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# Finance Act 2004

## Looking after the ordinary member

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# Agenda

- Overview
- New design opportunities
- Administration implications
- What are others doing
- What's next?



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# Overview

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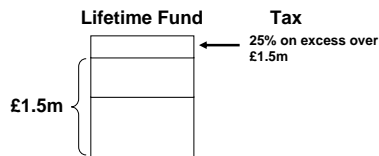
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## The new regime



- Tax sheltered allowance increases to £1.8m in 2010
- DB schemes - value £1 p.a. pension as £20
- Tax free lump sum - 25% fund value
- Full concurrency

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## Who is affected?

2005

<b>Top 1%</b> -arbitrary rules -anomalies -complex
<b>The 99%</b> -arbitrary rules -complex -anomalies

2006

<b>Top 1%</b> -limited tax relief -consistency -complex -many "winners"
<b>The 99%</b> - simple - flexible - no limits

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## The lucky 1%

- A £1,000 gross contribution has received:
  - £400 of income tax relief
  - £128 of employer NI relief
  - £10 of employee NI relief
  - Or a total of £538 tax and NI relief
- That £1,000 attracts a £550 tax charge when paid, £12 more than the tax and NI relief

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## New design opportunities

### Occupational pension schemes

## Design opportunities

- Removal of limits
- Flexible retirement
- Death benefits
- Contributions
- Tax free cash
- Trivial commutation
- Other changes

## Removal of limits

- Scheme specific earnings cap
- Old-style Inland Revenue limits
  - e.g. fixed 5% increases, 40 year limit
  - lift limits – past and future?
- Impact on contracts of employment
  - company issue but trustee implications
- Changes to be implemented by April 2011
  - but better to take action now

## Flexible retirement

- Work and draw pension at the same time
- Facilitate phased retirement
- Fragmentation
  - allow two or more pension segments
- Drawdown
  - allow through open market option?
- Phasing in retirement from age 55

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## Flexible retirement – an example

- Member reduces to 2½ days a week from age 60
- From age 60, he chooses to take half of his pension
- From age 65, additional pension of £4,375 pa payable
- Total pension from age 65 is therefore £7,175 pa

Benefit Statement			
How much will I get on retirement:			
(£ pa)	at 60	at 65	
Earned to date:	2,800	3,500	
	<del>5,600</del>	<del>7,000</del>	
Earned in future:	n/a	1,750	875
Total:	<del>5,600</del>	<del>8,750</del>	<del>7,875</del>
	2,800		4,375
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## Death benefits – before retirement

- Tax free lump sum of up to lifetime allowance
- Unlimited spouse's pension
- So choice between tax free cash or taxed pension
  - but tax free cash will generate taxable income
- Will schemes offer voluntary life cover?
- When is a DC benefit DB for LPI purposes?

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## Death benefits – after retirement

- Continued pension for up to 10 years
  - Tax free lump sum of up to unused lifetime allowance
  - Initial value of pension less pension instalments, less 35% tax
  - A dependant's pension up to level of member's pension
  - A funeral grant for pre-2006 pensioners
- Is typical 5 year guarantee still appropriate?

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## Contributions

- £215,000 tax sheltered contributions
- No limit in year before retirement
- Increased contribution flexibility
  - will members defer contributions to end of career?
- How do you facilitate contribution flexibility?
  - Do AVCs still have a place?
  - Should DC arrangements be merged?

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## Tax free cash

- Allow new maximum – 25% of taxable value?
  - large increase for most members
  - will members commute sensibly?
- Move to tax free cash plus (lower) pension?
- New maximum worse for some
  - early retirements
  - where tax free cash based on PAYE earnings

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Tax free cash

*That's not so hard*  
$$\frac{20^* \text{ pension}}{(3+20) \text{ CF}}$$

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## Commutation factors

- Cash commutation factors
  - typically penal
  - pressure to increase to closer to market related
  - much depends on Trust Deed
- Can we really justify maintaining current factors?

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## Tax Free Cash and AVCs

- 25% tax free cash available from each "arrangement"
- Can treat AVCs and main scheme as one arrangement (but care needed here)
- So, it will be possible to commute AVCs in full, hence
  - less scheme cash
  - increased cost to scheme, if poor value commutation factors

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## Trivial commutation

- Increased to 1% of lifetime allowance . . .
- . . . but test covers all registered pensions
- . . . and all benefits must be commuted within 12 months between ages 60 and 75
- Administrators need to be pro-active to avoid getting left with trivial benefits
- Retaining some trivial benefits is inevitable

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## Other changes

- LPI capped at 2½%
- Vesting after 3 months' service
- End of compulsory retirement

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## Administration implications

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## Dealing with the authorities

- Mandatory online reporting
- Scheme Registration for tax relief
- Annual event report of key relevant events
- Occasional request via pension scheme return
- Risk based assessment of schemes will dictate compliance approach

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## Dealing with members

- Recording primary/enhanced protection
- Reporting taxable value of benefits taken
- Testing against life time allowance
- Administering the recovery charge
- Explaining the new rules
- . . . and implementing and plan design changes

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What are others doing?

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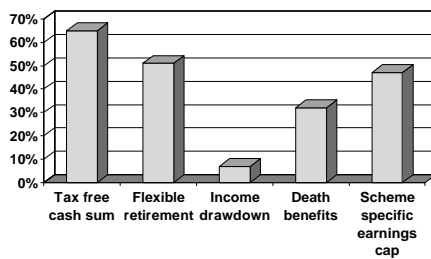


## What are others doing?

- Not very much
- Over 60% of FTSE350 companies are yet to form a preliminary view on plan design
  - Watson Wyatt, May 2005
- Over 60% of largest 100 pension schemes are still at the planning stage, although almost a third have made substantial progress
  - Hymans Robertson, March 2005

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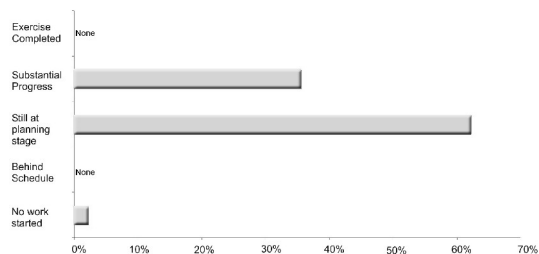
## What are others doing?



Source: Hewitt Bacon & Woodrow, 2004


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## State of readiness



Source: Hymans Robertson, March 2005

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What's next?

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What next?

- How do we engage our clients?
- Are we making things too complicated?
- Is there really very much to do?
- What are you doing with your clients?

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