Title: A 'risk warning' provision for members of occupational pension (trust-based) schemes **IA No**: **DWP2016_04** **Lead department or agency:** Department for Work and Pensions **Other departments or agencies:**	**Impact Assessment (IA)** **Date: 15/02/2015** **Stage: Final (Validation)** **Source of intervention:** Domestic **Type of measure:** Secondary Legislation **Contact for enquiries:** Jane Ball Jane.Ball3@dwp.gsi.gov.uk
Summary: Intervention and Options	**RPC:** Awaiting scrutiny

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)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
Not quantified	Not quantified	£0.01m	YES	IN

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

From 6 April 2015 people aged 55 and over with Defined Contribution pensions have increased flexibility over how they take their pension. Prior to accessing their pension using the new options, it is important that individuals understand and have the opportunity to consider any risks and implications of their decision. This is particularly relevant where members are not generally engaged with retirement decision making and do not take regulated advice or the offer of guidance from Pension Wise.

Despite existing statutory requirements on all pension schemes to signpost members to the Government's free guidance service, Pension Wise, there are concerns that members of occupational pension schemes may not take up the free guidance or not be well equipped to select the best retirement option that is suited to them. For contract based pension schemes, the FCA rules require providers to provide personalised risk warnings to clients accessing their pensions to give them greater protection from making potentially bad decisions when purchasing new products. These rules however do not apply to occupational pension schemes. Instead good practice is available in the "essential guide" from the Pensions Regulator (TPR) and is aimed at trustees and scheme managers who may choose to use it to offer generic (rather than personalised) risk warnings to their scheme members.

Government intervention is required to provide members of occupational pension schemes with sufficient protection for them to consider the risks involved with the new pension flexibilities and to ensure all members receive risk warnings, not just those who are members of contract based schemes or occupational pension schemes that adopt good practice by issuing risk warnings to members based on TPR's guidance.

What are the policy objectives and the intended effects?

The policy objective is to provide members of occupational pension schemes with mandatory risk warnings to help them consider the risks involved with the various decumulation options available under the scheme.

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

The preferred option is to place a statutory requirement on trust-based schemes (their trustees and/or the scheme manager) to provide generic risk warning information to their members, which is tailored to the options available to the member. Note this is in addition to sign-posting to Pension Wise. The legislation would not prescribe how trust-based schemes would deliver these risk warnings, only that the risk warnings should be included in the process by which members apply to access their benefits. It is anticipated that these schemes would utilise TPR's existing guidance and include risk warnings in existing communications to members before they access their benefits. For many schemes this would most likely be achieved by adding the appropriate risk warnings to the existing application forms sent to members. This option was considered the best approach to provide a balance of member protection, burdens on business and practical application.

A non-legislative approach would not be possible if we are to ensure that all members of occupational pension schemes receive consistent protection, not just those members of contract-based schemes or occupational schemes already adopting good practice consistent with TPR's essential guide.

Will the policy be reviewed? No	**If applicable, set review date:** N/A				
Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**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: Ros Altmann Date: 11/02/2016

Summary: Analysis & Evidence Policy Option 1

Description: Place a statutory requirement on trust-based schemes (their trustees and/or the scheme manager/administrator or provider) to provide generic risk warning information to their members, tailored to the option available to the members.

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low:	**High:**	**Best Estimate: N/A**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low		1		
High				
Best Estimate	0.1		0.0	**0.1**

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

There will be one-off costs to insurers, administrators and employers totalling around £86,000 in 2015/16 from making changes to communication products to include the relevant risk warning wording. There may also be some minimal costs of familiarisation totalling no more than £17,000. As the risk warnings can be appended to existing communications we do not expect any ongoing communication costs.

Other key non-monetised costs by 'main affected groups

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

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

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

There will be a benefit to members of trust-based pension schemes wishing to access their defined contribution pensions as they will be better informed of the risks of each option. These benefits have not been quantified.

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

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.0	**Benefits: 0.0**	**Net: 0.0**	YES	IN

Evidence Base (for summary sheets)

Problem under consideration

1. From 6 April 2015 people aged 55 and over with Defined Contribution pensions have increased flexibility over how they take their pension. To help people understand their retirement choices, the government introduced a free and impartial guidance service called Pension Wise.

2. To support the pension flexibilities new requirements were introduced from April 2015 so that trustees or managers must signpost members to Pension Wise and also give other key information to help members with their guidance conversation. For contract based schemes these requirements are part of FCA's Conduct of Business Sourcebook (COBS) rules whereas occupational pension schemes must follow DWP's Disclosure regulations[1].

