CORPORATE AND PROFESSIONAL
PENSIONS LIMITED

SPECIAL REPORT

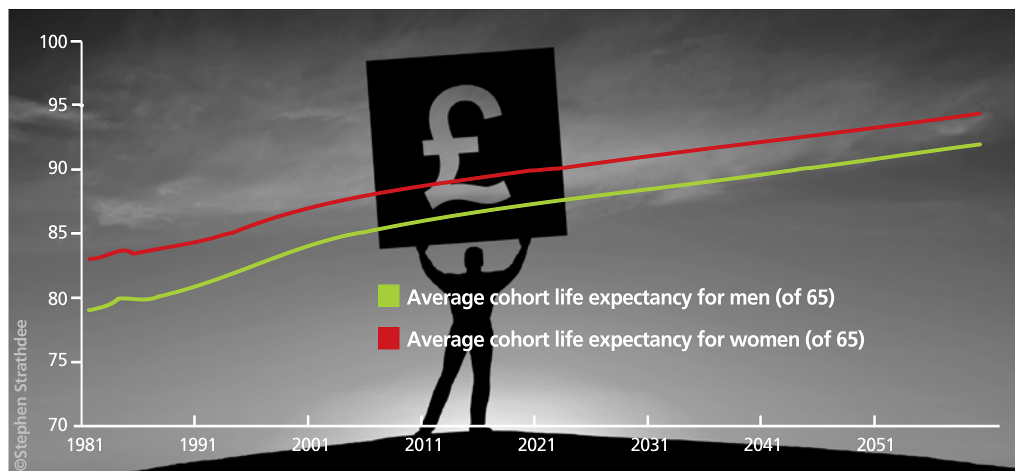
PENSIONS planning 2013/14

Living longer, costing more

The world of pensions has changed apace in recent years. Some changes have already happened, but many others are yet to be finalised.

The rising cost of pension provision has been the driving force for both the state and the private sector reforms. Not only are more people living to pension age, but once they become pensioners they are living longer, as the graph shows.

Life expectancy at age 65



The problem of cost has been worsened by low long-term interest rates and difficult investment conditions since the turn of the century. For example, to provide a level (non-increasing) pension annuity of £1,000 a year now costs about £18,500 for a 65 year-old non-smoking man or woman (EU rules mean that annuity rates now take no account of gender). Adding inflation-proofing increases this figure by almost 65%.

Among the state's solutions to date have been raising the state pension age and increasing national insurance contributions (NICs). Private sector employers have attempted to reduce costs by closing their final salary (defined benefit) pension schemes to new members and, increasingly often, to existing members as well.

In this special report we look at how past, present and future changes to pensions will affect you. If any of the reforms covered strike a chord, take expert advice before revising your retirement plans. The ever more complex world of pensions contains many financial traps for the enthusiastic amateur.

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State pensions – age limits rising

Changes to state pensions have come thick and fast, with more on the way in the coming years. A good example is the reform of the state pension age (SPA).

There was a time when SPA was a certainty, but since April 2010 women's SPA has been rising. The original plan was for it to reach age 65 – matching men's SPA – by April 2020, with the SPA for both sexes to rise to 66 between 2024 and 2026. However, the Government is now legislating for a further rise to a SPA of 67 between April 2026 and April 2028 in the Pensions Bill 2013. A SPA of 70 is now a distinct possibility well before 2050.

Date of birth	SPA for men	SPA for women
Before 6 April 1950	65	60
6 April 1950–5 April 1951	65	60-61
6 April 1951–5 April 1952	65	61-62
6 April 1952–5 April 1953	65	62-63
6 April 1953–5 August 1953	65	63-64
6 August 1953–5 December 1953	65	64-65
	SPA for men and women	
6 December 1953–5 October 1954	65-66	
6 October 1954–5 April 1960*	66	
6 April 1960–5 April 1961*	66-67	
6 April 1961–5 April 1977†	67	
6 April 1977–5 April 1978†	67-68	
6 April 1978–†	68	

* Move to SPA of 67 as being legislated for in Pensions Bill 2013

† As provided for in Pensions Act 2007 and now almost certain to be brought forward after future reviews

The Pensions Bill 2013 will radically change the structure of state pensions for anyone reaching SPA on or after 6 April 2016. Much of the fine detail has yet to be settled, but the broad shape of the new system is clear. The current state pension system consists of two tiers.

