Pension freedoms and choices

Budget 2014 revealed major changes for defined contribution (DC) pension fund members in terms of how they can take their benefits. The RPS has DC benefits in its BRASS and AVC Extra funds and the Industry-Wide Defined Contribution (IWDC) Section.

However, the reforms and interim changes also affected defined benefits (DB) provided by the RPS, which are those benefits linked to your salary and service.

These new freedoms offer savers more flexibility and choice, but also more risks to consider.

This short guide explains the pension changes that came in from 6 April 2015 by the Pensions Schemes Act 2015, such as:

- Options when taking DC funds
- Expected increase in minimum pension age
- Free impartial guidance
- Death benefits
- DC flexibilities and the Annual Allowance
- Potential impact on DC benefits

Important notes

- Where to go for advice
- Pension scams

Options when taking DC funds

You no longer need to buy an annuity with your DC funds at retirement. Before the changes came into effect, only people with small or very large pension pots had any flexibility over how to use their DC funds.

If you have DC funds in the RPS or in other schemes, you can choose to take up to 25% of these funds as a tax-free lump sum at retirement (called a Pension Commencement Lump Sum) but no more than £268,275 unless you have a lifetime allowance protection. More information on the protections can be found in the Lifetime Allowance guide. You can choose one, or a combination, of the following options for the remaining funds:

1. Use the funds to purchase an annuity at retirement; or
2. Withdraw all the funds in full, with income tax deducted from the lump sum that exceeds the tax-free limit; or
3. Use the funds as a flexible source of retirement income via a drawdown arrangement (you should note that this would need to be done by transferring your funds to an external provider, although the Trustee and Railpen Limited (Railpen) are considering the feasibility of offering drawdown in the future).

Under option 3, you may choose not to take a Pension Commencement Lump Sum but instead opt to take what are referred to as Uncrystallised Funds Pension Lump Sums. Under this approach, 25% of each payment you take from your DC funds will be tax-free and the remaining 75% of each payment will be taxed as pension. Railways Pension Scheme and British Transport Police Force Superannuation Fund members have access to a drawdown arrangement provided by Legal & General, which has been carefully selected by the Trustee. More information about this arrangement can be found at railwayspensions.co.uk.

BRASS funds are an exception to the above; these are paid at the same time as your other RPS benefits and are already typically available as a lump sum, which is currently tax-free.

The new pension freedoms also introduced changes to statutory transfer rights. Please see the ‘A guide to transfer options’ Read as you need guide. There are restrictions on the ability to transfer your funds to an external provider after taking your tax-free lump sum.

Transfers from private sector DB to DC schemes are still allowed but an individual must now take advice from an independent financial adviser before a transfer can go ahead.

Before making any decisions as to how you access your DC funds or decide what retirement option to choose, we strongly recommend you seek independent financial advice.

As well as the main reforms, some were introduced to offer more flexibility for small pension pots. The changes which could affect you as an RPS member are:

- An increase in the small lump sum payment limit, from £2,000 to £10,000; and
- An increase in the trivial commutation limit, from £18,000 to £30,000.

These changes mean that more members with a small amount of benefits within the RPS may be able to take them as a lump sum.

Broadly speaking, the rules relating to small lump sum and trivial commutation payments mean that, if you have a small amount of benefits in an RPS section, you may be able to take them as a lump sum when you reach age 55 (50 if you have a Protected Pension Age), with 25% available tax-free and the remaining 75% subject to income tax. The rules and above limits apply to the combined value of your DB and DC benefits. Therefore if you are close to or over 55 (50 if you have a Protected Pension Age) and have a small amount of benefits in the RPS, you may wish to contact the Helpline on 0800 012 1117 to see if these options are available to you.

The Budget also announced changes to income drawdown, which doesn’t currently apply to RPS benefits, although it may be possible to transfer IWDC Section, BRASS or AVC Extra funds to another provider who does administer income drawdown.

Expected increase in minimum pension age

The three options outlined in ‘Options when taking DC funds’ will be available at any time after your minimum pension age, which is currently either 50 or 55, depending on your circumstances.

However, the government has now confirmed its intention to increase the minimum pension age from 55 to 57 by 2028 and then increase it again in line with future changes to the State Pension age. From 2028 onwards, the minimum pension age will remain ten years below the State Pension age. Changes to minimum pension age apply to both DC and DB schemes and will affect when some RPS members can take their benefits. But, if you were born before the 1970s, you are unlikely to be affected by the change to the minimum pension age unless government plans are brought forward.

