INCENTIVE EXERCISES FOR PENSIONS

PRACTITIONERS' NOTES TO ACCOMPANY THE CODE OF GOOD PRACTICE

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Disclaimer

The Practitioners' Notes are for guidance only and do not purport to constitute legal advice. The Practitioners' Notes are not exhaustive and nothing in the Practitioners' Notes can be relied upon as evidence of compliance with any other legal or regulatory requirement. The Practitioners' Notes relate to circumstances prevailing at the date of their original publication and may not have been updated to reflect subsequent developments.

Following the Practitioners' Notes does not relieve a party of its legal or regulatory obligations and following the Practitioners' Notes may not prevent a claim being brought against a party.

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Introduction

These Practitioners' Notes are for use in conjunction with the Code of Good Practice for Incentive Exercises.

The Practitioners' Notes are being provided to assist all parties who are involved in an **Incentive Exercise**, particularly advisers to employers, trustees and members. The Practitioners' Notes provide examples of current good practice in some areas and provide commentary on the thinking behind some of the principles in the Code where the authors considered this would be helpful.

<u>To meet the requirements of the Code the principles set out in the Code itself should be followed. For the avoidance of doubt, the Practitioners' Notes do not have to be followed in order to meet the requirements of the Code.</u>

Please refer to the Glossary of Definitions in the Supporting Information section of the Code on page 23 to see what is meant by the various terms. These terms are highlighted in bold throughout the Code and these Practitioners' Notes.

A. Scope and Coverage of the Code

The Introduction section of the Code briefly sets out what is meant by an **Incentive Exercise** for the purposes of the Code. This part of the Practitioners' Notes provides examples and commentary on what is in and out of the scope of the Code.

A1. Introduction

There is a wide range of situations in which members make choices in relation to their pension rights. Many of these are well established and a routine part of the operation of pension schemes, such as commutation for a tax-free lump sum at retirement. Others are new one-off invitations or inducements initiated by employers, the most well-known of which are **Enhanced Transfer Value** (ETV) and **Pension Increase Exchange** (PIE) exercises.

In order to focus on areas posing greater risks, the Code applies to invitations or inducements that meet specific criteria. But employers, trustees and advisers are encouraged to consider whether it would be appropriate and helpful to members to apply some or all of the Code in other situations. In particular, it is expected that it would be appropriate to follow the communications principle of the Code (principle 3) for all member communications that set out a benefit option. There will be some situations where employers, trustees and advisers will have to use their judgement on the appropriate application of the Code. Where there is doubt, it is good practice to follow the relevant principles of the Code. There may be other areas clearly outside the Code, but where applying some aspects of the Code would be beneficial to members.

A2. Incentive Exercise scope and commentary

For the purposes of the Code, an **Incentive Exercise** is defined as followed:

An invitation or inducement (generally referred to as an "offer" throughout this Code) provided to a member to change the form of their accrued defined benefit rights in a UK registered pension scheme, which meets both of the following tests:

- *One objective of providing the invitation or inducement is to reduce risk or cost for the pension scheme or sponsor(s); <u>and</u>*
- *The invitation or inducement is not ordinarily available to members of the scheme.*

The first factor in determining whether or not a particular invitation or inducement to a member is within the scope of the Code is the objectives of making the offer available. An invitation or inducement that is provided solely for the members' benefit and which is expected to provide no financial benefit for the scheme (or sponsor) would not fall within the Code. For the purpose of falling outside the Code's definition, it is not sufficient for there to be no financial benefit on one particular measure or that any financial benefit is merely incidental.

The second leg of the definition is that the invitation or inducement is not ordinarily available to members of the scheme. This means that for the vast majority of schemes commutation at retirement falls outside the Code. For the purpose of considering whether the invitation or inducement is "ordinarily available", the content and context of the invitation or inducement should be interpreted more broadly than simply the financial terms of the offer. For example, an ordinarily available benefit option, that is being offered on ordinary terms, but which is being offered for the first time with an associated incentive (of any form), provision of financial advice, or potentially even a fundamental change to the communication of the option, is likely to satisfy this second leg, and may therefore be an **Incentive Exercise** if it also satisfies the first leg of the definition. For example, a bulk transfer offer to members offering normal transfer value terms and the provision of financial advice falls within the scope of the Code.

The Code does not apply to the introduction of new benefit options in pension scheme rules that will subsequently be made ordinarily available to members. For example, the Code does not apply to the introduction of a pension increase exchange offer that is subsequently made available to members as a matter of course as they approach retirement. However, the Code would apply if existing pensioners were made a similar offer. Employers, trustees and advisers are encouraged to consider the extent to which it would be appropriate and helpful to members to apply some or all of the Code both at the time of introducing the option in the rules and at each time when the option is subsequently offered to a member.

There are some situations where members are offered either a choice of different options or an option that involves a number of distinct steps or transactions. If the Code applies to one or more of the options or steps then it would be appropriate to apply the Code to all of the options (where relevant). All parties should consider the substance of the option(s) available and how best to protect members' interests in keeping with the Code.

A3. Examples of Incentive Exercises in and out of scope

The following are examples of exercises, offers and transactions that will generally fall within the scope of the Code.

Transfers of defined benefit pension rights will generally fall within the Code with two exceptions:

- Transfers in line with the normal operation of the scheme that are instigated by the member.
- Transfers to another defined benefit scheme which do not involve a change to a member's accrued rights or can be made without member consent under legislation.

The following situations are examples of **Transfer Exercises** that are within the scope of the Code:

- An offer of transfer values in excess of normal CETVs made for a limited period.
- Standard CETVs offered to some or all members through a one-off exercise that does not happen as part of the ordinary running of the scheme.
- A transfer offer targeted at a small group of members (for example, those with larger pensions).
- Situations where an employer offers an alternative incentive (for example, a pay increase) if members transfer their pension rights.
- Provision of transfer advice to selected members as they approach retirement.
- Conversion to a defined contribution benefit within the same occupational pension scheme.
- Immediate early retirement options implemented via a transfer to an immediately vesting individual pension policy.

