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| Title: Simplifying advice requirements for safeguarded pension benefits and introducing new consumer protections IA No: DWP 2017(2).1 RPC Reference No: Lead department or agency: Department for Work and Pensions Other departments or agencies: | Impact Assessment (IA) |
| | Date: May 2017 (updated June 2017 to reflect change in coming into force date) |
| | Stage: Final Stage |
| | Source of intervention: Domestic |
| | Type of measure: Secondary Legislation |
| | Contact for enquiries: Deborah.Sawyer@dwp.gsi.gov.uk |
| Summary: Intervention and Options | RPC: Fit for Purpose (Green) |

| 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) | One-In, Three-Out | Business Impact Target Status |
| 104.97 ¹ | 14.78 | -1.6 | In scope | In scope |

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

The pension freedoms were introduced in April 2015 to allow individuals greater choice in how and when they accessed their pension benefits. When they were introduced, the government put protections in place to ensure that individuals with “safeguarded benefits” (pension benefits with certain potentially valuable guarantees), who wished to access the freedoms did not surrender these without first being aware of their value. To this end, individuals with safeguarded benefits valued at over £30,000 are currently required to take financial advice before they can access their pension flexibly. However, representations from providers have made the government aware that for certain kinds of safeguarded benefits, known as “safeguarded-*flexible* benefits”, the current valuation method set in legislation for determining whether advice is required is complex and confusing for both members and schemes. Government intervention is therefore required to simplify this process. In addition, there is a general lack of awareness amongst members of the value of the guarantees associated with safeguarded-flexible benefits and additional government intervention is required to correct this on-going information failure.

What are the policy objectives and the intended effects?

The government intends to change the rules around the valuation process that is used to assess whether someone is required to seek financial advice. This will mean that schemes can use a simpler, more established process for valuing safeguarded-flexible benefits. The aim is to reduce the burden on schemes, and confusion for members. However, it is important that individuals with safeguarded-flexible benefits understand that their pension benefits offer potentially valuable guarantees of the option of a secure income at retirement, and the implications of giving them up. Therefore, while the policy will simplify the current processes by which schemes comply with the rules requiring members take financial advice (the advice requirement), resulting in some members no longer being required to take advice, it also seeks to ensure that all individuals who have safeguarded-flexible benefits – regardless of pot size – are well-informed of their value (through risk-warnings) before they make the decision to transfer or convert those benefits and so give up any associated guarantees.

¹ The original IA and RPC Opinion assumed this measure would come into force on 1 October 2017. The coming into force date is now 6 April 2018. The IA has been adjusted to show the minor change in impacts – there is a slight change in the net present value (now 104.97 instead of 104.98) and the business net present value (14.78 instead of 14.79). The RPC Opinion shows a Business Net Present Value of £14.79 million and a Societal Net Present Value of £104.98 million. The new coming into force date does not change the estimated costs to business.

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

- Option 1: Do nothing. Retain the rules for schemes to use the current valuation method.
- Option 2: Simplify advice requirements for safeguarded pensions benefits so that the £30,000 threshold for seeking advice is based on the transfer value of the pension pot (as opposed to the amount required to provide for the member's accrued benefits), and introduce a new requirement for firms to provide tailored communications (risk warnings) for members' with safeguarded-flexible benefits, when they seek to transfer, convert or otherwise flexibly access their pension savings (e.g. a cash-payment from their pension scheme). This is the preferred option.

The option of simplifying the advice requirement without introducing risk warnings for safeguarded-flexible benefits has been considered but rejected as this will not meet the policy objective of ensuring that all members are well-informed about their value. Those with a pot valued at £30,000 or less might not be informed about the value of the benefits at any point before surrendering them. Recent Pensions Ombudsman cases have suggested a significant lack of awareness about these benefits, and a majority of responses to the Government's Call for Evidence on the subject favoured members being better informed about their guarantees and their value.

A non-regulatory approach is not viable for the change to the valuation process. The current rules for assessing the value of safeguarded pension benefits are already in regulation, so to change these further regulatory amendments are required. A non-regulatory approach is also not appropriate for the risk warnings; producing tailored communications informing members of the value of their guarantees represents a cost to providers, so there is a risk that some providers may not comply, and as the payment of guarantees, irrespective of investment market returns, presents a financial liability for firms, there may be an incentive for providers not to inform members of the value of their guarantees before they are given up. Furthermore, if any providers do not comply with a voluntary code, the policy would not fulfil the key objective that all individuals with valuable guarantees are told they have these valuable guarantees and their value, before they proceed with a decision that will result in them being given up. When asked in the Government's Call for Evidence whether a voluntary solution was feasible, a majority of responders favoured risk warnings being a statutory requirement.

