PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

OCCUPATIONAL AND PERSONAL PENSION SCHEMES AND THE PENSION PROTECTION FUND (MISCELLANEOUS AMENDMENTS) REGULATIONS 2016 CONSULTATION

AND

CALL FOR EVIDENCE ON THE VALUATION OF PENSIONS WITH A GUARANTEED ANNUITY RATE

A RESPONSE FROM THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

“THE APPROACH TO RETIREMENT RISK WARNINGS NEEDS FURTHER THOUGHT.”

January 2016

INTRODUCTION

We are the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

The Pensions and Lifetime Savings Association (the Association) welcomes this consultation on proposed regulatory changes following the introduction of pension freedoms.

The changes to regulations in respect of pension sharing, scheme wind-up, inalienability, preservation of benefits and the Pension Protection Fund are for the most part straightforward, and we welcome these clarifications. We also welcome the proposed approach to valuation of money purchase and cash balance pots to which guaranteed annuity rates attach, and we have some suggestions for how the approach should play out in the regulations.

However, the approach to retirement risk warnings needs further thought. Risk warnings should come when it is clear that a benefit is being drawn (in the form of one or more lump sums (UFPLS), drawdown or an annuity). They should come from the scheme from which the benefit will be taken, and should describe in generic terms the risks associated with option that the member has indicated that he or she would like to take. Where the member is simply transferring to another scheme or provider, rather than directly taking his or her benefits, we do not think that yet another tranche of generic materials about all of options for taking income will serve the stated goal of protecting members. Our answers to the consultation questions, along with some further thoughts, are below.

CHAPTER 1. PENSION SHARING AND ATTACHMENT ORDERS ON DIVORCE

Consultation questions:

1. **Do you agree that these various technical amendments ensure that pension sharing legalisation reflects changes which have already been made regarding ordinary scheme benefits?**

The Pensions and Lifetime Savings Association agrees that the various technical amendments are largely consequential and reflect changes that have already been made regarding ordinary scheme benefits.

2. **Do you agree that the advice requirement should apply to pension credit members if they wish to transfer safeguarded pension credit rights valued above £30,000?**

Yes, advice should be required for pension credit members under the same circumstances that it is required for members.

3. **Are respondents aware of specific problems where an attachment order exists and the member has chosen to take "flexible benefits" (money purchase benefits or cash balance benefits) in a flexible manner? Can you give actual examples and numbers?**

We are not aware of any specific issues regarding attachment orders and flexible benefits. The number of attachment orders that remain is relatively small and well-run schemes operate an effective notification process.

4. **Do respondents think that notifying the former spouse at an earlier stage in the process is the solution? Do respondents think that this approach is sufficient or do they consider that further action might be more appropriate? If so, could respondents please give details of any action that they would like the Government to consider.**

We believe that in most cases notification is all that should be required. If what the member proposes is outside of the terms of the order, then the former spouse will in any case need to become involved because the scheme cannot distribute outside of the terms of the order. A harder case is where the conduct is within the terms of the order, but probably outside of the intent at the time of the order, when laws regarding member choice were more restrictive. We believe that notification of the spouse should be helpful in these hard cases.

5. **What do respondents think would be the practical difficulties of requiring the former spouse to confirm that they had received the notification?**

There would be some practical difficulties with requiring confirmation from the former spouse. Of course, the scheme administrator should take steps to ensure that notice has been delivered in an effective fashion.

6. **Do respondents think that problems will only arise where the member has flexible benefits? Or do respondents think that the former spouses of all members should be notified when the member applies to take benefits, regardless of the type of pension benefits involved?**

In our experience, attachment orders are more likely to be used where the benefits are salary-related and commutation in order to create a separate benefit for the spouse is undesirable. We read the current legislation as being capable of an interpretation under which a member who has safeguarded benefits is converting them in order to take them as a lump sum, the spouse would need to be notified, but this is not crystal clear. Therefore we think that the regulations would be more useful if they made clear that where safeguarded benefits subject to an attachment order are being converted to flexible benefits, the ex-spouse must be notified.

