Written Ministerial Statement

Pensions

The Chancellor of the Exchequer (Rt Hon George Osborne): This Government believes that individuals should be trusted to make their own decisions with their pension savings. One of the most important stages in life everybody has to save for is retirement, and one of the biggest financial decisions people will take is what to do with those savings when retiring. Under the old system, only those with very large or very small pension pots could access them with any flexibility.

That is why at the Budget I announced the most radical change to how people can access their pension in almost a century. From April 2015, everyone over the age of 55 with defined contribution pension savings will be able to access them as they wish, regardless of their total pension wealth, subject to their marginal tax rate.

Those who want the security of an annuity will still be able to purchase one. Equally, those who want to access all of their pension savings will be able to take them as a lump sum. Those who do not want to purchase an annuity or withdraw their money in one go, will be able to keep their pension invested and access it over time, for instance through a drawdown product.

These reforms mark a radical departure, by giving choice back to individuals, and since the Budget the government has consulted extensively on how best to implement the changes. I am pleased to say the reforms have overwhelmingly been positively received.

Later today I will lay the Government's full response to the consultation on delivering these changes before Parliament. Before then I wanted to provide a high level summary of the response, information about the resource expenditure for the guidance guarantee and the full details of the decisions with regard to private sector defined benefit pension schemes, which I am setting out in full this morning before markets open.

These reforms create more choices for individuals, and the Government wants people to be equipped and ready to make informed decisions. The right to free and impartial guidance I announced at the Budget will empower savers and ensure that they are clear on their retirement income options before they make any decisions about what to do with their savings.

Given the need for guidance to be trusted by savers, I can confirm today that the guidance guarantee will be provided by independent organisations – with no actual or potential conflict of interest – in order to ensure complete impartiality. Delivery partners will include the Pensions Advisory Service (TPAS) and the Money Advice Service (MAS). The Government welcomes expressions of interest from a range of trusted consumer-facing organisations, including Citizens Advice and Age UK, and looks forward to discussing further with these and other independent organisations how they can be involved.

The Treasury has obtained approval for an advance from the Contingencies Fund of £10,000,000 (out of the £20,000,000 development fund for the guidance guarantee announced at Budget) for preparatory work for the guidance guarantee in advance of Parliament's approval. Parliamentary approval for additional resource of £10,000,000 for this new expenditure will be sought in a Supplementary Estimate for HM Treasury. Pending that approval, urgent expenditure estimated at

£10,000,000 will be met by repayable cash advances from the Contingencies Fund. The repayment is expected to be made in the financial year 2014/15.

I can also confirm today that a new override will be introduced to ensure that pension schemes are able to offer individuals flexible access to their savings, and the tax rules will be amended to allow providers to develop new retirement income products that are tailored to the needs of individual consumers.

The Government wants to maximise freedom and choice for retirement savings, but not if this were to be at the expense of the wider economy. For most defined benefit scheme members, it will be in their best financial interest to remain within their scheme. However, the Government, having considered the issues carefully, agrees with the view of many stakeholders (including the Confederation of British Industry, Association of British Insurers and the National Association of Pension Funds) who have argued it is right to preserve the existing freedom to transfer out of a defined benefit scheme under the new arrangement. The Government will therefore continue to allow transfers from private sector defined benefit to defined contribution schemes, excluding pensions already in payment, subject to additional and important safeguards.

The Government continues to believe that transfers from unfunded public service defined benefit schemes should be banned, in order to protect the Exchequer and taxpayers. Transfers from funded public service defined benefit to defined contribution schemes will be permitted, and safeguards similar to those in the private sector will be introduced where appropriate.

The Government will present the document 'Freedom and choice in pensions: government response to the consultation' to Parliament and place copies of the document in the Libraries of both Houses. The relevant extracts from the defined benefit chapter of the consultation response document are copied below.

Extract from Freedom and choice in pensions: government response to the consultation.

For the majority of individuals, retained membership of a defined benefit pension is likely to be their best option, as defined benefit pensions offer a level of security and guaranteed indexation that defined contribution pensions do not. Furthermore, the transfer values offered when requesting to transfer out are often less than the net present value of the benefits that an individual would ultimately receive from their defined benefit pension.

Nonetheless, it is likely that some individuals will request transfers out of their defined benefit pensions, and for some individuals, this may be in their best interests.

Discussions with stakeholders during the consultation highlighted a range of estimates of the proportion of those who would seek to transfer from a defined benefit scheme. The majority of estimates were between 10% and 20% but with a number expecting transfers to be below 10%. These estimates are consistent with stakeholder feedback that the Budget announcements had resulted in only a very small number of additional requests for transfers.

A precise figure of the proportion of transfers will be inherently difficult to determine, being dependent on a number of factors, including: whether pension schemes actively promote transfers; the attractiveness of new financial products being offered in the defined contribution market; and any requirements to take, and the quality of financial advice.

Pensioners are excluded from the right to transfer

Currently, existing (as opposed to future) pensioners are prevented from transferring out of their defined benefit schemes by law. A number of stakeholders highlighted the risks of changing the current position; very few representations were received arguing to do so.

