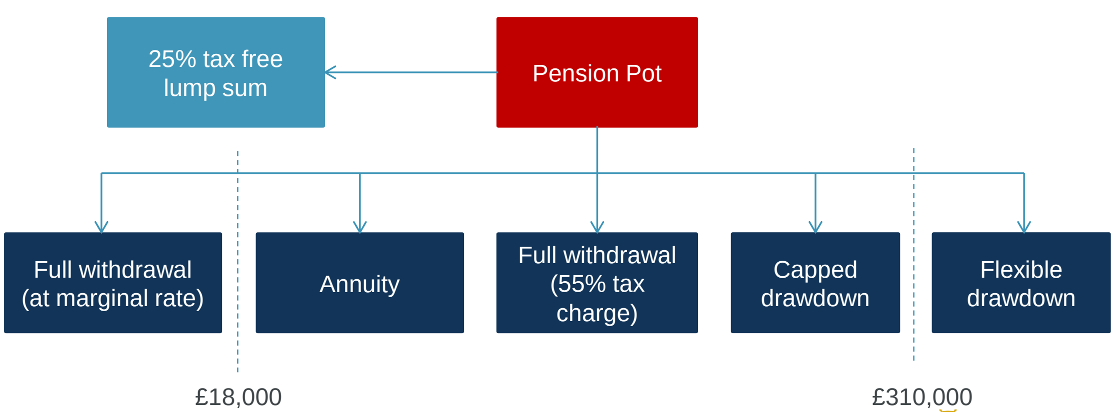
Institute and Faculty of Actuaries

A bit of background

- There has been an increased focus on saving and on sustainable pension provision
  - Auto-enrolment
  - Simplification of the state pension
- Defined benefit schemes have been in decline
- There has been a significant amount of debate as to whether defined contribution schemes are suitable
  - Office of Fair Trading market study on DC workplace pensions (September 2013)
  - DWP consultation “Re-shaping workplace pensions for future generations” (November 2013)
- The debate in relation to DC falls into
  - The accumulation phase – where does the risk lie and can adequate savings be made
  - The decumulation phase – how can the savings that members have built up be accessed
- Pensions liberation
  - Many of the changes go some way to addressing the perceived attractiveness of liberation

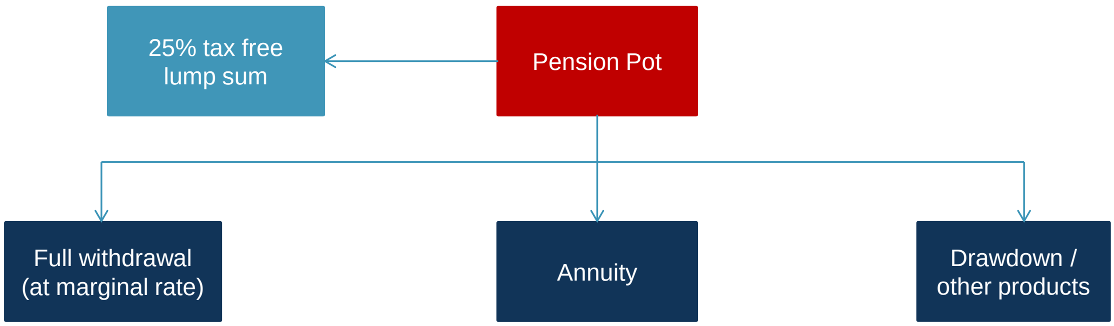
Institute and Faculty of Actuaries

The “old regime”



Institute and Faculty of Actuaries

The "new regime"



Institute and Faculty of Actuaries

When do the changes take effect?

- The fully flexible package of reforms will come into effect in April 2015
- In the meantime, a number of measures will come into effect from 27 March 2014. These include:
  - increasing the amount which can be taken as a lump sum under the general rules on "trivial commutation", from £18,000 to £30,000
  - the more attractive drawdown limits
  - a fivefold increase in the size of a single small pension pot that can be taken as a lump sum at age 60, from £2,000 to £10,000
  - in addition, increasing the total number of personal pension pots that can be taken as lump sums from two to three
- The tax changes were passed as budget resolutions and hence they had effect before the Finance Bill 2014 had received Royal Assent

Institute and Faculty of Actuaries

What effect has this had?

- Is DC now a more attractive option than DB?
- Is there going to be a sudden increase in transfers from DB schemes to DC schemes?
- The DWP consultation “Freedom and choice in pensions” closed on 11 June 2014
  - Remove the right to transfer from DB to DC
  - Cap the amount that can be transferred from DB to DC
    - Andrew Vaughan (former chair of the ACA) thinks that the right to transfer should remain (23 May 2014)
  - Allow flexibility “but only if it is clear that this would not create significant risks for the UK economy”

Annuities going forward

- The Budget has introduced uncertainties for the annuities market going forward
- Market reaction was to wipe approximately £6 billion off the value of insurers
- Since the Budget announcements annuity sales have halved (FT, 15 May 2014)
- There are also concerns that the financial markets could be affected by a decline in annuities
  - Annuity writers are heavy investors in gilts, corporate bonds and infrastructure, so a decline in annuities could lead to a decline in those investments
  - UK Debt Management Office (DMO) chief executive Robert Stheeman has commented that there is unlikely to be rapid fall-off for demand of gilts (23 May 2014)
  - A shift of focus from individual annuities to bulk annuities?

Annuities going forward

- The FCA published its "Thematic Review of the Annuities" in February 2014
  - This found that the annuities market is not working from a consumer perspective
  - The majority of consumers who purchased an annuity from their existing pension provider could have obtained a better rate if they had shopped around
  - Compulsory annuitisation is not working to the member's advantage
  - Huw Evans, director of policy of the ABI, has commented that the Review will need to be revisited because of the changes in the Budget (27 March 2014)
  - Members with smaller pension pots or lower life expectancy could be more likely to cash in their pension savings for lump sums than those with larger pots and longer life expectancy
- The market for annuities is likely to remain active, but will more variety need to be offered in order to attract pensioners?

Annuities going forward

- What could be offered?
  - Variable annuity products: guaranteed minimum benefit products, underwritten by an insurer, which allow investors access to their capital and also a level of guaranteed income.
  - With profits retirement policies: will new with profits products, which provide a guaranteed income stream, emerge?
  - Transfer of longevity risk: transferring longevity risk from individuals to insurers who can pool longevity risk. Such pooling will help to balance the savings of those individuals who die earlier than expected with those who outlive the average life expectancy.
  - Asset backed / index linked annuities: the attractiveness of asset backed annuities and index linked annuities could be increased if they were to offer more flexible drawdown options and the option to switch underlying investments.

Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

Institute and Faculty of Actuaries