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Freedom & Choice

Changes in pension legislation from April 2015: A practical guide for Trustees

Deloitte Total Reward and Benefits Limited
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This document is intended for Trustees of trust based occupational pension schemes as a high level reference guide.

We have made every attempt to make sure this document is correct at the time of going to press, however, it should be noted that in the run up to 6 April 2015, legislation and guidance is still being drafted, consulted upon and updated constantly. As such, this document is meant to provide a high level guide and Trustees are encouraged to work closely with their advisers to address and consider each area with respect to the circumstances of their own scheme(s).

Executive Summary

Introduction

The government is introducing some of the most significant changes to pensions legislation in almost a century. “Freedom & Choice in Pensions” will come into force from 6 April 2015. These changes will allow pension scheme members full flexibility in how they access their Defined Contribution (DC) pension saving when they reach retirement age. The Pensions Act 2015 received Royal Assent on 3 March 2015.

Although the changes are therefore primarily aimed at DC schemes, there will be significant impact on Defined Benefit (DB) Schemes as well.

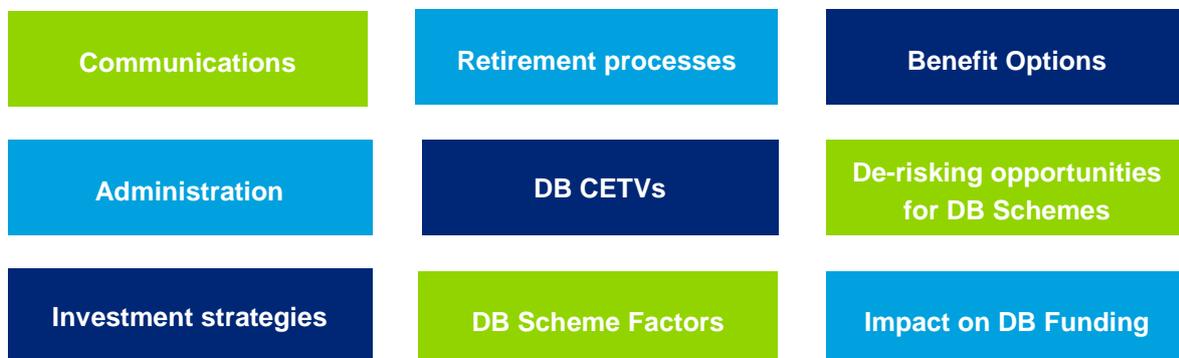
This document is intended to provide a high level guide to the issues that will need to be considered and provides a checklist for pension scheme Trustees (both DC and DB) to help them prepare their schemes for the changes.

The areas impacted by the changes are listed below. When preparing for the new legislation, Trustees should consider all of these areas, but have in mind the following four key factors:

<ul style="list-style-type: none">• Governance requirements	What additional governance/monitoring will be required when changes to member options within the scheme have been made?
<ul style="list-style-type: none">• Costs	What will be the costs of implementation, ongoing administration and governance of the new options?
<ul style="list-style-type: none">• Members’ requirements	Will the members actually use these new options? Can the new options be accessed elsewhere more cost effectively?
<ul style="list-style-type: none">• Sponsoring Employer	What options would the sponsoring employer like to see within the scheme and what level of additional costs would they support?

Areas impacted

There are a number of areas impacted by the changes and the Trustees should consider the possible implications in each of these areas.



Communications

Clarity of member communications will be of paramount importance.

Trustees should develop an overall communication strategy.

Clarity of member communications will be of paramount importance. This should include:

- the changes in general and the new freedoms available at retirement within the market;
- the new freedoms that will be made available to members from within their pension scheme; and
- how/where the members can access help/guidance/advice to help them make appropriate choices during their working life, at the point of retirement and beyond.

Trustees should develop an overall communication strategy that covers all of their members' pension saving journey in the scheme, from joining, ongoing saving, getting ready for when they retire and perhaps beyond.