7. **Does your scheme allow members to convert safeguarded benefits to flexible benefits?**
8. **Do respondents agree that only pension rights which rise to a preserved pension should be shareable rights and the value of a cash transfer sum should be excluded?**
9. **Do respondents agree that all Pension Death Benefits in payment and mentioned in Part 2 of Schedule 28 of the Finance Act 2004 should be excluded from shareable rights?**

We agree that contribution refunds, rights to cash transfer sums when there are fewer than two years' service and pension death benefits should not be shareable rights under the pension sharing legislation. We are accordingly content with the language being inserted in regulation 2 of The Pension Sharing (Valuation) Regulations.

10. **Do respondents agree that the proposed amendments to the regulations clarify that a reduction for underfunding should only be applied once, and only in cases where a pension credit is being implemented outside the scheme?**
11. **Do these changes make it clearer to trustees/managers what information legislation requires?**

12. **Is this the information that schemes should be providing? Do respondents have any other comments about valuations provided for the purposes of financial settlements connected with divorce proceedings?**
13. **Are underfunded schemes providing divorcing couples/the courts with reduced or unreduced valuations, or both? If schemes are only providing one are they being asked for the other?**

We are not aware of any situations in which a reduction took place both at the valuation and again at the discharge phase. However we agree that this would not be appropriate. The amendments to The Pension Sharing (Valuation) Regulations 2000 will make this very clear if there was any doubt.

CHAPTER 2: OCCUPATIONAL PENSION SCHEMES: SCHEME WIND-UP, INALIENABILITY AND PRESERVATION OF BENEFITS

14. Do the proposed amendments to the winding up regulations achieve the intended outcome?

15. The proposed amendment to the winding up regulations require a scheme to obtain member consent before discharging cash balance benefits by lump sum. Will this create any difficulties for schemes?

We believe that a statutory discharge on payment of an UFPLS when a scheme winds up is appropriate and that member consent should be obtained if the scheme is to receive such a discharge.

16. Are you aware of any unintended consequences which might result from the removal of the employment condition in Regulation 2(1B)(c) of the Assignment etc. regulations?

We are content with the removal of the employment condition and see no unintended consequences resulting from this removal.

17. Would it be useful if we inserted a cross-reference to Section 48 into the relevant regulations?

Section 48 very clearly applies to any transfer or conversion and therefore we feel there is little need to cross-reference throughout the relevant legislation. However, if it is felt that the insertion of a reference to section 48 in the Preservation of Benefit regulations will aid understanding, we would recommend inserting it only regulation 7, which is the general regulation on alternatives to short service benefits.

CHAPTER 3: PENSION PROTECTION FUND

18. Will these proposed amendments to the PPF Regulations implement the changes described above?

19. Do you agree that the proposed amendments to regulation 7 achieve the aim of ensuring that all eligible schemes have a mechanism by which to enter the PPF? Are respondents aware of any other practical scenarios which might not be covered by the proposed amendments, in relation to employers based in the UK or elsewhere within or outside the EU, in which the sponsoring employer of a PPF eligible scheme might not be able to have an insolvency event due to limitations on the jurisdiction of the courts to make a winding up order?

20. Is it possible for the insolvency events of friendly societies, industrial and provident societies, credit unions, limited liability partnerships, persons authorised under Part 4A of the Financial Services and Markets Act 2000 or the Society of Lloyd's and Lloyd's members to be stayed or come to an end? Should we cover these types of employers within regulation 6 of the PPF Entry Rules Regulations?

This suite of proposed regulatory changes addresses a number of technical issues stemming from recent legislation, and the Association welcomes them. We particularly welcome the changes to the definition of an employer that can experience an insolvency event under the legislation in the PPF Entry Rules. In our response to the Consultation on the draft of the Pension Protection Fund (Entry Rules) (Amendment) Regulations 2014 we welcomed the proposed regulations which aim to rectify an issue with the current regulations whereby an employer of an UK scheme could have an insolvency event outside the UK, but within the EEA, and yet employees of the UK-based scheme would not be covered by the PPF regardless of whether the scheme had been paying the PPF levy.

CHAPTER 4: RETIREMENT RISK WARNINGS FOR MEMBERS OF OCCUPATIONAL PENSION SCHEMES

The Pensions and Lifetime Savings Association does not believe that the proposed regulations serve their stated purpose of protecting members. They add an unnecessary cost burden for schemes which will ultimately be passed on to members.

