

## DB to DC transfers and conversions: New requirement for independent financial advice

### A. OVERVIEW

1. The Pension Schemes Bill 2015 (the “**Bill**”), currently making its way through Parliament, includes a requirement that, where a member with “safeguarded benefits” (broadly, defined benefits), or a survivor of such a member, wishes to:
  - 1.1 transfer those benefits to a DC arrangement, or
  - 1.2 convert the DB benefits to DC benefits in the same scheme,the scheme trustees must check that the member or survivor has received “appropriate independent advice”.
2. The Bill also provides for employers to pay for this advice in certain circumstances (yet to be specified).
3. More detail on these requirements is expected to be in DWP regulations, yet to be made publically available.
4. On 12th February, 2015, the Pensions Regulator published a consultation document on guidance for trustees on their new duty to check advice, from which we can glean what is likely to be required. This note is based on that draft guidance.
5. The consultation paper, on which comments are invited by 17th March, 2015, is on the Regulator’s website [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk).

### B. BACKGROUND

1. The Bill makes a number of changes to a member’s transfer rights. From 6th April, 2015, the right to transfer will apply separately in relation to a member’s specific benefit categories rather than to all of the benefits under a scheme.
2. The benefit categories are:
  - 2.1 “flexible benefits”: broadly money purchase and cash balance benefits,<sup>1</sup> and
  - 2.2 “safeguarded benefits”: benefits that are neither money purchase nor cash balance (broadly defined benefits).
3. The existing requirement that DB members must be at least one year away from normal pension age under the scheme to have a transfer right will continue to apply to transfers of “safeguarded benefits”.
4. Where a member has more than one category of benefit in a scheme, the member will be able to transfer-out either:
  - all of his benefits, or
  - all of his benefits in relation to one or more of the benefit categories.
5. Any transfer of safeguarded benefits (subject to the **de minimis** requirement in **Section E**

<sup>1</sup> For transfer purposes, money purchase benefits and flexible benefits other than money purchase benefits are expected to be separate categories, so one type can be transferred without the other.

below) will be subject to the requirement that the member obtains appropriate independent advice. This requirement will apply where a member wishes to transfer safeguarded benefits to a different scheme in order to acquire flexible benefits, or to convert safeguarded benefits into flexible benefits in the same scheme.

### C. THE ROLE OF THE TRUSTEE

1. The Regulator notes *"It is not the trustees' role to second guess the member's individual circumstances and choice to transfer safeguarded benefits. Nor is it their role to prevent a member from making decisions which the trustees might consider to be inappropriate to the member's circumstances"* (paragraph 9 of the draft guidance).

*"Requiring members to obtain appropriate independent advice does not make trustees responsible for checking what advice was given, what recommendation was made or to confirm whether the member is following that recommendation"* (paragraph 22 of the draft guidance).

2. The Regulator says trustees should ensure they have processes in place to implement DB transfer requests in a timely manner. They should maintain accurate and complete records of all requests received, and the transfers that have been made.
3. It suggests that trustees can support members by:
  - providing information on finding FCA- authorised advisers,
  - making them aware that the advice they obtain will be informed by their personal circumstances, and
  - informing them that the advice should explain the benefits being given up when compared to any future options.
4. Further, trustees should comply with all "reasonable" requests from the member's adviser

for information from the scheme relevant to a potential transfer.

**Comment:** We do not yet know whether these will be legislative requirements, in the as-yet unseen regulations, or are merely suggested best practice.

5. The Regulator notes that trustees will need to monitor and understand demand from members for transfers and the subsequent impact those transfers could have on **scheme funding**, including the effect of a transfer of those members with a large transfer value relative to the scheme.
6. Similarly, trustees will need to monitor the potential impact on **investments**, particularly regarding the liquidity required to pay large numbers of individual transfers, or in respect of members with a large transfer value relative to the scheme.

### D. STEPS ON RECEIPT OF A TRANSFER REQUEST

1. Although we have yet to see the relevant regulations, the Regulator's guidance sets out the process that trustees should follow where a member requests a transfer. This is largely based on the existing process for dealing with transfers out contained in the Transfer Values Regulations<sup>2</sup> as amplified by the Pensions Regulator's 2008 guidance on Transfer Values [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk).
2. Upon receipt of a member's request for a transfer value:
  - the trustees must ensure within **1 month** that the member has been notified of the requirement to take independent advice,
  - the trustees must respond with a statement of entitlement within **3 months** of the date of

<sup>2</sup> The Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847)

the member's application. This should include a formal quotation of the member's transfer value at the guarantee date (which must be within the same 3 month period), and

