

Guidance on transfer incentives

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Introduction

Background

We first issued guidance in this area in January 2007. We had clear evidence that inducement exercises had the potential to be run in a way that was detrimental to the security of members' benefits.

Since then, we have been actively monitoring the development of activity and the types of practices that have been forming. We also have more evidence on the types of behaviours that are being displayed.

What we have seen and experienced has concerned us. We now believe there is a need for us to take a stronger stance in this area to protect members' benefits. This has resulted in the regulator adopting a more proactive approach towards identifying and assessing these exercises. We are working more closely with other regulatory and enforcement bodies. The revision of our guidance supports these actions to enable clear consideration of the risks.

Many industry surveys indicate that various forms of incentive exercise are increasing in popularity. The main focus has recently been on transfer incentives. But other forms of incentive exercise that can be considered benefit modifications, rather than transfers, are becoming more common. One example is 'pension increase conversions', which carry similar risks. Our revised guidance applies equally to these alternatives where members are being asked to consent to changes or reductions affecting accrued rights.

The need for updated guidance

The aim of our original guidance on this issue was to establish a very high standard of practice where an employer considered that an exercise of this nature was a necessary and appropriate form of liability management for a scheme. Unfortunately, there has sometimes been a 'box-ticking' approach that has led to exercises being run without due consideration of the needs of scheme members, and in a manner that we do not consider in keeping with the spirit of the guidance.

As a result, we revised our guidance to provide a more principles-based approach. The guidance on which we have consulted highlighted key areas of consideration and clearly articulated our expectation that any exercise should be conducted with the utmost regard to members' interests. We expect market practices in this area to improve. The success in meeting that objective will be judged by the level of member understanding, and the focus on member outcomes.

The guidance was developed in consultation with the Financial Services Authority (FSA). Our approach is aligned with their expectations of the entities they regulate. A joint statement from both regulators was issued in July 2010 to this effect:

<http://www.thepensionsregulator.gov.uk/docs/transfer-values-joint-statement-july-2010.pdf>

The consultation process

The formal consultation process commenced on 13 July 2010 following publication of our consultation document. Consultation ran for 12 weeks, closing on 5 October 2010. We received 45 responses from a cross-section of stakeholders including trustees, pensions managers, legal firms, professional and trade bodies, consultants and administrators. A full list of the respondents (excluding those who wish to remain anonymous) is attached in the Appendix on page 11.

We are extremely grateful for all the responses received, which have helped us considerably in sharing industry views and finalising the guidance.

While respondents were free to provide comments on any aspects of the draft guidance, we specifically sought comments on the following questions included in the consultation document:

General questions

- 1 Do you agree that the principles-based approach adopted in this guidance is the right approach to take to protect members' benefits?
- 2 Do you think the guidance will fulfil the purpose of ensuring that offers are made with full appreciation of the risks being taken by all parties, and with the utmost regard for member outcomes?
- 3 Are there any additional messages for trustees and/or employers that you would like to see in the guidance?

Specific questions on each section

Section 1

Definition

This section is intended to outline who the guidance is for and who may be interested in the content of the guidance. It also seeks to explain the purpose of the regulator producing guidance in this area, and define the area of consideration.

4. Does this section clearly outline the area that this guidance covers; to whom it is intended to apply; and the scope of the regulator's expectations with respect to those operating or involved in this area?

Section 2

Understanding the principles

This section outlines the principles which should apply to any exercise being conducted. It expands what is meant by the principles and provides some points of consideration when considering and conducting incentive offers.

5. Do you think the principles outlined in the guidance are comprehensive and encompass what should be considered 'best practice'?

Section 3

Problems and concerns that can arise for members

This section is intended to get trustees and employers thinking about the members' perspective, the nature of the decision for them and their needs in making that decision.

6. Does this section achieve its intentions?
7. Are there any points from a members' perspective that need emphasising?

Section 4

Key points of note

This section outlines the key risks and considerations for employers and trustees when considering or becoming involved in an incentive exercise.

