EXPLANATORY MEMORANDUM TO

THE PENSION SCHEMES ACT 2015 (TRANSITIONAL PROVISIONS AND APPROPRIATE INDEPENDENT ADVICE) (AMENDMENT No. 2) REGULATIONS 2017

2017 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument makes amendments to the Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) Regulations 2015 ("the Appropriate Advice Regulations")[1] to provide for a simpler process for trustees and scheme managers to value members' pension savings, classified as 'safeguarded benefits', when determining whether the requirement to take financial advice applies. It also makes transitional provisions to require that members are informed promptly if they are affected by the change.

2.2 This instrument forms a package of amendments to the Appropriate Advice Regulations, alongside the Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) (Amendment) Regulations 2017 ("the Risk-Warning Regulations"). The amendments made by the Risk Warnings Regulations provide a new requirement for schemes to send members with 'safeguarded-flexible' benefits information about the guarantees those benefits offer, before they proceed to transfer, convert or flexibly access them.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

Other matters of interest to the House of Commons

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland.

4. Legislative Context

4.1 Section 48 (independent advice in respect of conversions and transfers) of the Pension Schemes Act 2015 ("the 2015 Act") imposed a requirement on the trustees or managers of occupational and personal pension schemes to check that members with "safeguarded benefits" (broadly, benefits under salary-related defined benefit schemes, or defined contribution arrangements with certain guarantees) must have taken appropriate independent advice before transferring, converting or taking certain

[1] SI 2015/742 - http://www.legislation.gov.uk/uksi/2015/742/content

lump sum payments in respect of those benefits. Section 48 (3) provides for exceptions to the requirement to be made in regulations.

4.2 Regulation 5 of the Appropriate Advice Regulations removes the requirement to check that advice has been received where the total value of a member's safeguarded benefits is £30,000 or less. It requires the total value to be calculated using the method for calculating the cash equivalent transfer value of salary-related defined benefits under occupational pension schemes. The Appropriate Advice Regulations also set out the process by which trustees or managers must check that a member has obtained advice, and circumstances in which information about the advice requirement must be provided to a member.

4.3 This instrument amends regulation 5 (of the Appropriate Advice Regulations) to make it simpler to determine whether advice is required in cases where a member has safeguarded benefits which are not salary-related occupational pensions. The regulation, as amended, provides that the requirement to obtain advice does not apply where the *transfer value* of the member's safeguarded benefits under the scheme is £30,000 or less. The "transfer value" is defined to mean, broadly, the payment that would be made to another scheme in respect of the benefits if the member were exercising a statutory right to transfer. Schemes will therefore be able to use the same valuation method to determine whether advice is required as for calculating the cash equivalent of benefits for transfer purposes. This reduces burdens on schemes and confusion for some members.

5. Extent and Territorial Application

5.1 The extent of this instrument is Great Britain.

5.2 The territorial application of this instrument is Great Britain.

5.3 Northern Ireland will be making separate parallel provisions.

6. European Convention on Human Rights

6.1 The Minister for Pensions, Richard Harrington MP has made the following statement regarding Human Rights:

"In my view the provisions of The Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) (Amendment No. 2) Regulations 2017 are compatible with the Convention rights."

7. Policy background

7.1 The pension freedoms give scheme members aged 55 and over with defined contribution pension savings greater flexibility under tax legislation in how and when they access those savings. The 2015 Act made a number of consequential changes to pensions legislation, including the advice requirement in section 48, and introduced the concepts of "flexible benefits" (benefits to which the freedoms apply) and "safeguarded benefits" (benefits to which the advice requirement applies).

7.2 Safeguarded benefits offer some sort of guarantee in relation to the level of pension income the member will or may receive in retirement. These guarantees offer a level of security in retirement which the member would lose if those benefits were transferred or converted. To ensure that members fully understand the implications of giving up these potentially valuable guarantees, the Government requires members take appropriate independent advice before they exchange their safeguarded benefits

for flexible benefits, or, in the case of benefits which are both safeguarded and flexible, exchange the benefits for different flexible benefits or directly access them using the freedoms.

7.3 The Department for Work and Pensions (DWP) was made aware that the method specified in the Appropriate Advice Regulations for calculating the value of the members' safeguarded benefits for the purposes of the £30,000 threshold was causing difficulties for schemes and confusion for members, when applied to "safeguarded-flexible benefits".

7.4 Safeguarded-flexible benefits are those calculated by reference to a member's individual "pot", but which (unlike other flexible benefits) include some form of guarantee in relation to a secure income in retirement. By far the most common safeguarded-flexible benefits offer members the option to secure a retirement income at a guaranteed annuity rate. These are most commonly found within personal pension schemes.

7.5 The valuation method specified in the Appropriate Advice Regulations is the same method used to determine the transfer value of salary-related occupational pensions, and so was not familiar to most schemes under which members had safeguarded-flexible benefits.

7.6 Responses to a call for evidence[2] (*"Call for Evidence on the Valuation of Pensions with a Guaranteed Annuity Rate")* which ran between November 2015 and January 2016 favoured using the "transfer value" of the members' benefits to determine whether the exception to the requirement to obtain financial advice applies. This allows schemes to use whichever calculation methodology they already used for the purpose of calculating statutory transfer values. This was preferred by personal pension providers of safeguarded-flexible benefits to the existing mandated approach.

