Title: Simplifying advice requirements for safeguarded pension benefits and introducing new consumer protections	Impact Assessment (IA)
IA No:	**Date:** September 2016
RPC Reference No:	**Stage:**
Lead department or agency:	**Source of intervention:** Domestic
Department for Work and Pensions	**Type of measure:** Secondary Legislation
Other departments or agencies:	**Contact for enquiries:**

Summary: Intervention and Options

RPC:

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2014 prices)	**One-In, Three-Out**	**Business Impact Target Status**
27.52	-	-		

What is the problem under consideration? Why is Government intervention necessary?

The pension freedoms were introduced in April 2015 to allow individuals greater choice in how and when they accessed their pension benefits. When they were introduced, the government put protections in place to ensure that individuals with "safeguarded benefits" (pension benefits with certain potentially valuable guarantees), who wished to access the freedoms did not surrender these without first being aware of their value. To this end, individuals with safeguarded benefits valued at over £30,000 are currently required to take regulated independent financial advice before they can access their pension flexibly. However, representations from providers have made the government aware that for certain kinds of safeguarded benefits, known as "safeguarded-flexible benefits", the current valuation method set in legislation for determining whether advice is required is complex and confusing for both members and schemes. Government intervention is therefore required to simplify this process. In addition, there is a general lack of awareness amongst members of the value of the guarantees associated with safeguarded-flexible benefits and additional government intervention is required to correct this on-going information failure.

What are the policy objectives and the intended effects?

The government intends to change the rules around the valuation process that is used to assess whether someone is required to seek financial advice. This will mean that schemes can use a simpler, more established process for valuing safeguarded-flexible benefits. The aim is to reduce the burden on schemes, and confusion for members. However, it is important that individuals with safeguarded-flexible benefits understand that their pension benefits offer valuable guarantees and the implications of giving them up. Therefore, while the policy will simplify the current advice requirement rules, resulting in some members no longer being required to take advice, it also must ensure that all individuals who have safeguarded-flexible benefits – regardless of pot size – are well-informed of their value (through risk-warning advice) before they make the decision to transfer or convert those benefits and so give up any associated guarantees.

What policy options have been considered, including any alternatives to regulation?

- Option 1: Do nothing
- Option 2: Simplify advice requirements for safeguarded pensions benefits so that the £30,000 threshold for seeking advice is based on the transfer value of the pension pot (as opposed to the amount required to provide for the member's accrued benefits), and introduce a requirement for firms to provide tailored risk warnings for safeguarded-flexible benefits. This is the preferred option.

The option of simplifying the advice requirement without introducing risk warnings for safeguarded-flexible benefits has been considered but discounted, as this will not meet the policy objective of ensuring that all members are well-informed about their value. Those with a pot valued at £30,000 or less might not be informed about the value of the benefits at any point before surrendering them. Recent Pensions Ombudsman cases have suggested significant lack of awareness about these benefits, and a majority of responses to the Government's Call for Evidence on the subject favoured members being better informed about their guarantees and their value.

A non-regulatory approach is not viable for the change to the valuation process as the current rules are already in regulation and further regulatory amendments are required to change these. A non-regulatory approach is also not appropriate for the risk warnings; producing tailored communications informing members of the value of their guarantees represents a cost to providers, so there is a risk that some providers may not comply. Furthermore, the payment of guarantees, irrespective of investment market returns, presents a financial liability for firms and so there may be an incentive for providers not to inform members of the value of their guarantee before they give it up. If any providers do not comply with a voluntary code, the policy would not fulfil the key objective that **all** individuals with valuable guarantees are told they have these valuable guarantees and their value, before they proceed with a decision that will result in them being given up. When asked in the Government's Call for Evidence whether a voluntary solution was feasible, a majority of responders favoured risk warnings being a statutory requirement.

Will the policy be reviewed? Yes **If applicable, set review date:** subject to Parliamentary Approval 6 April 2022 or 1 October 2022

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope?	**Micro** YES	**< 20** YES	**Small** YES	**Medium** YES	**Large** YES
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			**Traded:** N/A		**Non-traded:** N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: ______________________ Date: ______________________

Summary: Analysis & Evidence

Policy Option 1

Description: Do Nothing (baseline)

FULL ECONOMIC ASSESSMENT

Price Base	PV Base	Time Period	Net Benefit (Present Value (PV)) (£m)		
2015	**2017**	**10 Years**	**Low: 0**	**High: 0**	**Best Estimate: 0**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0		0	0
High	0		0	0
Best Estimate	0		0	0

Description and scale of key monetised costs by 'main affected groups'

Other key non-monetised costs by 'main affected groups

Under this option, the costs that are currently being incurred by providers of schemes whose members wish to transfer, convert or otherwise flexibly access safeguarded-flexible benefits will continue. The main costs are in valuing the associated guarantees, which may require actuarial support, and then checking that members have taken independent financial advice. For pensions with guaranteed annuity rate (GAR) type benefits, the costs of valuing the pension have been higher than was anticipated as the complexity of the valuation method was not foreseen. Therefore the full extent of these on-going costs was not accounted for in the original Impact Assessment[1]. Under the Do Nothing option, these costs will continue in the future and will represent the baseline against which the costs and benefits of other options are assessed. As such, these costs have not been specifically quantified.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant	**Total Benefit** (Present Value)
Low	0		0	0
High	0		0	0
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks	**Discount rate (%)**	3.5

There is uncertainty over the number of pension policies with safeguarded-flexible benefits, that is, safeguarded benefits that are not traditional salary-related (for instance final salary) pensions. We have used as a proxy the number of pension policies which offer members, whilst they are accumulating their pension benefits, a guaranteed rate at which they can convert their fund into a pension income at retirement, because we only have data on GARs and are not aware of any available data showing the incidence of other safeguarded-flexible benefits. We understand from insights from the industry that GARs are by far the most common type of safeguarded-flexible benefits in scope of this policy and therefore expect that data on GARs will be a reasonable proxy for safeguarded-flexible benefits as a whole.