8. Are there any other key considerations that you feel should be included in the guidance?

Main points raised in responses

The responses raised a number of interesting stakeholder viewpoints covering a range of matters addressed in the guidance. Generally, respondents were very supportive of our initiative to provide updated guidance in this complex area. Many shared our concerns that currently there are some exercises which are not of required standards. All respondents agreed that the principles-based approach was the right approach to take.

In response to comments that the title of the draft guidance did not reflect the content, we have amended the title to 'Guidance on incentives to transfer or modify defined benefits'.

The main comments raised specifically in relation to questions asked in the consultation document are detailed here.

1. Do you agree that the principles-based approach adopted in this guidance is the right approach to take to protect members' benefits?

All respondents agreed that a principles-based approach is the correct approach. Some respondents commented that a checklist approach does have advantages.

Some respondents felt that the principles-based approach was undermined to some extent by the comprehensive list of information contained in the Appendix. This may be treated by some as a checklist. In addition, some commented that there is significant overlap with the information that must be provided by a financial adviser when advising a member. The end result could be 'information overload' for the member.

Having considered these points, we believe that the Appendix serves a useful purpose in terms of illustrating the type of information which it may be necessary to include in an offer. However, we have also clearly stated that it is for illustrative purposes only. Information provided should balance the need to be open and transparent, clear, fair and not misleading.

Trustees and employers should ensure that all members receiving the offer have enough information to make an informed decision. They should consider how the advice process will interact with that, including whether members are being required to take independent financial advice when considering the offer.

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Main points raised in responses continued...

2. Do you think the guidance will fulfil the purpose of ensuring that offers are made with full appreciation of the risks being taken by all parties, and with the utmost regard for member outcomes?

The vast majority of respondents felt that the guidance would go some way to ensuring that all parties would appreciate the risks involved in such offers. They felt it would alert many to some of the risks that have not previously been understood.

However, many also felt that the risks of remaining in a defined benefit (DB) scheme should be made clearer – for example, in the context of an enhanced transfer value exercise, remaining in a DB scheme does not mean that the members' benefits are 100% guaranteed, although they are protected to an extent by the existence of the Pension Protection Fund (PPF).

Principle 1 of the guidance is that offers should be made in a way that is clear, fair and not misleading. Therefore, it is only right that members are made aware of the risks involved with each choice available to them before making a decision whether or not to accept an incentive offer. This has always been the intention, but we have sought to clarify this in the final guidance.

Some respondents were of the view that the tone of the guidance was overly negative and would constrain incentive exercises. They felt trustees would feel obliged to oppose such exercises through starting from the presumption that they are not in members' interests. Trustees would have insufficient information about members' personal circumstances to be able to move away from that position, this being the role of the financial adviser.

Concerns remain about the risks these exercises can pose to members. We are seeking to ensure that those considering running these exercises are aware of the risks. If they go ahead, they need to manage those risks appropriately. The final guidance more explicitly recognises that there will be members whose circumstances make it more likely that such an offer will be in their interests. These cases are likely to be in a minority, and very possibly a small minority, and high quality financial advice is absolutely key in identifying those individuals. We therefore expect fully independent financial advice be made accessible to all members and promoted in the strongest possible terms.

A number of respondents felt that the expectations of trustees set out in the guidance are too onerous and go far beyond their legal obligations. We acknowledge that, in some cases, trustees have no power to prevent such exercises from taking place. However, they are accountable for the procedural fairness around any modifications being made to members' accrued rights, and will usually be required to consent to the modification.

For all incentive exercises, trustees are able to play an integral role in ensuring that member communications are to a standard that allow members to make a well informed decision, and to provide checks and balances throughout the process to ensure members' interests are protected. We would question the governance of the scheme if trustees were found not to have engaged in any known exercise to ensure members' interests are protected.