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|---|---------------------|---|-----------------------|---------------------------|---------------------|
| Will the policy be reviewed? Yes | | If applicable, set review date: (subject to Parliamentary Approval) 1 October 2022 | | | |
| Does implementation go beyond minimum EU requirements? | | | N/A | | |
| Are any of these organisations in scope? | 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:

..... Date: 27/6/2017

Summary: Analysis & Evidence

Policy Option 1

Description: Do Nothing (baseline)

FULL ECONOMIC ASSESSMENT

| Price Base 2016 | PV Base 2017 | Time Period 10 Years | Net Benefit (Present Value (PV)) (£m) | | |
|--------------------|-----------------|-------------------------|---------------------------------------|---------|------------------|
| | | | Low: 0 | High: 0 | Best Estimate: 0 |

| COSTS (£m) | Total Transition (Constant Price) Years | | Average Annual (excl. Transition) (Constant | Total Cost (Present Value) |
|---------------|--|--|--|-------------------------------|
| Low | 0 | | 0 | 0 |
| High | 0 | | 0 | 0 |
| Best Estimate | 0 | | 0 | 0 |

Description and scale of key monetised costs by ‘main affected groups’

Other key non-monetised costs by ‘main affected groups

Under this option, the costs that are currently incurred by providers of schemes whose members wish to transfer, convert or otherwise flexibly access safeguarded-flexible benefits will continue. The main costs are in valuing the associated guarantees, which may require actuarial support, and then checking that members have taken financial advice. The costs of valuing safeguarded-flexible benefits, particularly those that offer the member option of a Guaranteed Annuity Rates (GARs) have been higher than was originally anticipated as the complexity of applying the valuation method set in regulation was not foreseen. Therefore the full extent of these on-going costs was not accounted for in the original Impact Assessment². Under the Do Nothing option, these costs will continue in the future and will represent the baseline against which the costs and benefits of other options are assessed. As such, these costs have not been specifically quantified.

| BENEFITS (£m) | Total Transition (Constant Price) Years | | Average Annual (excl. Transition) (Constant | Total Benefit (Present Value) |
|---------------|--|--|--|----------------------------------|
| Low | 0 | | 0 | 0 |
| High | 0 | | 0 | 0 |
| Best Estimate | 0 | | 0 | 0 |

Description and scale of key monetised benefits by ‘main affected groups’

Other key non-monetised benefits by ‘main affected groups’

| | | |
|--|----------------------|-----|
| Key assumptions/sensitivities/risks | Discount rate | 3.5 |
|--|----------------------|-----|

² Amendments to Pension Schemes Bill (private sector defined benefit transfers) IA No: RPC14-HMT-2212 <http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf>

There is uncertainty over the number of pension policies with safeguarded-flexible benefits, that is, safeguarded benefits that are not traditional salary-related (for instance final salary) pensions. We have used as a proxy the number of pension policies which offer members, whilst they are accumulating their pension benefits, a guaranteed rate at which they can convert their fund into a pension income at retirement, referred to here as GAR benefits. We only have data on GAR benefits and we are not aware of any available data showing the incidence of other safeguarded-flexible benefits³. However, we understand from insights from industry consultation that GARs are by far the most common type of safeguarded-flexible benefits in scope of this policy. Therefore, we expect that data on GARs will be a reasonable proxy for safeguarded-flexible benefits as a whole. This assumption was tested in the impact assessment accompanying the consultation in September 2016. There were no concerns raised by stakeholders that the safeguarded-flexible benefits which are not GARs would have a significant impact on the costing of this policy change. However, we have carried out sensitivity analysis around this assumption..

There is also uncertainty around the frequency that individuals with GARs will enquire about giving them up by accessing their safeguarded benefit flexibly and the costs associated with the current valuation method for determining whether advice is required. Where there is uncertainty, we have sought to use the most appropriate data sources currently available including asking pension providers to provide estimates of costs involved. We have also carried out sensitivity analysis on the most uncertain assumptions; results are presented in the 'Risk and Assumptions' section.

BUSINESS ASSESSMENT (Option 1)

| | | | |
|--|--------------------|---------------|--|
| Direct impact on business (Equivalent Annual) £m: | | | Score for Business Impact Target £m |
| Costs: 0 | Benefits: 0 | Net: 0 | N/A |

³ Other examples of where a benefit is safeguarded and flexible that are not GARs are cases where an occupational pension scheme offers members an option to purchase a scheme pension on the basis of pre-determined conversion factors.