[1] Amendments to Pension Schemes Bill (private sector defined benefit transfers) IA No: RPC14-HMT-2212 http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target £m
Costs: 0	Benefits: 0	Net: 0	N/A

Summary: Analysis & Evidence

Policy Option 2

Description: Simplify advice requirement and introduce tailored risk warnings

FULL ECONOMIC ASSESSMENT

Price Base 2015	PV Base 2017	Time Period 10 Years	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 0	Best Estimate: 27.52

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0		0	0
High	0		0	0
Best Estimate	0		15.1	**130.0**

Description and scale of key monetised costs by 'main affected groups'

There will be a modest cost to pension providers who have members with safeguarded-flexible benefits as they will need to familiarise themselves with the new rules. They will also incur costs from providing risk warnings to all individuals with safeguarded-flexible benefits who seek to transfer, convert or otherwise access them flexibly. There will be fixed costs to alter their systems so they can produce the risk warnings, and then on-going costs from producing and sending personalised risk warnings to members. The gross costs to businesses are estimated to be £0.3 million per year.

Other key non-monetised costs by 'main affected groups

There will be an indirect cost to financial advisors which is equal to the size of the direct saving to the group of individuals who no longer need to seek advice (a maximum of £15m per year). The impacts on financial advisors are assessed to be indirect as they rely on members changing their behaviour as a result of no longer being mandated to take advice.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant	Total Benefit (Present Value)
Low	0		0	0
High	0		0	0
Best Estimate	0		18.3	**157.6**

Description and scale of key monetised benefits by 'main affected groups'

Individuals who have safeguarded-flexible benefits worth more than £30,000 (when calculated as currently on the basis of the amount required to provide for the member's benefits), but with a transfer value of less than £30,000 will no longer be required to seek advice; estimated maximum savings are £15m per year.

There will be savings to pension providers as they will no longer be required to carry out a different and often more complicated calculation than that used to calculate transfer values to determine whether an individual with safeguarded-flexible benefits is required to seek advice. They will also no longer need to check that advice has been sought by certain members. Gross savings are estimated at £7m.

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks	Discount rate (%)	3.5

There is uncertainty over the number of pension policies with safeguarded-flexible benefits. We have used the number of pension policies which offer a GAR as a proxy, because we only have data on these and are not aware of any available data showing the incidence of other safeguarded-flexible benefits. We understand from insights from the industry that GARs are by far the most common type of safeguarded-flexible benefits in scope of this policy and therefore expect that data on GARs will be a reasonable proxy for safeguarded-flexible benefits as a whole.

There is also uncertainty over the proportion who will wish to access their safeguarded benefit flexibly and the costs associated with the current valuation method for determining whether advice is required. Where there is uncertainty, we've worked with the Pensions Regulator to use the most appropriate data sources currently available and, where appropriate, asked pension providers to provide estimates of costs involved.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			**Score for Business Impact Target £m**
Costs: -	**Benefits: -**	**Net: -**	**-**

Evidence Base (for summary sheets)

Problem under consideration

1. When the pension freedoms[2] were introduced in April 2015, the government put safeguards in place to make sure that individuals with "safeguarded benefits" (pension benefits with guarantees in relation to the level of secure pension income the member will or may receive) were fully aware of the potential value of their benefits before giving them up to take advantage of the new pension freedoms.

2. Individuals assessed as having a pension with over £30,000 of these safeguarded benefits are required to take regulated independent financial advice before they can transfer or convert those benefits into a form that can be accessed flexibly.

3. Safeguarded benefits include traditional salary-related occupational pensions and some other (primarily contract-based) pensions (known as safeguarded-*flexible* benefits) where the member is guaranteed a particular level of secure pension income, or has an option to take or purchase a pension or annuity calculated at a guaranteed rate.

4. As the most common types of safeguarded-flexible benefits are those with Guaranteed Annuity Rates (GARs) - where the member has an option to purchase an annuity at a contractually guaranteed rate at retirement, or on reaching a particular age - this term is used in the following discussion and the monetisation of costs and benefits.

5. Since April 2015 schemes have been required to value safeguarded benefits using the method for calculating cash equivalents of salary-related occupational pensions under the Occupational Pension Schemes (Transfer Value) Regulations 1996. This means that the benefits have to be valued by determining the amount required to make provision within the scheme for the benefits.

6. Schemes and providers offering GARs are therefore required to calculate the amount needed in the fund to provide for the member's accrued benefits, taking into account the GAR, in order to identify whether advice is required. Table 1 provides an illustration of how the member's pension is calculated (assuming the whole pension pot is used to purchase the guaranteed annuity rate).

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[2] From April 2015 individuals aged 55 and over have been able to access their defined contribution pension savings as they wish, subject to their marginal rate of income tax (rather than the previous 55% charge which most faced for full withdrawal).