The government has recognised that some individuals have a protected pension age (i.e. they can take their benefits before age 55) and are still considering the nature and extent of any protection that might be required for these individuals.

Free impartial guidance

For members who are about to reach or have already reached the minimum pension age, the government has introduced a free and impartial service to help them understand their retirement choices. This is called Pension Wise and is available online, over the phone (0800 138 3944) or face-to-face. Pension Wise is part of MoneyHelper and can be found [here]

Some guidance is also available to RPS members. A ‘Read as you need’ about your options at retirement can be found at www.railwayspensions.co.uk, under ‘Resources’ and ‘Read as your need guides’.

Death benefits

If you die before the age of 75 lump sum death benefits can be paid free of tax, subject to certain conditions. For example:

- Such benefits would be tested against your available Lump sum and death benefit Allowance and any excess could attract a tax charge.
- The lump sum must be paid within two years of the earlier of the date on which we first knew, or “could reasonably have been expected to know”, of the member’s death otherwise there will be a tax charge.

If you die at age 75 or later, tax will be payable at the recipient’s marginal tax rate, although a 45% rate will apply in limited circumstances.

DC flexibilities and the Annual Allowance

The ‘Annual Allowance’ is the limit on the amount that you can save tax-free in all pension arrangements, in a single annual Pension Input Period. The Annual Allowance had been increased from £40,000 to £60,000 with effect from 6 April 2023 (this is subject to further changes in the future), however, this will be reduced for people whose taxable income is more than £200,000 and who have an ‘adjusted income’ of over £260,000. This is referred to as the Tapered Annual Allowance.

If you start to take money from a DC pension arrangement, this might trigger a lower Annual Allowance known as the Money Purchase Annual Allowance (‘money purchase’ being another term for ‘defined contribution’) and it only applies to pension savings in DC arrangements. This had been increased from £4,000 to £10,000 a year with effect from 6 April 2023. So, if you also have a DB pension, you may still be able to receive tax relief on pension savings of up to £60,000 a year.

Potential impact on DC benefits

You may want to start thinking about how you will take payment of your DC benefits when you retire and the most suitable options for you. You may then want to look at how your DC funds are currently invested and consider whether this is still the right investment choice for you and ties in with how you may wish to take your benefits at retirement. There are various fund factsheets available in the BRASS and IWDC sections at www.railwayspensions.co.uk.

Important notes

Where to go for advice

We strongly recommend that you take independent financial advice from a suitably qualified adviser who is registered with the FCA before making a decision about how and when your benefits are taken.

Liverpool Victoria (LV) has been carefully chosen (which is authorised and regulated by the Financial Conduct Authority) to give Railways Pension Scheme and British Transport Police Force Superannuation Fund members access to financial advice.

You can contact Liverpool Victoria on: 0800 0234187. Alternatively, www.unbiased.co.uk can provide details of independent financial advisers in your local area.

MoneyHelper from the Money and Pensions Service (MaPS) brings together the support and services of three government-backed financial guidance providers: Money Advice Service, The Pensions Advisory Service and Pension Wise.

It offers free support on a wide range of financial matters, online and over the phone. This covers a variety of pension topics, including:

- Auto enrolment
- Building your retirement pot
- Pension problems
- Pension basics
- State Pension
- Taking your pension
- Tax and pensions
- Pensions and retirement

For more information visit https://www.moneyhelper.org.uk/en/pensions-and-retirement

Pension scams

If you are taking a cash lump sum from your Personal Retirement Account (PRA) to invest somewhere else, or you plan to take an income from a flexi-access drawdown product, then you should be aware of scams.

In particular, beware of people contacting you out of the blue wanting to discuss your pension, or adverts claiming to offer 'free pension reviews', a 'one-off investment opportunity' or a 'legal loophole'. Once you have transferred your benefits to one of these organisations, it is often too late to do anything about it. You could lose your entire pension savings and be asked to pay a large tax bill as well.

For further information about pension scams, visit www.thepensionsregulator.gov.uk/pension-scams All firms offering financial products or advice should be registered with the Financial Conduct Authority (FCA). If you are unsure about a firm that has contacted you, use the FCA's online register to check if the firm is registered at www.fca.org.uk/register or call 0800 111 6768 (or +44 207 066 1000 from abroad).
