The future of pensions

July 2014

Introduction

In his March Budget, Chancellor George Osborne proposed radical changes to the rules around pensions. Last week, the government confirmed which changes have been agreed and when they will take effect. Here, Kate Turner, Head of Advice Policy, summarises the key changes and explains what they will mean for people planning for retirement.

Access to cash from pensions after retirement

From April 2015, individuals will be able to take cash sums out of their pension when they retire - as little or as much as they like, even the entire fund. This means that, under these new rules, people will no longer be required to purchase an annuity; instead, they will have total freedom as to how they use their pension fund.

People may choose to use the money to pay for unforeseen needs, such as long term care, or turn it into income by purchasing an annuity; they could invest the money or spend it in a way that suits their circumstances at the time.

The first 25% they take will be tax free, but the rest will be subject to income tax at their highest marginal rate.

Towry comment

Annuities have been criticised and, in some cases, have been considered poor value. However, for the right client, in the right circumstances, they can provide a consistent income stream. From April next year there will be many more options available to people when they reach pensionable age, and taking the right advice will be critical.

Pension income (drawdown) limits to be removed

At retirement, investors currently have the option to take an income directly from their private pension fund. This is known as income drawdown and the amount they can draw each year is currently limited by the Government Actuary's Department (GAD) maximum. From April 2015, these limits will be removed allowing people to take as much as they like and decide where they want to invest it.

Towry comment

This change gives individuals the responsibility for ensuring that they don't run out of funds further into their retirement. It is another reason for ensuring that clients have sound retirement plans in place in the run-up to retirement.

Restrictions on pension contributions

After April 2015, if someone draws more than their tax-free lump sum from their pension they will still be able to make pension contributions, but only up to a reduced allowance of £10,000 per year. There are two exceptions to this rule:

- If a personal pension is worth less than £10,000 (a "small pot"), the member will be able to make total withdrawals from a maximum of three such small pots (and unlimited small occupational pension pots worth less than £10,000 each), without being subject to the reduced annual allowance.
- If they are taking their pension income under capped drawdown, they will not be impacted by the reduced allowance, unless they choose to withdraw more than the capped drawdown amount. This limit is known as the max GAD amount.

Towry comment

Careful planning will be required to ensure that those wishing to continue funding pensions, whilst accessing existing pension pots, are not inadvertently restricted in doing so.

Retirement age increases

In 2028, the age at which people can access their non state pensions will rise from 55 to 57. Thereafter it will be set at ten years below the state retirement age. The government is considering measures to protect the benefits of those people who currently have the right to access their pension at an earlier age.

This change will not apply to 'uniformed services' such as firefighters, police and the armed forces.

Towry comment

People currently under the age of 40 will wait at least two more years to access their pensions, underlining the importance of planning for retirement sooner rather than later.

Transfers from defined benefit (final salary) schemes

If people have a private sector defined benefit pension scheme they will be able to take advantage of the new rules allowing unlimited withdrawals. However, to do this they will need to transfer their funds to a defined contribution scheme.

If clients are considering a transfer, they will be required to take impartial financial advice from an FCA (Financial Conduct Authority) authorised person before making a decision.

Individuals who are retired and already taking a pension from a defined benefit scheme, will continue to be precluded from transferring their benefits out of the scheme.

Towry comment

The right to transfer funds from defined benefit schemes remains a good option for many people. However, it is a complex area and we are pleased that it has been recognised by the authorities that professional advice should always be sought before considering this option.

Possible change to tax charge when you pass on your pension

Currently, if people are in drawdown, or over 75 years old, any lump sum paid from their pension to beneficiaries on death is taxed at 55%. The Chancellor thinks this is too high and will be reviewing this rule. We expect that details of any changes will be announced in this year's autumn statement.

Towry comment

A reduction of the tax rate applicable to certain pension lump sum death benefits would be welcomed and we look forward to further clarification on this.

Impartial guidance for investors

With the increased options available to retirees, the government has promised to make free and impartial guidance available to everyone approaching retirement.

This guidance will be provided by independent organisations who have no actual or potential conflict of interest, such as the Money Advice Service and the Pensions Advisory Service. The guidance provided will stop short of recommending a particular product or provider.

There will be no charge for this service, which will be made available through a range of channels including telephone, online and face-to-face.

Towry comment

The provision of independent guidance is a positive step in highlighting the variety and complexity of the different options available to people when planning for retirement. However, we do not believe that it is intended that the guidance will be a substitute for personalised advice about the ongoing need to manage a retirement income over a period of 20 – 30 years.

Summary

The pension changes announced this year are, without doubt, the most far reaching in almost a century. In giving us access to our pension funds, and removing the requirement to purchase an annuity, the Chancellor is allowing us to make our own decisions about our financial future.

Further legislation, in the form of a Pensions Tax Bill and amendments to the existing Pension Schemes Bill, is required and will be progressed in the autumn.

At Towry, we believe we have a responsibility to help our clients, understand what the changes mean to them and their families, and ensure that they plan for every eventuality. If you would like clarification on any of the points mentioned in this bulletin, please get in touch with your usual Towry contact who will be happy to assist.

Kate Turner

Head of Advice Policy

The information given in this bulletin is based on our understanding of the proposals outlined in the July 2014 Treasury response 'Freedom and choice in pensions', which may be subject to change. Whether any tax will be payable, at what level it is charged and whether tax relief will be available, will depend upon individual circumstances. This update is solely for information purposes and is not intended to be, and should not be construed as, financial advice.