3. Despite these requirements there was concern that some members may not be well equipped to make important decisions, without additional warnings to help them fully understand the implications of their decisions. This being particularly relevant to members who are not generally engaged with retirement decision making and who do not take regulated advice or the offer of guidance from Pension Wise, which could result in them making irrational or ill-informed decisions about their decumulation options (i.e. accessing their benefits).

4. To strengthen member protection the FCA introduced new COBS rules from April 2015. These apply to contract based schemes only and requires them to give personalised risk warnings to clients[2] accessing their pension. Schemes must ask the client relevant questions, based on how they want to access their pension savings, to determine whether risk factors are present. If there are, a risk warning must be given which may include setting out options the client has.

5. The FCA rules do not apply to occupational pension schemes. However, to ensure that members of occupational pension schemes did receive some further level of protection, TPR developed guidance on generic risk warnings which are included in the TPR's essential guide for trustees and managers on how to communicate about pension flexibilities[3]. This guidance however is good practice only with no statutory backing, so schemes can choose to ignore it. This means some members of trust-based schemes may not have the information they need to understand the risks associated with the retirement options they are choosing between. This missing information, combined with myopia, means there is a risk that individuals make inappropriate decisions for their circumstance.

Rationale for intervention

6. Government intervention is required to provide members of occupational pension schemes with sufficient protection for them to consider the risks involved with the new pension flexibilities and to ensure all members receive risk warnings, not just those who are members of contract based schemes or occupational pension schemes that adopt good practice by issuing risk warnings to members based on TPR's guidance.

Policy objectives

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[1] The impacts of these changes to the Disclosure regulations are set out in the accompanying Impact Assessment http://www.legislation.gov.uk/ukia/2015/127/pdfs/ukia_20150127_en.pdf

[2] FCA use the term 'client' as these individuals may be existing members of that scheme or alternatively potential new members shopping around.

[3] http://www.thepensionsregulator.gov.uk/docs/essential-guide-pension-flexibilities-april-2015.pdf

7. The policy objective is to provide members of occupational pension schemes with the appropriate level of protection to help them consider the risks involved with the new pension flexibilities that are relevant at the point in time.

Description of options

8. The preferred option is for a requirement to be added to regulations for occupational pension schemes to provide generic risk warnings to members with flexible benefits. These risk warnings would be tailored to the decumulation options available to the member when accessing their benefits. This option will require trust-based schemes to, most likely through existing communications, give members information on the main risk factors (similar to information included in TPR's "essential guide"). The legislation would not prescribe how trust-based schemes would deliver the risk warnings, only that the risk warnings should be included in the process by which members apply to access their benefits. It is anticipated that these schemes would utilise TPR's existing guidance and include risk warnings in existing communications to members. For many schemes this would most likely be achieved by adding the appropriate risk warnings to the application forms sent to members. The member will then see the risk warnings before applying. This will therefore only apply to the member's existing scheme (ceding scheme). We consulted on draft regulations based on this option between November and January.[4]

9. The legislation would also require schemes to send out a statement to members informing them they should seek advice or guidance, if they've not already done so and read the risk warning information. This can be sent out at the same time as the risk warnings.

10. A previous option was consulted on requiring schemes to provide members with risk warnings when the member notifies them that they wish to apply for a retirement product or transfers. This was rejected on the basis that for many schemes this would either involve introducing a new communication point, or system changes, which would be costly compared to altering the wording of existing communications.

11. The previous option also required schemes to send out a declaration that members would need to sign. The move from a declaration to a statement should meet concerns that well-governed schemes may seek to record the declaration and therefore take on an extra administrative burden. This option was considered the best approach to provide a balance between member protection, burdens on business and practical application.

12. A non-legislative approach of doing nothing was ruled out in the pre-consultation phase as it would not tackle the risk that only members of those occupational schemes adopting good practice will receive appropriate levels of consumer protection.

13. A further option, to legislate for occupational pension schemes to provide personalised risk warnings to their members, was also ruled out in the pre-consultation phase. Whilst it is important that members have access to risk warnings in all pension schemes, it is also important that we don't put disproportionate burdens on trust based schemes. Many members will transfer out of the scheme in order to take advantage of products offered by personal pension schemes that will also provide the personalised risk warnings to these members at the point they make a decumulation decision and decide on a specific product.

Monetised and non-monetised costs and benefits

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[4] Consultation opened on 23rd November and closed on 15 January. It can be viewed at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/482743/pensions-misc-amdts-2016-and-gar-valuations-consultation-nov-2015-2.pdf

14. The changes to the regulations have been designed to minimise the extra burden on businesses by aligning as far as possible with existing requirements, including those made in April 2015 requiring schemes to signpost members to Pension Wise. For example, the trigger points that they will need to communicate with the member have been aligned with existing practices of communication, so, in line with the previous changes, we expect the costs will be minimal and one-off, arising from changing the wording of existing communications, most likely application forms, rather than creating new communications. In addition, some schemes will already be voluntarily issuing information from TPR's essential guide to scheme members since April 2015.