Offers for members to change the form of their rights (without transferring them out of the scheme) come in many varieties, and tests for application of the Code are: 1) the objectives behind the offer, and 2) whether they are ordinarily available under the scheme. Examples of **Modification Exercises** that are within the scope of the Code are:

- A **Pension Increase Exchange** (PIE) offer made to a group of existing pensioners – where pensioners have the option of changing the form of their pension increases.
- A one-off early retirement offer to older deferred members where the sponsor has agreed to enhance the terms or provide financial advice for a limited period.
- An offer to transfer accrued rights to a different section of the scheme which provides accrued rights in a materially different form.
- Offers for immediate early retirement combined with changes in the form of pension increases or pattern of pension income (for example, flexible drawdown).

EXERCISES ALREADY IN PROGRESS

The Code applies to all circumstances where an offer is made available to a member after the date of publication of the Code.

Where at the date of publication of the Code an offer has already been made to a member in writing, the exercise is outside of the scope of the Code. However, employers could still consider how relevant aspects of the Code could be applied given the nature of the offer to members and the stage the exercise has reached.

B. Illustrative Advisory Process

This section of the Practitioner's Notes has been provided primarily to assist **Member Advisers.** It provides an illustrative **Advisory Process** that may be of help when designing processes and providing **Advice,** for both **Transfer Exercises** and **Modification Exercises.** Many of these issues will be equally valid when providing **Guidance**, with differences as set out in the section of the Code on how to apply principle 2. These notes may also be helpful to employers, trustees and their advisers, for example when considering and comparing the **Advisory Processes** offered by different **Member Advisers** and when considering member protection issues.

It is important to emphasise that the illustrative **Advisory Process** is simply illustrative. It is recognised that **Member Advisers** will construct **Advisory Processes** in different ways, and the illustrative process set out in this section is just one of a number of possible approaches. The content of this section has been written with current FSA COBS requirements in mind, but these do need to be considered in addition, as applicable. In particular, following this illustrative process does not ensure compliance with other requirements – this is the **Member Adviser's** responsibility. However, it is expected that **Advisory Processes** will generally address the issues identified in this section in one way or another, and that any issues that are relevant and material will not be ignored without good reason, certainly where this may result in less protection for members.

When giving **Advice**, we would expect an **Advisory Process** to generally include the steps set out below.

B1. Investigating the benefits being given up

The **Member Adviser** will need to investigate and understand the benefits being given up as part of the offer for each category of member. This is generally expected to involve (not all items mentioned below are relevant to all exercises):

i. Analysing the pension scheme's rules, booklet and other relevant communication material, which would generally be made available to the **Member Adviser** by the employer and/or trustees.

ii. Be in a position to demonstrate that they have clarified any aspects of benefits and administrative procedures that are not clear, including seeking direct access to the trustees' administrators, and legal and actuarial advisers as required. This might include understanding the detail of the following (list not exhaustive): increases that apply to different parts of the pension including GMP; early, late and ill health retirement rights and benefits; death benefits; commutation and other retirement options; bridging pensions and "step ups" at State Pension Age or GMP Age if applicable.

iii. Seeking a view from the employer and/or trustees on the likelihood of future discretionary benefits, including consideration of the history of any such increases, and considering whether this is a relevant factor for their advice.

iv. Seeking a view from the employer and/or trustees on the terms for any options and their likely development in the future (for example, early and late retirement terms, commutation terms) and understanding the attractiveness of those terms, and considering whether this is a relevant factor for their advice.

It will generally be helpful for employers, trustees and **Member Advisers** to confirm in writing their common understanding of the relevant benefit structure before the offer is issued to members. One way of addressing this step is for the **Member Adviser** to prepare a written summary of all aspects of the benefits under consideration, for each applicable category of members, and circulate this to the employer and/or trustees (and their advisers if appropriate) for comment and agreement (an "Existing Benefit Summary"). As an alternative, it may be helpful for the Existing Benefit Summary to be prepared by the trustees or their advisers, and for the **Member Adviser** to have access to the trustees or their advisers in case of questions.

B2. Investigating the benefits being offered

The **Member Adviser** will need to investigate the alternative benefits being offered to members. It will generally be helpful to prepare a written summary of their understanding of the offer, and circulate this to the employer and trustees (and their advisers if appropriate) for comment and agreement ("the Alternative Benefit Summary"). Where the alternative benefits involve an insurance product providing benefits on a defined contribution basis:

i. The investment options and expense terms of the product will need to be investigated by the **Member Adviser**.

ii. There should be a reasonable range of investment fund options available to members to cater for various member risk attitudes.

iii. The **Member Adviser** will generally wish to select a suitable investment fund option that will be the standard recommendation for each of the **Member Adviser's** categories of member risk attitude ("Default Fund Advice").

iv. Generally, it would not be appropriate for Default Fund Advice to require further member intervention once the member has invested (for example, lifestyling should generally be automatic and not rely on the member to make subsequent investment switches, because they may forget to do so).

v. The **Member Adviser** will wish to be satisfied that there is a suitable range of investment funds available in the proposed insurance product to enable him/her to provide suitable Default Fund Advice for a wide range of members, and satisfied that the expense terms within the insurance product are reasonable.

It would be normal to involve the **Member Adviser** in the choice and design of the insurance product.

As an alternative, it may be helpful for the Alternative Benefit Summary to be prepared by the trustees or their advisers, and for the Member Adviser to have access to the trustees or their advisers in case of questions. This may be particularly appropriate where the alternative benefits are being provided within the pension scheme (for example, a **Pension Increase Exchange** exercise).

B3. Considering the employer covenant

The **Member Adviser** may wish to consider the extent to which the financial strength (or weakness) of the sponsoring employer to the scheme, and the funding position of the scheme, are materially relevant factors to the **Advice** or **Guidance**. This may include consideration of the protection offered by the Pension Protection Fund, including the powers that the Pension Protection Fund has to unwind certain transactions in certain situations. In forming this view, the **Member Adviser** may wish to discuss the situation with the employer and the trustees of the pension scheme.