- the trustees must give the member the statement of entitlement within **10 working days** of the guarantee date. This should include a further notice that the member will be required to provide the scheme with evidence that the member has received independent advice before a transfer of benefits can be arranged.
3. To obtain the transfer value, the member must then make a further application in writing within **3 months of the guarantee date** confirming that the member wishes to transfer and providing the trustee with confirmation that they have obtained independent advice from the FCA-authorized adviser.
  4. The trustees must then check that the member has received financial advice from an FCA-authorized adviser (see **Section F** below).
  5. The trustees must transfer the guaranteed transfer value within **6 months** of the guarantee date. **The 6 month time limit applies only where the trustees have been able to check that the member has obtained independent advice about the transfer.**

#### E. DE MINIMIS REQUIREMENT

1. Where the member's initial cash equivalent transfer value of his or her safeguarded benefits in the scheme is less than £30,000, the member is not required to obtain independent financial advice for the purposes of making a transfer.
2. This de minimis limit relates only to the benefits in the scheme in question. Benefits in other schemes can be ignored.
3. It also only relates to safeguarded (i.e. defined benefit) benefits, so money purchase benefits in the same scheme can be ignored.

#### F. EVIDENCE OF APPROPRIATE INDEPENDENT ADVICE HAVING BEEN OBTAINED

1. The giving of advice by independent financial advisers ("IFAs") on the conversion or transfer of safeguarded benefits will become a FCA-regulated activity on 6th April, 2015. In order to qualify as "appropriate financial advice" for the purposes of the Bill, the advice must be provided by an IFA who is regulated by the FCA for the purpose of the new regulated activity.
2. Trustees must ensure that the member has provided the scheme with a signed confirmation from the IFA. This must include the following statements:
  - that the adviser has permission to carry out the new regulated activity to provide advice on the transfer of safeguarded benefits,
  - that the advice has been given on the transfer of safeguarded benefits to flexible benefits,
  - the name of the member to whom the advice was given and the scheme in which they hold safeguarded benefits, and
  - the adviser's FCA registration number.
3. The Regulator says trustees should keep these details, **although it is not necessary to obtain a copy of the advice and recommendation provided.**
4. The trustees must check the adviser's details on the Financial Services Register maintained by the FCA before the transfer is made. The Regulator also suggests that the scheme should conduct periodic additional checks, for example through further communication with the adviser directly.
5. Where there are any concerns about the adviser, these should be reported to the FCA.
6. In the event of a problem corroborating information on the Financial Services Register, the trustees should contact the member as soon

as possible, telling him that the transfer will not proceed until the trustees have received the correct information, and that the transfer is at risk if the confirmation is not received within 3 months of the guarantee date.

7. Trustees should keep a record of the checks undertaken.
8. Readers who have been the victim of identity theft may want to consider what would happen if the signed confirmation from the IFA referred to in 2. above is, in fact, provided by someone who is purporting to be the IFA (perhaps providing "independent advice" at a knock down rate to the member). In that situation it is clear that the member will not have received "appropriate financial advice". So the question which arises is whether the trustees will obtain a good discharge in respect of the transfer if they proceed with the transfer.
9. We will not be able to answer this question until the final legislation is available. However, the starting presumption is that the trustees will not receive a good discharge in this situation.
10. It may, therefore, be sensible for the trustees to agree with the sponsoring employer whether additional checks should be undertaken to validate the genuineness of the certificate (as it will be the sponsoring employer, if solvent, who will end up having to make up any shortfall if the member has to be re-provided with the benefits in the scheme, after the transfer value has disappeared).

#### G. IMPACT ON TRANSFER VALUE ASSUMPTIONS AND SCHEME FUNDING

1. The statutory basis and approach for calculation of CETVs is unchanged by the Bill. But the Regulator says trustees should consider the impact on their DB scheme funding that the number and size of transfer requests could have. In particular, they should consider whether there could be a material risk to their funding assumptions. For example, the Regulator says it may be necessary to understand

how current and future age profiles, likely member demand, and size of transfers could impact on expected investment returns, liquidity and views on the strength of the employer covenant.

2. Where the scheme is underfunded, trustees may request an insufficiency report. In some situations, it may be appropriate to reduce transfer values for underfunding. Trustees should balance their responsibilities to transferring members with those remaining in the scheme. Trustees should obtain advice from their actuary. The Regulator's 2008 Transfer Value guidance sets out what trustees need to consider to reach a balanced view.
3. The Regulator notes that transfer bases can be changed at any time, informed by funding position and experience, and trustees should discuss with their advisers' options to respond to material changes to the scheme's overall position.
4. We remain sceptical that there would be a "run on the bank" as a result of changes that will take effect on 6th April, 2015 in respect of transfers of defined benefit benefits to a personal pension scheme in order for the member to take advantage of, for example, flexible drawdown.
5. That said, it is clearly sensible for the trustees to keep the position under review.