Number of businesses affected

15. Whilst the legal requirement to make the changes described above falls to the trustee, in practice this work will be done by the third party administrator, insurance provider, master trust or employer depending on how the scheme is governed. For example, bundled schemes will use an insurance provider who would make the changes centrally which means the trustees of individual schemes will not incur the costs themselves. Furthermore, the majority of unbundled schemes will have a contract with an administrator who would also make the changes centrally on their behalf. Where schemes are unbundled and self-administered then the employer or trustee would be responsible for making the changes themselves.

16. There are 1,850 trust-based defined contribution schemes with 12 or more members[5]. Information collected by TPR shows there are just over 200 unique insurers, administrators and master trusts which provide services to the vast majority of these schemes. These 200 businesses will be directly affected and will need to change the templates used for communications to members of the schemes they service. This leaves around 260 unbundled defined contribution schemes which are either self-administered or have no administrator recorded by TPR which we assume would carry out the work themselves.

17. In addition there are 880 dual-section hybrid schemes with 12 or more members and where the members are potentially eligible to access their pension flexibly. We do not have any information on how these are governed so assume they are unbundled, self-administered schemes with the employer or trustee needing to carry out the work themselves.

18. This gives a total of just over 200 businesses carrying out the work centrally for a number of schemes and up to 1,140 schemes where the employer or trustee will carry out the work separately.

19. This is likely to be a maximum figure as we would expect some of these businesses are already providing risk warnings to members in line with TPR's essential guide. The consultation provided evidence that the TPR good practice is being followed in some schemes in a mix of ways but certainly not all. There was not enough evidence provided to quantify how many schemes and providers are already complying with the requirements. Therefore, for the purposes of estimating the impacts on business we assume that there is currently no voluntary compliance and the costs represent a maximum.

Micro-Schemes

20. Micro-schemes, which have between 2 and 11 members, account for 92% of the total trust-based market, but only 1% of total trust-based membership[6]. These are not included in the number of businesses calculated above. The vast majority of these will be in bundled arrangements and use an insurance provider. For

[5] DC trust: a presentation of scheme return data 2015-2016, TPR

[6] DC trust: a presentation of scheme return data 2015-2016, TPR

example, over 80% of micro schemes (where the split is known) are small relevant schemes and over half of these are known to use one of the 10 largest providers[7]. It is highly likely that the remaining micro-schemes will either use an administrator or smaller insurance provider and therefore we do not expect micro schemes to be directly affected by the changes, and the associated administrators or providers will already be included in the volumes above.

21. However, even if the trustees do self-administer the scheme, the nature of the changes required will be different for micro-schemes as they are likely to provide bespoke communications already given the small number of members. Therefore changing the wording is not likely to be a separate, one-off task and we would expect this to be part of their usual business. Therefore we do not expect any micro-schemes to be adversely affected[8].

Transitional "One-Off" Costs

22. Transitional costs are likely to occur for providers and administrators to familiarise themselves with the new requirements and to update or supplement the wording of the information they already provide to members. These costs would occur in the run up to April 2016. However, as the requirements already feature in TPR's guidance, and given the prominence of the changes in April 2015 it is likely that industry will have already explored to an extent how they can comply with the overall requirements so the scope of further changes resulting from the regulations is unlikely to be material.

23. The unit costs of complying with the new requirements are difficult to quantify as it will depend on the current level of automation in providers' communications, the complexity involved in changing them, and the number of communication products (or application forms) that need to be changed. However, the additional text required to comply – at a minimum level – only amounts to a few paragraphs with example wording already available from TPR's essential guide. This will need to be inserted into existing application forms; the number of which will depend on the number of decumulation options provided by the schemes.

24. The industry has already had to make changes to their member communications from April 2015 to signpost members to the Pension Wise service and we expect these costs to be broadly equivalent. We have split the affected businesses into two groups:

- For the 200 insurers and administrators carrying out the work centrally we assume a unit cost based on two hours[9] of labour costs at £19.10 per hour (including any non-wage costs)[10] in 2014/15 prices. This would cover the time taken to produce the statement and change the templates of their application forms for any of the schemes they administer and this would apply to each application form that requires changing.

- For the 1,140 self-administered schemes we assume one hour of work at the same wage level as we expect the change should be more straightforward for an individual scheme. Again, this would apply to each application form requiring changing.

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[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298436/better-workplace-pensions-march-2014.pdf

[8] This is in line with assumptions made for similar regulatory changes, such as the requirement to signpost members to Pension Wise.

