

## **Incentive Exercises for Pensions**

### **A Code of Good Practice (version 2 - January 2016)**

#### **Boundary Examples and Other Examples**

##### **Introduction**

The Code is intended to represent good industry practice and remains voluntary.

These examples do not form part of the Code.

In any particular proposed situation, users of the Code will need to consider and reflect the full facts and circumstances of the situation when considering the application of the Code. The examples below are intended to be a guide in the areas they cover, but they are not hard and fast rules. In particular, it would not be within the spirit of the Code to “cherry-pick” the facts of a situation to fit a particular example in order to conclude that an exercise is not within the scope of the Code, when other facts demonstrate otherwise. For example, an exercise may not count as “Business as Usual” if a company intends to stop or change an option in the near future, even if this is not written down or communicated to members.

In each situation, users of the Code will need to also consider requirements other than the Code. For example, in the context of Transfer Exercises, users of the Code will need to be fully aware of the legal requirement for some members to obtain advice before transferring, and the legal requirement for employers to pay for that advice in full in some circumstances. These and other requirements, and other regulatory guidance, have generally been ignored in these examples - the comments below relate solely to the application of the Code.

##### **These examples fall into four areas as follows:**

- Cases A1 to A7 are Boundary Examples of situations which may fall within / without the scope of the Code, particularly considering features of “business as usual” situations
- Case B8 discusses the application of the Code to the backdating of Pension Increase Exchange exercises
- Case C9 discusses IFA fee structures
- Case D10 discusses the application of the proportionality threshold to Transfer Exercises

## Preamble to Cases A1 to A7

These cases consider the boundary between business as usual (“BAU”) and “Incentive Exercises” (as defined under the Code). For a group exercise to fall outside of the scope of the Code because it is BAU, the IEMB would generally expect at least the following features to be present and to be clearly communicated to the applicable members:

- Not time limited (i.e. open ended)
- The same options, on consistent terms, being offered as in a BAU context (appropriate changes in terms simply because of, for example, ageing, is consistent)
- The same access to, and level of payment for financial advice, being offered as in a BAU context
- Consistent communications in style, content, balance etc. to those being offered as in a BAU context
- The communications and options being from the same party (or parties) as those being offered as in a BAU context

Whilst ***any given individual*** would have the same options, terms etc. available to them under a BAU exercise, the Code is not intended to restrict trustees and/or employers making different options, terms etc. available to different groups of individuals.

In deciding whether the options, terms etc. are the same/consistent as in a BAU context it would not be appropriate to look at a snapshot in time, but at the terms that are likely to be available on an ongoing basis, taking into account any changes that may be in the contemplation of the trustees or employer.

The Boundary Examples below illustrate these points.

### Case A1: Changing retirement processes – example where the Code does NOT apply

- An employer and trustees (or just the trustees) work together to review normal retirement communications and processes, which might (for example) include: making them more glossy, quoting estimated transfer values in retirement packs, introducing new options, highlighting more options etc.
- The employer, working with the trustees, appoints a financial adviser firm to assist members in making retirement decisions (this advice may be paid for, or not paid for, or partly paid for, by either the employer or the trustees).
- The new retirement process includes the trustees writing to all deferred members as they approach age 55 setting out their options, and concurrently the company providing access to financial advice at any time from age 55 to the point the member retires.

**Viewpoint:** *In this situation, the trustees and employer might conclude that the introduction of this new retirement process is BAU activity and is not an Incentive Exercise. A key reason for this conclusion could be the open-ended access to the new communications, new options and the financial advice, on an ongoing basis, on the same terms. We would expect the open-ended access to be clearly communicated to members (albeit subject to review from time-to-time). In this situation, whilst the Code may not apply, employers and trustees are encouraged to adopt the principles of the Code and, in practice, we would anticipate that the only consequence of the Code not applying is that there is flexibility about who pays for the advice, ie the member can be asked to pay for some or all of the advice.*

## Case A2: Changing retirement processes – example where the Code DOES apply

- An employer and trustees (or just the trustees) work together to review normal retirement communications and processes, which might (for example) include: making them more glossy, quoting estimated transfer values in retirement packs, introducing new options, highlighting more options etc.
- The employer, working with the trustees, appoints a financial adviser to assist members in making retirement decisions. It is initially proposed that part (but not all) of the financial adviser's costs will be covered by the employer for the next year (but probably not beyond that).

**Viewpoint:** *In this situation, the trustees and employer might conclude that the Code applies. A key reason for this conclusion could be the intention to partially fund the financial adviser costs but for only 12 months, which means that the offer of subsidised advice is time-limited, and therefore “one-off”. This in turn may influence member behaviour. As the employer and trustees are likely in this situation to adopt the majority of the principles of the Code in any event, the main implication of the Code applying in this situation is that the employer would be required under the Code to fully pay for the financial advice, if the offer is time limited.*

### Case A3: Retirement catch-up (or launch) exercise – example where the Code does NOT apply

- Having agreed a new retirement process, new retirement communications and access to financial advice as set out in Case A1, the employer and trustees agree to undertake a “catch-up” exercise, writing with the same options, same terms and same access to advice, to all non-pensioners currently over age 55.
- It is clear in the communication that the options, and access to the financial advice, are available at any time from the time of writing, up to retirement, for those individuals included in the exercise.
- Access to financial advice includes one-time partly paid access (at a time of the member’s choosing up to their retirement), and these are the same terms offered when writing to these members from now until they start to draw their pension.
- The initial communications come from the trustees (with an enclosed employer offer of access to advice), and these are the same parties writing to the member as they approach their normal retirement age about BAU retirement, and the communications are in consistent terms throughout this period.

