**Summary**

- In August, the draft Taxation of Pensions Bill introduced flexi-access drawdown, removing restrictions on withdrawing money after 55. It also introduced uncrystallised funds pension lump sum, which are ad-hoc payments from a pension pot without entering drawdown. Capped drawdown, with its GAD limits, remains.
- Flexi-access will likely be cheaper to administer than capped, but those in capped drawdown will not be automatically transferred across, meaning they may pay unnecessary charges.
- It is expected that a sizeable minority of DB members would look to take advantage of the new Budget flexibilities.
- Schemes will see an increase in enquiries, whether they offer drawdown or not, and will be expected to ensure members can at least transfer to a scheme offering those facilities.
- Most schemes are looking at market options to provide this flexibility and will provide financial advice, instead of providing in-house drawdown or giving members cash.

# Bend and snap?

**The retirement income flexibilities generated by the Budget will simplify pensions for members, but will also bring complications for schemes and providers. Peter Davy looks at the challenges ahead**

"No caps. No drawdown limits… No one will have to buy an annuity." At one level, George Osborne's budget changes are hard to beat as a piece of pensions simplification.

As Hargreaves Lansdown head of pensions research Tom McPhail puts it: "For pension scheme members it's pretty simple; what would they like? I can give a lump sum, some income – a guaranteed income or an investment backed income. If they just tell us what they want, we can do it for them."

That, however, is for the members. "Behind the scenes, for the industry practitioners, it is terrifically complicated," says McPhail.

That complexity has become clearer with the draft Taxation of Pensions Bill last month. Again, the proposals initially look simple: flexi-access drawdown is introduced, for example, removing restrictions on withdrawing money after 55. The first 25 per cent is paid tax-free, the remainder at the marginal rate. It also introduces 'uncrystallised funds pension lump sum' (UFPLS) – ad hoc payments from the pensions pot, without entering drawdown, taxed in a similar fashion.

"At the moment it would appear that you can basically just phone up your scheme and ask for £20,000, and it will be in your bank account for next day," says MGM Advantage pensions technical director Andrew Tully.

Since it can be accessed without advice, this creates obvious challenges in terms of protecting members – most obviously from the tax implications.

"There are numerous pitfalls the unwary can drop into," said Tully.

From a systems point of view too there are also challenges, according to Towers Watson senior consultant Dave Roberts – particularly for pension schemes.

"The ad-hoc payments means

that, conceptually, a DC pension becomes a savings product, rather like a bank account that you could take money out of on a daily basis. I think it is unlikely many pension schemes would have the systems to support that."

These can be developed, but at a cost, he notes. The question is who will meet it.

**Drawdown difficulties**

Drawdown rules are also more complex than they first appear, since while the income requirement for flexible access rules is removed, capped drawdown, with its GAD limits, remains.

The result is to allow those in capped drawdown to keep a money purchase annual allowance of £40,000, rather than being limited to contributing £10,000 to their schemes under the new flexi-access rules. (The lower limit in flexi-access is designed to prevent employers from exploiting a tax loophole by using a larger allowance to channel income through the pension.)

However, for drawdown providers, it's an unnecessary complication, says AJ Bell chief executive Andy Bell, requiring two different sets of rules.

Added to that, there are the interim rules until next April, such as the decrease in the flexible drawdown minimum income requirement from £20,000 to £12,000.

"It is trying to create a monster of administration," he says.

Moreover, flexi-access drawdown is likely to be cheaper to administer due to its simplicity, and therefore attract lower charges. Despite this, those in capped drawdown won't be automatically transferred, even if they are not putting more than £10,000 into their money purchase schemes – which government figures show only 2 per cent do.

"The heart of the concern is that pension savers will be paying drawdown fees they don't need to," says Bell.

Nor are the issues necessarily limited to drawdown providers. For a start, Roberts points out that while the £40,000 annual allowance for defined benefit accrual is unaffected by flexible drawdown, the DC £10,000 annual allowance restriction triggered by flexi-drawdown applies across all schemes. It is unclear yet how a scheme is expected to know whether a member has accessed DC rights flexibly elsewhere, and what requirements there will be on schemes to inform HMRC when they do know.

"We know nothing about the reporting requirements," he says. As ever, the devil will be in the detail.

**"A DC pension becomes a savings product, rather like a bank account that you could take money out of on a daily basis. I think it is unlikely many pension schemes would have the systems to support that"**

**A common problem**

In fact, the changes affect those across the pensions landscape: DC and DB; companies, trustees and providers.