It may be helpful for the **Member Adviser** to prepare a written summary of their understanding of the security of members' benefits and their proposals for giving advice on this aspect, and circulate this to the employer and trustees (and their advisers if appropriate) for comment and agreement ("Security of Benefits Summary"). In many cases, it may be sufficient to state to members that the **Member Adviser** is ignoring this issue when providing **Advice**, and to explain to the members the potential consequences of this, including the protection of the Pension Protection Fund and the risks should the employer fail.

Where the employer argues that their covenant is "weak" and this should be a material relevant factor in the **Advice**, the **Member Adviser** should not rely exclusively on the employer's view before providing **Advice** on this basis.

B4. Assessing suitability

For both **Transfer Exercises** and **Modification Exercises,** the **Member Adviser** will wish to have processes and procedures that address the following (using FSA's COBS language):

i. "**Know Your Client**".

ii. Dealing with "**Vulnerable Clients**" (the Code expects the **Member Adviser** to have a written policy that is used to identify and advise potentially **Vulnerable Clients**).

iii. "**Suitability**" (in order to assess **Suitability** for an **Incentive Exercise** offer, the **Member Adviser** will generally need evidence of having considered and advised on capacity for loss, attitude to risk and ability to manage risk, in the context of the **Member Adviser's Know Your Client** and **Vulnerable Client** policies).

It may be helpful for **Member Adviser** firms to have standard written statements relating to all three of the above areas that they can share with other parties to an **Incentive Exercise** offer.

B5. Example Advisory Process

In the light of the contents of the Existing Benefit Summary, the Alternative Benefit Summary and any Security of Benefits Summary, the **Member Adviser** will generally wish to design an **Advisory Process** that has been tailored to the circumstances of the offer that includes the following steps (note: this is just an illustration of one possible process):

i. Initial written communication from the **Member Adviser** to the member.

ii. Agreement of a contract between the member and the **Member Adviser**.

iii. It may be helpful to issue an initial fact-find to the member before the first meeting, to be completed and returned prior to the meeting or at the meeting, to be discussed and confirmed with the **Member Adviser** at the meeting, covering matters that the member can be reasonably expected to understand without the **Member Adviser's** assistance (for example, confirmation of basic member data, personal health and family details, and initial attitude to risk questions).

iv. A more detailed fact-find, generally to be completed at the first meeting or call, including items that require **Member Adviser** explanation and assistance (for example, more detailed investigation into capacity for loss, attitude to risk and ability to manage risk, including investigation of other pension benefits and wider financial circumstances as appropriate).

v. Consideration of **Know Your Client**, any **Vulnerable Client** issues and **Suitability**, following which, if a member is classified as potentially Suitable to accept the offer, then the offer is considered further as per the steps outlined below, otherwise the member is advised not to proceed.

vi. For potentially Suitable members, for **Enhanced Transfer Value** offers, a process whereby the **Member Adviser** identifies and obtains member agreement for the appropriate Default Fund Advice in the light of attitude to risk and any other relevant factors.

vii. For all offers, it will generally be appropriate to provide to the member unbiased benefit projections or benefit valuations (as appropriate), along with an explanation of what they mean. For **Enhanced Transfer Value** offers, these will generally be in the form of a "Transfer Value Analysis" in line with FSA requirements. Commentary on possible other value comparisons is provided in the "Advice for Pension Increase Exchange exercises" and the "Advice on Total Pension Increase Exchange exercises" sections of the Practitioner's Notes (sections D and E).

viii. A process by which the **Member Adviser** can ensure that all other relevant factors identified as part of the Existing Benefit Summary, the Alternative Benefit Summary and the Security of Benefits Summary are explained to the member and the member is provided with the support they need to identify whether these matters are important to them and are likely to impact on their decision one way or another. This might usefully include a warning that aspects of these summaries may be subject to change in the future (for example, legislative risk).

ix. A process whereby the **Member Adviser** draws together all of the above and reaches a conclusion in the face-to-face or telephone meeting on the **Recommendation** for the member, that is discussed and where possible agreed with the member, and is recorded in writing in a letter to the member with key reasons for the conclusion. When providing **Advice**, the conclusion will include a clear recommendation that the member should or should not accept the offer. The **Member Adviser** will wish to take all reasonable steps to ensure that the member understands the **Recommendation** and the reasons.

The **Member Adviser** will wish to place evidence of having completed each aspect of the **Advisory Process** for each member on the member's file – it may be helpful to have this evidenced by suitable confirmations from the member (such as signatures or emails).

C. Illustrative Insistent Customer Reporting Process

Where **Advice** is being provided, principle 4 of the Code sets out that good practice includes the reporting of **Insistent Customers** to other parties at the end of an exercise. This section of the Practitioner's Notes has been provided to assist **Member Advisers** and other parties when considering how this might be achieved**.**

Having advised members, the **Member Adviser** will be in a position to collect data that classifies members into a number of "recommendation" categories, for example:

i. Member did not provide enough information and/or **Advisory Process** not completed.

ii. A recommendation was made to the member to accept the offer.

iii. A recommendation was made to the member not to accept the offer.

It is recognised that this is personal information and it would not be appropriate to share this information on a named basis with other parties without the agreement of the member.

For **Transfer Exercises** to an insurance product, the **Member Adviser** will be aware of which members accept the offer, and can provide a summary report on which members followed the **Recommendation**, and which members did not, to the other parties, including the **Insurer**. Note that where a member is advised to accept the offer, and does accept the offer, but is technically classified as an "insistent customer" (under the **Member Adviser**'s approach to following FSA requirements) because they disagree with part of the advice (for example, they wish to choose a different investment fund), such members need not be classified as "**Insistent Customers**" for the purposes of the Code.

