

The New DC flexibilities: Issues for DC Schemes

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Agenda

PAST

- Budget 2014 and enacted legislation
- 2015 further tweaks
- Introducing the flexible DC landscape

PRESENT

- Benefit design and implementation: options spectrum
- Legal process/ documentation

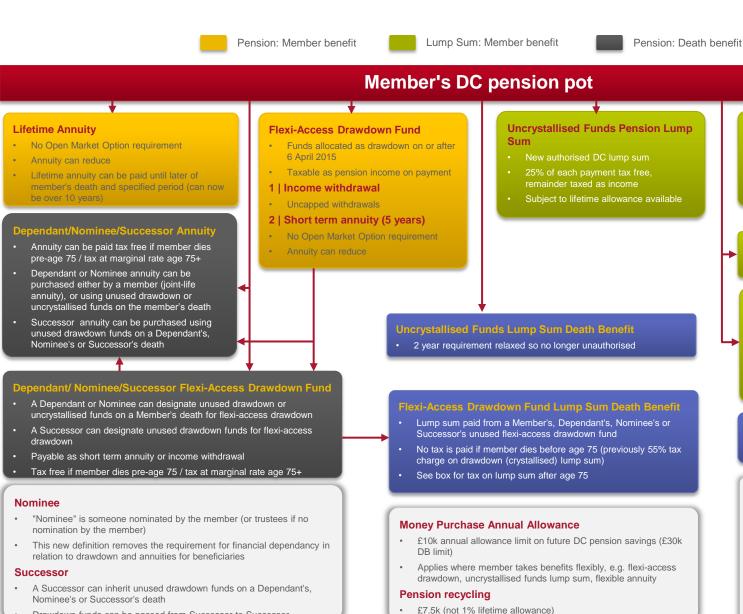
FUTURE

- Full drawdown in occupational schemes?
- Resolving legal uncertainties?

2014 - 2015

DC Tax Changes

Drawdown funds can be passed from Successor to Successor



Pension commencement lump sum

Lump sum: Death benefit

- Payable in connection with lifetime annuity or designating funds for drawdown
- Payable tax free subject to available lifetime allowance

Small Pot (£10k) Lump Sum

• Eligibility reduced from age 60 to 55

Trivial Commutation Lump Sum

- · Only payable for DB benefits
- Payment must extinguish DB benefits only
- Reduced from age 60 to 55
- No change to £30k calculation (both DB and DC)

Winding up lump sum death benefit

Abolished

Tax on lump sum death benefit

- Most tax-free where Member dies before age 75 and paid within 2 years
- Tax applies where Member dies over age 75 or where Member dies before aged 75 but after 2 years
- Tax rate reduced from 55% to 45% from 6 April 2015
- From 6 April 2016 lump sums previously subject to 45% tax instead taxed at recipient's marginal rate in most cases

Present – where are we now?

key issues

Occupational scheme design strategies and implementation

- Balance of power: employer; trustees; or member control?
- Options spectrum: no change -v- full decumulation section
- Legal and fiduciary issues
- Checklist (see Appendix)

Balance of power | Who controls design and implementation?

Standard approach: rules govern

ToPA - taxes law easement

how to apply an overriding power for trustees (<u>without</u> employer consent) to implement member requests for new flexibilities?

Section 68 pensions easement

trustee resolution (overrides rules restrictions): well-trodden pensions change route; requires employer consent

Benefit design spectrum | Scheme structure

Minimal change... but some changes are necessary / advantageous

- (Partial) TVs of DC
- Careful review of retirement options and defaults
- Wrap-up changes to rules

Combinations / Drawdown lite

- Offer scheme-specific DC cash above current £10k cash limit?
- Allow mix of annuity and cash?
- Limited cash spreading?
- Some continued investment post NRA

Full decumulation section

- · Opt-in basis?
- Administration issues for older membership profile
- Charges
- Member protection: ability to make decisions
- Trustee protection / discharges
- Age discrimination?

Minimal change approach | Still points to consider

- NRA options: locking members into default annuities -v- continued DC investment until member positively elects to draw pension
- (Partial?) transfers: of DC up to crystallisation date
- Wrap-up changes:
 - NMPA definition: will rise from 55 to 57
 - October 2015 removal of early leaver DC refunds
 - Expand BAU retirement option to include transfers out (from DC and DB schemes)?
- Impact on future DC accrual / AA limit

Drawdown-lite | Go-faster version of current options

- Scheme-specific DC cash: extend above £10k small pot level (noting the £30k "full" trivial commutation lump sum for DC disappears from 6 April)?
- Facilitate (limited) mix of annuity + cash (above PCLS level)?
- Offer limited cash spreading option: e.g. over defined number of years (to facilitate income tax planning)?
- Scheme structure: expand (or re-write) retirement provisions of existing accumulation section?
- Maximum age for annuities / transfers: whether to retain (or indeed introduce) age 75 restrictions

Future

Full decumulation section (1) | treat as new product?