**Viewpoint:** *In this situation, the trustees and employer might conclude that this is an extension of BAU activity and is not an Incentive Exercise, and therefore the Code does not apply. A key reason for this conclusion could be the open-ended access to the new communications, new options and the financial advice, on an ongoing basis, for this group of members, on the same terms as currently being offered. We would expect the open-ended access to be clearly communicated to members (albeit subject to review from time-to-time). In this situation, employers and trustees are encouraged to adopt the principles of the Code and, in practice, we would anticipate that the main consequence of the Code not applying is that there is flexibility about who pays for the advice, i.e. the member could be asked to pay or partly pay for the advice.*

*The Code does not seek to restrict the options, terms, and communications etc. that are available to different groups of members. This means that, in this situation, if the trustees and employer decide (for other reasons) not to make the same options and advice available in the future to members who are currently under age 55 (as they go through age 55 and then approach retirement), this would not necessarily invalidate the conclusion that the Code does not apply to the currently proposed catch-up exercise.*

#### Case A4: Retirement catch-up exercise – example where the Code DOES apply

- The employer and trustees work together to agree a new retirement process, new retirement communications and access to financial advice as outlined as set out in Case A1.
  - The employer decides to write to all members over age 55 to provide them with a personalised options letter, and has no intention of making this a business as usual process (eg writing again every few years), and the regular BAU retirement communications will continue to come from the trustee.
- OR
- The employer intends to partly pay for advice for only a limited period of time (the employer may or may not make the trustees or the members aware of this intention).
- OR
- The employer has agreed certain preferential transfer value terms with the trustees and intends that these will only be available for a limited period of time (the employer may or may not make the trustees or the members aware of this intention).

**Viewpoint:** *In these situations, the employer and trustees may conclude that the employer's intended actions are not an obvious extension of BAU activity and that therefore the Code applies. As the employer and trustees are likely to adopt the majority of the principles of the Code in any event, the main implication of the Code applying in this situation is that the employer would be required under the Code to fully pay for the financial advice.*

#### Case A5: PIE catch-up exercise – example where the Code DOES apply

- The employer and trustees work together to introduce a new “at retirement” PIE option and start to communicate this to upcoming retirees (the Code does not apply in this situation).
- Subsequently, the employer and trustees wish to roll out an equivalent offer to existing pensioners as a one-off time-limited exercise (to avoid selection risk in the future as pensioners’ age).

**Viewpoint:** *In this situation we would expect the trustees and employer to conclude that the pensioner exercise is within the scope of the Code. This is because it is time limited. In particular, members have a period of time to access IE Guidance or Advice and to accept the offer. The Code may not apply if the offer, and the access to any IE Guidance / Advice, was not time limited.*

#### Case A6: Trivial commutation reminder to pensioner group – example where the Code DOES apply

- The trustees write to a group of pensioner members who have relatively small pensions to offer them full commutation of benefits.
- The offer is time limited in order to reduce selection risk, and includes access to a helpline for a period.

**Viewpoint:** *The trustees might conclude that the time limitation of the offer and the helpline makes it a one-off exercise and the Code applies. As the employer and trustees are likely to adopt the majority of the principles of the Code in any event, the main implication of the Code applying in this situation is that the trustees (or employer) would be required under the Code to fully pay for the IE Guidance or Advice. However, where the proportionality test applies (i.e. the payment made is less than £10,000), the Code's requirements have been considerably softened.*



**Case A7: Trivial commutation reminder to pensioner group – example where the Code does NOT apply**

- The trustees write to a group of pensioner members who have relatively small pensions to remind them (even if this is the first time of writing) of their right to fully commute their benefits subject to certain conditions.
- The offer, the terms, and any access to help, is not time limited, and this is made clear in the communication (it is acceptable for the terms to change through time as a result of members aging).

**Viewpoint:** *In this situation, the trustees might conclude that this is a reminder of a BAU option, and that therefore the Code does not apply. In this situation, trustees are encouraged to adopt the principles of the Code and, in practice, we would anticipate that the main consequence of the Code not applying is that the trustees do not need to pay for IE Guidance or Advice for any member, regardless of the size of the amount paid out as full commutation of benefits. The trustees and employer are still encouraged to consider whether the provision of access to IE Guidance or Advice would be helpful to their members based on their knowledge of the scheme.*

## Case B8: PIE backdating – a reminder of the Code’s requirements

- The employer and trustees work together to make a pension increase exchange offer to a group of existing pensioners.
- Part of the offer involves backdating the higher pension by 3 months – this is because, in discussions with the administrator, it is specifically identified that backdating to this date will be materially administratively easier than no backdating or backdating to a closer date.

