

BBS briefing note

Guidance on Transfer Incentives

The Pensions Regulator has recently issued a consultation document on guidance for trustees and managers of occupational defined benefit pension schemes. The guidance relates to transfer incentive or other benefit modification exercises run by sponsoring employers and replaces the “Inducement offers” guidance published in January 2007.

This *BBS briefing note* summarises the proposed guidance.

BACKGROUND

Since the initial guidance was issued in 2007, the Regulator has been actively monitoring activity in this area and has been concerned at what it has seen. As a result, the Regulator has taken a stronger stance under the new guidance in order to protect members’ benefits. The guidance is aimed at both employers and trustees and seeks to clarify the roles each party should play. The guidance is mainly directed towards transfer incentive (commonly known as Enhanced Transfer Value) exercises, but also covers other forms of incentive exercise, including pension increase conversions, i.e. where members give up future pension increases in exchange for a higher initial pension.

The guidance has been developed in consultation with the Financial Services Authority (FSA) and a separate joint statement has also been issued. The reference to “inducement” has been replaced throughout by the term “incentive”, to avoid confusion with the use of term inducement in relation to the auto-enrolment regulations.

KEY POINTS

A summary of the key points of the guidance is as follows:

- The Regulator is concerned that members of pension schemes will be disadvantaged by incentive exercises, particularly if they are not conducted in a manner that makes it most likely members will make a fully informed choice.
- Trustees should start from the presumptions that such exercises and transfers are not in the members’ interests and should therefore approach any exercise cautiously and actively.
- Employers should ensure that any offers made are consistent with the principles outlined in the guidance.
- Members should be presented with the appropriate information in a way that is clear, fair and not misleading, to enable them to make a decision that is right for them.
- Fully independent and impartial financial advice should be made accessible to all members and promoted in the strongest possible terms; in almost all circumstances, the structure of the offer should require that members take financial advice.
- Trustees should engage in the offer process and apply a high level of scrutiny to all incentive exercises to ensure members’ interests are protected. Above all, trustees should ensure they are comfortable that the selection, remuneration and broader commercial interests of advisers are aligned with members’ interests.
- No pressure of any sort should be placed on members to accept the offer.



BBS briefing note (continued)

THE REGULATOR'S EXPECTATIONS

Any incentive exercise offered by employers should adhere to 5 key principles:

1. The offer should be clear, fair and not misleading.
2. The offer should be open and transparent, with all parties involved aware of the purpose of the exercise and the interests of each party.
3. Conflicts of interest should be identified and managed in a transparent manner.
4. Trustees should be consulted and engaged from the start of the process.
5. Fully independent and impartial advice should be made accessible to all members.

The Regulator believes that adherence to these principles should enable members to make an informed choice. This will not, however, remove any legal or reputational risk to those making the offer.

KEY POINTS OF NOTE - EMPLOYERS

The guidance sets out key points of note for employers, including:

- Such exercises are fraught with legal and reputational risk and members' claims on the employer can be made many years after the exercise took place.
- Cash incentives distort the members' decision making process. The Regulator finds it difficult to see how cash incentives lead to sound decisions being made.
- Incentive exercises can be very costly, which can outweigh the benefits.
- The Regulator expects that an incentive exercise will not be conducted if it could have an adverse effect on the employer's ability to fund the scheme's deficit.

KEY POINTS OF NOTE - TRUSTEES

The guidance sets out further key points of note for trustees, including:

- Trustees should start from the presumption that such exercises are not in the members' best interests and proceed accordingly.
- Trustees must ensure that members' interests are protected at all stages.
- Trustees should be satisfied that the broader commercial interest, remuneration basis and process for selection of advisers does not militate against members receiving impartial advice.
- Trustees should consider the source of the employer's capital used to fund the incentive, its effect on the employer's covenant and its ability to meet contributions due to the scheme.
- If trustees are unable to resolve their concerns, they should seek their own legal advice and consider raising their concerns with the Regulator.

BBS VIEW

It is clear that the Regulator continues to take a dim view of incentive exercises in general and the revised guidance certainly "ups the ante" from its original guidance. In particular, feedback from the pensions industry is likely to strongly dispute that trustees should automatically presume that all such exercises are unlikely to be in the members' interests.

It will, therefore, be interesting to see if the Regulator will maintain this strong stance in the final guidance.

This BBS briefing note is based on BBS's understanding of the law and is provided for information only. It should not be relied upon as a definitive statement of the law and detailed legal and financial advice should be obtained on the specific circumstances before proceeding.