Table 1: How the current rules on advice requirement calculate the value of a member's safe-guarded pension, and therefore determine whether advice is required, for different sized pension pots.		
Pot size	**Accrued Rights** (Value of safeguarded benefits against which a member must take financial advice).	**Is advice required?**
£10,000	£30,000 (assuming GAR guarantee of 10% of value, and a life-of-payment for 30 years).	**No** - even with the current method of calculation, where the value of the GAR is taken into account, the pension pot is not greater than £30,000, (and this is assuming a generous guaranteed annuity rate). If the individual goes ahead with a transfer, the transfer value will still be £10,000.
£25,000	£75,000 (assuming GAR guarantee of 10% of value and a life-of-payment for 30 years).	**Yes** – although the pot contains less than £30,000, when using the existing method of valuation which takes account of the GAR, the pension is worth more than £30,000 and advice is required. However, if the individual goes ahead with a transfer, the transfer value will still be £25,000.
£40,000	£120,000 (assuming GAR guarantee of 10% of value and a life-of-payment for 30 years).	**Yes** – the value of the pension is greater than £30,000. If the individual goes ahead with a transfer, the transfer value will still be £40,000.

7. The calculation method set out for estimating the current value of the GAR (by reference to the Occupational Pension Schemes (Transfer Value) Regulations 1996[3]) was previously used only by occupational defined benefit schemes and had not formerly applied to most schemes under which members have GARs (the majority of which are held in personal pensions and other contract-based products). These schemes therefore did not have standardised processes in place to value GAR benefits in terms of the current value of the future income that they offer. As a result, the government has been

[3] The method used for calculating the value of GARs is equivalent to the existing method set out in the Occupational Pension Schemes (Transfer Value) Regulations 1996 for calculating the cash-equivalent value of salary-related benefits. This involves estimating the amount of money that would have to be invested to secure the same promised income guaranteed by the scheme, at the date the calculation is made. This is well established for salary related Defined Benefit schemes.

made aware that the requirements have been causing difficulties for schemes and providers. Personal pension providers have reported that the requirement to value the income promise element of GARs places potentially significant practical and financial burdens on them[4].

8. The government has also received representations from schemes and consumer bodies that the current approach is confusing for members, who are often given two values for their pension pot when they enquire about transferring their pension: one including the value of the guarantee, which is used to determine whether they are required to take advice, and another for the (lower) value they will be able to transfer, which is usually just the amount in their pot.

9. Finally, the government's Call for Evidence on the valuation of pensions with a Guaranteed Annuity Rate[5] revealed that many members were not fully aware of the potential value of GARs. In addition, recent Pensions Ombudsman Service cases[6] indicate that some members are unaware of the existence of a GAR.

Rationale for intervention

10. The detailed requirements which apply to schemes and providers when members seek to transfer, convert or otherwise flexibly access safeguarded benefits are set out in The Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) Regulations 2015[7]. These were originally introduced alongside the pension freedoms which, by giving greater choice about how and when members accessed their pension benefits, significantly increased the appeal of accessing safeguarded benefits flexibly. As GARs constitute a guarantee regarding the rate of secure pension income a member can secure, they were categorised as a safeguarded benefit. It is especially important to make members aware of the benefits of GARs as they are found in pension schemes which otherwise look identical to schemes without any guarantees. This results in an information failure, where individuals lack full information about the fact that they have a GAR or of the conditions or value attached to it – for example due to the long term and complex nature of pensions contracts and a lighter disclosure and regulatory regime at the time consumers took out these benefits.

11. To ensure that individuals were fully informed before potentially giving up their GAR by accessing the pension freedoms, the government's safeguards require that individuals with GARs valued at more than £30,000 seek financial advice so that they understand

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/505678/government-response-misc-regs-consultation-23-nov-2015-and-call-for-evidence-on-gar-valuation.pdf
[5] https://www.gov.uk/government/consultations/occupational-and-personal-pension-schemes-miscellaneous-amendments-regulations-2016
[6] PO 563 and 569 https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-563.pdf
https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-569.pdf
[7] SI 2015/742

the implications of continuing with any decision that would result in them surrendering their GAR. However, the methodology currently set in legislation for determining the value of a member's GAR and whether they are therefore required to take financial advice has led to confusion and put an excessive burden on schemes. Government intervention is therefore required to simplify the valuation process for members accessing their GAR benefits, and to reduce unnecessary burdens on pension schemes and providers.

12. However, not all GAR-holders will be covered by the advice requirement; those with a GAR valued at less than £30,000 are exempt as it would be disproportionate for those with very small pots to be required to seek and pay for independent financial advice. This means that, despite the advice requirement, there is still an on-going information failure whereby some individuals may not understand their GAR and the value it represents when making a decision about whether to make use of the pension freedoms[8]. Furthermore the proposed simplification of the valuation process for pensions with GARs for the purpose of the advice requirement will mean that some members with GAR benefits who were previously required to take independent financial advice before transferring their benefits will no longer have to do so. Therefore additional government intervention is required in order to make sure that all individuals understand the value of their GAR and can make an informed decision, even if they are not required to seek independent financial advice.

Policy objectives

13. The government intends to amend the valuation process for safeguarded benefits. This will have the effect of simplifying the valuation of GAR benefits, so that schemes will be able to apply the same simple method used to calculate the realisable transfer values, rather than carrying out a different (often more complicated) calculation to assess who is required to seek financial advice. The aim is to reduce the burden on schemes.

