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Plan Design : Post-simplification plan design flexibility

Current Issues in Pensions: 27th October 2005

Design opportunities covered


- Combining occupational schemes and personal pensions
- Flexible retirement with continued work
- Death benefits
- Lump sums
- AVCs
- Existing Inland Revenue limits
- Restructure in line with PPF?



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Current position

- Closure of defined benefit plans to new entrants
- Significant number of private sector employees remain in defined benefit plans
- Some changes for existing members
- Further pressure for changes
- Pensions Act and Finance Act changes represent an opportunity to have a fresh look at benefit design for existing plan members
- Few organisations have completed their simplification reviews



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Combining Occupational Pension Schemes with Personal Pensions

- In future, it will be possible to have accrual in an occupational scheme and contribution to a personal pension concurrently
- Staggering possible – draw benefits in tranches
- Proposals received considerable enthusiasm as a concept
- Practicalities mean that take up of this flexibility is likely to be limited in the short term

The Act of 2004
Making Them All One of the Same

Combining arrangements – hybrid designs

- Layering: DB accrual as safety net on first tier of pay, DC on upper tier of pay
 - ☺ limits final salary volatility
 - ☺ protects lower paid from risk
 - ☺ DC without the trust risks
- Lower DB accrual rate with DC top-up
- Greater opportunity for hybrid designs

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DB flexible retirement: Design: benefit timing

- All at the same time?
- In two stages if still in service, otherwise at same time?
- In multi stages if still in service, otherwise at same time?
- Multi stage even if not in service?
- Only AVC benefits separate?

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DB flexible retirement Design: future accrual

If in service, accrual:

- Continues in full?
- In which case, is accrual on new joiner scale?
- Defined contribution future service only?
- Discontinues, but full risk cover?
- Discontinues, as if leaver?

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DB flexible retirement General issues

- Interaction with employment contract
- Selection against the scheme
- Communication
- Retain skills and knowledge
- Ageing workforce
- Demand from employees
- Nature of work

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DB flexible retirement Impact on employer costs

- ☺ ↓ if "Offer: opt to take benefit early if also opt out of further accrual"
 - age discrimination?
 - review early retirement factors
- ☹ ↑ Barber elements: increased numbers claiming unreduced pension early
- ☹ ↑ if effect on investment strategy is lower equity investment if more pensioners

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DB flexible retirement Administration a nightmare ☹?

- Traditionally, each member has a unique category, and each category has its own record structure
- Multiple record per member, but linked?
- Change system's "membership flow"
- Change audit processes- opportunities for error/fraud
- Communications must acknowledge multiple statuses
- Cost of changes

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Making the Pension System

Death benefits: Lump sum versus pension

- Defined Benefit Lump Sum
 - Unlimited
 - Counts towards Lifetime Allowance
 - tax: 0% to outstanding member LTA, 55% on excess
 - only on death before age 75
- Dependant's pension
 - unlimited if paid on death before age 75
 - tax: recipients' marginal income tax rates

The Act of 2008
Making the Pension System

Death benefits: DIS design "4x LSDB + 2/3 pension → 8x LSDB"

- ☺ Tax efficiency
- ☺ Flexible – can buy annuity if required
- ☺ Less mortality risk for scheme
- ☺ Member or dependant choice?
- ☺ Trustee onus to choose recipients for large sum
- ☺ Insurance - especially free cover limits
- ☺ Contracting out restrictions
- ☺ S67 issues perhaps if for current members?

The Act of 2008
Making the Pension System

Tax free cash sums

- Higher sums available for many individuals
- Most schemes are allowing lump sums up to new limits
- Consider protection for those who may be worse off under new limits
- AVCs may now be taken as cash
 - Review commutation factors
 - Less commutation of scheme pension

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Fund a more secure
investment

Additional Voluntary Contributions

- Should AVC facility be maintained?
 - No longer a requirement
 - Other options now available
- If facility is retained, should contribution limit be changed?
 - Higher overall contribution limits
 - May wish to restrict amount of lump sum available from AVCs

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Current Inland Revenue limits

- Opportunity to remove all limits
- But, consider impact on costs
 - Double provision of benefits over cap?
 - Higher cash alternative may already have been provided
- Retain some limits?
 - Scheme earnings cap
 - Pensionable service limit
- Administration implications of retaining all current limits
- Scheme modification regulations

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Restructure scheme benefits in line with PPF benefits

- Aim: members' benefits match what they expect
- Convert pre 97 pension increases to extra accrued pension?
- Use new Section 67 or obtain member consent
- ☺ If scheme enters PPF, members get higher benefits, closer to what they expect
- ☺ No expected benefit cost to the Company

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Restructure scheme benefits in line with PPF benefits

- ☺ If scheme never goes into PPF then little point
- ☺ Would the PPF Board unwind this?
- ☺ Risk of PPF structure changing
- ☺ Initial cost of communications and administration
- ☺ Blocks in scheme rules/contracting-out

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Summary

- Plan reviews still work in progress for many
- Less than six months to A-day
- Administration implementation
- Communication with members
- Likely that there will be even greater range of plan designs in future

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