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“INDUCEMENTS” – TPR GUIDANCE PUBLISHED

1 INTRODUCTION

Reacting to the growing number of employers offering defined benefit (DB) scheme members inducements (or incentives) to transfer out or accept a reduction in benefits, the Pensions Regulator (TPR) has published guidance aimed at employers, trustees and scheme members. Whilst recognising that employers may have “business and commercial” reasons for putting forward inducements, TPR’s interest lies in fulfilling its statutory objective of protecting members’ benefits. The purpose of the guidance is therefore to help all parties identify and understand the implications of inducements.

2 KEY POINTS

- An inducement is where an employer offers scheme members a financial incentive to transfer out of a DB scheme or to accept a reduction in benefits.
- This may be in the form of an enhancement to the transfer value, a direct cash payment or both.
- The guidance states that trustees and employers must give scheme members full and proper advice so that members fully understand the implications of transferring out of a DB scheme.
- TPR also takes the view that trustees should consider carefully and apply a high level of scrutiny to all inducement offers.

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3 RECOMMENDATIONS FOR EMPLOYERS

In TPR's opinion, whenever an employer is contemplating an exercise to offer an inducement to scheme members its communications to members should include several key messages, such as:

- a recommendation that the member takes independent financial advice before making any decision;
- an explanation of the benefits being given up in exchange for the inducement;
- the details of the inducement, including the amount and whether it is affected by any member choice;
- why the employer is making the offer and how long it will remain open;
- confirmation that the member does not have to accept the offer and that the member may retain his or her benefit entitlement under the scheme; and
- the tax implications for the member of accepting the inducement payment.

The guidance also sets out particular information that should be included in member communications, depending on the type of inducement involved. For example, where a transfer out of a DB scheme is proposed, the member should be provided with an explanation that the receiving scheme may not afford the same level of benefits. The risks inherent in, and the guarantees offered by, the member's DB scheme should also be explained[1].

[1] The risk of employer insolvency, the protection afforded by legislation and the Pension Protection Fund should be covered here

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4 RECOMMENDATIONS FOR TRUSTEES

TPR's guidance, perhaps surprisingly, requires trustees to take an active role in any inducement offer made to the members of their scheme.

In TPR's opinion, given the trustees' duty to act in the best interests of scheme members, they should consider whether to question or challenge the appropriateness of an inducement offer. Trustees should, for example, take into account the impact of the use of employer resources in this way on the scheme's funding. (We think that what TPR has in mind here is the possible use of such funds to improve the funding of the DB scheme directly). They should also ensure that members are given all the information they might reasonably need to be able to make an informed choice and that they are made aware of the importance of seeking independent financial advice. In the latter respect, possibly even going as far as seeking to persuade the employer to pay for such advice.

With regards to potential data protection issues, TPR urges trustees to make their decision on the merits of an inducement offer before providing the employer with any information it needs in order to contact the membership.

If an inducement offer is to proceed, TPR advises trustees to check that the employer's communication material contains the key messages it prescribes (see section 3 above). In addition, it suggests trustees consider issuing their own communication to members, especially where they consider that an offer is not in members' best interests. This is subject to the all important warning that trustees should stop short of giving members financial advice if they are not authorised to do so by the Financial Services legislation.

5 RECOMMENDATIONS FOR MEMBERS

TPR notes that members who are offered inducements are often faced with a complicated financial decision which will be influenced by their attitude to risk. In the case of an inducement to transfer, TPR states that they probably

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need to consider:

- whether the transfer value they are offered represents good value for their DB scheme benefits;
- the type and likely amount of benefits the transfer value will secure under the scheme to which it is paid and the likelihood of those benefits being provided; and
- the value to them of the cash inducement.

In the case of an inducement to accept a reduction in benefits, the member will need to consider the cash inducement offer compared to the value of the benefits given up.

Given the complexity of the decision, TPR strongly recommends that members take independent financial advice.

6 TAX IMPLICATIONS

In a display of seemingly joined-up thinking, HM Revenue & Customs (HMRC) have issued an announcement on the taxation of "employer cash inducement payments to pension scheme members" which states that:

- direct cash payments to members will be subject to income tax and national insurance contributions (NICs); and
- enhancements to transfer values of the pension fund will be treated for tax and national insurance purposes in the same way as any employer's contribution.

The announcement notes HMRC's previous advice was that inducement payments were not taxable or liable for NICs. How such transactions will be treated now (in the light of their new stance) depends on their status. In general, where such transactions have already been processed and/or employers can illustrate that offers were made to their employees on the basis of previous

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advice from HMRC, such advice will be honoured. However, if an employer has not yet made an offer to scheme members or cannot illustrate that, in making an offer, it relied on HMRC's former view, then HMRC will apply its revised understanding.

7 EFFECT OF THE GUIDANCE?

As was the case with the guidance on "Scheme Abandonment", there may be little here which is new to parties involved in inducement exercises. However, the level of detailed information which TPR envisages being provided and the extent of the trustees' role may take some by surprise.

TPR perhaps sees the issue of such guidance as the only way in which to draw attention to the fact that it is unhappy with employers using inducements to reduce or avoid DB liabilities, as they do not contravene current legislation and, for the time being at least, it is unable to take direct action against them.

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