14. However, it remains important that all individuals are still aware of the value of their GAR before accessing the pension flexibilities and giving up their GAR. Therefore while the policy will simplify the current advice requirement rules, and remove the requirement for some individuals to take advice, it should also ensure that all individuals with GARs are well-informed about their value before they make the decision to transfer or convert their pension pot and give up their GAR.

Description of options considered

[8] Responses to the government's Call for Evidence on the Valuation of Pensions with a Guaranteed Annuity Rate raised concerns that members are often not fully aware of the potential value of GARs attached to their pension benefits. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/505678/government-response-misc-regs-consultation-23-nov-2015-and-call-for-evidence-on-gar-valuation.pdf. Similarly, cases brought to the attention of the Financial Ombudsman have shown that individuals do not always have complete information about their GAR – e.g. http://www.financial-ombudsman.org.uk/publications/ombudsman-news/115/115-annuities.html

15. In March 2016, the government committed to simplifying the valuation process for the purpose of determining who is required to take financial advice[9]. It has been proposed that the value of safeguarded benefits, including those with a GAR, will be treated as equal to the transfer payment. In the case of pension benefits with a GAR, this may mean using the actual pot size rather than carrying out a complex actuarial calculation to identify the amount required within the scheme to make provision for the member's accrued benefits and options.

16. This measure will make it simpler for providers and members to identify which members with GAR benefits are required to take advice. It will also have the incidental effect of reducing the number of GAR-holders required to pay for independent financial advice.

17. A non-regulatory approach is not viable as the current rules around advice requirements are already in regulation and further regulation is required to amend the rules.

18. Since the requirement to seek financial advice will still be based on a threshold, not everyone will be required to seek independent financial advice. This is because it would be disproportionate to require those with a very small pot to obtain and pay for independent financial advice before being able to access their pension flexibly. However, this also means that those below the advice requirement threshold (whose safeguarded-flexible benefits are valued at £30,000 or less) may not have clear information about the potential value of their guarantees, before they decide to give up their GAR by accessing their pension flexibly. In addition, members with a pot size in excess of the £30,000 threshold will still benefit from information about the GAR before they make a decision to incur the costs of regulated financial advice. Therefore, the government intends to ensure that all individuals with a GAR, regardless of pot size, are sent a risk warning. This would be tailored to reflect the nature of the guarantee and will be designed to inform members about the value of their guarantee. It would be sent if the member sought to transfer or convert their flexible benefits or access them directly using the flexibilities (and therefore risked giving up the guarantee).

19. The proposed risk warning would consist of:

- A narrative section, which describes the nature of the guarantee and warns the member that these guarantees will be lost should the member take certain actions, such as transferring out of the scheme

[9] Government response to: Occupational and Personal Pension Schemes and the Pension Protection Fund (Miscellaneous Amendments) Regulations 2016 and the call for evidence on the valuation of pensions with a guaranteed annuity rate - https://www.gov.uk/government/consultations/occupational-and-personal-pension-schemes-miscellaneous-amendments-regulations-2016

- Two comparative income projections – one showing the annual income the member would receive should they take up their guarantees; the other projecting the income the same size pension pot would purchase on the open market.

20. Simplifying the advice requirement without introducing risk warnings would mean there is an on-going information failure, as not all individuals with safeguarded-flexible benefits would be informed about the value of their benefits. This would mean that the policy objective of ensuring that all individuals are well-informed about their guarantee before potentially giving it up when seeking to transfer, convert or access their pension would not be met.

21. For the production of risk warnings a voluntary approach has been considered, but discounted. This is because it would require **all** providers to adhere to a voluntary code - but informing individuals about their GARs would represent a cost to providers and so there is a risk that some providers will not comply. Compliant providers would incur costs in producing disclosure material. Furthermore payment of guarantees, irrespective of investment market returns, presents a financial liability for providers and so there is an implicit incentive not to voluntarily inform members before they give up their GAR-benefits. There is therefore a risk that some consumers would not be informed of the value of their guarantee before they gave it up.

22. In addition, recent cases determined by The Pensions Ombudsman, such as PO 563[10] and 569[11], and the concentration of savers with a GAR is in older age ranges[12] which suggests that this is a current issue on which legislation for standardised and comparable risk warnings, including projections, may be expected to achieve faster and more complete consumer protection than development and implementation of a voluntary approach.

23. The options therefore being considered are:

    - Option 1: Do nothing. This would mean providers and schemes will continue to be required to carry out the complex calculation. Certain members with GARs will be required to seek financial advice but providers will not have to supply information on the value of the GAR to other members.

    - Option 2: Simplify advice requirements for pensions with GARs so that the £30,000 threshold for seeking advice is based on the transfer value of the pension pot, as opposed to the value of the future income the GAR could provide; and introduce a requirement for firms to provide personalised risk warnings to all members with GARs. The risk warning will contain a written element that sets out -

[10] https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-563.pdf

[11] https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-569.pdf

[12] GARs are typically found in older schemes. Although firm practices will have varied, we have assumed 2001 is a reasonable cut-off date after which very few new schemes had GARs. The House of Lords judgment of 2001 against Equitable Life, which had tried to reduce payments to 90,000 Guaranteed Annuity Rate holders, will have severely dampened any remaining appetite for offering GARs after 2001.

– that their pension contains valuable guarantees;

– when the GAR can be taken and any other important conditions attached to it and;

– that the guarantee will be surrendered should it, or any other enhancements attached to it, not be exercised by the pot holder and;

– two income projections showing the income that the member could receive with and without the guarantee.