General approach

There are parts of the new legislation and guidance that Trustees will need to comply with, and we have highlighted these where appropriate. Having said that, **Trustees are under no obligation to provide any of the new flexibilities at retirement from within their pension scheme(s).**

As a minimum, Trustees will need to ensure compliance with the new legislation (which will mainly relate to disclosure requirements for members at retirement and the need for confirmation of independent financial advice on payment of a DB CETV). Trustees will also need to decide upon what flexibility choices at retirement that they will provide over and above the options already provided.

To do this, we would recommend that Trustees consider the views of the sponsoring employer(s) and also the potential governance and administration requirements at high level in the first instance.

As a starting point, we would recommend that Trustees adopt a "business as usual" approach, perhaps with some of the simpler additional flexibilities included in their schemes. In short:

Defined Contribution Schemes

Business as usual plus the option of full withdrawal at retirement

Defined Benefit Schemes

Business as usual plus the option of a CETV at retirement

That is to say:

- for a DC scheme, continue to offer up to a 25% tax free cash lump sum on retirement alongside annuity purchase, but perhaps with the additional option to make a full withdrawal of all pension saving on retirement; and
- for a DB scheme, continue to offer up to a 25% tax free cash lump sum on retirement along with a reduced scheme pension, but perhaps with the option to take a Cash Equivalent Transfer Value (CETV) at retirement.

Although this is our expected general approach, the actual approach adopted by Trustees will depend upon a number of factors, for example, the desires of the sponsoring employer, the profile of the membership and the costs of implementation and administration.

Collaborative Approach

With so many areas impacted by the changes and new regulations which schemes will need to meet, it will be important for Trustees to work closely with their advisers and consult with the sponsoring employer in making decisions and implementing strategies.



Trustee checklist

A checklist of the areas that Trustees will need to consider is included in the appendix to this document. This is an initial guide only and the full extent of action required will very much depend upon the specific circumstance of each scheme and any additional legislation or guidance that is issued following the publication of this document.

1 Introduction

Background

The government is introducing some of the most significant changes to pensions legislation in almost a century. The new “Freedom & Choice in Pensions” will come into force from 6 April 2015. The changes will allow pension scheme members full flexibility in how they access their Defined Contribution (DC) pension saving when they reach retirement age. The Pensions Act 2015 received Royal Assent on 3 March 2015.

This flexibility for members can range from full withdrawal of their DC pension savings on the day of retirement, to purchasing an annuity, to leaving the monies invested in their pension scheme to access at a later date. In short, once a member has reached age 55 (or 57 from 2028) they can choose to access as little or as much of their DC pension saving whenever they wish to do so.

Although the changes are primarily aimed at DC schemes, there will be significant impact on Defined Benefit (DB) schemes as well. Please note that for DB schemes, the freedoms will not apply directly, but will apply to Additional Voluntary Contributions (AVCs) saving within DB schemes made on a DC basis. All references to DC schemes in this document therefore include AVCs on a DC basis.

This document is intended to provide a high level guide to the issues that will need to be considered and provides a checklist for pension scheme Trustees (both DC and DB) to help them prepare their schemes for the changes. Trustees with hybrid schemes (both DC and DB, or with DB/DC underpins to benefits) may need further consideration.

Timescales are tight and new updates, guidance and developments are emerging every day. This document should however provide a guide to navigate through the issues.

The changes are primarily aimed at DC Schemes, however there will be a significant impact on DB Schemes as well.

AVCs within DB schemes will be subject to the changes.

DB/DC Hybrid schemes may need special consideration.

The changes

The full choice in flexibilities at retirement for DC pension saving will come into force from 6 April 2015. The broad options at retirement for DC pension saving will be:

- **25% tax free cash lump sum**
- **Purchase an annuity (subject to income tax)**
- **Full withdrawal at retirement (25% tax free, the remainder subject to income tax)**
- **Flexi- Access Drawdown (25% tax free, the remainder subject to income tax)**

Subject to the amount of savings an individual member has, they may choose a combination of the above options. In addition, more retirement products are expected to come to the market in future, such as fixed term annuities, variable annuities, “later-life” deferred annuities and fixed “drawdown” products.

What is required?