1. **The basic state pension** worth up to £110.15 a week for a single person in 2013/14), for which 30 'qualifying years' of NIC contributions/credits are needed to receive the full amount.

2. **The additional pension – the state second pension (S2P)**, which applies only to employees (not the self-employed) and is earnings-related. Defined benefit schemes can contract out of S2P. The maximum additional pension can be over £160 a week at present.

The new single-tier state pension from April 2016 will be available to both the employed and self-employed. Subject to transitional provisions, the maximum pension will be around £145.40 a week (in 2013/14 terms) for 35 or more 'qualifying years' of NICs/credits. The amount was chosen to match that currently payable under the standard minimum guarantee element of Pension Credit – today's effective floor on pensioner's income benefits. The other element of Pensions Credit, the savings credit, will be withdrawn for those reaching SPA from 6 April 2016.

There will be no option to contract out of the single-tier pension and so all contracting out will end. Unlike the current system, entitlement will be based on the individual's personal contribution record and cannot draw on a current or former spouse's or civil partner's NICs record. Once in payment, the single-tier pension will at least increase in line with the rise in earnings. The transition from the current two-tier system to the new single-tier system is inevitably complex. The Pensions Bill 2013 contains legislation to ensure that state pension benefits accrued before April 2016 will not be reduced once the new regime begins. As a result, it is possible to enter the single-tier system with an entitlement above £145.40 a week, in which case the excess is only inflation protected in line with the Consumer Prices Index (CPI) and no further state pension benefits can be built up. However, full NICs will still be payable until SPA.

The new system will create winners and losers. In the short term winners will outnumber losers, although most people will see no difference because of the transitional provisions. In the longer term – 2060 onwards – the losers will marginally outnumber the winners.

Occupational pensions in decline

Employer-sponsored occupational pension schemes used to be the bedrock of private pension provision. However, the number of 'active members' (i.e. employees accruing benefits) in private sector final-salary schemes was only 1.9 million in 2011, down from 4.6 million in 2000.

If you are still accruing benefits in a final-salary scheme, consider yourself lucky: you are unlikely to accrue them if you change job, unless you move to a public sector employer. The Government has made one change to final-salary schemes which, in contrast to many previous reforms, may have slowed the closure process. As with state pensions, the Government has altered the statutory basis of inflation increases from the RPI to the CPI. The switch applies to both deferred pensions (for early leavers) and pensions in payment.

All public sector schemes, along with some private sector schemes, switched to the CPI basis from April 2011. However, many private sector schemes have continued to use only the RPI in making adjustments, because their trust documentation refers to that index.

The advent of the single-tier state pension and end of contracting out is expected to lead to more closures of private sector final salary schemes, not least because of the loss of contracting out NIC rebates for employers and employees.

PLANNING POINT – If you have a preserved pension – often incorrectly labelled a 'frozen pension' – from a former employer's final-salary occupational scheme, it makes sense to look at your transfer options now. Falling long-term interest rates could mean your transfer value has risen in recent years.

Auto-enrolment and NEST

October 2012 marked the official start of the five-year phased introduction of auto-enrolment, supported by the introduction of the National Employment Savings Trust (NEST). Auto-enrolment is the latest Government effort to encourage private pensions provision.

Auto-enrolment involves quasi-compulsory contributions. NEST is being developed as a pension suitable for lower-earners who do not currently have easy access to pensions. Under the current plans:

- NEST will be run as a single occupational scheme, independent of the government.

- Ultimately all taxpaying employees – in broad terms those with income over £9,440 in 2013/14 (probably £10,000 in 2014/15) – aged between 22 and the SPA will be automatically enrolled into a pension scheme, which could be NEST or another pension scheme that allows auto-enrolment.

- Employees may opt out, but they will be automatically re-enrolled every three years or on changing employer.

- Employers will generally have to pay a contribution equivalent to at least 3% of an eligible employee's qualifying earnings, in a band between £5,668 and £41,450 in 2013/14, if the employee has earnings of more than £9,440. The required contribution will be lower during a phasing-in period, which is due to last until early 2018.

- Employees will ultimately have to pay a contribution to bring the total up to 8% of band earnings. Allowing for income tax relief, this implies a 4% net employee contribution, if the employer pays the 3% minimum.

If you are an employer, auto-enrolment will apply to you, even if you have only one taxpaying employee.

PLANNING POINT – The long phasing-in period for auto-enrolment is not an excuse for ignoring the issue. If you are an employer, you need to start thinking now about the impact of auto-enrolment – and those 3% contributions – on your business.