The proposed regulations state that where:

- "the trustees become aware, by whatever means, that the member is considering" transfer, purchase of an annuity, taking a lump sum, or putting benefits into drawdown, and
- the member has already received –
    - information from the scheme describing the choices generally available at retirement,
    - guidance about characteristic features of retirement options,
    - a flyer about Money Advice,
    - sign-posting material about Pension Wise,
    - an estimated value of his or her accrued rights, and
  - statements about tax implications associated with flexible benefits

then, the trustees should send the member generic risk warnings about each of the possible decisions that they may be about to implement.

This is being done by way of a regulation 19A to The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (the "Disclosure Regulations") which will join:

- Regulation 18A, which requires that the information listed in the paragraph above about pensions choices to be given within 2 months where:
    - a member is over 54 years and 8 months in age,
    - has flexible benefits and
    - requests information about the benefits or tells the trustees that he is interested in making a decision about the benefits;
- Regulation 18B, which requires an explanation of annuities and signposting to Pension Wise to be given within 20 days where
    - a member is over 54 years and 8 months in age.
    - has flexible benefits and
    - there is a contact between the member and the trustees or managers "in connection with what the member may do with his flexible benefits"; and
- Regulation 19, which requires the same information as regulation 18A, where the member is within four months of the scheme's normal retirement age, unless the information in regulation 18A has been given within 12 months, in which case less information needs to be given.

We do not believe that yet another general information pack about pension choices generally and all of the possible pitfalls to all of the possible alternatives will be helpful to the member. In contrast, information about the risks associated with the option for taking pension income or lump sums that the member has under active consideration, provided before the member has made a final decision, could be useful. This can only effectively come from the provider of the income, whether it is in the form of a lump sum or series of lump sums, an annuity or drawdown.

Risk warnings will be much more effective if they come from the provider who will provide the benefits. This is also consistent with the way risk warnings are approached in the contract-based environment, and so when the member is switching over to a contract-based product, he will receive FCA-mandated risk warnings at a similar time.

Other problems with the proposed regulations are:

- The disclosure process at retirement is already unduly complex due to the confusion created by regulations 18A and 18B of the Disclosure Regulations. As currently drafted the proposed changes only add to this confusion about who is supposed to get which information in what circumstances, and to what time deadline. Schemes are already conflating regulations 18A and 18B because it is not clear which applies when a member makes a general inquiry, or why there are two different regulations at all. The likely result of the proposed language would be yet more general information which would go out in all sorts of situations, even though all the research shows that large quantities of general information are not digestible and only add to member confusion.
- To the extent that this step is interposed when the member attempts to transfer, it clutters a transfer process that that already takes more time than it should from the member’s point of view. The more barriers we put in place where the member wishes to transfer, the more likely the member is to simply take the whole pot in cash and have done.
- Some schemes and/or administrators are already giving their versions of risk warnings concerning the benefits that they offer at a time that makes sense for the members and this additional process risks disturbing a system that is already working in many schemes.
- The language of the proposed regulations requires the trustees to send risk warnings within 7 days where "the trustees have become aware, by whatever means, that the member is considering, or have decided to" take a transfer, purchase an annuity, get a lump sum, or take flexible benefits. This language is vague and inappropriate as some trustees may hear about people's plans in the workplace, and all will have become aware that the member is considering

transferring or taking benefits by virtue of a request under regulation 18A or 18B.

It is not clear how the Department came to an estimated overall cost to the industry £44,000 in connection with implementation of regulation 19A. This is closer to a per-scheme cost than an overall cost to the sector. Each scheme will need to take advice on the circumstances in which to issue the additional materials and how they should be drafted. The risk warnings may then need to be designed, drafted, approved and printed. There will also be systems changes to ensure that the materials are mailed at the appropriate time.

21. Do respondents agree that the proposed amendments to the disclosure regulations would provide appropriate protection for members of occupational schemes, ensuring that members have an adequate understanding of the risks involved?

No, we do not think that the proposed amendments provide meaningful protection for members.

22. Do respondents agree that the approach we have taken is workable? Is there anything we could do to clarify the timescale?