24. Table 2 sets out what each of these options would mean in terms of advice requirements.

Table 2: Illustration of impact of policy options for members with different-sized pension pots

Member pot size	£10,000 cash value (But with £30,000 of accrued rights even assuming a GAR of 10% and payments for thirty years).	£25,000 cash value (£90,000 of accrued rights even assuming a GAR of 10% and payments for thirty years).	£40,000 cash value (£120,000 of accrued rights even assuming a GAR of 10% and payments for thirty years).
Option 1	Member is not required to take independent advice. Provider is not required to send a risk warning with projections before the member transfers.	Member needs to obtain independent financial advice. Provider is not required to send a risk warning with projections before the member transfers.	The member needs to obtain independent financial advice. Provider is not required to send a risk warning with projections before the member transfers.
Option 2	Member is still not required to take financial advice. The member will receive tailored risk warnings with projections before they transfer.	The member is not required to take financial advice. The member will receive tailored risk warnings with projections before they transfer.	The member is still required to take financial advice. The member will also receive tailored risk warnings with projections before they make the decision to pay for

			independent financial advice in the process of pursuing the transfer.

Monetised and non-monetised costs and benefits

25. The following section sets out the estimated costs and benefits arising from Option 2, compared to the baseline (Option 1 – Do nothing).

26. Overall the measure would represent a net benefit to businesses. There will be some small costs to pension providers in familiarisation with the new rules and the cost of producing risk warnings, but these will be outweighed by the benefits from businesses no longer having to do complex valuations to determine advice requirements for individuals with GARs and no longer having to check that advice requirements for certain members have been fulfilled.

27. There will also be a saving to certain individuals who no longer need to pay for independent financial advice (and a corresponding indirect cost to financial advisors).

<u>Amendment of advice requirement valuation method</u>

Cost to businesses:

- *Cost of familiarisation*:

28. We have estimated that there are 16 contract-based providers who have members with GARs. This is based on data from FCA[13] covering October – December 2015, which covers 95% of the contract-based providers and finds 15 providers have GARs (so we assume 100% would mean 16 providers have GARs).

29. For trust-based schemes, we have used data from TPR's 2014 Governance survey[14] which provides the percentage of schemes with GARs, by scheme size. Applying these proportions to the number of schemes, as reported in TPR's scheme return data (Jan 2016) gives 318 trust-based schemes with GARs. This may over-estimate the number of schemes who face familiarisation costs as the same TPR data shows that small schemes are more likely to have GARs and in these schemes the work of familiarisation and implementing changes will typically be carried out by an administrator or another other service provider. In practice many schemes use the same service provider, so the number of distinct firms who need to familiarise themselves with the change would likely be much less than 318.

30. The transfer value of the benefits is a well-understood concept, as it is the amount which the scheme would pay to the member's receiving scheme when they transferred. Therefore the

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[13] FCA Data Bulletin October – December 2015, https://www.fca.org.uk/static/fca/documents/data-bulletin/data%20bulletin%20suppl%20apr%2016.pdf

[14] TPR Governance Survey 2014, http://www.thepensionsregulator.gov.uk/docs/governance-survey-report-2014.pdf. The survey did not distinguish between money purchase GARs, which are not safeguarded benefits, and non-money purchase GARs. Although it is understood that a significant proportion of GARs may be money purchase GARs there is no robust data on this point. We have therefore assumed that all GARs in the survey are non-money purchase. Assuming the alternative - that all GARs were money purchase - would result in a very marginal reduction in net savings to business of around £7K each year.

familiarisation times are expected to be fairly short. We have assumed that a pension professional from each of the 334 schemes and providers with GARs will need to read and digest around two pages of guidance. This is estimated to take around 5 minutes (based on an average reading time of 300 words per minute) plus an additional ten minutes to digest the information. Based on an average hourly wage of £25.34[15] this gives a total cost of £2,113.

Benefit to businesses:

- *Firms no longer need to adopt a different valuation method when determining whether advice requirement applies:*

31. Based on data from FCA, we know that the number of people aged 55+ that accessed their pension and had a GAR in the last quarter of 2015 was 14,995 or 59,820 as an annual equivalent.[16] This is based on data from the first year after the pension freedoms were introduced – when pent-up demand before the policy was introduced may mean higher volumes in the first year than we would expect going forward. To try and minimise the risk that this will over-estimate the number of GAR-holders who would choose access their pot going forward, we have used the latest data available – October-December 2015. It should also be noted that this data only records those who have actually *accessed* their pots. It does not account for those who may have enquired about accessing their pot but then decided not to at that time[17]. In this way, these volumes may under-estimate the number of people for whom the advice requirement calculation is required. However, in the absence of any data on the number of GAR-holders enquiring about accessing their pot, we have used data for the number who actually accessed their pots.

32. We do not have good data showing the number of individuals with GARs in trust-based schemes, so have made an approximate estimate, based on the number of schemes with GARs[18], by size, multiplied by the average number of members (from TPR data). This gives an estimate of 50,355. In order to estimate how many GAR holders are aged 55+ (and so eligible for the pension freedoms) we use data from TPR and ASHE[19]. Assuming that no DC scheme member under 30 will have a GAR, as GARs tend to be found in older schemes[20], we calculate that 16% of those aged 30 to State Pension age are aged 55+. This gives an estimated 7,957 individuals aged 55+ who have GARs. In line with the recent Impact Assessment on Exit Charges[21] we have assumed that 20% of those eligible for the freedoms would have accessed them in the first year after the policy was introduced (1,591 individuals), and 13% from 2016/17 onwards (207 individuals). This gives very low volumes of those with trust-based pensions with GARs who are eligible for pension freedoms and

[15] The gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs, is £24.77. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015 relating to information collected in 2014/15. This is then uprated by average earnings to give £25.34 in 2015/16 terms. http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

would choose to access them. This is consistent with our understanding from the pensions industry that the majority of GARs are in personal pensions.