For **Modification Exercises** (or **Transfer Exercises** to an occupational pension scheme), the **Member Adviser** will not necessarily be aware of which members actually accept the offer. In such circumstances, principle 4 may be addressed, for example, by obtaining the member's permission as part of their offer acceptance form (which will generally be sent to a trustee representative), to send a record of their response to their **Member Adviser.** The **Member Adviser** can then collate the responses, compare them to the advice given, and prepare a summary report for the other parties.

D. Advice for Pension Increase Exchange exercises

At the date of publication of the Code, **Advice** and **Guidance** in relation to **Modification Exercises** (for example, **Pension Increase Exchange** exercises) is unregulated, and historically there has been no guidance for **Member Advisers** on the content of the **Advice** or **Guidance** that it might be appropriate to give to members. We anticipate that practice in this area will develop quickly following the publication of the Code.

As outlined in the Code in the section on how to apply principle 2, the requirement is that either **Advice** or **Guidance** is provided to members in relation to **Modification Exercises**. Where **Guidance** is provided rather than **Advice**, the Code requires that a **Value Requirement** is complied with.

This section of the Practitioners' Notes provides commentary and support on the provision of **Advice** and **Guidance** that it is hoped will be of assistance to **Member Advisers** and other parties involved in **Pension Increase Exchange** exercises. The section is written primarily with **Advice** in mind, which requires tailored written **Recommendations** to be provided to members. However, the same issues will generally be of relevance to **Guidance**.

This section should be considered in conjunction with the "Illustrative Advisory Process" section of the Practitioners' Notes (section B).

D1. Introduction

The comments below reflect the views of the authors of the Code as to the level of **Advice/Guidance** that is likely to be acceptable good practice at the time of publication. Where providing **Advice**, **Member Advisers** will wish to collect information on the issues outlined below (a member "fact find"), formulate views on the issues, assist the member in understanding the issues, use this information in forming their recommendation, and refer to the issues in the letter of recommendation to the member. Where providing **Guidance**, **Member Advisers** will need to ask members relevant questions, assist the member in understanding the issues, and refer to the issues in the written record of the **Guidance** meeting that is provided to the member.

The employer (and where applicable trustees) will wish to ensure that the relevant issues are effectively communicated to members during the **Advisory Process**. To facilitate this, it may be appropriate to include reference to some of the issues in the early written communications to members and for the employer to seek to ensure that the **Member Adviser** is adequately addressing the issues in their **Advice**.

The content of this section is not exhaustive. It is very likely that other relevant issues will exist in particular cases. It is also likely that it will become common practice to consider other issues not mentioned in this section. It is the responsibility of the **Member Adviser** to consider all relevant issues.

It may be helpful to note that the process outlined below mirrors the process for providing regulated advice on **Enhanced Transfer Values**. That is:

- The **Member Adviser** will need to assess potential **Suitability** giving due regard to **Know Your Client** and **Vulnerable Client** principles.
- A mathematical input to the **Advisory Process** that is used by the **Member Adviser** to assess the financial attractiveness of the offer.
- Other factors will also be important in forming the final recommendation.

For **Enhanced Transfer Value** exercises, the mathematical input is provided using a Transfer Value Analysis. For **Pension Increase Exchange** exercises, **Member Advisers** may wish to discuss with the employer and trustees other ways of illustrating the reasonableness of the offer. These might include:

- Highlighting and explaining the **Balanced Deal Percentage**.
- Projecting the member's income based on different outcomes for inflation and life expectancy.
- Estimating a "Capital Loss" figure for each member, based on assumed average longevity (perhaps with assistance from either the employer's actuary or the trustee's actuary) – this is discussed further below.

In this section, the word "inflation" is used to mean any of the following, depending on the context and relevance to the offer:

- Retail Prices Inflation.
- Consumer Prices Inflation.
- Pension increase inflation for different elements of pension (for example, 5% Limited Price Indexation).
- The likely future path of a member's own expected inflation, given their spending habits and recognising that pensioners can experience higher inflation than other groups.

D2. Suitability

In line with the Illustrative Advisory Process (section B of the Practitioners' Notes), we envisage that a **Member Adviser** will generally want to initially consider the potential **Suitability** of the offer to the member, bearing in mind the principles of **Know Your Client** and ensuring appropriate application of the **Member Adviser's Vulnerable Client** policy.

Assessing potential **Suitability** may include consideration of:

- Personal circumstances and financial needs – sources and timing of income and outgoings in the short and long-term.
- Capacity for loss – for example, what would the impact be on the member's overall circumstances if the member accepted the offer and lived for longer than average life-expectancy and/or inflation was higher than expected for a period?
- Attitude to risk and ability to manage risk, including inflation risk and longevity risk – for example, can the member take other actions in response to risk and loss if need-be (for example, reduce spending, downsize home, rely on other income)?

D3. Base value assessment

Having considered **Suitability**, a key question that the **Member Adviser** will wish to consider is whether the member is likely to be better or worse off following acceptance of the offer. In forming this opinion the **Member Adviser** will wish to balance the short term and long term financial views and needs of the member with the terms of the offer and the **Member Advisers'** own views.

A good starting point for this (but only a starting point) might be to seek to assess whether or not the member is likely to be better off over their expected lifetime (i.e. receive more or less pension income) assuming:

- a "best estimate" future inflation assumption; and
- a "best estimate" life expectancy.

This can be illustrated by projecting the member's income based on different outcomes for inflation and life expectancy. Another way of illustrating this, that may be a helpful addition in some circumstances, is for the **Member Adviser** to work closely with the employer's actuary or the trustee's actuary to quantify an assessed "Capital Loss" figure for each member and discuss how it might be appropriately communicated to members (this is equivalent to the gain that the scheme is expected to make if the member accepts the offer on a relevant set of assumptions). (Note that this calculation is easy to complete alongside the assessment of the **Balanced Deal Percentage**.) Where material and/or helpful, the **Member Adviser** can then explain the Capital Loss figure to members, which may help a member quantify the potential financial implications of the offer.

