

Retirement savings and financial advice – changes in the pipeline

Alert | 07 October 2016



Introduction

Two consultations and a call for evidence are underway which look set to simplify certain elements of financial advice in the retirement savings context.

Key points

- The DWP is [consulting](#) on the way in which certain retirement savings, those regarded as both “safeguarded benefits” and “flexible benefits” (referred to as “safeguarded-flexible benefits” in the consultation), are valued for the purpose of the “[appropriate independent advice](#)” requirements.
- In conjunction with these changes, the DWP is also proposing to introduce new tailored risk warnings to be sent to members with safeguarded-flexible benefits who are contemplating either transferring their benefits to a DC arrangement, converting their benefits into DC, or directly accessing their benefits flexibly (a “relevant transaction”).
- In addition, a DWP [call for evidence](#) is asking for views on how best to iron out some of the practical difficulties facing trustees and scheme administrators when applying the advice requirement in the context of overseas transfers.
- Meanwhile, as announced in the [2016 Budget](#), HMT is [consulting](#) on amendments to the definition of financial advice, with the aim of removing regulatory uncertainty and ensuring that firms can offer consumers the help they need.

Background – the advice requirement

With effect from 6 April 2015, individuals with “flexible benefits” (generally, DC benefits) were given [greater freedom and choice](#) over how to access their retirement savings. To coincide with this, a new requirement to take appropriate independent financial advice from an FCA authorised adviser was introduced for members with “safeguarded benefits” (generally speaking, DB benefits).

However, DC benefits which offer guarantees (for example, a contractual right to a minimum level of pension or a minimum rate of conversion of their “pot” into a pension or an annuity) are both “flexible benefits” and

“safeguarded benefits” under the legislation.

The appropriate independent advice requirement does not apply where the total value of a member’s (or survivor’s) safeguarded benefits under a pension scheme is £30,000 or less. However, the Government is aware that the calculation method for valuing DC benefits with guarantees for this purpose (“safeguarded-flexible benefits”) has been proving problematic in practice.

The Government therefore called for evidence on the application of the advice requirement to safeguarded-flexible benefits back in November 2015. In its March 2016 [response](#), the DWP announced that it would make it simpler for providers and members to identify when the advice requirement applies. It is now consulting on [draft regulations](#) to implement appropriate changes.

Valuing benefits for the advice requirement

Current position

Currently, trustees and managers are required to value safeguarded benefits using the cash equivalent transfer value method for DB occupational pension schemes. As a result, members with safeguarded-flexible benefits can end up with two different values for their benefits:

- one which is calculated for the purpose of ascertaining whether the advice requirement applies, representing the estimated present value of the pension the member could secure by exercising their guarantee at a future point, and
- a second (usually lower) transfer value, generally representing the realisable cash (or fund) value of the member’s DC pot.

Having two calculation methods causes confusion where the value for the purpose of the advice requirement is above £30,000, but the realisable cash value on a transfer (or fund available to be paid as a lump sum) is lower. In addition, many safeguarded-flexible benefits, such as DC benefits with guaranteed annuity rates (“GARs”), exist within personal pension schemes or other contract based arrangements. This can cause difficulties for providers who are not familiar with the occupational pension scheme transfer methodology and do not have the necessary systems and processes in place to estimate the value of benefits appropriately.

Proposed changes

The DWP proposes simplifying the regulations so that the value of safeguarded benefits, including safeguarded-flexible benefits, is treated as equal to the actual transfer payment to which the member would have a statutory right in respect of those benefits (ignoring any potential reduction in a scheme which is underfunded). The regulations will come into force on either 6 April or 1 October 2017, depending on the speed with which they receive Parliamentary approval.

Transitional provisions

Transitional provisions will apply to certain members with safeguarded-flexible benefits in the six months leading up to the new regulations coming into force. Where such members would no longer be required to take advice once the regulations come into force (but would have been beforehand), the trustees must generally inform them of this in writing within 20 days of the regulations coming into force.

Unsurprisingly, the transitional provisions will not apply where the relevant transaction has already concluded before the regulations come into force or the time limit for carrying it has out expired.

Tailored risk warnings

As the new method for valuing safeguarded-flexible benefits will produce a lower value in many cases, fewer people will be caught by the requirement to seek appropriate independent advice.