The principle behind the new legislation is to allow individuals greater flexibility in the way they access their DC pension saving at, and throughout, retirement. Although there are certain aspects of the legislation that pension schemes must comply with, it is not necessary for pension schemes to offer the full range (or indeed any) of the new flexibilities.

If a scheme is unable to accommodate a member's requirements for flexibility at retirement, the member will have the opportunity to transfer the value of their pension saving out of the scheme to an alternative pension provider who may offer the flexibilities that they require.

More choice may mean more confusion for members. Trustees have a duty to make sure their members are informed of the options available, to provide information to members and inform them of where they may get further assistance. Some of the decisions made at retirement may be irreversible, hence the importance of clear communication.

It is not the Trustees' role to prevent their members from making mistakes with their pension saving.

“It is not the trustee’s role to.....prevent a member from making decisions which the trustees might consider to be inappropriate to the member’s circumstances.”

Pensions Regulator: Consultation document: DB to DC transfers and conversions

When preparing for the new legislation, Trustees should bear in mind the following four key factors:

- **Governance requirements**

What additional governance/monitoring will be required when changes to member options within the scheme have been made?

- **Costs**

What will be the costs of implementation, ongoing administration and governance of the new options?

- **Members' requirements**

Will the members actually use these new options? Can the new options be accessed elsewhere more cost effectively?

- **Sponsoring Employer**

What options would the sponsoring employer like to see within the scheme and what level of additional costs would they support?

At the very least, if Trustees do not wish to include any of the new flexibilities within their scheme(s) they will need to ensure compliance with the new legislation (which will mainly relate to disclosure requirements for members at retirement and the need for confirmation of independent financial advice on payment of a DB CETV).

Pensions Liberation Fraud

Trustees should note that the new flexibilities may see an increase in Pensions Liberation Fraud. Trustees should work with their advisers and administrators to minimise the possibility of this fraud happening to their members. Trustees should make their members aware of the potential for such fraud to occur.

“This government believes in the principle of freedom. Individuals who have worked hard and saved responsibly throughout their adult life should be trusted to make their own decisions with their pension savings” – George Osborne

2 General Considerations

There are a number of general considerations for Trustees in respect of the Freedom & Choice changes for both DC and DB pension schemes. These are set out below.

Consulting with the Employer

The sponsoring employer will be interested in the potential changes to its pension scheme as a result of Freedom & Choice for the reasons set out below:

Increased costs

Ultimately, it is the sponsoring employer who picks up the cost of trust based occupational pension schemes. The sponsoring employer is likely to want to have “successful retirements” following the changes to maintain some element of workforce management and succession planning via the pension scheme. Trustees should therefore consider consulting with the sponsor when making decisions on what flexibilities will be offered in their scheme.

Workforce management

Trustees should engage with the sponsoring employer on the upcoming pension changes, including:

- The amount of flexibility / options that members should be offered within the scheme where applicable (both DC & DB);
- The administration and communication processes in respect of the changes; and
- The additional costs that may be incurred in setting up and administering the additional flexibilities within the scheme;

De-risking opportunities in DB schemes

The freedoms may also mean there is an opportunity for the sponsoring employer to de-risk its DB scheme(s). This de-risking may offer members of DB schemes additional flexibility to access their pension saving and may improve the overall funding level of the DB scheme. Trustees would be recommended to follow the Code of Practice on Incentive Exercises as issued by the Incentive Exercises Monitoring Board in relation to these potential de-risking options.

Communication Strategy

Clear communication

Ongoing communication strategy

Scheme documentation

It is likely that many pension scheme members are already aware of the upcoming changes. It will be important for members to have a clear understanding of how the changes could/will impact their pension saving in their scheme. Clarity of communication will be essential, particularly for those close to accessing their benefits. We have set out below some guidance on what the communication strategy should consider initially. It is important to note that the communication strategy should be reviewed and refined as experience develops. Trustees may wish to issue communications jointly with the sponsoring employer.