D4. Member communications – technical content

To assist the **Member Adviser** in the **Advisory Process**, this section suggests that it would be useful for the following information to be assessed for each member, and made available to the **Member Adviser** on a member-by-member basis. In many cases, early member communications from the employer will also provide much or all of this information to the member. However, a balance will need to be found between setting out useful information to members whilst keeping it brief enough for them to read it.

i. Key underlying assumptions used in calculating the alternative pensions being offered to members, and used for assessing the **Balanced Deal.**

ii. The **Balanced Deal Percentage** (this will also be provided to the member).

iii. If deemed helpful, the Capital Loss for the member (as outlined in D3 above).

iv. A table of each element of the member's pension (for example, pre-1997 excess, post-88 GMP etc) both currently and should the member accept the offer, along with an explanation of future pension increases on each item of pension both currently and should the member accept the offer.

v. For a range of inflation assumptions, the following:

- A "cross over" age for the member, which is the age from which the offer pension will be lower than their current pension.
- A "break even" age for the member, which is the age from which the total income received on the offer pension to that time will be lower than the total income received on their current pension to that time.
- The average life expectancy for a member of the relevant age and sex (this can be based on a "best estimate" assumption, and will be the same for each inflation assumption).

It may be helpful to show this information both as a table of figures and as a series of charts. If charts are provided, it is important that they are to scale, and that they show all three of the above ages on the chart.

vi. The range of inflation assumptions to be illustrated would generally helpfully include:

- The inflation assumption used to calculate the offer and disclosed to members.
- A low inflation assumption (for example, 0% pa or 1% pa).
- A high inflation assumption (for example, 5% pa where pension increases are currently capped at 5% pa, but something higher where current pension increases are currently uncapped).

vii. Additional illustrations may be helpful in relation to dependants' pensions, depending on the impact of the offer on such pensions.

viii. The **Member Adviser** may also have a view on "best estimate" inflation that differs from the assumption used in the offer (see D5 below) and may request from the employer and their advisers that various figures are also prepared on this basis to assist them in the **Advisory Process.**

Note that whilst every effort should be made to explain what this information means to the member in any written communications, it is recognised that many members may not understand the information without further explanation and assistance. In particular, evidence suggests than some individuals find it difficult to interpret graphs, whilst others find it difficult to interpret tables of numbers. It is therefore suggested that this information is primarily provided for use by the **Member Adviser**, to enable them to assist the member through **Guidance** or **Advice** as appropriate. Therefore, in some cases, the employer, trustees and **Member Adviser** may decide that some of this information should not be provided to members up-front, but should be provided instead by the **Member Adviser** at the time of the **Advice** and **Guidance** meeting (similar to the way a Transfer Value Analysis is often provided in the context of an **Enhanced Transfer Value** exercise). If **Advice** or **Guidance** meetings are to be held on the telephone, it may be helpful to provide the relevant information the member in the form of a technical document, so that the **Member Adviser** can refer to it during the discussion.

D5. View on future inflation

Generally, an important part of the **Advisory Process** will be for the **Member Adviser** to consider and provide a view to members on whether future actual long term inflation (in many cases over many decades) is likely to be more or less than the inflation assumption used in the offer. Whilst challenging, the level of challenge is similar to assessing likely future investment returns for the purposes of setting critical yields for advising on a transfer.

Taking account of recognised sources (see list below), the **Member Adviser** is likely to wish to form a justifiable, unbiased house view of their best estimate for future inflation (perhaps over different time periods) at the time of the offer. It might be helpful to set out this view in writing, along with justification, and to offer this this document to members on their request as a record of the view. If the view is that long term inflation is likely to be less than that underlying the offer, this may make it more likely that the **Member Adviser** will recommend accepting the offer. If the view is that long term inflation is likely to be more than that underlying the offer, this may make it less likely that the **Member Adviser** will recommend accepting the offer.

When assessing their view on future inflation, the **Member Adviser** may wish to consider any or all of the following at the time of the offer:

i. Break-even rates of inflation within gilt markets as published on the Bank of England's website, over different time periods.

http://www.bankofengland.co.uk/statistics/Pages/yieldcurve/default.aspx

ii. Consensus Inflation Forecasts of leading economists over shorter time frames.

iii. The Bank of England's long term target for inflation (noting that the target is currently set by reference to Consumer Prices Inflation rather than to Retail Prices Inflation).

iv. The long term expected difference between Retail Prices Inflation and Consumer Prices Inflation, taking care to distinguish between which measure is appropriate for which purpose.

v. The long term inflation assumption that would have been adopted at the date of the offer by the employer for their pension accounting figures (under IAS19 or FRS17), which the **Member Adviser** may wish to discuss with the employer.

vi. The long term inflation assumption that would have been adopted at the date of the offer by the trustees for their cash equivalent calculations, which is likely to be the inflation assumption underlying the **Balanced Deal Percentage** calculations.

When considering inflation risk, and the acceptable level of risk for a member to take, the **Member Adviser** may wish to consider that inflation risk may be asymmetric (i.e. the risk of inflation in the future being much higher than a current best estimate may be more than the risk of it being much lower). For example, the risk of long term inflation being permanently in excess of 7% pa in the future may be materially more than the risk of long term inflation being permanently less than -2% in the future. All other things being equal, this might make the **Member Adviser** less likely to make a recommendation to accept the offer.

When considering inflation risk, and the acceptable level of risk for a member to take, the **Member Adviser** may also wish to consider the potential variability for future inflation around their central best estimate. For example, in times of significant economic and inflationary uncertainty, the **Member Adviser** may be less likely (all other things being equal) to make a recommendation to accept the offer.

In some cases, the member may have views on the above points, and the **Member Adviser** may wish to take these into consideration when providing advice. In some cases these views might take precedence over the **Member Adviser's** views where the views are strongly held. Where the member's views on future inflation have influenced the final recommendation, the **Member Adviser** is likely to wish to record this in the final recommendation letter (**Advice**) or in the written record of the meeting (**Guidance**).

It might also be helpful for the **Member Adviser** to explain the difference between likely future pension increases and the member's likely own actual expected future inflation (which may be higher). This may also be relevant to the member's decision in some circumstances.