3. Are there any additional messages for trustees and/or employers that you would like to see in the guidance?

Several respondents felt that the principles-based approach would be well supported if some case examples of both 'good' and 'poor practice' were included. We have carefully considered this point. We have concluded that there is a significant risk that any case example we provide would be viewed as a prescriptive template. We do not believe this is appropriate and goes against the principles-based approach we are promoting. Therefore, we have decided against the inclusion of such examples in this case, given the experience of reaction to our previous guidance on inducements.

We have received a number of comments about the powers which would be available to us where we are not satisfied that an incentive exercise has been run to an appropriate standard. To clarify, we have a number of powers that we believe are relevant in this area, including the power to remove or appoint trustees and, in certain cases, our anti-avoidance powers.

Several respondents also asked for clarification about the powers we believe are available to trustees if they are opposed to an exercise. As mentioned above, in cases where a scheme modification is required to implement the exercise, the trustees will sometimes have the power to prevent the exercise proceeding. In other cases, as is stated in the guidance, they are able to issue their own communications to members to raise their concerns. They can also raise their concerns with the regulator. Trustees should take legal advice if they are unsure of what powers are available to them in respect of their scheme.

Some respondents requested that the guidance clearly addresses the issue of customers who wish to go ahead and accept an offer despite having been advised that it is unlikely to be in their best interests: known as 'insistent customers'. We accept that there will be some insistent customers, and that trustees do not have power to prevent such transfers from taking place. The final guidance confirms this position.

Section 1

4. Does this section clearly outline the area that this guidance covers, to whom it is intended to apply, and the scope of the regulator's expectations with respect to those operating or involved in this area?

The majority of respondents answered this in the affirmative. Some felt that it would benefit readers if there was some further clarification given as to the types of exercise which the guidance is not intended to cover. The draft guidance clearly stated that it was not intended to apply to schemes closing to future accrual. We have further clarified in the final guidance that it is not intended to apply to modification to future accrual of benefits. It does apply to exercises where members are asked to make a choice regarding benefits already accrued, including scenarios covered by s67 of the Pensions Act 1995.

Others felt that this and other sections should distinguish more between enhanced transfer values (ETVs) and other types of incentive exercise, in particular recognising that it is likely there are different advice requirements for different types of exercise. On this point, we recognise that different factors will need to be considered depending upon the type of incentive offer. We remain of the view that independent financial advice should always play a significant role in ensuring the member fully understands the implications of accepting or not accepting an offer.

In the final guidance, we have recognised more explicitly that the advice requirements are likely to differ between different types of incentive exercise. We have maintained the message that members obtaining high quality independent financial advice is always paramount.

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Main points raised in responses continued...

Section 2

5. Do you think the principles outlined in the guidance are comprehensive and encompassing of what should be considered 'best practice'?

All respondents agreed with high level principles themselves and that they comprehensively outline the responsibilities for employers and trustees and their role in driving 'best practice'.

Several respondents made comments in particular in respect of principles 1 and 5:

Principle 1

Many respondents provided positive comments about inclusion of reference to the **British Code of Advertising, Sales, Promotion and Direct Marketing**, and agreed that the principles of the code are highly relevant to these exercises.

There was strong feeling amongst respondents that the deferred annuity cost is not necessarily relevant and could be confusing for members if this is included. This is because such a value is not equivalent to the value of benefits being given up, due to the added premium which is paid for securing benefits with an insurance company which is covered by capital adequacy requirements. We have considered this and have removed this specific reference. However we believe that in cases where advice is not required as part of the offer, similar information should be provided to members by the employer.

Principle 5

Many believe that the employer should pay for advice in all circumstances, rather than make a judgment about whether members are likely to understand the offer put to them. Respondents also felt that this requirement should not extend to a member's own selection of adviser. It was felt that the draft guidance was ambiguous about the regulator's expectation and that further clarification should be given. We have sought to make our position on this clearer in the final guidance.

We have stressed that advice should be paid for, and members should be required to take independent financial advice, before accepting an offer, in all cases where the employer is not confident that members will be able to understand the offer and its implications. We have also clarified that employers are not expected to subsidise the cost of an adviser of the members' choosing.