1. Initial communication (DC and DB Schemes)

Scheme members will want to know what Freedom & Choice is all about and how it will impact their pension savings in your scheme. Some members may now be planning their retirement post April 2015. Trustees may wish to consider issuing an initial communication to members ahead of April 2015. This should cover:

- general information as to the changes which will apply to DC pension saving from April 2015;
- a reminder to DC members to review their investment options and in particular to review their position if they have entered into the “lifestyling” phase prior to their retirement;
- a statement that the Trustees are reviewing which options to provide and processes required to facilitate those options;
- management of members’ expectations if the Trustees are not likely to provide all of the new freedoms within the scheme; and
- that the Trustees will write to members once again to inform them of the changes that will be made to scheme once these have been decided upon.

2. Communicate changes made to the Scheme (DC and DB)

Once the Trustees have decided upon the changes which will be made to the scheme, this should be communicated to members. This communication will need to set out information as to what retirement options will now be available to members and the processes which must be undertaken in order to make retirement decisions. Trustees should also highlight the importance of taking independent financial advice when making retirement decisions, including signposting members to **PensionWise** and the **Guidance Guarantee**.

3. Review scheme booklets and member notifications (DC and DB)

Trustees should consider updating the scheme documentation (e.g. member booklets, websites, newsletters, etc) to reflect any changes made to the scheme.

4. Ongoing communication strategy (mainly DC)

With the increased flexibility and options available to members, Trustees will need to make sure members are provided with sufficient information and guidance to enable them to make appropriate decisions about their retirement benefits. This will include information on joining, regular communications, benefit statements, “warm-up” packs (sometimes referred to as “wake-up” packs) pre-retirement and options at, and beyond, retirement, where applicable.

Trustees should review the ongoing communication strategy for the scheme. The Pensions Regulator encourages Trustees to document their approach to communications in a plan, setting out the communication objectives, how they will be achieved and who is responsible for the different aspects of communications.

The overall objective of the communication strategy should be to promote better outcomes for members at retirement.

The Pensions Regulator has issued a draft essential guide to communicating with members about pension flexibilities.

This draft guide has been issued in advance of the disclosure regulations being finalised. It is designed to help Trustees meet the new requirements and provides suggestions for wording in respect of the generic risks associated with different options. The draft guide will be updated once the draft regulations have been passed by the government.

Scheme Administration

Administration complexities costs (DC and DB)

Offering the increased flexibilities and options at retirement as a result of the new freedoms will lead to increased costs. There may be implementation costs for some options and there is likely to be increased ongoing administration costs. On top of this, the Trustees may spend more time and have increased costs in respect of additional governance requirements.

Retirement correspondence (DC and DB)

Retirement correspondence and processes will need to be reviewed to accommodate the new freedoms:

- Draft regulations have been published setting out the additional disclosure requirements for DC schemes at retirement which come into effect from 6 April 2015, including signposting the Guidance Guarantee.
- Administration processes will need to be updated. In particular, once members have accessed their benefits flexibly, it will be necessary for notification to be made to them in respect of their new reduced Annual Allowance (known as the **Money Purchase Annual Allowance**). This information will need to be recorded for future reference.

DC Retirement Processes

Freedom & Choice changes will also impact DB administration processes, The Pensions Act 2015 requires that members must seek **Independent Financial Advice** from an FCA authorised individual if they are considering taking a Cash Equivalent Transfer Value (CETV) that has a value (before any reductions that are applied due to any underfunding) of over £30,000. Trustees must confirm that such advice has been received before they can pay such a transfer.

DB Retirement and CETV processes

Trustees may consider quoting a CETV as part of DB retirement options correspondence. This will need to be clearly communicated and processes will need to be updated to allow members to make fully informed decisions.

The Financial Conduct Authority has issued a Policy Statement in respect of its “second line of defence”.

The Policy Statement “Retirement reforms and the guidance guarantee: retirement risk warnings” has been issued by the FCA and applies across the pensions industry, including trustees of DC schemes (and schemes with a DC element).

The statement has been issued to provide a “second line of defence” from concern that individuals who do not take regulated advice or do not use the PensionWise service may not have enough information to make important decisions, some of which may be irreversible.

The draft essential guide to communicating with members about pension flexibilities issued by the Pensions Regulator has been designed to help pension scheme Trustees to meet the requirements in the statement.