D6. Other relevant matters for member input that may influence the Recommendation or Guidance

It may be in some members' interests to accept an offer even where the **Balanced Deal Percentage** is less than 100%. In order to ascertain this, when providing **Advice**, **Member Advisers** may wish to collect information on the following:

i. Health, personal life expectancy, family history, with a view to ascertaining whether the member has good reason to believe that their life expectancy may be less or more than average.

- A genuine expectation of shorter life expectancy will, all other things being equal, make it more likely that the **Member Adviser** can recommend acceptance of the offer.

- The **Member Adviser** may wish to investigate the potential impact on life expectancy of certain conditions/lifestyles (for example, smoking) so as to help ascertain whether the member's view is of significance to the decision.

- It would generally not be appropriate for a **Member Adviser** to accept a member's "guess" at their life expectancy without some rational evidence for this.

ii. Income needs now, and likely income needs in the future, with a view to ascertaining whether "more income now, less later" is appropriate for the member, and recognising that there may be other ways of achieving similar objectives that may be more appropriate for the member – for example borrowing money, equity release.

iii. The relevance of overall financial and family circumstances – other income sources and other assets, and the ability to cope with financial loss and the member's attitude to risk.

iv. Debts – recognising that there are other ways to deal with debts and that obtaining more income is not always the best way to deal with debt as the additional income may simply be paid to the creditors for no additional gain to the member (**Member Advisers** may wish to refer members to debt management specialists).

v. Current or potential future long term care needs and the likely need or desirability for income at that time.

vi. The potential impact on state benefits, means tested benefits, and universal benefits, of accepting the offer, both in the short term and longer term.

vii. The potential impact on the member's tax position of accepting the offer, both in the short term and longer term.

viii. The extent to which the member's circumstances are such that they can bear the risks of accepting the offer, which is typically inflation risk combined with longevity risk. For example, what might be the implications if inflation is in excess of 5% pa in the future? What might be the implications if the member lived to 100? Does the member understand the concept of inflation and are they willing and able to bear this risk?

ix. When considering longevity risk, it should be remembered that "life expectancy" is an average: it is the average expected age at death for a member of a current specific age; this means that it is as likely that a member lives for longer than this age as it is that they die before this age; therefore, it will generally be important that the implications of living significantly longer than the life expectancy are discussed with the member.

x. The potential impact on dependants' benefits should generally be explained to the member, and it is likely to be appropriate for the member's views to be recorded and factored into the recommendation.

xi. It might be appropriate to discuss the potential impact on future discretionary pension increases with the member.

xii. It might be appropriate to discuss with the member the potential impact of employer insolvency risk and the protection offered by the Pension Protection Fund, in the short term and in the longer term.

D7. Form of written recommendation / note of Guidance

Given the current limited experience within the **Member Adviser** market in providing **Advice** in this area, we thought it would be useful to provide an example of the content of a recommendation letter that we envisage could be provided to a member. This illustration is not complete, and should not be assumed to be legally adequate in any way. However, it may be a helpful starting point for **Member Advisers** when considering a possible outcome of **Advice**, and therefore the nature of the fact finds, information to be collected and recorded, and issues to be discussed with members that may be helpful. The written record of a **Guidance** meeting might take a similar form (but without the need for a recommendation).

The following is a simplified version of example text that might appear in the "reasons for recommendation" section of a letter (the "you" refers to the member; the "me" refers to the **Member Adviser**):

- You understand that the offer made to you is based on a number of assumptions about unknown future events. These include:
    - How long a man / woman of your age might live, on average.
    - Inflation.
    - How much it will cost the scheme to keep paying your pension if you don't accept the offer.
    - How much it will cost the scheme to pay your pension at the new level if you accept the offer.
- You understand that my recommendation to you is based on a number of assumptions about unknown future events. These might mean that you would have been better off staying with your original pension. These include:
    - How long you might live.
    - Inflation.

    - Future changes to the amount of income you might need.
    - Increases to your pension if you do not accept the offer.
    - Increases to your pension if you accept the offer.
- You understand that there might be future unexpected changes that cannot be predicted. These include:
    - Unexpected changes to your personal circumstances.
    - Future unexpected expenses or changes to your income needs as a result.
    - Changes to the scheme rules that might affect the increases to your pension if you do not accept the offer or the increases to your pension if you accept the offer.
    - Changes the Government might make to the rules and laws on pensions. These might affect the increases to your pension if you do not accept the offer or the increases to your pension if you accept the offer.
    - Changes the Government might make to state pensions, which might affect how much state pension you receive.
    - Changes the Government might make to income tax, which might affect how much pension you receive once tax has been taken off.
- [If true:] You understand that the offer is made to you because it is likely to work out cheaper for the scheme in the long run. You therefore accept that the offer is likely to save the scheme money and this means that members on average are expected to lose money.
- You understand that the Balanced Deal Percentage is [insert figure, for example, 80%]. This means that, based on one set of assumptions for the future, and assuming you live for what is expected to be an average time for someone your age, you are giving up an estimated [20%] of the value of your future pension increases by accepting the offer. (This figure is explained further in our Balanced Deal Percentage sheet that we have provided to you.)
- [If deemed helpful: You understand that based on one set of assumptions for the future, and assuming you live for what is expected to be an average time for someone your age, and assuming future inflation is [insert figure, for example, 3% pa], you might lose the equivalent of [insert Capital Loss figure] over your lifetime if you accept the offer. You might lose more or less than this amount, or you might gain. (This figure is explained further in our Capital Loss sheet that we have provided to you.)]
- We have discussed how long you might live, and you confirmed you are a smoker, and we concluded that your life expectancy might be [insert period, for example, 2 years] shorter than the average for a man/woman of your age stated in your employer’s offer letter. You confirmed that this makes you more inclined to accept the offer.

- We discussed how much income you need now and how much you might need in the future, and you have provided information to me that supports your view that having more income at this time in your life is much more important to you than having income later in life. You are therefore happy for your income later in life to be less than it otherwise would have been if you do not accept the offer. You understand that your income in the future could be a lot less.

