Lincolnshire COUNTY COUNCIL
Working for a better future

Regulatory and Other Committee

Open Report on behalf of Executive Director of Finance and Public Protection

Report to:	**Pensions Committee**
Date:	**09 April 2015**
Subject:	**Pensions Freedom and Choice**

Summary:

This report updates the Committee on changes in Pensions Regulations that allow individuals to transfer their LGPS benefits to defined contribution arrangements from April 2015.

Recommendation(s):

That the Committee note this report.

Background

1 The new pension flexibilities announced in the budget last year will allow individuals aged 55 and over greater choice around how they access their pension savings. The Pensions Scheme Act 2015 received Royal Assent on 3rd March 2015 to introduce these flexibilities from 6th April 2015. The initial statement from the Chancellor in June 2014 announcing greater freedom for defined benefit pension scheme members appeared to be aimed at the private sector schemes only, as it stated that unfunded public sector schemes would be exempt from this. However, it has been confirmed that funded public sectors scheme, principally the LGPS, would be included in the changes.

2 The flexibilities allow for an individual over 55 to have full access to their pension pot in a defined contribution (DC) arrangement and the freedom as to how and when they access it, and in what form, e.g. as cash. Previously, this DC pot would have been used to purchase an annuity at retirement to secure a guaranteed monthly income for life and/or drawdown a 25% lump sum from their pension fund.

3 This flexibility is only for members in DC schemes. However, members of defined benefit schemes (other than the unfunded Public Sector schemes) are

able to transfer out to a DC scheme and then have the access as described above. Therefore, from 6th April 2015, LGPS non-pensioner members will have the flexibility to take their benefits as up-front cash via a transfer to a DC arrangement. However, this flexibility comes at the expense of the remaining life-long pension and so it is not always obvious whether this will be in a member's best interest. Furthermore, it is acknowledged that this may have a material impact on the fund's financial position, with the impact either positive or negative.

4 There have been two key safeguards built in to the process:

- **Financial advice**

  A fund would need to check that a member had received appropriate independent advice before being allowed to transfer to a DC arrangement. However, members with 'pension wealth' below £30,000 will be exempt from having to take advice. LGPS members will have to pay for their own advice.

- **Cash Equivalent Transfer Value (CETV) reductions**

  DCLG will have the right to arrange for reductions in CETV's from funded public service pension schemes, in the event that there is the need to protect the taxpayer (and the scheme).

Both of these safeguards have potential problems, which are listed below.

5 Financial advice concerns:

- The £30,000 limit is based on the cash equivalent transfer value and therefore the Fund will not have to consider the value of any benefits the member has in other registered pension schemes, however, it is not clear whether the LGPS is treated as one scheme. If it does then account would have to be taken of service in other LGPS funds that has not been consolidated in the LGPS fund handling the transfer request.

- If each LGPS fund is considered independently, then the member may have several transfers that would not require financial advice, but the value of which in total could be well above the limit.

- LGPS funds will not be required to review whether or not the financial advice is "correct", just that a member has received independent advice and that the advice is from a reputable source e.g. an adviser authorised by the Financial Conduct Authority (FCA). The rules around this check will be set out in secondary legislation. Inappropriate financial advice could leave members with much poorer retirement incomes.

- Pension transfer advice is complicated, requiring specific permission from the FCA. It could be seen as expensive, especially as the cost is to be borne by the member and must be paid even if the transfer does not proceed.

- Funds will need to be sure that their processes are robust enough to ensure that transferring members have received advice from a properly qualified financial adviser that complies with all the requirements of the legislation. If this is not properly evidenced and recorded, funds will be open to challenge in future.

- Information about the increased options now available at retirement will need to be clearly communicated to employers and members before any financial advice is sought to avoid any unnecessary expense being incurred. Equally, funds will also need to avoid the situation where members retire unaware of the new flexibility after which it would be too late to do anything. Again, funds could be exposed.

6 CETV reduction concerns:

- There is a question mark over whether CETV's should be reduced at all. LGPS benefits are guaranteed and paid under statute and therefore members have every reason to expect full payment of those benefits. The introduction of reduced CETVs could be inconsistent with this.

- Requiring funds to reduce CETV payments “in the event that there is a cost risk to taxpayers” misses the point: payment of a full CETV may still be a lower cost to the fund, and paying a CETV will actually reduce pension risk as the fund no longer has to meet that liability.

- Any approach adopted to reduce CETVs could result in very different reduced transfer payments for (say) two members with identical benefits in two separate funds. Also, the impact could vary between different employers within the same fund, potentially giving much added cost and administration.

- Any sort of reduction obviously reduces the amount of cash available to members, and reduces the likelihood that the member will be advised that a transfer is in his or her best interests.

7 The Government’s initial estimate was a take-up rate of around 10% of those approaching retirement. Take up by members will depend upon a number of things, including:

- whether transfers are actively promoted by employers/funds

- what is available in the DC market

- the quality of financial advice

- any cash taken above HMRC tax-free pension limits is subject to the individual’s marginal income tax rate

8 These changes may impact the Fund in two areas –funding level and deficits, and cash flow. The potential impacts are explained below.

9 **Funding Level and Deficits**

The value of the funded pension liability is usually higher than the actual CETV paid out. However, if the fund is in deficit, the reduction in assets following the transfer may reduce the deficit in monetary terms but also reduce the funding level.

For example:

Before transfer:

Liabilities (L)	Assets (A)	Deficit (A-L)	Funding Level (A/L)	CETV
£200	£140	(£60)	70%	£160

One member decides to transfer out her benefits. The fund loses £100 of liabilities and the CETV paid is £80. This gives the revised funding position below.

After transfer:

Liabilities (L)	Assets (A)	Deficit (A-L)	Funding Level (A/L)	CETV
£100	£60	(£40)	60%	£80

10 **Cash flow**

Transfers out of the Fund mean one-off lump sum payments rather than smaller pension payments being paid over a number of years into the future. This will impact both cash flow and potentially the investment strategy. The Fund may need to invest in more liquid, income generating assets, to avoid disinvestment costs if assets have to be sold at inopportune times. The impact of up-front settlement mentioned above will also accelerate negative cash-flow positions. Funds may need more readily available income from existing assets.

11 One positive aspect of transfers out is that they remove some key risks, such as investment, inflation and longevity, in respect of the liabilities transferred.

12 We will be working with WYPF to look at communication to members and employers and ensuring that we have processes in place to meet the new requirements. Officers will be monitoring the situation and report back to the Committee should the take-up be more than expected and start to impact either the cash flow or the funding position. The Fund's actuary, Hymans

Robertson, is able to provide high level impact analysis at either a Fund or employer level if required. They would also be willing to present to the Committee to explain this analysis and answer any questions. The Committee should consider whether they require any further analysis on the potential impact of the new flexibilities offered to members under the Pension Scheme Act 2015.

Conclusion

13 The new flexibilities brought in under the Pensions Scheme Act 2015 bring additional complexity to managing transfers out of the Fund and potentially increase the liquidity requirements of the investment strategy.

14 The Committee should consider whether they require any further analysis on the potential impact of the new flexibilities offered to members under the Pension Scheme Act 2015.

Consultation

a) Policy Proofing Actions Required

n/a

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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