Legal Advice

Trust Deed and Rules

Statutory Override

Legal advice

There is a statutory override in the new legislation enabling Trustees to pay benefits in line with the new freedoms with effect from 6 April 2015, without needing to amend the Trust Deed & Rules. In spite of this, Trustees may wish to consider taking legal advice to make sure there are no unintended consequences of providing additional flexibility and also to maintain a record of which options are allowable under their scheme.

Examples of possible areas that should be reviewed in scheme rules include (these are discussed in more detail in this guide):

- Availability of retirement options (DC)
- Provision of non-statutory CETVs (DB)
- Taking partial transfers of benefits (DB and DC)
- Trivial commutation and “small pots” limits (DB)

There are also other considerations for which the Trustees may need to seek legal advice, for example, the scheme’s discharge forms on payment of CETVS and making sure Trustee indemnities are appropriate in light of the expanded options offered to members at retirement.

3 Defined Contribution (DC) Schemes

Freedom & Choice will increase the range of options available at retirement to members of DC pension arrangements. This will also include Additional Voluntary Contributions (AVCs) within DB pension arrangements.

When considering the changes, Trustees should be mindful of the Pensions Regulator's six DC principles and the underpinning 31 detailed DC quality features representing the required standards of governance and administration for DC schemes. Further, DC Trustees should also be mindful of the requirement to issue an annual governance statement commenting on the operation and governance of their scheme(s).

Benefit Options

Trustees will need to consider what flexibilities and options should be made available to members in the scheme and how these changes will be facilitated.

The full range of options will cover:

- 25% tax free cash lump sum
- Purchase an annuity (subject to income tax)
- Full withdrawal at retirement (25% tax free, the remainder subject to income tax)
- Flexi- Access Drawdown (25% tax free, the remainder subject to income tax)

(There may be added complexities in the approach for AVCs within DB pension arrangements; Trustees should take legal advice to support any decisions taken.)

As a starting point, we would recommend that Trustees adopt a “business as usual” approach, perhaps with some of the simpler additional flexibilities included in their schemes. That is to say for a DC scheme, continue to offer up to a 25% tax free cash lump sum on retirement alongside annuity purchase, but perhaps with the additional option to make a full withdrawal of all pension saving on retirement.

This full withdrawal of DC benefits from the scheme at retirement would be via a one-off lump sum (known as an “Uncrystallised Funds Pension Lump Sum” or UFPLS).

It is worth noting that:

- the concept of trivial commutation for DC schemes will no longer exist under the new pension legislation, as members will be able to access full withdrawal of their DC pension saving, regardless of the size of their pension savings; and
- Flexi Access Drawdown is regulated by the FCA, whereas there is currently no regulator in respect of the operation of UFPLS. It is expected that the Pensions Regulator may issue guidance on the operation of UFPLS.

What should be made available to members?

Added complexity for AVCs in DB Schemes

“Business as usual” approach

Full withdrawal at retirement via Uncrystallised Funds Pension Lump Sum

DC Investment Strategy

In a trust based DC scheme, members are able to choose where to invest their pension savings from a range of funds. Where no investment decision is made, their pension savings are invested a default fund, selected by the Trustees.

The new freedoms may either increase member engagement with their investment choices or cause more members to rely on the default option. Either scenario will mean that Trustees will need to take investment advice and carefully consider the investment choices offered to members. There is likely to be greater emphasis on selecting an appropriate default fund. Careful communication and the provision of clear investment information will be of paramount importance in helping members to achieve better outcomes.

Areas that will need to be considered include:

Default investment strategy

- The default investment strategy and lifestyling process which gradually switches members' benefits into less risky assets as they approach normal retirement age.
- Traditional lifestyling processes assume members will take 25% of their DC pension saving as cash at retirement and use the remainder to purchase an annuity. This leads to a gradual switch of the DC savings from growth assets into 'matching' assets (i.e. cash and bonds) in the period up to retirement. The switching is phased over a period of circa 5 to 10 years typically.

