



Fire Officers' Association

GUIDANCE NOTE 11 NPI Pensions Simplification - The Basic Facts

Over recent years, the Government has initiated several investigations into UK pensions provision, and you may have seen articles in the media about them. As a result of these exercises, it has now made significant changes to the tax framework in which pensions sit - the current 8 tax regimes for pensions are being rolled into 1 - and has increased protection for members of pension schemes, notably final salary pension schemes.

This leaflet outlines the changes that are being made through the Pensions Act 2004 and the Finance Act 2004. In some instances there will be greater pensions flexibility, and for the majority of people, pensions will be much more simple going forward.

Most of the changes will be effective from 6 April 2006, known as A-day. Where this is not the case, the effective date has been shown.

Please take time to read the Important Notes section at the end of this leaflet. It contains some words of caution and shows where you can obtain further information.

Minimum Retirement Age

- From 6 April 2010, it will not normally be possible for individuals under age 55 to commence pension income benefits.
- Between 6 April 2006 and 5 April 2010, it will be legal for those over the age of 50 to begin any pension benefits. This includes any retirement lump sum payment and annuity income or drawdown.
- It will continue to be a requirement that retirement income benefits must start prior to age 75.

If our records show that you intend to retire under age 55, but after 5 April 2010, we may now use age 55 as your intended retirement age.

Multiple Pension Scheme Membership

From A-Day, an individual can be a member of as many pension schemes as they wish, at the same time, regardless of the types of scheme and their personal circumstances.

Increases In Annuity (Pension Income)

- From 6 April 2005, it will no longer be a requirement for an annuity (pension income), purchased from Protected Rights funds, to increase each year it is paid.
- From 6 April 2005, it will no longer be a requirement for an annuity (pension income), purchased from money purchase occupational pension scheme funds accrued after 5 April 1997, to increase each year it is paid.
- The removal of these requirements will enable a non-increasing annuity (level annuity) to be purchased
- A level annuity will offer a higher level of starting income, although that income would lose its purchasing power over time because of inflation.

Pension Contributions

- There will be a single limit on the tax-advantaged contributions that can be paid each year into pension schemes by, and for, an individual. This new limit will be known as the 'Annual Allowance'.
- The first Annual Allowance, which will be for the 2006/2007 tax year, has been set at £215,000. It is likely to increase each subsequent tax year.
- With the benefit of tax relief, individuals will be able to contribute up to the higher of:
 - a) £3,600 gross and
 - b) 100% of relevant UK earnings.
- There will be no limit on the amount that employers can contribute to pension schemes in respect of an employee. For large contributions, employers' corporation tax relief may not be available immediately.
- If the total combined individual and employer contributions exceed the Annual Allowance then the individual will be taxed at 40% on the excess. This tax is known as the Annual Allowance charge.
- In some instances, for example with final salary occupational pension schemes, the actual contributions made by, and for, a particular member may not be clear. Therefore, an estimated contribution will be calculated, based on the increase in pension that has accrued from one year to the next.

Maximum Pension Benefits

- The maximum pension limits that the Inland Revenue have in place today, for example, a pension equal to 2/3rds of salary from an occupational pension scheme, will be removed. Instead, the total value (in cash terms rather than annual pension amounts) of all an individuals tax privileged pensions must fall below a new limit, known as the Standard Lifetime Allowance.
- The first Standard Lifetime Allowance, which will be for the 2006/07 tax year, has been set as f 1.5m. It is likely to increase each subsequent tax year.
- If the total value of an individual's pensions exceeds the Standard Lifetime Allowance, the excess will be subject to a tax charge. This will be known as the Lifetime Allowance charge and will be paid when the excess funds are used to provide benefits.

- The Lifetime Allowance charge will be 55% if the excess funds are paid as a cash lump sum and 25% if they are used to provide pensions income (which will then also be subject to income tax, just like any other pensions income).
- If individuals have already accrued very high value pensions that are worth more than the first Standard Lifetime Allowance at A-day (£1.5m), they can apply to the Inland Revenue to protect those pensions from the Lifetime Allowance charge. This protection must be sought, from the Inland Revenue, prior to 6 April 2009.

Retirement Cash Lump Sums

Currently there are different limits on the amount of cash that can be taken upon retirement for different types of pension scheme. These limits will be removed in favour of one simple limit. The maximum cash sum available from a scheme will be 25% of the capital value of the benefits held under that scheme. Therefore, for money purchase pension schemes, such as personal pensions, the maximum cash lump sum available will be 25% of the fund value. It is expected that the fund value will include any Protected Rights and that part of those rights will be available as cash.

- For defined benefit pensions, such as final salary pension schemes, the scheme will calculate the value of the pension to ascertain the maximum that can be taken as cash. It is expected that Guaranteed Minimum Pensions and other contracted-out rights will be able to contribute to the cash sum available.
- At A-day some occupational pension scheme members will have rights to take more than 25% of the value of the pension then accrued as a cash sum; and those rights will be automatically retained within that pension scheme. They will also be uplifted in line with the increase in the Standard Lifetime Allowance. However, benefits accrued after A-day must fall inside the new 25% limit. If benefits are transferred from the scheme, the 25% limit must apply to all benefits.
- If the cash sum taken, in total from all pension schemes, exceeds 25% of the Standard Lifetime Allowance (£375,000 for 2006/07) then a tax charge will be made.