A transferring scheme will not be able to deliver meaningful risk warnings to members and the proposed regulation will impose needless burdens on an already encumbered transfer process with little or no benefit to members.

Do respondents agree that 7 days is an appropriate maximum timescale for trustees to send out risk warnings? Seven days from whatever event triggers the requirement will not be sufficient time. Most schemes will need to respond to member inquiries through their third party administrators, who will struggle to provide a response so quickly, especially if the initial contact is in the workplace. The vagueness of the trigger also will make it difficult to comply with this requirement inasmuch as a decision may need to be made as to whether the conditions for action set out in regulation 19A are present.

23. Do respondents think that putting the need to send out a statement to the member in legislation is necessary?

It makes sense for schemes from which the benefits are being accessed to send out a set of risk warnings specific to the benefits being taken prior to receiving the transfer.

This is already the case for personal pension schemes and the system appears to work well.

However, we do not think that the transferring scheme should be required to send out a large packet of material listing all of the member's possible choices and giving risk warnings specific to each of them once the member has decided to transfer. We doubt that the member would find it useful, particularly since they will have already received the other mandated materials describing options generally and signposting him to Pension Wise. A set of generic risk warnings pertinent to the option being considered by the member would be far more useful.

24. Do respondents agree that paragraphs 4B and 22B of Schedule 2 should be disapplied with regard to members of unfunded defined benefit public service schemes?

This would seem to make sense, inasmuch as these provisions should only apply to those who can transfer their benefits.

25. Do respondents agree that the current requirements are clear, or should they be clarified in guidance?

We would rather see the Department bend its efforts towards making the regulations themselves more clear. Guidance can clarify the intention of the drafters, but it is the regulations that are legally binding, and they are already muddled .

More thought should be given to whether the current regulations are fit for purpose inasmuch as they appear to require different information and timing for responses to general inquiries. They also include questionable provisions, such as the one requiring a scheme offering non-flexible benefits to warn that the benefit is likely to be less valuable if the member does not wait until normal retirement age – even if this is not true for that scheme. The Department should revisit all of the disclosure legislation with the thought of making it more useful and streamlined for the new, more flexible world rather than simply adding another regulation into the mix. This is particularly true as regards disclosure, where all of the research shows that less is more.

CHAPTER 5: VALUATION OF PENSIONS OFFERING A GUARANTEED ANNUITY RATE (GAR) AND THE ADVICE SAFEGUARD: CALL FOR EVIDENCE

The Pensions and Lifetime Savings Association welcomes examination of the way in which money purchase or cash balance benefits to which guaranteed annuity rates ("GAR"s) attach are treated under the pensions legislation. Since the change to the definition of "money purchase benefits" became effective in 2014, a number of questions have arisen about how to treat these benefits where they are no longer considered "money purchase".

One of the most vexatious of these has concerned how to value the GAR for the purpose of furnishing a cash equivalent transfer value ("CETV") under The Occupational Pension Schemes (Transfer Value) Regulations 1996. Through a process of elimination under those regulations, one is led to conclude that the CETV should be calculated using the salary-related method, even though in most cases under the rules of the contract only the money purchase or cash balance pot is actually available on transfer.

We think that it will be important to clear up this problem by adding a provision to those regulations stating that where a benefit is a money purchase or cash balance pot to which a guaranteed annuity rate attaches, then it is appropriate to value the benefit for the purpose of the CETV using the cash balance or a money purchase method, respectively. Then it will be appropriate to simply allow benefits to which GARs attach to be valued for the purposes of the advice requirement in line with their CETV, as are other benefits for the purpose of determining the applicability of the advice requirement.

1. **Do you think that changing the GAR valuation process for the purposes of the £30,000 advice threshold would make it easier for providers to determine, and for consumers to understand, when independent financial advice is required?**

Yes. Currently, it is not completely clear how to evaluate what a benefit consisting of a GAR attached to a money purchase or cash balance pot is worth. The salary-related method is not fit for purpose., In contrast, the actual worth on transfer will be in most cases the value of the money purchase or cash balance pot without any allowance for what the value of the GAR would have been had an annuity been purchased at retirement. A valuation methodology that reflects what the pot would actually be worth on transfer is more appropriate and easily understood.