Lifestyling process and period

- Scheme members may be less likely to select these traditional options at retirement, and so the current lifestyling target funds at retirement may no longer be appropriate and should be reviewed.
- Trustees may wish to consider offering a number of 'default' investment lifestyling strategies which depend upon a member's intentions on how to access their DC pension savings at retirement.
- Trustees should also consider the period over which lifestyling occurs and communicate with members when their lifestyling process is about to start, to make sure the switching period remains appropriate.

Fund range pre and post retirement

- For those members who are undecided on how they may access their DC pension saving at retirement, Trustees should consider what their "**default** default" investment strategy should be.
- Trustees may need to consider reviewing the range of funds available to better meet the needs of the members. This may take into consideration the retirement options available within and outside their scheme. Trustees should also consider the range of funds available post retirement, for those members who want to leave their funds invested until a later date.

Communications and provision of investment information

- Trustees should consider the investment information made available to members and whether the current communication of this information is sufficient.
- Any changes to the default investment strategy and lifestyling option will need to be clearly communicated, but the Trustees should also consider whether more regular communications are required, highlighting the investment options available and the importance of retirement planning.

DC Annual Benefit Statements

Legislation requires DC Schemes to provide active members with annual benefit statements which set out a statutory projection of the benefits they may expect to receive at retirement. These are often referred to as the Statutory Money Purchase Illustrations (or SMPs). The legislation prescribes the minimum information which must

be contained within these statements, and this continues to assume an annuity purchase at retirement. Trustees should consider whether they would wish to include further information over and above the statutory requirements in respect of the Freedom and Choice changes within these statements to assist DC members with their retirement planning.

4 Defined Benefit (DB) Schemes

Although Freedom & Choice is primarily aimed at DC pension schemes, there may be significant potential impacts for DB pension schemes. Members may wish to try to take advantage of the flexibilities by taking a transfer of the value of their DB pension savings to a DC arrangement. Therefore there are a number of considerations for Trustees in respect of DB schemes. **Rather like funding, Trustees should take an integrated approach to DB CETVs, considering the investment strategy, covenant strength and funding strategy.**

DB Benefit Options

Cash Equivalent Transfer Values (CETVs)

Non-statutory CETVs

Part of retirement process

Independent Financial Advice

DB members have a statutory right to a CETV up until one year from normal retirement (provided they have ceased accruing benefits). Trustees have the discretion (Trust Deed & Rules permitting) to pay a CETV up until the point that the member crystallises their benefits at normal retirement.

The changes in respect of Freedom & Choice may mean that more DB members may wish to transfer the value of their DB pension saving to a DC arrangement to access their benefits flexibly. Trustees will need to consider whether they will allow the payment of (non-statutory) DB CETVs up to normal retirement age. Further, Trustees should consider whether CETVs should be provided to members as part of the “warm-up” packs at retirement.

From 6 April 2015, it will be a requirement that members taking a CETV that has a value of £30,000 or more (before any reductions for underfunding are applied) from a DB arrangement to a DC arrangement will need to have taken Independent Financial Advice. Trustees will be under a duty to confirm that independent financial advice has been received from an FCA authorised individual before paying the CETV amount to the receiving pension scheme. There is no requirement for the Trustees or the sponsoring employer to pay for or engage an appropriate adviser to facilitate this process, unless the advice is required as a result of an exercise instigated by, or on behalf of, the sponsoring employer.

Trivial commutation of defined benefits

Increased limits

Smaller liabilities

Incentive Exercise

In his 2014 Budget, George Osborne increased the limits for the trivial commutation of DB pension savings at retirement:

- Trivial Commutation capital value limit increased from £18,000 to £30,000; and
- “Small Pots” capital value limit increased from £2,000 to £10,000 and the number of allowable “Small pots” commutations for members increased from two to three.

Trustees should consider whether they will implement these higher limits in their scheme. If so they should review and amend the scheme rules to facilitate the new limits.