#### H. MEMBER COMMUNICATIONS

1. The Regulator notes that members may be unaware of whether they have safeguarded benefits in a scheme. Communications such as the scheme booklet should be reviewed and updated to explain the new requirement to take appropriate independent advice before transferring safeguarded benefits and the impact of new pension flexibilities (paragraph 36 of the draft guidance).
2. Where a statement of entitlement is given to a member as a result of the transfer request, the information the member must be provided with includes a statement to explain whether the

member's transfer value has been reduced and, if so:

- the amount by which it has been reduced,
  - the reasons for the reduction, and
  - an estimate of any date by which it may be possible to provide an unreduced transfer value.
3. The Regulator notes the importance of the member being made aware of the time limits applicable to making a transfer application so that the member does not find his pension coming into payment because of delay.
  4. Where a member's pension has become payable, the transfer cannot be made even if the trustees wanted to do this on a discretionary basis as the member's pension would then be converted into an unauthorised member payment. The pension, having started, would stop and be replaced by, it is assumed, money purchase benefits under a flexible drawdown arrangement in a personal pension scheme.

**Comment:** In other words, a transfer request from a member close to the date his pension is required to come into payment under the scheme rules should be treated as a "red flag" case and actively monitored.

5. Members requesting transfers which fall into this "close to pension coming into payment" date category should be given clear and regular reminders of the need for the transfer to be completed on a timely basis and that the transfer right will be lost if the scheme has not passed over the transfer value to the receiving scheme before the pension would otherwise come into payment.
6. This is an area of high legal risk; in particular, where the scheme has the power to allow transfers on a non-statutory basis (e.g. after the statutory transfer right has been lost, but before

the member's pension comes into payment). In that situation, whether the power is a trustee-only power or a trustee and employer joint power, it should be made very clear to the member that the discretion to allow this non-statutory transfer to take place is granted subject to conditions along the following lines:

- the member must comply with all requirements which the trustees (and, where applicable, the employer) determine must be met in order for the scheme to be fully discharged in respect of the transfer payment, and
- if the transfer is not fully completed before the due date the pension comes into payment, then the discretion will not be exercised (and the transfer will not be paid).

**Note:** Where the transfer payment is made in circumstances where the scheme does not get a full discharge, it will be the employer (if solvent) – not the trustees that is at risk of having to pay twice. Hence a keen employer interest in getting this exercise right (and the associated duty of care which the trustees owe to the employer).

## I. EXTENSION OF TIME LIMIT FOR COMPLETING A TRANSFER REQUEST

1. The Regulator says that, where trustees have carried out a check to determine whether the member has obtained appropriate independent advice but the check could not confirm this, or the trustees had been unable to perform the check due to factors outside their control, they do not have to proceed with the transfer request.
2. The Transfer Values Regulations give the Regulator power to extend the 6 month payment period in limited circumstances. The Regulator's 2008 guidance sets out these circumstances and the information that any request for an extension should contain.

## J. ACTION POINTS

1. Trustees should amend member communications (including scheme booklets and, where applicable, scheme benefit information on scheme websites) where there are "safeguarded benefits" to draw members' attention to the impact of the new pension flexibilities and the new requirement to obtain appropriate independent advice before transferring safeguarded benefits
2. We expect the new requirement to apply to any statement of entitlement requested on or after 6th April, 2015. In relation to any requests made after that date, trustees will have 1 month to notify the member of the requirement to take independent advice.
3. Additionally, statements of entitlement must be amended to include a further notice to the member that they will be required to provide evidence of their having received independent advice before the transfer can be made.
4. Once the member formally applies for the transfer, the trustees must check that the written request includes a signed confirmation from the financial adviser including the statements in **Section F.1** above, and should keep these details.
5. The trustees then need to check the adviser's details on the Financial Services Register prior to effecting the transfer. In addition, the trustees, having consulted with the employer, need to decide on their stance in respect of additional steps to validate the genuineness of the identity of the financial adviser (see further discussion in **Section F.7-9** above).
6. Trustees should keep a record of the checks undertaken.
7. Trustees will also need to consider in due course whether to commission a fresh assessment of the scheme's funding position from the scheme actuary in light of the number of transfers, and to consider the extent of the need for a reduction in transfer values due to funding levels.
8. Trustees will also need to ensure that the assumptions they use to calculate transfer values continue to be appropriate.
9. Trustees should have adequate procedures in place to respond to member transfer requests in a timely manner (paragraph 10 of the draft guidance).
10. Trustees should maintain accurate and complete records of all requests received and transfers that have been made (see **Section C.2** above).

## K. STATUS OF GUIDANCE (WHEN FINALISED)

1. Guidance from the Regulator does not absolve the trustees from their duties under trust law or under statute.
2. Furthermore, the fact that trustees may have complied with guidance is not, of itself, sufficient to demonstrate compliance with their statutory and trust law duties.
3. So, in other words, guidance should be read critically and not following slavishly.

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