33. Combined with the figures for contract-based schemes, this gives a figure of 60,027 individuals aged 55+ who have GARs and would choose to access their pension, per year.[22]

34. We assume that pension providers would only need to carry out the complicated calculation to see if the advice requirement applies if the individual's pot is greater than £10,000 (as with very small pots, even with the GAR, the value is highly unlikely to be above £30,000[23]) and less than £30,000 (because if the individual's pot is £30,000 or more, the firm would know that advice was required, regardless of how much extra value was added by the GAR). The FCA data[24] provides a breakdown of pots with GARs accessed by pot size. This 28% are over £10,000 but less than £30,000. Therefore we assume that providers would have to do the calculation for 16,954 individuals per year.

35. We assume that the cost of the calculation is around £188 per individual. This is based on taking an average from approximate estimates of the cost provided by pension schemes in response to a request for information from DWP[25]. Therefore we estimate that the total savings to businesses from no longer being required to calculate the value of GARs for

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[16] FCA Data Bulletin October – December 2015. Note that the most recent quarter has been chosen as the most representative quarter of the data to date, as the initial quarters may have been affected by pent up demand prior to the introduction of the pension freedoms in April 2015.

[17] For example, research by LCP found that only 18% of those with DB pensions requesting a transfer value actually proceeded to payment. https://insight.lcp.uk.com/acton/attachment/20628/f-0157/1/-/-/-/-/Transfer%20analysis-Issue%204-Aug%202016.pdf. However, this research applies to DB pensions not safeguarded-flexible benefits – the proportion of those who proceed to payment after seeking a transfer value may not be the same for DB pensions as for those with safeguarded-flexible benefits. We are not aware of any comparable research or statistics applying to safeguarded-flexible benefits.

[18] TPR scheme returns data 2015/16, http://www.thepensionsregulator.gov.uk/docs/file-one-schemes-2016.xlsx

[19] Based on ASHE data showing the age breakdown of active DC members, applied to TPR scheme return data showing the number of DC trust based members http://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/workplacepensions/datasets/annualsurveyofhoursandearningspensiontablespensiontypebyagegroupandbygrossweeklyearningsbandsp1 http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-a-presentation-of-scheme-return-data-2016.aspx

See Exit Charges IA - https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525859/impact-assessment-cap-on-early-exit-charges-in-trust-based-occupational-pension-schemes.pdf

[20] GARs are typically found in older schemes. Although firm practices will have varied, 2001 has been taken as a reasonable cut-off date after which GARs generally ceased to be offered. The House of Lords judgment of 2001 against Equitable Life, which had tried to reduce payments for 90,000 Guaranteed Annuity Rate holders, will have severely dampened any remaining appetite for offering GARs after 2001.

[21] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525859/impact-assessment-cap-on-early-exit-charges-in-trust-based-occupational-pension-schemes.pdf

[22] Although the current advice requirement applies to members of all ages with a GAR, the analysis focusses on those aged 55 and above. Those aged 54 and below have a statutory right to transfer their pension savings but not access those savings flexibly. The incentive to transfer is therefore be considerably reduced within this group, compared to those aged 55 and over Furthermore, the majority of GARs were sold in the 1980's so members with over £30,000 of pension savings are more likely to be aged over 55.

[23] Insight from providers suggests that the annuity rates offered by GARs tend to be around double the typical annual rate for annuities.

[24] FCA Data Bulletin October – December 2015, https://www.fca.org.uk/static/fca/documents/data-bulletin/data%20bulletin%20suppl%20apr%2016.pdf

[25] When asked for a rough indication of the unit cost of valuing a GAR, two providers responded, giving a range of estimates from £50 to £400 per transaction. In the absence of any better data, we have used a mid-point.

those seeking to transfer, convert or otherwise flexibly access their benefits is around £3,178,956 per year.

- *Firms no longer need to check if advice has been sought:*

36. There will be additional savings to providers and schemes as at present they are required to check whether advice has been taken by all those who are required to do so. As the advice threshold will now be based on the transfer value of the pot, not taking into account the value of the GAR, the group of individuals whose GAR is worth more than £30,000 but whose pot is worth less than £30,000 will no longer be required to seek advice.

37. While the FCA data provides a breakdown of GARs by pot size, we do not have any data showing the distribution of pension size including the value of the GAR. Insight from providers suggests that the annuity rates offered by GARs tend to be around double the typical annual rate for annuities. Therefore as a rough estimate we have assumed that a £15,000 pension pot with a GAR would be equivalent to a £30,000 pension pot without a GAR.

38. We estimate that of the 60,027 individuals with GARs who would choose to access their policy, 21% would have a pot that is less than £30,000 but above £15,000. This is based on FCA data[26] and assumes that the distribution of pot sizes is even, so that 75% of those with a pot size between £10,000 and £30,000 have a pot that is greater than £15,000. This gives an estimate of 12,716 individuals who would no longer need to seek advice.

