DC pensions: 
*All change from April 2015*
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‘The most fundamental reform to the way people access their pension rights in almost a century’.

That’s how the Chancellor described his proposals on ‘freedom and choice’ in accessing DC pension rights, which are scheduled for April 2015; but those aren’t the only issues which trustees and managers of DC schemes are having to deal with: other significant changes are progressing on the same timetable. This briefing looks at how all the changes fit together. Later briefings in this series will drill down into the detail of the ‘freedom and choice’ proposals.

The key headline is that there are major changes coming to the ways in which, and the age at which, individuals are likely to access their DC pensions savings.
DC pensions: all change from April 2015

ACCESSING DC SAVINGS: CURRENT OPTIONS

At the moment, members access their DC pension rights in three ways:

– through cashing out lower value rights – up to GBP10,000 per pot or GBP30,000 across all schemes, from age 60;

– by buying an annuity, or

– by going into drawdown – either on a capped basis, so there’s a maximum amount that can be taken each year; or on a flexible or unrestricted basis if they have a secured minimum income of at least GBP12,000.

ACCESSING DC SAVINGS: FUTURE OPTIONS

From April 2015, individuals with DC funds (including AVC funds in defined benefit schemes) have a wider range of possible options, though it’s not mandatory for a scheme to offer all these options.

– Members can still use their DC funds to buy an annuity. Some of the restrictions which currently apply to annuity design are being lifted, so more flexible products are likely to come on to the market.

– Members can still cash out small DC pots of up to GBP10,000 and they can do this from normal minimum pension age which is normally age 55. The higher GBP30,000 limit won’t apply to DC rights.

– Members will be able to make lump sum cash withdrawals from their DC savings. Again, that will apply normally from age 55.

– Drawdown takes a new form from 6 April 2015 – under flexi-access drawdown, there’s no minimum income requirement and no restriction on the amount that can be taken at any time. Current capped drawdown arrangements can continue, but existing flexible drawdown funds, and all new drawdown arrangements on or after 6 April 2015, will be new-style flexi-access drawdown funds. Again, these will be available normally from age 55.

Depending which of these options a member takes, they may trigger a restricted annual allowance for future DC contributions. There are also special rules for members who are currently in drawdown. Later briefings will look at these issues in more detail.

RIPPLE EFFECTS

You can immediately see that there are much wider options for DC savers about how they use their funds and how to manage their retirement income. That means there’s an urgent need for information, especially for members who may be making these choices in the near future. That group isn’t limited to members approaching normal pension age – it extends to members approaching age 55.

A much broader range of members will be able to use something other than the traditional annuity purchase route, so standard default options also need to be updated. A lifestyling fund which moves into gilts over an extended period up to normal pension age isn’t likely to be appropriate for individuals who want to cash out their funds – or go into drawdown targeting ongoing investment returns – at some point from age 55 onwards. An urgent review of investment options, particularly default funds, is needed; and you’ll need to communicate with members not only about their new options for accessing funds but also about the impact on their investment choices.
OTHER DEVELOPMENTS IN DC GOVERNANCE

In line with the Regulator’s Code of Practice on the governance and administration of DC schemes, DC trustees need to be ready to provide a ‘comply or explain’ statement in the next set of scheme accounts about the extent to which they do, or will, comply with the 31 quality features set out in the Code. The most lengthy section of the Code considers issues around investments, including the design and governance of the range of options offered by a DC scheme. It’s going to be important to ensure that your pre-April 2015 review of investment options dovetails with your wider scheme review under the Code and demonstrates that you fulfil the relevant quality features.

Overlapping with some of the Regulator’s DC Code quality features, the Government will introduce governance and reporting requirements from April 2015 on areas including the design and monitoring of default investment strategies, standards of administration and value for money. There will be a requirement to make a separate independently audited statement in the annual report on these issues.

April 2015 will see the first stage of restrictions on charges being introduced. The most significant of these is that charges in default funds of schemes which are used to meet auto-enrolment obligations will be subject to a cap, initially set at 0.75% of funds under management. The cap applies to all member-borne charges and deductions excluding transaction costs. In addition, the Government intends to promote transparency by requiring standardised disclosure of transaction costs and charges for these schemes.

Reviewing investment options

The good news is that trustees can tie all this together with their review of fund suitability in light of the flexible access changes. The starting point is to gather information about the scheme’s membership profile - what’s the age profile and risk appetite of the membership, and what is the spread of their earnings and typical pot sizes? How are they most likely to want to access their pension savings? These issues will have a direct impact on what types of fund trustees will want to offer and particularly on their choice of default options.

Communications and disclosure

Members will be entitled to guidance on the range of DC options available to them at retirement, and schemes will need to build in signposts to this guidance in member communications. But this guidance isn’t likely to be enough to enable members to make informed choices. We expect that most schemes will want to go further in providing information about the new rules – both in terms of what information they provide, and when they provide it, across the whole lifecycle of an individual’s scheme membership. Most immediately, members will need information about the options available and the need to keep their investment choices and contribution levels under review.

Our next briefing in this series will look at the new withdrawal and flexible access rules in more depth.

You can also find out more by visiting our DC resource base, www.allenovery.com/dchq.

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