Mindful of the need to protect consumers, the Government intends to introduce a new requirement for schemes to send risk warnings to all members with safeguarded-flexible benefits before they carry out a relevant transaction. This new requirement will apply irrespective of pot size (so whether or not the appropriate independent advice requirement will apply), and will also apply to members below age 55 who wish to transfer their benefits to another scheme.

These new warnings will be in addition to those required under the disclosure regulations and the FCA rules (see our [Alert](#) for details).

Content

The consultation proposes that the risk warnings should be tailored to the guarantees in question and should:

- communicate the fact that the member's benefit has valuable guarantees, explain any applicable terms and conditions, and warn that the guarantees can be lost in certain circumstances
- include two comparative income illustrations (estimates) of the rate of secure pension income that the member would receive on exercising the guarantees, compared with what the same size pot could buy on the open market
- ensure both illustrations enable a like for like comparison and interpret the guarantees in a monetised format.

Enforcement

Non-compliance with the requirement to provide such risk warnings could see trustees and managers facing a fine from TPR of up to £5,000 (for an individual) or £50,000 in any other case.

Overseas pensions transfers

Individuals who have a statutory right to transfer their pension benefits have the option of transferring them overseas. For the transfer to be made free of UK tax, the receiving scheme must be a qualifying recognised overseas pension scheme (QROPS).

The appropriate independent advice requirement applies equally to domestic and overseas transfers of safeguarded benefits. But, as those seeking to transfer their benefits overseas have run up against practical difficulties, the DWP has issued a [call for evidence](#).

Individuals looking to transfer benefits overseas often seek advice from a non-UK based financial adviser on any number of issues, including local tax rules, the suitability of overseas pension schemes or, in some cases, because they are required to do so by the overseas financial jurisdiction. UK advisers may be unwilling or unable to offer specialised transfer advice covering non-UK tax and pension rules.

As a result, individuals wanting to transfer their safeguarded benefits overseas can find themselves in the position of having to pay for two sets of advice – one to meet the condition of the appropriate independent advice requirement and another from an overseas adviser on the local implications of the transfer.

Options set out in the call for evidence

Options being considered by the Government include:

- leaving the appropriate independent advice requirement unchanged
- removing the advice requirement entirely
- permitting overseas members to seek equivalent advice in their country of residence and introducing a way for trustees / administrators to check that the member has genuinely received advice from a local adviser.

The Government is keen to ensure that any alternative process includes some form of protection for members and that it should only apply to members with safeguarded benefits who are resident overseas (or, potentially, those intending to move overseas).

Changing the definition of “financial advice”

The Financial Advice Market Review (FAMR) was launched in August 2015 to examine how financial advice could work better for consumers. One of its key findings is that confusion amongst advisers over what amounts to regulated advice is leading to some consumers missing out entirely.

Whilst some consumers need full advice covering all their financial needs, those with more straightforward finances (or relatively small amounts to invest) can find that the cost of regulated advice outweighs the benefits. FAMR concluded that individuals in these circumstances might benefit from “high quality and more specialised and detailed guidance services”. But it also found that firms were reluctant to offer guidance due, at least in part, to “fear of inadvertently straying into the provision of regulated advice without meeting the higher regulatory requirements”.

According to FAMR, the confusion over what amounts to regulated advice stems from the fact that there are two definitions of financial advice. MiFID defines advice by reference to the giving of a personal recommendation, whereas a later definition in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO) is less specific. As the MiFID definition is seen as clearer for both firms and their customers, FAMR recommended amending the RAO to draw a “clearer boundary” between regulated advice and guidance. HMT is therefore consulting on proposed changes to bring the two definitions into line.

As well as clarifying the definition of financial advice, the FCA is set to produce new guidance to support firms offering services that help consumers to make their own investment decisions without a personal recommendation.

Next steps

- The DWP's consultation on the advice requirement closes on 7 November 2016. It is anticipated that the regulations will come into force either on 6 April or 1 October 2017.
- The call for evidence on the advice requirement and overseas transfers runs until 23 December 2016.
- HMT's consultation on the definition of financial advice closes on 15 November 2016. As part of the consultation process, the Government intends to hold targeted roundtables for representatives of affected parties.

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