- We discussed that nobody knows what inflation might be in the future and this means that nobody knows how much your pension might increase in the future. It also means that nobody knows how much it will cost you to maintain your standard of living. I have provided you with our note "Future Inflation Expectations" which sets out my firm's view that [insert figure, for example, 3% pa] is a reasonable future inflation assumption at the current time; you confirmed that you do not have strong views on this.

- We discussed the risks and uncertainties associated with how long you might live, your income needs and future inflation, and you are comfortable taking these risks in the context of your overall finances, and this appears reasonable to me based on the information you provided to me. In particular, we discussed that if future inflation is higher than [insert figure, for example, 3% pa] or you live longer than the average life expectancy for your age, your income is likely to be materially lower in the future than it otherwise would have been.

- [Insert a paragraph on the impact on dependant's pensions and the member's view on this, for example, if true:] There is no impact on dependants' pensions as a result of accepting the offer.

- [Insert a paragraph on the impact on state benefits including means tested benefits and on the member's tax position, for example, if true:] There appears to be no impact on your state benefits and tax position of you accepting the offer.

- [Insert a paragraph on long term care, for example, if true:] We discussed the potential relevance of the need to provide for the costs of your long term care in due course (for example, nursing home). We agreed that this was not materially relevant to your decision at the current time.

- [Insert a paragraph on discretionary increases where relevant, for example:] We discussed the potential impact on discretionary increases, and you concurred with our view that discretionary increases appear unlikely to be made whether or not you accept the offer. You understand that past discretionary increases cannot necessarily be taken as a guide to future discretionary pension increases.

- [Insert a paragraph on the implications of insolvency where appropriate, for example:] Neither we nor you are aware of any reason to be concerned about the financial strength of [employer] for the foreseeable future. We noted that in the unlikely event that the [employer] were to fail, and if they were unable to support your pension scheme at that time, and the scheme remained in a similar financial situation to now, and if you accept the offer, then if [employer] failed in the short term you would end up with higher protection in the Pension Protection Fund but if it failed in the longer term the protection would be less [if true].

- On the basis of the above, the offer gives you the opportunity to meet your financial objectives over time, and I therefore recommend you accept the offer. However you should consider the impact on your circumstances in the short, medium and long term if your actual experience does not match the assumptions above.

E. Advice for Total Pension Increase Exchange exercises

The Code uses the term "Total Pension Increase Exchange" to refer to exercises that involve a transfer from a pension scheme to an annuity product (or similar). These are **Transfer Exercises** under the Code and **Advice** must be provided to members in order to follow the Code.

This section of the Practitioners' Notes provides commentary and support on the provision of **Advice** that it is hoped will be of assistance to **Member Advisers** and other parties involved in **Total Pension Increase Exchange** exercises. This section should be considered in conjunction with the "Illustrative Advisory Process" section of the Practitioners' Notes (section B).

E1. Nature of Advice for Total Pension Increase Exchange offers

Many of the principles of providing **Advice** on **Pension Increase Exchanges** (see section D of the Practitioners' Notes) equally apply to Total Pension Increase Exchange offers. It will also generally be appropriate to consider the following so as to consider all the options for the member holistically:

- Whether it is in the member's interests to draw pension benefits at the current time in any event.
- The benefits of alternative early retirement options from the scheme.
- Any other potentially relevant alternative benefits (for example, transfer to personal pension, drawdown, enhanced ill health or smokers' annuities).

The implications on tax-free cash benefits, the member's tax position (particularly if they are still earning income), and dependants' pensions.

E2. Assessments of value

Generally a **Member Adviser** will emphasise the comparison of pension amounts when advising on a **Total Pension Increase Exchange** exercise. In some circumstances it may also be helpful to illustrate a change in overall expected value of the alternative under consideration.

Assessing the value to the member of different options can be challenging. When assessing the option of transferring to an immediate annuity, one way in which this might be done is as follows.

Calculate and compare the following:

1. The amount of the transfer value being offered, including any incentive (assuming reinvestment in the pension scheme)

2. The cost of replicating the scheme's early retirement benefits, which may be taken as being the total of:

    - The tax-free cash lump sum that the member wishes to take; plus
    - The cost of replicating the remaining early retirement benefits by purchase of a suitable annuity at the current age, actual spouse's age, actual health etc. (including provision for contingent dependant's pension and scheme pension increases).

It may not be possible to obtain annuity quotations in the market to exactly replicate the scheme's early retirement benefits. For example, this may be because these involve unusual pension increase combinations, including contracted-out benefits. However, it may be possible to obtain quotations for something close to the scheme's early retirement benefits.

The difference between the two calculations above is one representation of a "Capital Loss" figure for the option under consideration, albeit it does not allow for any improved security that may arise from transferring to an annuity. (The concept of Capital Loss is discussed further in the "Advice on Pension Increase Exchange exercises" section of the Practitioners' Notes (section D).

F. Record Keeping

Principle 4 of the Code sets out that good practice is to maintain records of the exercise. This section of the Practitioners' Notes provides examples of an approach to record keeping that may be of assistance to various parties involved in an exercise.

When planning record keeping, it may be helpful to note the distinction between two sets of records:

Scheme-level information: used by the employer and their adviser; associated generic communication content issued to members. This would generally include an audit trail of the process leading to the issue of the offer and selection of the **Member Adviser**. Retained records should permit the relevant stakeholders (including employers, trustees, **Member Advisers**, dispute resolution bodies and providers) to establish whether the offer was in accordance with the Code.

Advisory process information: The retained information would generally provide an audit trail of the broad **Advisory Process** for members. The information should establish an audit for relevant stakeholders (including **Member Advisers**, members, **Pension Providers**, regulators and dispute resolution bodies) to establish whether **Advice** or **Guidance** was delivered in accordance with the Code.

When planning record retention, it may be helpful to agree with all parties a record keeping summary table to ensure that each party is aware of their responsibilities for that particular exercise. Example tables are provided below in case they are of assistance.