The administrative process to allow these higher limits should be relatively straight forward and lead to improved efficiencies within DB schemes by extinguishing smaller liabilities. Therefore this may be an option which the sponsoring employer may be keen to offer in their DB scheme. Trustees should note that a recent update by the Incentive Exercises Monitoring Board has confirmed that any exercise to offer these options to members should be viewed as an “incentive exercise” and therefore be subject to the Code of Practice on Incentive Exercises.

DB Investment Strategy

With the possibility of an increased number of CETVs from the DB schemes as members approach retirement, Trustees should review the investment strategy of their DB scheme.

Liquidity

Payment of numerous CETVs and/or significantly large CETVs could cause liquidity problems for DB schemes. Further, payment of such CETVs could significantly alter the liability profile of the scheme, reducing the efficacy of the current investment strategy.

Disinvestment strategy

Trustees should consider the membership profile of their DB scheme and take investment advice on the possible liquidity requirements and disinvestment strategies should the number of CETVs being paid increase post April 2015.

Monitor experience post April 2015

Post April 2015, Trustees should monitor ongoing trends in relation to the proportion of members who take CETVs and at what age the CETVs are taken, so that this can be considered as part of full investment strategy reviews.

Re-consider hedging strategies

If significant hedging strategies are currently being considered, the Trustees may wish to consider putting implementation on hold until they have greater certainty on the CETV experience post April 2015.

Actuarial advice and DB funding

Trustees will need to take actuarial advice in relation to their DB scheme in respect of the CETV calculation basis, scheme funding and cash commutation factors. Further detail is provided below:

Cash Equivalent Transfer Values

Calculation Basis

- A DB CETV should be a ‘best estimate’ of the value of providing the accrued pension **within** the DB scheme. Trustees are responsible for setting the calculation basis, having taken actuarial advice. The basis is usually set using market conditions at the calculation date, taking into account the scheme’s investment strategy and the membership characteristics.
- The basis for calculating CETVs should be regularly reviewed so it remains fit for purpose. This is particularly relevant given the recent falls in bond yields. The CETV basis is usually reviewed following the triennial valuation.

Review Frequency

- This basis may need to be reviewed in preparation for the new freedoms to make sure it remains fit for purpose and that it is aligned with other retirement options. This will have greater importance if Trustees wish to provide non-statutory CETVs up to the point of normal retirement.
- Historically, DB schemes received a relatively low number of CETV requests and even less proceeded to payment. Reviewing the basis once every 3 years has therefore been reasonable. With the introduction of Freedom & Choice Trustees may wish to consider a more regular review of the calculation basis.

Scheme funding and reducing CETVs

Reducing CETVs

- Payment of numerous CETVs and/or significantly large CETVs from an underfunded DB scheme could cause significant reductions in security for the remaining members' DB pension saving.
- Trustees should therefore seek advice from their Scheme Actuary on whether they should consider applying a reduction to CETVs on account of the funding level within the scheme. Trustees should consider the likely amount of the reduction and then also consider the covenant strength of the sponsoring employer and the agreed funding strategy. Trustees may also wish to request that the sponsoring employer pays additional contributions to "top-up" reduced CETVs to their full, unreduced level.

Impact on funding

- If Trustees then decide to apply a reduction to CETVs they will need to commission an Insufficiency Report from the Scheme Actuary that sets out the maximum reduction that may be applied to CETVs.
- Trustees should be aware that reducing CETVs may not fully protect the security of remaining members' benefits. The amount of any reduction applying to CETVs should also be kept under regular review.
- Trustees should understand the interaction between the CETV basis and the funding basis, and understand the likely impact on the funding level if a significant number of members take a CETV at older ages up to normal retirement.

Cash Commutation Factors

Consistency with CETV basis

Fixed or variable

Impact on funding

If Trustees decide to provide the option of a CETV amount at retirement, then they should consider the consistency of the CETV basis with the cash commutation factors within the schemes.

Cash commutation factors have traditionally been set with respect to long term assumptions and so may not be market related. Indeed, some cash commutation factors are "hard-coded" in the scheme rules. These "fixed" factors can make planning for retirement more predictable for scheme members.