**Viewpoint:** *The backdating is in line with the Code because there is a clear administrative benefit from the proposal. If there was no clear administrative benefit from the backdating proposal, the backdating would not be in line with the Code as it would be considered to be a cash incentive. It is difficult to envisage circumstances where backdating of more than 12 months would be consistent with the Code in any event.*

## Case C9: Financial adviser costs – a reminder of the Code’s requirements

- An employer, in agreement with the trustees, is running a Transfer Exercise (for example providing advice to all members over age 55 on their options).
- The employer appoints a firm of financial advisers to provide advice to the members and wishes to fully pay for that advice in line with the Code.
- The financial adviser firm proposes a fee structure as follows:
  - A one-off upfront fixed fee to be paid by the employer to set up the project
  - A fixed fee (per member who receives advice) to provide the basic advice on whether or not to transfer (it is proposed the employer meets this cost)
  - A further “administration” charge per transfer, to process any transfer that arises (employer to also meet this cost)
  - An additional fixed £ charge for any transfer to an income drawdown arrangement as this involves additional costs (it is initially proposed that the member meets these cost)
  - Higher charges are payable for any special cases, defined as those involving overseas considerations and those with complex tax issues

**Viewpoint:** *The Code has a number of key principles for Advice, and in this context it is worth noting:*

- *Advice should be “tailored to the individual and their circumstances as a whole including consideration of all materially relevant factors known after reasonable enquiries”*
- *The party making the offer should “pay for the Advice (or IE Guidance) and associated services”; and*
- *“Remuneration for Advice must not be related to take up rates or involve commission”.*

*In the context of the example given, the employer and trustees might conclude that:*

- *If a member is to receive Advice, that Advice must consider all relevant matters and cannot be narrowed in scope, for example it could not be narrowed to exclude the possibility of an income drawdown transfer, or of consideration of complex tax matters. This is also consistent with FCA requirements*
- *It would be good practice for the party making the offer to agree a fee structure with the financial adviser that is expected to result in the vast majority of members being able to receive a recommendation on next steps and to also be able to initially implement that recommendation at no cost to member. In many situations this might be expected to include the employer paying any income drawdown implementation fees (which might be expected to include basic initial investment strategy advice to the member)*
- *As long as the various parts of the fee appear to be appropriate relative to the work involved for each task, the parties might conclude that a fee structure in the form above does not represent remuneration that is “related to take up rates” (albeit that higher fees are paid if members implement a transfer)*

- *The parties might conclude that it is within reasonable good practice to limit the total cost of the Advice needed that will be paid for by the employer in cases that are expected to be few and obscure (e.g. overseas cases, where there are very few of these). Such members might be excluded from the exercise or informed that they will need to pay the additional costs if they wish to receive Advice, with a full and open explanation of the reasons for this.*
- *The parties might conclude that it is within good practice for the employer not to pay for any ongoing advice (post transfer) required in relation to maintenance of the income drawdown products (e.g. regular review of investment strategy and the amounts to draw down)*
- *In order to demonstrate the above points, it may be good practice for the Financial Adviser to publish a table of agreed charges to the employer, trustees and members, that covers charges up to and including a transacted transfer, and also separately discloses any expected charges thereafter; it may also be good practice for the Financial Adviser to agree to disclose to the employer and/or trustees the incidence and amounts of any additional charges that are made beyond this table, along with an explanation for those additional charges.*

*We are aware that the Advice and guidance market and the requirements of Regulators are quickly evolving at the time of publications of these examples. This may mean that good practice in this area, within the high level principles of the Code, also evolves over the near future.*

## Case D10: Application of proportionality threshold to transfers in current environment

V2 of the Code introduces a proportionality threshold. For Transfer Exercises, this is £10,000. That is, for transfers less than £10,000, the Advice principle of the Code is softened, and the Code only requires that IE Guidance is made available to members.

Whilst the Code sets this out as good practice, there may be practical challenges to applying this threshold at the current time in the current regulatory environment. In particular:

- Financial advisers are generally not able to apply a proportionality threshold for the provision of Advice
- Insurers generally do not apply a proportionality threshold when receiving money from a DB transfer, and may continue to seek evidence of Advice having been received
- If an employer and trustees do not pay for Advice for a member, that member may find it difficult (or expensive) to find a regulated advisor who is willing to provide Advice on such a small transfer
- This may expose such members to the risk of pension scams, particularly if in turn they seek advice from unregulated advisers, and consider transferring to unregulated products

**Viewpoint:** *In the current regulatory environment, it may be difficult to justify distinguishing between members with transfers of more / less than £10,000, and employers and trustees may therefore conclude that it makes sense that it would be good practice to offer to pay for Advice for members who have a transfer of less than £10,000, if they are included in an exercise.*