[9] This is in line with assumptions made for similar regulatory changes, such as the requirement to signpost members to Pension Wise.

[10] This estimate is based on the assumption that pension's administration is likely to be a higher wage paying profession than general administration. The estimate of £19.10 is based on the gross median hourly rate for an associate professional, which has then been increased by 27% in line with the Green Book to account for non-wage costs. The hourly rate data are taken from the most recent available ASHE, 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

25. The number of application forms that require changing will depend on the number of decumulation products offered by trust-based schemes. In September 2015, TPR conducted a survey of flexible pension access[11] which showed the majority of schemes (93%) provided access to at least one decumulation option and a minority (14%) provided access to all four main decumulation options asked about[12]. Therefore, we make the following assumptions:

- For the 200 insurers and administrators carrying out the work centrally we assume that the schemes they provide services to will between them offer all four main decumulation options, so four application form templates will need changing, plus the statement. This gives a unit cost of £191.00 based on 5 times 2 hours of work at £19.10 per hour, giving a total cost of £40,000.

- For the 1,140 self-administered schemes we might expect an average of around 2 decumulation options provided (based on the TPR evidence), plus the statement. This would give an average unit cost of £57.30 based on an average of 3 times 1 hours of work at £19.10 per hour, giving a total cost of £65,000.

26. We envisage the new wording will need to be inserted into the existing communication product used when sending the member their application or transfer details. Therefore we estimate a maximum transitional cost of **£105,000**. This is expressed in 2014/15 prices.

<u>Familiarisation Costs</u>

27. It is inevitable that administrators and providers will need to familiarise themselves with the changes required before making them, but given the existence of the TPR guidance and the FCA rules on 'personalised risk warnings', the content of new regulations is likely to be familiar. Based on it taking around 30 minutes reading and digesting time for a professional with a wage of £24.77 per hour[13] in each of the businesses affected[14] to familiarise themselves with the requirements, we anticipate total familiarisation costs of no more than **£17,000**.

<u>Potential printing costs</u>

28. A further cost that potentially may occur is the cost of printing communication materials. It is likely that any such costs, if they occur, will be negligible because TPR already provide examples with the required information that, at a minimum, could be adapted and inserted into existing printed material.

<u>Ongoing costs</u>

29. The new risk warning requirements can be met by amending existing communication material sent out by providers, currently used to meet existing regulations. This means the new requirements can be delivered without material ongoing costs to business as firms should only have to change their communications once to accommodate the new wording in their existing materials.

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[11] http://www.thepensionsregulator.gov.uk/docs/flexible-pension-access-survey-2015.pdf

[12] Withdrawal of tax-free lump sum, Uncrystallised Funds Pensions Lump Sum (UFPLS); drawdown; lifetime annuity

[13] The estimate of £24.77 is based on the gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs. It is assumed that for a single professional employee would undertake this work. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip.

[14] The total of 200 insurers, administrators and master trusts carrying out work centrally, and the 1,140 self-administered schemes

Direct costs and benefits to Business (OI3O)

30. The regulations have been designed to minimise the burdens on schemes whilst providing more protection to members considering their retirement options. Based on the reasoning above, we expect total one-off costs of around **£122,000** to occur in 2015/16 as a result of providers amending their communications. But we expect no other ongoing costs. The Equivalent Annual Net Cost to Business (EANCB) based on a 10 year appraisal period rounds to **£0.01m**.

Small and Micro Business Assessment

31. The pension providers and administrators affected are typically large businesses, although there will be some smaller businesses also. The government does not believe it would be appropriate to provide an exemption from the new signposting requirements for any small businesses because:
    - failure to ensure that all trust-based pension providers clearly and prominently signpost all of their eligible customers to the guidance service at all of the key communication points listed further above risks consumer detriment;
    - this may create an unfair playing field (in terms of lower regulatory compliance costs for smaller firms and, more significantly, in terms of these firms having a greater likelihood of remaining as benefiting from consumer inertia if their customers don't seek guidance); and
    - It is not likely that the costs will pose a significant burden on even the smallest providers.
    - Even where micro-schemes are self-administered the required changes are not likely to be a separate, one-off task but instead will be part of their usual business due to the small number of members affected. Therefore we do not expect any micro-schemes to be adversely affected.

Monitoring and Implementation Plan

32. This Impact Assessment accompanies the Government Occupational and Personal Pension Schemes and the Pension Protection Fund (Miscellaneous Amendments) Regulations 2016. Subject to Parliamentary approval, the regulations will come into force in April 2016.

33. Monitoring and evaluation of the policy will be picked up via the Pension Regulator as business as usual work.