Whilst cash commutation factors may be fixed, CETV bases are usually market related. If CETVs are to be included as part of the retirement quotations, this may lead to apparent inconsistencies in retirement quotations for members. This is allowable under current legislation and guidance, however such inconsistencies could drive member decisions, for example if the member can get a larger tax free cash lump sum by taking a CETV to a DC arrangement and then retiring.

Changes to the cash commutation factors could impact the funding position of the scheme. The cash commutation factors may be used in the funding calculations where an allowance is made for members to take a proportion of their benefits as cash at retirement. Changing the factors may therefore change the value placed upon the liabilities within the scheme. Further, any such changes may impact the value disclosed in the sponsoring employer's accounts.

Trustees should review the rules and also consult with the sponsoring employer before making any changes to the cash commutation factors.

Codes of Practice and other considerations

CETVs

The Pensions Regulator is consulting upon a Code of Practice on DB to DC transfers and conversions. Trustees should consider this when reviewing CETVs. This will be reviewed in 2016, based upon experience to that date.

Incentive Exercises

If the sponsoring employer is keen to include CETVs at retirement in the scheme, as good practice Trustees should consider the content of the Code of Practice on Incentive Exercises when reviewing the scheme's communications.

Notifiable Events

Trustees should be aware that payment of a CETV which is more than the lower of 5% of the value of the scheme assets and £1,500,000 is a Notifiable Event.

Freedom & Choice for DB Schemes

The government has signalled its intent to consult upon extending the new freedoms to DB schemes directly.

Appendix: Trustee Checklist - General (minimum compliance requirements highlighted)

Area	General actions / considerations
Consulting with Employer	Seek Employer's view on amount of flexibility / options offered within the Scheme (including DB CETVs at retirement if applicable)
	Consult on the additional costs of setting up and administering the new options
	Consider any de-risking strategies that may be proposed by the Employer as a result of the changes
Communication	Issue initial communication to members with information about the changes from April 2015
	Once decided upon, communicate the changes to be made to the Scheme to the membership
	Review Scheme documentation
	Consider the ongoing communication strategy for the Scheme
Scheme Administration	Consider administration complexities and costs of additional flexibilities
	<i>Review the retirement process and communications to ensure they meet the new requirements (including signposting the guidance guarantee and meeting the FCA's risk warning requirements). Review DB CETV communications to confirm the need to take Independent Financial Advice before a DB CETV above £30,000 is paid.</i>
Legal Advice	Review the Trust Deed & Rules and determine whether any amendments are required
	Consider the implications of the statutory overrides
	Seek guidance on the legal issues arising from the Freedom and Choice changes (e.g. discharges and indemnities)

Trustee Checklist - DC/DB Specific (minimum compliance requirements highlighted)

Area	Defined Contribution (DC) Schemes (including AVCs)	Defined Benefit (DB) Schemes
Benefit Options	Decide upon what flexibilities / options are to be offered within the Scheme	Consider whether to allow individuals to take a non-statutory CETV up to and at normal retirement age
	Consider reviewing annual benefit illustrations to reflect the new freedoms.	Consider whether CETVs be provided as part of the retirement process.
	Consider the processes of notifying and recording when the Money Purchase Annual Allowance has been triggered	Ensure the CETV process includes confirming and recording Independent Financial Advice has been received by member prior to CETV completion.
		Consider implementing the new higher limits for trivial commutation and payment of “small pots”
Investment Strategy	Review the appropriateness of the default investment strategy	Consider the membership profile and take investment advice on the possible liquidity and disinvestment requirements as a result of DB CETVs
	Review the appropriateness of the lifestyle strategy and switching period	Monitor ongoing trends in relation to Scheme experience of DB CETVs and consider this as part of full investment strategy reviews
	Consider the investment fund range available to members	
	Consider the investment information made available to members, including the type and frequency of the information provided.	
Actuarial advice		Review the basis used for CETV calculations
		Seek advice on whether CETVs should be reduced and the level of reduction that should apply
		Consult with the Employer on whether they would be willing to support payment of full CETVs
		Consider the consistency of the CETV basis with the cash commutation factors within the Scheme
		Consider the Code of Practice on DB-DC transfers and conversions
		Consider the impact on scheme funding

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