Drawing benefits – a wider choice

There was a time when buying an annuity was the only retirement option available outside of final salary schemes once you had taken your tax-free cash. Now there is a wide choice and one which is likely to expand as new legislation is introduced.

Annuities An annuity may well be the right way to draw all or some of your benefits, particularly if you have few other sources of income when you retire. A key factor is that the payments from an annuity will last for the rest of your life – however long that may be.

If you decide on an annuity, you should never just accept what your pension provider offers. In recent times the annuity market has become more sophisticated, and you will need independent advice to discover all that is available to you.

Income withdrawals It has been possible to make regular withdrawals from your pension fund since 1995 (rather than buying an annuity). This involves investment risk – your withdrawals and pension fund could both fall in value – so in general it is only suitable if you have other sources of retirement income.

The income withdrawal option, now officially called 'drawdown', gives you considerable flexibility in choosing your income and, on the whole, offers superior death benefits to annuities. The entirety of the remaining fund can be paid as a lump sum death benefit, subject to a flat 55% tax charge, but normally no IHT. Income withdrawals used to stop at age 75, but following various changes it is now possible to continue withdrawals for as long as you wish. Another reform was the introduction of flexible drawdown, which allows income to be drawn free of any limits. However, you must have at least £20,000 of guaranteed lifetime income to apply for flexible drawdown.

'Third Way' annuities This term applies to retirement income products which fit neither the annuity nor the income withdrawal categories. They often incorporate some income guarantee – though lower than an annuity would provide – with limited flexibility and similar death benefits to income withdrawal. This has been the main area of innovation and recent legislative changes may see it develop further.

PLANNING POINT – The decisions you take at retirement are crucial and can be irreversible. You should start reviewing your options at least six months before you want your retirement income to start.

Tax relief and contributions

Pension contributions have always received favourable tax treatment. In very broad terms:

- Personal contributions attract full income tax relief, with a minimum of 20% relief, even for non-taxpayers.

- Employer contributions are fully relievable against profits and exempt from NICs.

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In April 2011 the government cut the annual allowance (the limit on total tax-relievable pension contributions from all sources) from £255,000 each tax year to £50,000 and introduced rules to allow carry forward unused allowance from the previous three years. A further cut to £40,000 is due from 2014/15. Any contribution above the available allowance effectively receives no tax relief. In extreme circumstances this could mean you will personally have to pay full income tax on some of your employer's pension contributions.

The lifetime allowance – effectively the maximum value of pension benefits before special tax charges can apply – has also been subject to cuts. It was reduced from £1.8 million to £1.5 million on 6 April 2012 and is due to fall again to £1.25 million from 6 April 2014.

PLANNING POINT – The reductions to the lifetime and annual allowances, together with the carry forward relief rules and impending 2014 transitional provisions, mean it is more important than ever to undertake a thorough review of your pension contribution plans.

Non-pension retirement options

It would be wrong to consider pensions as the only retirement planning option. You may not be able to make contributions to any pension arrangements because to do so would attract tax penalties. Other routes to building a retirement fund include:

Individual savings accounts (ISAs), from a tax viewpoint, are the mirror image of pensions: there is no tax relief on the initial investment, but no income tax when benefits are taken.

Collective funds Open-ended investment companies (OEICs) and unit trusts form the basis of many of the investments underlying pension arrangements. Outside of the shelter of a pension they will normally be subject to more tax, but the treatment of capital gains remains attractive.

Maximum investment plans (MIPs) are specialist investment-based life assurance policies. Underlying funds incur tax – generally at no more than basic rate on income and gains – but there is no further tax if plans are run to maturity. The 2012 Budget, however, placed an effective £3,600 total annual contribution cap on such plans started from 21 March 2012.

For most people pension arrangements remain the most tax-efficient way of investing for retirement. If, for whatever reason, you choose not to use pensions, you should seek professional advice before selecting the alternative(s).

The importance of reviews

One theme running through this report is the many changes already made, being made and yet to be made to all areas of pension provision.

In this environment, it is more important than ever to keep your retirement plans under regular review. This is a task which you need to undertake with your professional adviser, because they will have in-depth knowledge of developments in the pension market.

Important notes

1. **The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.**

2. **The value of your investment and the income from it can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.**

3. **Shares and share-related funds should be regarded as long-term investments and should fit in with your overall attitude to risk and your financial circumstances.**