BUDGET 2014: ANNOUNCEMENTS AFFECTING PUBLIC SERVICE PENSIONS

At Budget 2014 the Chancellor announced major reforms to allow people greater choice over how they access their defined contribution pension savings. As part of these reforms the Treasury launched a consultation, *Freedom and choice in pensions*[1], which proposes, amongst other issues, two specific changes which could affect public service pension schemes. There was also a further announcement on the detail of the welfare cap.

Restrictions on CETV transfers

Members of a defined benefit pension scheme can currently transfer their pension to another pension scheme, subject to certain conditions. Members of a defined benefit scheme may be more attracted to transfer benefits to a defined contribution scheme as a result of the proposals to change how defined contribution pension savings can be accessed. If more people transfer their rights from unfunded public service pension schemes to defined contribution schemes, this would expose the Exchequer to significantly higher costs. The Government consultation therefore proposes to remove the option to transfer from a public service defined benefit scheme to a defined contribution scheme, except in very limited circumstances. A selected section of the consultation text is contained at the annex.

Changes to the Minimum Pension Age

The Minimum Pension Age is the age from which a pension scheme member can take their pension without incurring a tax charge of up to 55% (unless the member has a ‘protected pension age’) and is currently set at age 55. As part of the reforms to accessing defined contribution benefits, the Government is consulting on raising the minimum age to 57 from 2028 (unless people have built up pension savings in defined benefit schemes with a lower Normal Pension Age). The Government consultation seeks views on its preference that the new minimum age should apply to all pension schemes which qualify for tax relief but has sought views on whether this is the correct approach, particularly given the recent reforms to public service pension schemes. Importantly the changes would not impact on ill-health retirements before age 57. A selected section of the consultation text is contained at the annex.

Welfare Cap

The Government announced at Spending Round 2013 that a cap on welfare spending will be introduced to improve spending control. Budget 2014 caps welfare spending in scope for the years 2015-16 to 2018-19 at the level of the OBR’s forecast, as published in the OBR’s March 2014 ‘Economic and fiscal outlook’. A forecast margin of 2% above this level will ensure that policy action is not triggered by small fluctuations in the forecast. The Treasury have confirmed that public service pension scheme expenditure will not be caught by the welfare cap.

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1 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/294795/freedom_and_choice_in_pensions_web_210314.pdf

Annex

Selected consultation text

Restrictions on CETVs

"5.3 Currently, members of a defined benefit pension scheme have the right to a Cash Equivalent Transfer Value (CETV). This allows them to transfer to any other pension scheme, subject to certain conditions. If they transfer to a defined contribution scheme (assuming that the defined contribution scheme accepts the transfer), they would typically convert their defined benefit pension rights into a discrete pension 'pot'. This is an option which is not likely to be taken out by many defined benefit pension scheme members (in public service schemes in particular), unless an adviser or product provider can, exceptionally, demonstrate that it is in the individual member's best interests to do so. There are strict regulatory requirements on pension transfers which will continue to be in place under the new system, and defined benefit schemes will continue to offer their members a secure income in retirement. However, the government recognises that the attractiveness of transferring from defined benefit to defined contribution may increase as a result of the changes to the tax framework for how defined contribution pension savings can be accessed.

Public sector schemes

5.4 The majority of public service defined benefit schemes operate on an unfunded basis. This means the contributions of members and employers are used to pay for pensions in payment, with any surplus payments required being met by taxpayers through payments from the Exchequer. As there are no pension 'funds' for these schemes, where a member chooses to take a CETV there is a direct upfront cost to the Exchequer, which must both provide the CETV and cover the cost of any foregone contributions which would have been used to pay for pensions in payment.

5.5 More people transferring their rights from unfunded public service defined benefit schemes to defined contribution schemes, to take advantage of the new tax rules, would therefore expose the Exchequer to significantly higher costs on a current year basis.

5.6 Initial government estimates suggest that the net cost of 1% of public service workers transferring out of public service schemes each year would be £200 million. This burden would be borne by the Exchequer, which would need to fund the additional costs by placing the burden onto taxpayers or onto current scheme members by imposing higher contributions. The government believes that continuing to allow people to transfer from a public service defined benefit scheme to a defined contribution scheme to take advantage of the new system would therefore be unfair on both the taxpayer and remaining scheme members.

5.7 Having considered these issues carefully, the government intends to introduce legislation to remove the option to transfer from a public service defined benefit scheme to a defined contribution scheme, except in very limited circumstances. In the interest of fairness to members and consistency across schemes, the government's preferred approach is to treat all public service schemes equally including those which are funded or have funded elements. However, were there to be a different approach adopted for non-public service schemes (discussed below), the government would consider how best to treat the funded elements of the public service schemes.

5.8 The government does not intend to change the rules affecting transfers from public service defined benefit schemes to other defined benefit schemes (or vice versa). The government has recently announced reforms to the Fair Deal policy which will allow staff previously outsourced from the public services to transfer accrued benefits from private pension schemes back into the public service pension schemes. Furthermore, transfers between defined benefit schemes are necessary for the operation of the Public Sector Transfer Club. The Club allows public servants to transfer their benefits between public service pension schemes, and some other defined benefit schemes, on preferential terms. The aim of these policies is to improve labour mobility between public service employers. The government has committed to retaining this as part of the wider deal on public service pension reform, and this is not affected by the changes to the tax framework proposed in this consultation."

Changes to the Minimum Pension Age

"3.29 In most circumstances, the current tax rules allow people to access their pension savings in some form from age 55. In a system where people are required to secure an income for themselves, the age when they choose to do so can be seen as largely a question for individuals. However, in a more flexible system it is important to ensure that providing people with access to their savings is balanced with the need to provide them with incentives to accumulate sufficient pension savings. The government also needs to reflect that people will be living and working for longer in the future.

3.30 The government therefore proposes to increase the age at which an individual can take their private pension savings at the same rate as the increase in the State Pension age. It is important people have the opportunity to plan properly for this change and so the government proposes to wait until 2028 (when the State Pension age will rise to 67) to fully implement this change. From 2028, people will not be able to draw their private pension benefits without a tax penalty until age 57[8], whether or not this is the point at which they stop work. From then on, the minimum pension age in the tax rules will rise in line with the State Pension age so that it is always ten years below.

3.31 The government's desire is for the new system to be simple and transparent and therefore proposes that the new minimum age will apply to all pension schemes which qualify for tax relief. However, views are welcomed on whether this approach is correct, given the issues outlined in Chapter 5 of this consultation, and the recent reforms to pension ages in the public service pension schemes.

[8] Unless people have built up pension savings in defined benefit schemes with a lower Normal Pension Age

3.32 Moving the minimum pension age to 57 will not prevent pension schemes offering retirement at earlier ages to people who have severe health problems. Nor will this change prevent people stopping work younger than 57 if they can afford to do so using resources other than pensions. Many people already save for their retirement in other ways. Raising the minimum age for taking benefits from tax-privileged schemes is, however, an important signal, and provides people with extra time to accumulate their pension savings and aligns with the government's other pension reforms."