7.7 The same call for evidence also revealed industry support for members with safeguard-flexible benefits to be made more aware that their savings contained potentially valuable guarantees.

7.8 The Risk Warnings Regulations introduce a requirement that trustees and scheme managers inform all members with safeguarded-flexible benefits of their guarantees via a tailored communication – a personalised 'risk warning' - when the member seeks to transfer, convert or take a relevant cash lump sum from the scheme.

7.9 The personalised risk warning must include a narrative section explaining the guarantee, its features and how it can be exercised or surrendered, and a projection of the income the guarantee might provide, relative to the income a pension pot of the same size would purchase on the open market.

7.10 The Regulations contain transitional provisions to ensure that if an individual is part way through the process and has not yet taken financial advice they are informed that they may not have to do so from 6th April 2018. This allows individuals to make an informed choice to defer the decision to transfer until the advice requirement no

[2] The call for evidence was published as a separate chapter within a wider consultation on miscellaneous regulatory amendments following the introduction of the pension freedoms – see https://www.gov.uk/government/consultations/occupational-and-personal-pension-schemes-miscellaneous-amendments-regulations-2016

longer applies. The transitional period starts on 1st October 2017 to align with pension schemes' systems and covers the 6 months prior to the Regulations coming into force.

8. Consultation outcome

8.1 The call for evidence referred to in paragraph 7.6 ran for 8 weeks from 23 November 2015 to 15 January 2016. There were 20 responses received from industry bodies, consumer representatives and pension specialists. Views were sought on the suitability of the valuation method for the purpose of determining whether members are required to take financial advice, and whether new consumer protections, such as risk warnings tailored for different guarantees, should be required by legislation.

8.2 A majority of responses favoured the option of using the transfer value of the member's benefits as a valuation method. There was also concern expressed that members were not informed about their guarantees and their value. The majority of those respondents who expressed a view also supported proposals for government developing risk warnings.

8.3 A further consultation (*"Valuing pension for the advice requirement and introducing new consumer protections")* on draft regulations (comprising a single instrument incorporating the measures included in this instrument and those in the Risk Warnings Regulations) ran for six weeks between 26 September and 7 November 2016[3] seeking views on, among other things, the design and content of risk warnings. There were 27 responses to the second consultation. DWP also organised a workshop to hear pension providers' views on 24 October 2016, as well as a session with pension specialists from administrators and law firms on 27 October 2016.

8.4 The workshops and responses to the consultation were supportive that the draft regulations allowed schemes to use the "transfer value" when valuing pensions for the advice requirement. There were two only minor technical points raised. As a result, the provisions of this instrument have been amended to make it clear how the new valuation method applies to members with pension credit rights[4] who do not have a statutory right to transfer. It has also been amended to remove a potential for inconsistent treatment of members regarding when advice is required, as a result of schemes exercising their discretion to provide more generous transfer values than required by legislation.

8.5 A more detailed analysis of the consultation outcome is available at https://www.gov.uk/government/consultations/valuing-pensions-for-the-advice-requirement-and-introducing-new-consumer-protections.

9. Guidance

9.1 A DWP factsheet, "Pension benefits with a guarantee and the advice requirement"[5] provides general information on safeguarded benefits. DWP will work with the Financial Conduct Authority and The Pension Regulator to explore how more certainty can be provided on the types of benefits that are in scope of the risk warning requirement introduced by the Risk Warnings Regulations (those captured by section

[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555564/consultation-valuing-pensions-for-the-advice-requirement-and-introducing-new-consumer-protections.pdf
[4] rights to pension savings that are required, where pension savings are shared on divorce.
[5] https://www.gov.uk/government/publications/pension-benefits-with-a-guarantee-and-the-advice-requirement

74 (c) of the Pension Schemes Act 2015). DWP will also explore what other information or examples of best practice can be published to help schemes meet the requirements.

10. Impact

10.1 The annual net impact of the package of measures contained in this instrument and the Risk Warnings Regulations on business, charities and voluntary bodies is estimated to be a saving of £1.6m. The estimated costs of meeting the new requirement to send risk warnings are outweighed by the benefits to pension providers of being able to adopt a simpler and less burdensome process for valuing members' benefits.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment is submitted with this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses. No specific action is proposed to minimise the regulatory burdens on small business. However, the impact on small and micro-business is estimated to be minimal. This is because only a small minority of small and micro pension schemes are expected to have members with benefits that are both safeguarded and flexible. Where such schemes exist, the number of members with safeguarded-flexible benefits is also expected to be small in number. The cost of complying with the new risk warnings will be low.

12. Monitoring & review

12.1 The Risk Warnings Regulations insert a review provision into the Appropriate Advice Regulations, which will require the Secretary of State to review the Appropriate Advice Regulations (as amended by this instrument) and publish a report setting out the conclusions of the review within five years of this instrument coming into force, and subsequently at intervals not exceeding five years.

12.2 The operation of these regulations will be monitored on an on-going basis by means of representation and feedback from the pensions community and The Pensions Regulator.

13. Contact

13.1 James Calverley at the Department for Work and Pensions can answer any queries regarding the instrument; email: James.Calverley@dwp.gsi.gov.uk.