

## **Simplifying advice requirements for safeguarded pension benefits and introducing new consumer protections**

### **Department for Work and Pensions**

**RPC rating: validated**

#### **Description of proposal**

‘Pension freedoms’ were introduced in April 2015, allowing individuals flexible access to their pension savings. Alongside this, the Government put protections in place to ensure that individuals with ‘safeguarded benefits’ (pension benefits with certain potentially valuable guarantees – such as guaranteed annuity rates or GARs) 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 have flexible access to their pension.

For certain kinds of safeguarded benefits (known as ‘safeguarded-flexible benefits’), however, the current valuation method, set in legislation, for determining whether advice is required is complex and confusing for both members and schemes; this involves estimating the amount of money that would have to be invested to secure the same promised income guaranteed by the pension scheme. The proposal is to replace this with the transfer value of the pension pot, with the threshold for financial advice staying at £30,000.

Given that the transfer value of the pension pot is significantly lower than the amount needed to provide for a member’s accrued benefits, the proposal will result in fewer individuals being required to seek independent financial advice. The Government are, therefore, also introducing a requirement for firms to provide tailored communications (‘risk warnings’) for members with safeguarded-flexible benefits, when they seek to transfer, convert or otherwise access their pension savings flexibly.

#### **Impacts of proposal**

##### Simplification of advice requirements

Using information from the Financial Conduct Authority (FCA) and The Pensions Regulator, the Department estimates the number of pension providers with GARs to be 565. Based upon estimates of the number of individuals with GARs, the take-up of ‘pension freedoms’ so far, and survey data on the proportion of those enquiring

about accessing their pension who subsequently go on to access it, the Department estimates that 61,122 members would enquire about accessing their pension each year. Where the transfer value of an individual's pension pot is between £10,000 and £30,000, pension providers will no longer have to carry out the existing complicated calculation to determine whether financial advice is required. (It is assumed where the transfer value is less than £10,000 the accrued benefit value is unlikely to exceed £30,000). FCA data on pension pots with GARs that have been accessed suggests that providers would have to do these calculations for 27 per cent of these members, equating to 16,480 individuals each year.

This figure is multiplied by an estimated average cost of £188 per individual, derived from providers, to give a total saving of £3.09 million each year; this is the main impact of the overall proposal on business. There is a further benefit of £0.235 million per year to providers from not having to check that financial advice has been sought.

There is an estimated £11.1 million saving per year to individuals from no longer having to purchase independent financial advice (12,260 individuals multiplied by £900). The IA presents this as an indirect cost to independent financial advisors.

#### Introduction of risk warnings

Providers are already required to produce statutory money purchase illustrations (SMPs) as part of members' annual benefit statements, and the methodology for producing risk warnings projections is largely the same. For contract-based providers, the Department assumes that the main cost will be a one-off system change. Using responses from providers, this is estimated to total £2.8 million, based upon an average cost of £175,000 per provider. Ongoing costs are estimated at £1.1 million per year, based upon an average £15 per individual in contract-based schemes and £57 per individual in trust-based schemes.

Overall, the proposal is estimated to have a societal net present value (NPV) of £105.0 million. This is driven mainly by the savings to individuals from not having to purchase independent financial advice. The business NPV is £14.79 million, which translates into an equivalent annual net direct cost to business (EANDCB) of -£1.6 million.

## Quality of submission

The Department has provided a sufficient level of analysis and supporting evidence to enable validation of the EANDCB of -£1.6 million. The Department's 'risks and assumptions' section (pages 28-35), which includes a detailed sensitivity analysis, is an example of particularly good practice in this area. There are, however, a number of areas where the IA could be improved:

*Explanation of the measure's suitability for the fast track.* Although submitted as a validation IA, the submission includes an assessment of the impact on individuals, independent financial advisers and a small and micro business assessment - this is welcome, particularly given that the overall proposal includes a regulatory measure (requirement for risk warnings) that exceeds £1 million gross cost to business. On balance, the RPC considers that this measure is a necessary protection enabling the overall deregulation and, therefore, consistent with the conditions for fast track suitability set out in the Regulatory Policy Committee's case histories guidance.<sup>1</sup> We note, however, that the regulatory measure appears to have a wider scope than the deregulatory measure – as it would apply to all individuals with a GAR who enquire about accessing their pension regardless of pot size). The Department should take into account the relative scope of the regulatory and deregulatory measures when determining the suitability for the fast track of any such future measures.

*Options.* The IA would benefit from explaining whether other options were considered, in particular having a transfer value/pot size threshold which broadly equates to the existing £30,000 accrued rights valuation threshold.

*Non-monetised costs/risks.* In its discussion of non-monetised impacts, the IA refers to the benefit to individuals from receiving risk warnings; it does not, however, refer to the risk to individuals (of making the wrong pension choice) who will no longer receive independent financial advice - this risk seems unlikely to be fully mitigated by the risk warnings.

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<sup>1</sup> <http://regulatorypolicycommittee.weebly.com/case-histories.html> . (Section 4.3.3, page 35.)

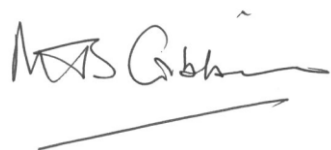
*Resources used to comply with regulation.* The IA correctly excludes the lost income to independent financial advisers from the EANDCB and NPV; this income should not, however, be described as indirect (since this would imply it should be included in the NPV), but as ‘resources used in complying with regulation’ (as per RPC case histories, section 4.3.4, pages 35-36).

### Departmental assessment

| Classification   | Qualifying regulatory provision |
|--|---------------------------------|
| Equivalent annual net direct cost to business (EANDCB) | –£1.6 million                   |
| Business net present value                             | £14.79 million                  |
| Societal net present value                             | £104.98 million                 |

### RPC assessment<sup>2</sup>

| Classification                      | Qualifying regulatory provision (OUT) |
|-------------------------------------|---------------------------------------|
| EANDCB – RPC validated              | –£1.6 million                         |
| Business impact target score        | £8.0 million                          |
| Small and micro business assessment | Not required - deregulatory           |



**Michael Gibbons CBE**, Chairman

<sup>2</sup> For reporting purposes, the RPC validates EANDCB and BIT figures to the nearest £100,000