Some respondents felt that the guidance should more explicitly indicate that financial advice to members should not be remunerated based on commission or the level of take-up. We agree and have explicitly made this point in the final guidance.

Section 3

6. Does this section achieve its intentions?

The majority of respondents agreed that this section does achieve the intention of encouraging employers and trustees to think about the members' perspective when constructing or reviewing an incentive offer. However, a number of respondents appeared to have interpreted the section to be aimed at members. Therefore, the final guidance includes a paragraph to clarify the purpose of this section.

Some respondents said that they would prefer the wording in this section to be more balanced, as some of the language implies that all offers are based on the member accepting a reduction in benefits which is not always the case. We have taken this point on board and have amended the language accordingly.

7. Are there any points from a member's perspective that need emphasising?

Several suggestions were made for inclusion in this section, in particular that the implications of not accepting an offer should equally be made clear to members and that the role of the employer covenant should be explained to members.

We consider that these points are adequately covered in this section. The degree of security and role of the PPF are both specified as areas that members will need to consider. This includes the role of the employer covenant.

Section 4

8. Are there any other key considerations that you feel should be included in the guidance?

Few disagreed that the offer of immediate cash as part of an incentive offer has the potential to distort the member's decision-making process. However, many pointed out that there will be circumstances where the member's immediate cash needs may genuinely take priority over retirement provision, for example, where mortgage payments are in arrears and the member has no other means of repaying them. Respondents felt that it is important to consider the member's overall financial circumstances, which should naturally happen as part of a robust advice process.

The regulator accepts this, although maintains the view that where cash incentives form part of an offer, there is an increased risk that members may wrongly perceive this to be of greater value than the potential impact on their retirement benefits.

Many respondents commented that it would be impractical to calculate the impact of an individual transfer on the employer accounts and would not be helpful to the member to have this information. We believe that the member should be made aware of the extent to which the employer will benefit from running such an exercise, but on reflection appreciate that it is not practical for this to be calculated on an individual basis.

However, during the feasibility study for such exercises, we would expect that the effect on the FRS17 liabilities of a certain level of take-up would have been calculated. We believe this should be communicated to members. We have clarified this in the final guidance.

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The way forward

We expect trustees and employers to run incentive exercises in a manner consistent with the principles set out in the guidance. Through the application of these principles, we expect that consistently 'good industry practice' will further evolve, with employers engaging trustees early in the process, and trustees being fully aware of their role in protecting members' interests throughout the process.

Appendix

The following organisations provided responses to the consultation:

1. ABI
2. ACA
3. Actuarial Profession
4. Aegon
5. APL
6. Barnett Waddingham
7. BDO Investment Managers
8. Buck Consultants
9. Capita Hartshead
10. CBI
11. Eversheds
12. Friends Provident
13. Heath Lambert
14. Hewitts
15. Hymans Robertson
16. IoD
17. IPTG
18. ITS Limited
19. JLT Benefit Solutions
20. JLT Wealth Management
21. KPMG
22. Law Debenture
23. Legal & General
24. Legal & General Actuaries
25. Mercer
26. Pension Capital Strategies
27. Pete Davis
28. PMI
29. Professional Standards Board for Transfer Incentive Exercises
30. Punter Southall
31. PwC
32. Royal Mail
33. Sackers
34. Societe Generale
35. Standard Life
36. Tesco
37. TISA
38. Towers Watson
39. TPAS
40. Travers Smith
41. Travis Perkins
42. TUC
43. Windsor Actuarial Consultants
44. Wragge & Co
45. Xafinity Consulting

How to contact us

Napier House
Trafalgar Place
Brighton
BN1 4DW

T 0870 606 3636

F 0870 241 1144

E customersupport@thepensionsregulator.gov.uk

www.thepensionsregulator.gov.uk

www.trusteetoolkit.com

Consultation response

Guidance on transfer incentives

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