Deferral Of State Pensions & Lump Sum Option

- The Government will encourage those individuals who do not need to commence their State pensions at State Pension Age to defer its commencement.
- If it is deferred, when State benefits are started, an option is to be made available to take the deferred pension payments as a cash lump sum.

Commutation of Trivial Pensions

The ability to commute pensions of a trivial size already exists for some pension schemes and some pension benefits. The ability to offer such commutation is being extended to all pensions, including those in payment, but new rules will be in place to prevent abuse of the facility. The rules are:

- The total value of all an individuals pensions must be less than 1 % of the Standard Lifetime Allowance, (£15,000 for the 2006/2007 tax year). Pensions in payment, as well as those due to come into payment in the future, will all count towards this limit.
- The individual must be over aged 60, but under age 75.
- The triviality payment must extinguish all the individual's rights under the scheme making the payment

- All triviality payments must be made within one 12-month period.
- As is the case now, a tax charge will be made on any amount that exceeds the tax-free cash sum which would otherwise be available from the scheme.
- These new rules may increase or decrease your retirement options depending on your personal circumstances.

Annuities With Lump Sum Death Benefits

- It will be possible for insurance companies to offer an annuity that pays out a cash lump sum upon the death of the annuitant before age 75.
- The lump sum can represent the difference between the annuity instalments paid prior to death and the amount of funds originally used to purchase the annuity. They will be known as 'value protected' annuities.
- The lump sum paid would be subject to a tax charge of 35%. Income Drawdown (Income Withdrawals)
- The minimum and maximum amounts that can be taken under an Income Drawdown arrangement are being revised. Whilst the individual is under age 75, the minimum amount will be £1 pa and the maximum will be 120% of the highest annual annuity that could otherwise be purchased.
- The maximum must be reviewed every five years, or earlier if any further scheme funds are used for drawdown or an annuity is purchased.
- Upon death prior to age 75, a dependant's annuity or drawdown may commence, or the value of the unused pension funds may be paid as a cash sum, subject to a tax charge of 35%.
- Once age 75 is reached an annuity must be purchased or drawdown may continue subject to revised limits. Post age 75 drawdown will be known as Alternatively Secured income, or ASI for short.
- The minimum ASI will be £1 per annum and the maximum will be 70% of the highest annuity that could be purchased for someone, of the same sex, who is 74 years and 364 days old. Upon death in ASI, restrictions are placed on the use of remaining pension funds.

Personal Pension Waiver of Premium

Personal pension contracts issued prior to 6 April 2001 may allow waiver of premium benefit to be added, where it is not already being provided. From A-day, it will no longer be possible to add waiver of premium benefit.

Benefits on Death Before Retirement (Vesting)

Cash lump sums up to the Standard Lifetime Allowance may be paid free of tax. These could include the return of pension funds, or contributions, and the life assurance benefit offered by a defined benefit pension scheme. Dependant's pensions may also be paid, but these will not count towards the Standard Lifetime Allowance.

Protection For Pension Scheme Members

The Pensions Act 2004 contains several measures that aim to provide greater protection for members of pension schemes, particularly those in final salary schemes. These measures include:

- The introduction of a new regulator, known as the Pensions Regulator, to replace the Occupational Pensions Regulatory Authority (OPRA).
- The introduction of the Pensions Protection Fund.
- A minimum knowledge requirement for occupational pension scheme trustees.
- The requirement for 50% of an occupational pension schemes trustees to be nominated by the scheme membership.

The introduction of a Financial Assistance Scheme. Important Notes

1. This leaflet outlines our understanding, as of November 2004, of the changes in pensions and tax law that have been introduced in, or are proposed by, the Finance Act 2004 and the Pensions Act 2004. The changes are summarised here and this leaflet should not be treated, or relied upon, as a statement of law. Whilst every effort has been made to ensure that it is correct, it does not constitute legal advice and NPI cannot accept any legal responsibility for it. NPI always recommends that you seek independent financial advice regarding the matters raised in this guidance note.
2. There may be a difference between what the law will permit and what your pension scheme, or other pensions arrangement, is willing to offer. The changes in law will not affect the investments, bonuses, or charging structures of your policies with us. If your policy contains a guaranteed annuity rate or an option to switch funds free of a Market Value Adjuster at a particular point in time, those options will remain unchanged, providing they do not breach the law.
3. If you had planned to retire or start receiving your retirement income, including any available cash lump sum, after 5 April 2010 at an age under 55, you should seek financial advice.
4. Further information on the Pensions Simplification issues outlined in this leaflet can be found on our website: <http://www.npi.co.uk/simple> The information on the website will be updated on a regular basis.

Additional information on the Governments pensions reforms can be found on the website of the Department for Work and Pensions, at: <http://www.dwp.gov.uk/lifeevent/penret/penreform/>

If you require financial advice as a result of the change in pensions law and taxation outlined in this leaflet, please speak to your financial adviser.

If you are thinking of deferring your retirement we suggest that you seek financial advice before making your decision.