39. Checking if advice has been taken requires checking the written statement from the authorised independent adviser and confirming that it reports that:

    - the advice is in relation to the member;
    - the advice is specific to the type of transaction proposed by the member and;
    - that the adviser has permission to carry on the regulated activity through checking the Financial Services Register.

40. We have assumed that checking if advice has been taken takes up to an hour of an administrator's time with an average wage of £19.54 per hour[27]. This is in line with the

[26] FCA Data Bulletin October – December 2015, https://www.fca.org.uk/static/fca/documents/data-bulletin/data%20bulletin%20suppl%20apr%2016.pdf
[27] The gross median hourly rate for an associate professional (assumed to be equivalent to a pension administrator), increased by 27% in line with the Green Book to account for non-wage costs, is £19.10. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015 relating to information collected in 2014/15. This is then uprated by average earnings to give £19.54 in 2015/16 terms.
http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

assumption used in the DB transfers Impact Assessment[28] where an equivalent requirement was introduced. Applying this to the 12,716 individuals who would no longer seek need to seek advice each year gives a total cost saving of £248,458 per year.

Benefit to individuals:

41. The 12,716 individuals per year who will no longer need to seek advice, will benefit from no longer having to pay for advice (unless they voluntarily choose to seek advice). This is estimated to save £1,170 per person[29]. Assuming none of the 12,716 voluntarily seeks advice, this gives a maximum total saving of around £14,877,512 to individuals with GARs per year.

Indirect cost to Independent Financial Advisers:

42. There will be an indirect cost to financial advisors which is equal to the size of the savings to the group of individuals who no longer need to seek advice (a maximum of £14,877,512 per year). The impacts on financial advisors are assessed to be indirect as they rely on members changing their behaviour as a result of no longer being mandated to take advice.[30]

Introduction of risk warnings

Cost to businesses:

- *Cost of familiarisation:*

43. We assume each of the 334 schemes and providers with GARs has to familiarise themselves with the new rules. Although these risk warnings include the production of projections, all schemes are required to produce Statutory Money Purchase Illustrations (SMPIs) as part of members' annual benefit statements[31]. In addition, the methodology that should be used for producing risk warnings projectionsis the the same methodology already used by schemes, to fulfill their statutory requirement to produce SMPIs under the Disclosure of Information Regulations 2013. as part of the requirements set by the Financial Reporting Council's statutory guidance for SMPIs (AS TM1). Therefore the familiarisation costs are not expected to be large because schemes will have systems in place that produce such projections. Based on it taking around 30 minutes reading and digesting time for a professional with an average wage of £25.34 per hour[32] in each of the providers or schemes

[28] DB transfers IA http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf

[29] This is from previous discussions with the Pensions Regulator and the Association of Professional Financial Advisers which resulted in an estimate based on an average cost of financial advice used in this analysis is £156 per hour, and the average time required for advice is 7.5 hours. This was used in the DB transfers impact assessment: http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf.

[30] The impact on financial advisers is assessed to be indirect as the duty applies primarily on pensions businesses without a direct requirement for financial advisers. This approach is consistent with that taken in the DB transfers IA http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf

[31] See Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013

[32] The gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs, is £24.77. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015 relating to information collected in 2014/15. This is then

affected, the total familiarisation costs are estimated at £4,227. This assumption is consistent with a previous impact assessment for a requirement to provide a type of risk warning to members[33].

- *Cost of producing risk warnings:*

44. The costs of producing risk warnings will depend on how the change is implemented. For contract-based providers we assume the change is implemented via a system change, with minimal on-going costs. However for trust-based schemes, we assume that costs are on-going but with no upfront costs - as member numbers are so small that a system amendment would be disproportionate[34].

45. The change required – either through manual intervention or through a system amendment – would be:

    - The insertion of semi-standard paragraphs into the statement of entitlement or other product. The text would need to be different for each different guarantee, but there would be a limited number of different guarantees, and the same text could be used for all members with the same guarantee.

    - The calculation of two analogous projections that illustrate the annual income the member would secure by a) using their pension pot to exercise the guarantees (GAR) available within the scheme/contract, and b) what the same pension pot would secure by purchasing an equivalent annuity on the open market. The illustrations would be new, but use an established methodology, already used by schemes and providers to illustrate projections of annual income at a future date, to determine the value of the member's pot in both projections, and estimate the "open market annuity" rate for the second 'comparison' projection.

46. For contract-based schemes, we have assumed a one-off cost to implement the change via a system change. There is uncertainty over how much work will be required as it depends on how systems are set up and how easily they can be changed. We expect the minimum requirements of the change could be achieved through 40 hours of an administrator's time at the lower end[35], and 160 hours of a professional's time at the upper end[36]. This is in line with

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uprated by average earnings to give £25.34 in 2015/16 terms. http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

[33] "A 'risk warning' provision for members of occupational pension (trust-based) schemes" Impact assessment, 2016, http://www.legislation.gov.uk/uksi/2016/294/impacts

[34] We base this assumption on earlier estimates of members and schemes/providers in contract-based and trust-based schemes. The 16 contract-based providers communicating with 59,820 members with GARS each year would be very likely to view a system change as a value for money investment. The 334 trust-based schemes communicating with 207 members each year would be very unlikely to find a system change proportionate.

