

DC retirement reform from April 2011

From April 2011, retirement options for defined contribution (DC) members are changing. The requirement to annuitise by age 75 has already gone and a DC member will have more freedom in what they can do with their DC 'pot'.

The government has confirmed that individuals will be able to draw an income directly from their DC 'pot', provided they satisfy a new income threshold, which will be known as the Minimum Income Requirement (MIR). To pass this threshold, the individual must have secured a lifetime annual pension income of at least £20,000. There was much debate within the pensions industry on the appropriate level of MIR, but the £20,000 level should mean that people are unlikely to fall back on the State as they cannot exhaust this secured part of their savings.



What counts towards the Minimum Income Requirement?

The MIR can be made up of a variety of pension income sources, including income from State Pensions, any defined benefit promises as well as annuities that have already been secured. Importantly, the benefits must be in payment for them to count towards the MIR. The requirement is that the individual should have a secured income of £20,000, noting that there is no requirement for the pension to be inflation protected.

Once an individual has secured the MIR, they will have increased flexibility as to what they can do with their DC 'pot'. If they so choose, they can start drawing an income straight from their 'pot' and can continue to do so without the need to annuitise. In effect this means that they can drawdown any amount from their 'pot' (up to the full amount in one go!) as and when their personal finances require. Any drawdowns will, however, be taxed as income at their marginal rate.

Impact on Trustees

The first reaction from Trustees may be that this change will not immediately impact their scheme, as many DC members are currently unlikely to be in a position to secure a pension close to the MIR. However, this may not always be the case.

In the first instance, Trustees should consider their DC membership. If there is a significant proportion of the membership also having accrued defined benefit rights within the scheme, many members may be closer to the £20,000 limit than the Trustees may originally have thought. Therefore, the Trustees should consider whether this increased flexibility is to be made available in their scheme.

DC members, who are interested in this option, are for the first time going to have a target income in mind. This has never existed in a DC environment before. Therefore, do existing lifestyle strategies need to be reviewed with this target in mind? The typical lifestyle options are aimed to target 75% bonds/gilts and 25% cash at retirement. This is so members have a good idea of the cash lump sum they will have when they retire. However, if more than 25% can be taken as cash, the appropriate investment strategy for them is likely to be different. There are many different ways in which a lifestyle could be constructed for scheme members able to target the MIR.

The traditional lifestyle approach will continue to apply for the vast majority of scheme members, but if they do want to look to do something different, they will need to start taking more ownership and responsibility for their investment decision making. Consequently, Trustees will need to decide what support and flexibility they are prepared to offer scheme members with their retirement planning.

In a nutshell

- **The requirement to purchase an annuity by age 75 has been removed**
- **The government has introduced the concept of a Minimum Income Requirement of £20,000. Once an individual has secured this level of retirement income, they are able to draw an income directly from their DC 'pot' of an unlimited amount (i.e. up to 100%)**
- **Traditional lifestyle approaches may not be appropriate for scheme members that want to take advantage of this additional flexibility. Trustees should consider whether their current lifestyle structures and the support that they provide at retirement remain appropriate.**

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2011 PricewaterhouseCoopers LLP. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.