Stakeholders highlighted the significant adverse selection risk of allowing current pensioners to transfer out of their defined benefit schemes. Such a scenario would place significant risk onto the pension fund, and would be unfair to remaining members, and could require schemes to increase their funding requirements. Stakeholders noted that retaining the current position whereby pensioners have no statutory right to transfer would retain equality with those who have already purchased annuities with their defined contribution savings. The Government has therefore decided to retain the current ban on existing pensioners transferring out of defined benefit schemes. Netting out pensions in payment from the total asset base reduces substantially the amount of assets potentially subject to transfers.

Timing of transfers out of defined benefit schemes

The timing of any transfers out of a defined benefit scheme will also make a difference to the impact on scheme investments.

Stakeholders noted that members of private sector defined benefit pension schemes who wish to transfer would benefit by doing so as close as possible to the point they crystallise their pension. It is unlikely that transferring to a defined contribution scheme earlier in life would lead to greater pension wealth in retirement compared to accruing more years of defined benefit pension, or, for those with deferred benefits, benefitting from index linked up-lifting. This means that any transfers would be likely to take place over a number of years, in line with the age profile of members, rather than all at once.

Wider defined benefit investment trends

As a number of responses to the consultation highlighted, in recent years, there has been a significant trend of de-risking by defined benefit pension schemes, characterised by shifts in asset allocation from equities into fixed income. This trend has been driven by changes in the regulatory approach, accounting standards, increasing risks from longevity, and the increasing maturity of schemes, with most closed to new members (and some to future accruals).

Therefore it is expected that there will still be a strong continuing demand for high quality fixed income assets, including government and corporate bonds, in the future from defined benefit schemes, even allowing for a possible reduction in demand due to transfers out.

Impact on financial markets

Taking into account the exclusion of pensioners from the right to transfer; the limited number of active and deferred scheme members for whom it would be in their best interests to transfer; and the likelihood that those transferring would do so when they reach the scheme's normal age for crystallising their pension pots, the Government believes that the overall impact on the existing defined benefit asset base is likely to be limited if private sector defined benefit to defined contribution transfers continue to be allowed.

From a market perspective the impact of maintaining defined benefit flexibility will at the margins necessitate greater liquidity in asset holdings. However the main driver underpinning portfolio

restructuring in the future is likely to continue to be increasing maturity of defined benefit schemes and corresponding de-risking, irrespective of any decision on defined benefit flexibility.

Therefore, the Government has decided that retaining the existing flexibility of transfers out of private sector defined benefit schemes for all pension members (other than those whose pensions are already in payment), together with the additional safeguards outlined below, is appropriate.

<u>Introducing additional safeguards – supporting individuals to make an informed choice</u>

A number of stakeholders who supported retaining the current right for private sector transfer suggested that current safeguards could be improved.

At present, although the majority of defined contribution schemes will only accept transfers if professional financial advice is taken, guidance for transfers from defined benefit schemes only stipulates that such advice has to be taken when transfers are instigated by the employer not when they are instigated by the employee. The Government intends to make it a statutory requirement on the transferring scheme for all individuals who are considering transferring out of defined benefit schemes to take advice, from a professional financial adviser who is independent from the defined benefit scheme and authorised by the FCA, before transferring. The FCA are today publishing a thematic report on enhanced transfer values out of defined benefit schemes, summarising examples of good and bad advisory practice.

As a result, defined benefit schemes will be required to check that a member has taken advice from a professional financial adviser who is independent from the defined benefit scheme and authorised by the FCA before allowing a transfer out of the scheme. In most cases the individual pension member will need to pay for the financial advice. However, responsibility for paying for the financial advice will fall on the employer if the transfer is from defined benefit to defined contribution schemes within the same scheme, or as a result of an employer led incentive exercise.

The proposal to make it a statutory requirement to take professional financial advice was recommended by a large number of stakeholders including the ABI and CBI. It will ensure that all pension fund members are fully informed before taking any decision, and counteract the risk that a significant number of pension scheme members act against their own best interests or are coerced out of their scheme. This requirement for professional financial advice would not apply to small pot holders with pension savings below £30,000 as the trivial commutation rules would still apply.

<u>Introducing additional safeguards – protecting pension schemes</u>

Although it is unlikely that the number of members of defined benefit schemes wishing to transfer would be sufficient to destabilise any individual scheme, this was nonetheless a concern raised by a number of stakeholders who were supportive of allowing continued flexibility.

At present pension fund trustees have the power to ask the Regulator for longer to make transfer payments if the interests of the members of the scheme generally will be prejudiced by making the payments within the usual period. Trustees are also able to reduce the transfer values offered to individual members to reflect the schemes current funding position. As it stands current powers available to trustees are sufficient to keep schemes viable under the new flexible pensions regime. However the Government wants to ensure that trustees are fully aware of these powers and are prepared to use them should the need arise. The Government therefore intends to ensure that there is new guidance to trustees on the powers available to them to maintain the sustainability of

schemes. The Government will work with the Pensions Regulator, employers and trustees to develop the guidance.

Future changes to private sector defined benefit transfers

A number of stakeholders raised the issue during the consultation of allowing full or partial withdrawals direct from a defined benefit scheme, rather than an individual first needing to transfer to a defined contribution scheme. The argument being that requiring members first to transfer to defined contribution schemes creates additional unnecessary burdens and that allowing full or partial withdrawals from defined benefit schemes would better enable the pensions industry to provide the pension products that their members want. The Government intends to consult further on this issue.

HM Treasury

21 July 2014