[35] This gives a unit cost of £782 – 40 hours multiplied by a gross wage of £19.54 from ASHE (uplifted by 27% to account for non-wage costs and uprated to 2015/16 terms)

the assumptions used in the Commission Ban impact assessment[37]. Taking the average of these estimates gives an average unit cost of £2,418. Based on 16 contract-based schemes having GARs, the estimated total cost is £38,178 and this would occur in the first year of the policy. After these one-off costs, we assume that contract-based schemes then only face negligible on-going costs to produce the risk warnings – these are estimated at £3.26 per individual requiring a risk warning. This is based on an assumption of ten minutes of a Pensions administrator's time[38]. With 59,820 individuals in contract-based schemes requiring risk warnings each year, the estimated on-going cost for contract-based schemes is £194,807 per year.

47. For trust-based schemes, we assume no upfront costs, but a larger on-going cost of £19.54 each time a risk warning is produced. We assume a pension administrator would need to manually over-ride the system to insert appropriate standard text for a member's policy from a database, then insert the two projections, based on fairly standard calculations. In light of these requirements, we have assumed it would take one hour of a pension administrator's time. Based on the assumption that 207 members with trust-based schemes who have GARs will require risk warnings each year, this gives a cost of £4,042 per year.

48. Combining the costs (up-front and on-going) faced by contract-based and trust-based providers from producing the risk warnings gives a total cost of £237,027.

- *On-going cost of sending risk warnings:*

49. Providers will also need to send the risk warnings to individuals once created. For those who are currently required to seek advice, we assume that communication is already established and no extra postage or admin will be required. However those with a pot of less than £15,000 (who we assume do not currently need to seek advice – based on the rough assumption that a £15,000 pot with a GAR would be equivalent to a £30,000 pot when the value of the GAR was included in the calculation) would not otherwise have been sent communications at this point from providers (i.e. advising them that they need to seek advice) so the risk warning will form a new communication point. Based on the proportion with a pot less than £15,000 (from FCA data[39]) we assume 26,162 individuals need to be

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[36] This gives a unit cost of ££4,054 – 160 hours multiplied by a gross wage of £25.34 from ASHE (uplifted by 27% to account for non-wage costs and uprated to 2015/16 terms)

[37] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494298/impact-assessment--banning_member-borne_commission-in-ae-schemes.pdf

[38] The gross median hourly rate for an associate professional (assumed to be equivalent to a pension administrator), increased by 27% in line with the Green Book to account for non-wage costs, is £19.10. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015 relating to information collected in 2014/15. This is then uprated by average earnings to give £19.54 in 2015/16 terms. http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

[39] FCA Data Bulletin October – December 2015, https://www.fca.org.uk/static/fca/documents/data-bulletin/data%20bulletin%20suppl%20apr%2016.pdf

communicated with each year as a result of the policy, at a cost of £1 for sending a letter[40]. This gives an estimated cost of £26,162 per year.

Summary of costs and benefits

Summary of costs to businesses	**Year 1**	**Subsequent years**
Familiarisation with new rules on advice requirement	£2,113	0
Simplified valuation method	-£3,178,956	-£3,178,956
No longer needing to check if advice taken for certain members	-£248,458	-£248,458
Familiarisation with rules on risk warnings	£4,227	0
Cost of producing tailored risk warnings	£237,027	£198,849
Cost of sending risk warnings	£26,162	£26,162
Net cost to businesses	**-£3,157,885**	**-£3,202,403**

Summary of costs to individuals	**Year 1**	**Subsequent years**
Certain individuals no longer need to seek financial advice	-£14,877,512	-£14,877,512
Net cost to individuals	**-£14,877,512**	**-£14,877,512**

Risks and Assumptions

50. There is uncertainty around the analysis due to limited data on the incidence of safeguarded-flexible benefits and the characteristics of individuals who hold them. The assumptions have been made on the best evidence currently available. There is also uncertainty around the processes and costs involved in implementing the changes. We will look to gather more evidence during the consultation. If evidence emerges to contradict our current assumptions we will revisit the analysis at final stage.

Wider impacts

51. N/A

Small and Micro Business Assessment

52. The pension providers affected are typically large insurance businesses servicing large numbers of schemes and policy holders. However, if small and micro-schemes are self-administered the number of members affected by the changes will be very small indeed and the work required to provide the risk warnings is not expected to be significant, given that small schemes already have a statutory requirement to produce illustrative projections of annual annuity income in retirement. Therefore we do not expect any micro-schemes to be

[40] This covers the postage costs and is based on previous consultation with the pensions industry around changes to disclosure of information regulations. Department for Work and Pensions (DWP), July 2013, The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013: Government response, https://www.gov.uk/government/consultations/occupational-and-personal-pension-schemes-disclosure-of-information-regulations-2013

adversely affected. They will also benefit overall from the simplification of the advice requirement.

53. The policy intent for tailored risk warnings is to ensure that all individuals with GARs are well-informed about their value before they make the decision to transfer or convert their pension pot and give up their GAR. Exempting any subset of pension providers from this requirement would risk some consumers not being informed of the value of their guarantee before giving it up. Granting small and micro businesses that offer safeguarded-flexible benefits a full exemption from the proposed cap would not be compatible with the aims of the policy.

54. If evidence emerges as part of the consultation that the changes would have a disproportionate impact on small and micro-businesses, the Government would expect to take steps to mitigate these impacts.

Implementation of preferred options

55. The preferred option is Option 2 - to simplify advice requirements for safeguarded pensions benefits so that the £30,000 threshold for seeking advice is based on the transfer value of the pension pot (as opposed to the amount required to provide for the member's accrued benefits), and introduce a requirement for firms to provide tailored risk warnings.