Table 1: Example record keeping table for Enhanced Transfer Value exercises

Item/Owner and users	Employer	Trustees	Member Adviser	Member	Insurer / Pension Provider	Regulators/ Dispute Resolution Bodies
Employer objectives document	Owner	User			User	User
Member Adviser selection process	Owner	User			User	User
Agreement to pursue offer to members	User	Owner	User		User	User
Scheme benefit summary/ies	User	Owner	User		User	User
Member data - Scheme	User	Owner	User		User	User
Member data – Offer	Owner	User	User		User	User
Initial communication letter	Owner	User	User	User	User	User
Offer letter	Owner	User	User	User	User	User
Reminder letter	Owner	User	User	User	User	User
Fact find			Owner	User		User
Copies of member/adviser correspondence			Owner	User		User
Records of telephone calls			Owner			User

Recommendation / advice letter and report			Owner	User		User
Post Advice outcome data	User	User	Owner		User	User
Insistent client letter			Owner	User		User
TVAS Report			Owner	User		User
Copies of general correspondence with member			Owner	User		User

Table 2: Example record keeping table for Pension Increase Exchange exercises

Item/Owner and users	Employer	Trustees	Member Adviser	Member	Insurer / Pension Provider	Regulators/ Dispute Resolution Bodies
Employer objectives document	Owner	User				User
Member Adviser selection process	Owner	User				User
Agreement to pursue offer to members	User	Owner	User			User
Scheme benefit summary/ies	User	Owner	User			User
Member data - Scheme	User	Owner	User			User
Member data – Offer	Owner	User	User			User
Initial communication letter	Owner	User	User	User		User
Offer letter	Owner	User	User	User		User
Reminder letter	Owner	User	User	User		User
Fact find			Owner	User		User
Copies of member/adviser correspondence			Owner	User		User
Records of telephone calls			Owner			User

Recommendation / advice letter and report			Owner	User		User
Post Advice outcome data	User	User	Owner			User
Insistent client letter			Owner	User		User
Copies of general correspondence with member			Owner	User		User

Table 3: Example record keeping table for Total Pension Increase Exchange exercises

Item/Owner and users	Employer	Trustees	Member Adviser	Member	Insurer / Pension Provider	Regulators/ Dispute Resolution Bodies
Employer objectives document	Owner	User			User	User
Member Adviser selection process	Owner	User			User	User
Agreement to pursue offer to members	User	Owner	User		User	User
Scheme benefit summary/ies	User	Owner	User		User	User
Member data - Scheme	User	Owner	User		User	User
Member data – Offer	Owner	User	User		User	User
Initial communication letter	Owner	User	User	User	User	User
Offer letter	Owner	User	User	User	User	User
Reminder letter	Owner	User	User	User	User	User
Fact find			Owner	User		User
Copies of member/adviser correspondence			Owner	User		User
Records of telephone			Owner			User

calls						
Recommendation / advice letter and report			Owner	User		User
Post Advice outcome data	User	User	Owner		User	User
Insistent client letter			Owner	User		User
TVAS Report			Owner	User		User
Member-specific illustrations of early retirement benefits from the scheme *(with and without cash?)*			Owner	User		User
Member-specific illustrations of early retirement benefits from providers *(with and without cash?)*			Owner	User		User
Copies of general correspondence with member			Owner	User		User

G. Cooling off periods

As set out in how to apply principle 5 section of the Code, a two week cooling off period should be designed into the process, from the point at which each member returns his/her option forms. This section of the Practitioners' Notes provides additional commentary on this.

For **Modification Exercises**, one way in which this can be achieved is by designing option forms such that they allow members to change their minds within two weeks.

For **Transfer Exercises**, the position is made more complex by the need for insurers to issue their own cooling off notice, and this is discussed below.

Following receipt of a transfer value, an **Insurer** is generally required to issue a cooling off notice. This derives from FSA requirements and typically lasts for 28 to 30 days. However, in practice, if a member wishes to change their mind during that period, they will not be able to transfer the money back into the pension scheme, because the pension scheme will generally not have a legal mechanism it can use to receive the money. The only option available to the member would be to transfer the money to another personal pension product.

Therefore, one way to achieve a genuine cooling off period would be:

- That the parties design their own "cooling off period", i.e. a two week period after each member has made their final decision, during which the members' benefits remain in the scheme and the member can change their mind (about their decision to transfer out).

- That the relevant parties liaise closely with the **Insurer** about their own cooling off periods and notices, so that members' expectations can be appropriately managed if they are likely to receive a further (FSA required) cooling off notice from the **Insurer**, albeit one that they are unlikely to be able to act upon.

H. Balanced Deal Calculations

Under principle 2 of the Code, a **Balanced Deal Calculation** will need to be completed for a **Modification Exercise**. This section of the Practitioners' Notes provides additional commentary how this calculation might be undertaken.

1. The trustees, following advice from the scheme actuary, set the CETV basis that is applicable when applying Section 67 of the Pensions Act 1995. It is open to the employer and/or their advisers to challenge the trustees on their basis prior to a **Modification Exercise**, to ensure it is appropriate for that purpose. It is open to trustees to review their basis prior to a **Modification Exercise**, to ensure it is appropriate for that purpose.

2. Once the trustees have set/confirmed the basis, they may choose to disclose the basis to the employer and their advisers.

3. The employer's adviser may use this basis to complete their own calculations and work with the employer to decide whether or not they are intending to make a **Balanced Deal** offer (with **Guidance**), or a lower offer (with **Advice**).

4. The employer may then put a proposal to the trustees and their advisers as to the terms of the offer and the nature of the intended **Guidance** / **Advice**.

5. There might then be a final step in the process where the trustees would ask the scheme actuary (or another adviser appointed by the trustees) to confirm that the **Balanced Deal** test has indeed been appropriately met (or confirm the **Balanced Deal Percentage** being reported by the employer).

6. If acceptable to all parties, it may be more efficient to agree up-front that only one adviser will complete the calculations and the other will have access to their calculations.