

Revised Code of Practice on Incentive Exercises

Alert | 01 February 2016



Introduction

On 1 February 2016, the Incentive Exercises Monitoring Board (“IEMB”) published [version 2 of the Code of Good Practice on Incentive Exercises](#) (“Version 2”).

Key points

- As anecdotal evidence indicates employers and trustees are complying with the Code, Version 2 is not substantially different to the original.
- However, a new proportionality threshold has been introduced so that financial advice / guidance is not required where the offer relates to certain lower value benefits.
- The Code now explicitly covers “Full Commutation” exercises
- Version 2 applies to offers made on or after 1 February 2016. Where an offer has been made in writing to a member on or before that date it will remain subject to the original version of the Code (published in June 2012).

Code of Good Practice on Incentive Exercises

The Code was introduced in response to industry and government concerns that incentive exercises (“IEs”) could be conducted in a way that disadvantaged pension scheme members. It was written by an industry working group and published in June 2012. (See our [Alert](#) for details.)

The objectives of the Code are to ensure that all IEs are:

- carried out fairly and transparently
- communicated in a balanced way and in terms that members can understand
- available with appropriate financial advice (or in some limited circumstances, financial guidance) that is paid for by the party initiating the exercise

- able to achieve high levels of member engagement, and
- provided with regulated access to an independent complaints and compensation process.

What is an IE?

The Code defines an IE as “an invitation or inducement... [or offer] ... provided to a member to change the form of their accrued [DB] rights in a UK registered pension scheme, which meets both of the following tests:

- one objective of providing the invitation or inducement is to reduce risk or cost for the pension scheme or sponsor(s); and
- the invitation or inducement is not ordinarily available to members of the pension scheme.”

Types of IE

Broadly, the Code deals with two types of IE:

- “Transfer Exercises” – for example, involving an offer to members of transferring out their DB rights on an enhanced basis (as distinct from a normal individual transfer request)
- “Modification Exercises” – for example, Full Commutation exercises (where a cash lump sum is offered in full replacement for a pension that would otherwise have been available) and pension increase exchange (“PIE”) exercises (which involve an enhancement to pension income in return for surrendering all or part of future pension increases).

For Transfer Exercises, financial advice (including a final, tailored written recommendation) should be provided to the member. For Modification Exercises, either:

- financial advice should be provided or
- the so-called “Value Requirement” should be met, and “IE guidance” (broadly, a guidance process by which a member is assisted by an adviser in making a decision) provided to the member.

For an exercise to meet the Value Requirement, in aggregate, members who are offered the IE must not be worse off after the IE than they were before. For this purpose, calculations are made using the framework for actuarial equivalence tests under section 67 of the PA95.

The review

Over the last three years, the IEMB has assessed the effectiveness of the Code, with a view to recommending either that it continues, or that it be set aside in favour of legislation.

Anecdotal evidence suggests that trustees and employers want to comply with the Code, despite its voluntary nature, and the IEMB believes that it has resulted in “better behaviours, better run exercises and less risk of members being disadvantaged”.

In the IEMB’s opinion, changing or withdrawing the current principles of the Code could risk a decline in good practice. It has therefore decided to update the Code to reflect the changing environment, in particular the pension freedoms introduced in 2015.

What's new?

Proportionality threshold

The key change is the introduction of a “proportionality threshold”,

- for Transfer Exercises and similar, this applies where a member is being offered a transfer value of £10,000 or less
- for Full Commutation exercises and similar, this applies where a member is being offered a cash commutation payment of £10,000 or less
- for PIE exercises and similar, this applies where the pension that can be modified under the offer for a particular member is a pension of £500 per annum or less
- for other exercises, a broadly equivalent value / pension may be set by users of the Code.

The Code states that the proportionality threshold should be applied cumulatively. For example, although the proportionality threshold would apply to an initial offer of a PIE exercise in respect of a pension amount of £400 per annum, it would not apply to a subsequent offer to the same member for a further modification of a pension amount of £100 per annum or more.

Where the proportionality threshold applies to an offer, there is no requirement to:

- provide financial advice
- structure the guidance process so that the member has to take IE Guidance before the offer can be accepted.

However, IE Guidance should be made available and readily accessible to members who wish to have it. Further, the Code suggests that the parties may wish to consider whether it would be good practice to provide or require further financial advice or guidance, based on their knowledge and experience of the membership.

Other changes

The Code now takes account of additional possible IEs, such as Full Commutation exercises (see above). In addition, it also makes clear that while IEs are typically started by the employer, on occasion they might be initiated by another party, such as the trustees. The party who initiates the offer is not only responsible for following the Code (and seeking to ensure that other parties also do so) but, as noted above, “should” also pay for any financial advice and associated services, such as helplines.

Rather than update the Practitioner Notes which supported the original Code, the IEMB has introduced “Boundary Examples”. These aim to help illustrate how the Code could and should be applied in practice.

The examples fall into four areas:

- situations which may fall within / without the scope of the Code, particularly considering “business as usual” situations
- the application of the Code to the backdating of PIE exercises

- IFA fee structures, and
- the application of the proportionality threshold to Transfer Exercises.

Winding-up Lump sums (“WULS”)

The Code is not intended to apply generally in relation to exercises associated with winding-up, as “trustees can be expected to set terms for all options appropriately in the context of a wind-up”. This means that WULS are currently outside of the Code’s scope.

However, the Code asks all parties to be mindful of its principles, in such circumstances, to ensure that member’s interests are appropriately protected. Further, the IEMB predicts the growth of WULS being used as IEs and therefore intends to consult, during 2016, on whether or not it should be specific about which types of WULS should fall within the Code and prepare some additional Boundary Examples to support this.

Compliance

TPR supports the Code and will continue to monitor IEs through the scheme return.