2. **If the valuation method is changed, do you think the new method**

should treat the value of GAR benefits, for the purposes of the advice requirement, as equal to the transfer payment that would be made in respect of those benefits, if the member were to proceed with a transfer to another scheme? If not, what other method might be suitable?

Yes. We think that the valuation methodology should be the same for both formulating a CETV and for the purposes of determining application of the advice requirement. This is the way it is for all other benefits. We would recommend that the CETV methodology should be determined by the way in which the pot is invested – cash balance or money purchase.

It is not appropriate that money purchase or cash balance pots to which GARs attach be valued using a salary-related method. The value of a pot to which guaranteed annuity rates attaches is mostly determined by the investment performance of that pot, and the guaranteed annuity rate only describes the rate at which the pot can be converted under particular circumstances. In contrast, the salary-related method is appropriate for benefits that rest on length of service and salary rather than investment performance.

3. **Do you think such a change to the application of the advice safeguard to GAR benefits would significantly reduce the level of protection provided by the requirement to members with GAR benefits?**

We do not think there would be any harm in allowing pension benefits to which GARs attach to be transferred without advice so long as the pot is below £30,000 in value. Although a pension pot of less than £30,000 may well yield an income that may provide a significant supplement to a state pension, the cost of advice could easily outweigh the value of the GAR.
However, members should be made aware of the presence of a GAR, the rate that will apply and the date that it becomes available. This should be true in all cases, whether or not the GAR is offered through an occupational scheme (and the benefit is usually considered a money purchase benefit and therefore a flexible benefit because it is an aspect of an insurance policy rather than expressed in the scheme rules) or through a contract-based arrangement (in which case it is usually considered a non-flexible benefit).

4. **Should such a change in the valuation method apply only to arrangements under personal pension schemes where there is no guarantee about the amount in the member's pot, but the member has the right to exercise a guaranteed annuity rate (or other guaranteed rate of conversion) at a future point? If not, what other types of flexible safeguarded benefits should the new valuation method apply**

to?

We do not see why GARs attaching to cash balance benefits should be subject to different rules than GARs attaching to money purchase pots. In both cases, most of the value of the benefit resides in the accumulated pension pot rather than in the GAR.

Nor do we think that the valuation methodology should only apply to personal pension plans. Occupational pension schemes sponsored by insurers, such as executive plans, often have GARs and may not always fit within the exemption that makes most pension benefits with GARs held by larger occupational schemes money purchase.

5. **Are there any potential unintended consequences, for providers or members, in simplifying the GAR valuation process for the purposes of the £30,000 advice threshold?**

We are not aware of any unintended consequences to treating these benefits as cash balance or money purchase benefits for valuation purposes. They were treated as money purchase benefits until the new definition of "money purchase benefits" became effective in July 2014. We would expect more problems with any other method.

6. **What steps do you think Government and/or industry should take to ensure that members who would no longer be legally required to take advice if the valuation process is changed are still made aware of the potentially valuable guarantees they would be giving up?**

We think that some form of notification of the existence and potential value of GARs should be incorporated into a restructured set of disclosure regulations. With the materials describing the benefits that the member has in his own scheme under Part 3 Schedule 7 of those regulations, members who have access to GARs at retirement should be notified of the existence of the GAR.

In practice, most pension schemes are doing this when they describe the benefits under the plan, but there would be no harm in making the requirement more explicit. This should apply even where the scheme rules do not promise guaranteed annuity rates and the benefit is therefore considered a money purchase benefit to which the advice requirement would never apply.

7. Do you think that providers who offer pension benefits with a GAR should be required to use a statutory risk warning to make their members aware of the implications of giving up the guarantees attached to their pension fund, or could these risk warnings be delivered via a voluntary approach on the part of providers and trade bodies?

Please see our answer to question 6 above. We believe that schemes are voluntarily disclosing the GAR where they think appropriate. From our point of view, this feature and its potential value should be disclosed as part of the description of benefits under the scheme. We do not think that another set of materials describing all sorts of risks, and in which perhaps some sort of warning about the GAR is buried, needs to be sent to the member. The information should be where he expects it – in his description of the benefits he holds in his scheme.