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# The New DC flexibilities: Issues for DC Schemes

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**9 September 2015**

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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

 Pension: Member benefit

 Lump Sum: Member benefit

 Pension: Death benefit

 Lump sum: Death benefit

## Member's DC pension pot

### Lifetime Annuity

- No Open Market Option requirement
- Annuity can reduce
- Lifetime annuity can be paid until later of member's death and specified period (can now be over 10 years)

### Dependant/Nominee/Successor Annuity

- Annuity can be paid tax free if member dies pre-age 75 / tax at marginal rate age 75+
- Dependant or Nominee annuity can be purchased either by a member (joint-life annuity), or using unused drawdown or uncrystallised funds on the member's death
- Successor annuity can be purchased using unused drawdown funds on a Dependant's, Nominee's or Successor's death

### Dependant/ Nominee/Successor Flexi-Access Drawdown Fund

- A Dependant or Nominee can designate unused drawdown or uncrystallised funds on a Member's death for flexi-access drawdown
- A Successor can designate unused drawdown funds for flexi-access drawdown
- Payable as short term annuity or income withdrawal
- Tax free if member dies pre-age 75 / tax at marginal rate age 75+

### Nominee

- "Nominee" is someone nominated by the member (or trustees if no nomination by the member)
- This new definition removes the requirement for financial dependency in relation to drawdown and annuities for beneficiaries

### Successor

- A Successor can inherit unused drawdown funds on a Dependant's, Nominee's or Successor's death
- Drawdown funds can be passed from Successor to Successor

### Flexi-Access Drawdown Fund

- Funds allocated as drawdown on or after 6 April 2015
- Taxable as pension income on payment
- 1 | **Income withdrawal**
  - Uncapped withdrawals
- 2 | **Short term annuity (5 years)**
  - No Open Market Option requirement
  - Annuity can reduce

### Uncrystallised Funds Pension Lump Sum

- New authorised DC lump sum
- 25% of each payment tax free, remainder taxed as income
- Subject to lifetime allowance available

### Pension commencement lump sum

- 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

### Uncrystallised Funds Lump Sum Death Benefit

- 2 year requirement relaxed so no longer unauthorised

### Flexi-Access Drawdown Fund Lump Sum Death Benefit

- Lump sum paid from a Member's, Dependant's, Nominee's or Successor's unused flexi-access drawdown fund
- No tax is paid if member dies before age 75 (previously 55% tax charge on drawdown (crystallised) lump sum)
- See box for tax on lump sum after age 75

### Money Purchase Annual Allowance

- £10k annual allowance limit on future DC pension savings (£30k DB limit)
- Applies where member takes benefits flexibly, e.g. flexi-access drawdown, uncrystallised funds lump sum, flexible annuity

### Pension recycling

- £7.5k (not 1% lifetime allowance)

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 (without 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:
    - lifestyle no longer appropriate?
    - maintain same balance of power as pre-NRD section or 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
1) “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 ( <u>but</u> value on scheme or buyout basis?)
2) “Core DB” approach – DB promise is not conditional upon account value; the DB is <u>always DB</u>	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	<ul style="list-style-type: none"> <li>• Always take the DB liabilities and related assets into the DB valuation <u>OR</u></li> <li>• 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)</li> </ul>

# 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

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Any Questions?





# Appendix

# Checklist | 1

## Employer appetite for design changes

☐

No change / minimal cash option

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Drawdown lite

☐

Full drawdown

☐

BAU liability management for DB?

# Checklist | 2

## Legal considerations

- ☐ Scheme rules audit
- ☐ Fiduciary / technical due diligence
- ☐ Budget “minimum” rule changes ↔ new design; documentation
- ☐ Trustee standing policies
- ☐ Scheme and trustee protection in the new world (discharges; indemnities)
- ☐ 2015/2016 wrap up (DC refunds; DB contracting out changes etc.)
- ☐ Supplier terms (admin; new investment strategies)

## Checklist | 3

### Member communications: compliance review (minimum ↔ best practice)

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Transitional period – pre 6 April 2015

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6 April – implement design changes

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“Business as usual” following  
implementation



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