For a start, the signs are that drawdown is to be increasingly popular. Selectapension, which provides a pensions transfer tool for IFAs, has seen a 35 per cent increase in drawdown cases since the budget, according to the firm's national accounts director.

"The overall usage is up significantly," he says. At the same time, the average size of pensions involved has shrunk to £163,112, from £177,472 in the same period last year.

"It is bringing smaller pots into the arena."

And this is before the changes are in effect. Moreover, according to Aon Hewitt, its polling of 300 pension professionals found most DB schemes felt a sizeable minority of their members would also look to take advantage of the Budget flexibilities.

The result is that – even if they don't offer drawdown or UFPLSs (since both are optional) – providers and trustees can expect increasing queries from their members about the new flexibility.

At the very least, they are required to ensure members will

**Case study**

Cheviot Trust, a multi-employer master trust founded for the legal sector, began looking at drawdown more than a year ago, before the new flexibilities were announced.

Established in the 1930s, unlike most DC schemes it already has a significant number of members either reaching or approaching retirement with substantial pots – £200,000 or more.

"We could see increasing numbers of members were going out to drawdown under advice, and while in the past we have thrown our hands up and said it's too difficult and complex, we thought we would have a look," explains Elspeth McKinnon from the Cheviot Trust.

Working with consultant P-Solve, it has developed a drawdown solution (being updated in light of the budget changes) to offer a facility for members to go into either after taking their own independent advice or after a streamlined, cost-effective advice service through an IFA included in the facility.

The scheme has also began contacting members five or six years from retirement to inform them about the choice and guide them to an appropriate fund (rather than the default lifestyle offering targeting gilts and cash – again, which is being revised) if they are considering drawdown.

McKinnon recognises that a master trust is better placed than most employer schemes to offer drawdown, and the trust is planning to open the facility to other schemes that are uncomfortable with leaving members to the retail market.

"I think employers will want to get shot of people at retirement. That's what they always want to do. However, rather than throwing them out into the big wide world, they can say there is a trust option; it's just not ours."

have the opportunity to transfer to a scheme offering the new facilities. And, here again, there could be difficulties, according to Bob Stark at pensions advisors Portal Group.

Stark warns that IFAs may start to challenge those that put obstacles in the form of exit charges or penalties in the way of members looking to transfer. For DC schemes, these will be relatively obvious.

For those wishing to transfer from DB schemes to take advantage of the new flexibilities it will be down to the transfer value, and is likely to focus on the critical yield – the annual growth rate the member would need to match the benefit the scheme offers.

"If it is much over 10 per cent you start getting a bit suspicious," says Stark. However, what is fair is a complex question, and one that could cause a number of disputes.

"There is potential for the Pensions Ombudsman to become very, very busy in the near future."

**"Culturally it may well be that trustees and employers are a bit uncomfortable letting members fend for themselves"**

**Considering the options**

For all the complexity however, for trustees and employers there are probably four options around drawdown and the new flexibility. Aon Hewitt head of DC consulting Jan Burke summarises them as: 'get involved' with an in-scheme drawdown solution for members; 'get smart' by identifying external preferred providers; 'get out' by delivering cash and letting members make their own decisions; and get 'back to basics', with a re-think of the whole DC approach, considering whether they might be better served with options such as a master trust.

Unsurprisingly, the consultant found little appetite in schemes for providing in-house drawdown (7 per cent), with trustees and companies reluctant to leave themselves responsible for DC members potentially years after retirement. However, there is also widespread reluctance to just cut members loose with their cash.

"Culturally it may well be that trustees and employers are a bit uncomfortable letting members fend for themselves," says Burke.

Instead, 57 per cent said they would look at the options available in the market and identify preferred providers, with half also intending to fund financial advice.

The approach has the benefit of potentially giving members a better deal by using the company's size to negotiate prices (an important consideration given that fees are usually much higher in the retail world). It also opens the door for trustees to examine the consistency between pre-retirement accumulation and the preferred decumulation products, ensuring fund ranges or providers in the run up to retirement match those they will go into in the drawdown world, reducing frictional costs.

Before any of this can be done, however, trustees must know what members want, says Burke. Only then can they begin to make informed decisions on what they should offer.

"Much depends on the demographics of the scheme, and we are encouraging trustees to understand their members," says Burke. "Once you've understood the member profile, then you can take a view of what members will do post retirement."

**Written by Peter Davy, a freelance journalist**