- Positive opt-in basis only? eligibility criteria in rules; minimum pot size?; different considerations from "simple" drawdown-lite approach
- Administration: e.g.
 - increased burden of distributing unused DC on death with 65+ cohort. Limit need for trustee exercise of discretion by requiring binding nominations? (NB. IHT considerations where member direction)
 - investment options:
 - lifestyling no longer appropriate?
 - maintain same balance of power as pre-NRD section <u>or</u> remove the default option and require positive choice (and limit trustee exposure)?
 - thresholds for drawdown: fixed v flexible
- Charging provisions: member or employer or both?; set out in rules (and member application see below)

Beneficiaries: allow continued drawdown after member death?

Full decumulation section (2) | treat as new product?

- Member protection issues (and defence against "running out of money" and other claims)
 - mental competency for investment and decumulation decisions in old age or poor health – what is trustee's role? how to assess this?
 - protective default option if drawdown funds fall to unsustainable levels?
 - bankruptcy protection against drawing all DC? (N.B. Horton v Henry appeal expected (Jan 2016) on treatment of undrawn DC)
- Rules structure: wholly new section? operate as an aggregator scheme?
- Scheme and trustee (and employer) protection:
 - sign up and discharge terms upon application to this new product?
 - discharge terms in trust deed and rules
- Age discrimination: maximum age or drawdown for life? attach age threshold to any member protection provisions? Point to consider

DC accounts with contracted-out DB underpins

- Two approaches; very different implications
- Particular issues where benefits are "near the line"
- Industry level issue; further legislation/ easement required?

	<u>Possible</u> ramifications – big legal caveat here		
Approach	CETVS	Retirement	Funding
"Flip-flop" – if <u>above water</u> when tested, entire benefit is DC	DC: TV right will crystallise; no IFA needed	DC: Issue PensionWise disclosures; Full DC flexibility	Exclude DC/DB account assets and liabilities from DB valuation for all above water members
"Flip-flop" – if <u>below water</u> when tested, entire benefit is DB	DB: TV right ends one year before NPA; IFA needed if value ≥ £30K	DB: no need for PensionWise disclosure; must secure DB; no DC flexibility	Include DB underpin rights and full accounts for all under water members in DB valuation (but value on scheme or buyout basis?)
"Core DB" approach – DB promise is not conditional upon account value; the DB is always DB	Statement of entitlement for DB Does member have statutory right to take DC excess (all non DB at CETV quote) separately as partial TV of "money purchase"?	DC flexibilities (plus PensionWise disclosures) only apply to any excess DC after DB underpins secured	 Always take the DB liabilities and related assets into the DB valuation <u>OR</u> Consider whether prudent to exclude above water DC/DB accounts from DB deficit plan (if adding them artificially improves funding level of "pure" DB liabilities)

Other changes on the horizon...

Lifetime allowance

- Reducing to £1 million from 6 April 2016, CPI increases from 6 April 2018
- Protections will be introduced that are similar to 2014 protections

Annual allowance

- Reduced annual allowance for those with "adjusted income" over £150K
- Annual allowance reduces to £10K for incomes over £210K
- Not apply if net income less than £110K

Green paper on pensions tax relief

- Change EET to TEE with Government top-up?
- Principles: simple and transparent; personal responsibility; build on automatic enrolment success; sustainable

Any Questions?



Appendix

Checklist | 1

Employer appetite for design changes

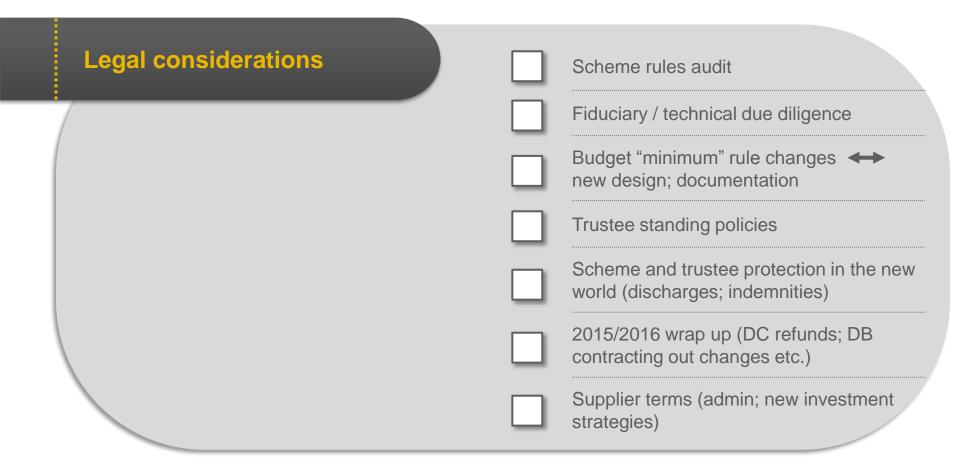
No change / minimal cash option

Drawdown lite

Full drawdown

BAU liability management for DB?

Checklist | 2



Checklist | 3

Member communications:
compliance review (minimum

best practice)

☐ 6 April – implement design changes

"Business as usual" following implementation



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