Summary: Analysis & Evidence

Policy Option 2

Description: Simplify advice requirement and introduce tailored risk warnings

FULL ECONOMIC ASSESSMENT

| Price Base 2016 | PV Base 2017 | Time Period 10 Years | Net Benefit (Present Value (PV)) (£m) | | |
|--------------------|-----------------|-------------------------|---------------------------------------|---------|----------------|
| | | | Low: 0 | High: 0 | Best Estimate: |

| COSTS (£m) | Total Transition (Constant Price) Years | | Average Annual (excl. Transition) (Constant | Total Cost (Present Value) |
|---------------|--|--|--|-------------------------------|
| Low | 0 | | 0 | 0 |
| High | 0 | | 0 | 0 |
| Best Estimate | 2.8 | | 1.1 | 12.2 |

Description and scale of key monetised costs by ‘main affected groups’

There will be a cost to pension providers who have members with safeguarded-flexible benefits in familiarising themselves with the new rules. Providers will also incur costs from providing risk warnings to all individuals with safeguarded-flexible benefits when they seek to transfer, convert or otherwise access those benefits flexibly; including fixed one-off costs to alter their systems so they can produce the risk warnings, and on-going costs from producing and sending personalised risk warnings to members when they seek to transfer. In the 6 month period before the policy comes into force and the short period after the policy coming into force, providers will incur costs in adhering to transitional arrangements. The gross costs to businesses are estimated to be £3.41 million in the first year and £1.15 million per year in subsequent years.

Other key non-monetised costs by ‘main affected groups

There will be an indirect cost to financial advisors. This will be equal to the size of the direct saving to the group of individuals who no longer need to seek advice (a maximum of £5.56m in the first year and £11.12m in subsequent years). The impacts on financial advisors are assessed to be indirect as they rely on members changing their behaviour as a result of no longer being mandated to take advice.

| BENEFITS (£m) | Total Transition (Constant Price) Years | | Average Annual (excl. Transition) (Constant | Total Benefit (Present Value) |
|---------------|--|--|--|----------------------------------|
| Low | 0 | | 0 | 0 |
| High | 0 | | 0 | 0 |
| Best Estimate | 0 | | 13.7 | 117.2 |

Description and scale of key monetised benefits by ‘main affected groups’

Individuals who have safeguarded-flexible benefits worth more than £30,000 (when calculated as currently on the basis of the amount required to provide for the member’s benefits), but with a transfer value of less than £30,000 will no longer be required to pay for financial advice (from an adviser authorised by the Financial Conduct Authority) before proceeding to transfer or flexibly access their pension benefits; estimated maximum savings are £5.56m in the first year and £11.12m in subsequent years.

There will be savings to pension providers who have members with safeguarded-flexible benefits. Providers will no longer be required to carry out different and often more complicated calculations to assess whether an individual with safeguarded-flexible benefits is required to seek advice. Instead, they will be able to establish if a member is required to take advice by using the transfer value of the benefits. In most cases this will be considerably simpler and less costly. In addition, they will also no longer need to check that advice has been sought by certain members. Gross savings are estimated at £1.66m in the first year and £3.33m in subsequent years.

Other key non-monetised benefits by ‘main affected groups’

Members with a GAR will receive a tailored risk warning before making the decision to give up their GAR, by say accessing the pension freedoms. This is expected to benefit members by making them less likely to give up potentially valuable benefits without being fully aware of the implications of doing so. These benefits have not been monetised.

| Key assumptions/sensitivities/risks | Discount rate |
|--|---------------|
| <p>There is uncertainty over the number of pension policies with safeguarded-flexible benefits, that is, safeguarded benefits that are not traditional salary-related (for instance final salary) pensions. We have used as a proxy the number of pension policies which offer members, whilst they are accumulating their pension benefits, a guaranteed rate at which they can convert their fund into a pension income at retirement, referred to here as GAR benefits. We only have data on GAR benefits and we are not aware of any available data showing the incidence of other safeguarded-flexible benefits. However, we understand from insights from the industry that GARs are by far the most common type of safeguarded-flexible benefits in scope of this policy. Therefore, we expect that data on GARs will be a reasonable proxy for safeguarded-flexible benefits as a whole. This assumption was tested in the impact assessment accompanying the consultation in September 2016. There were no concerns raised by stakeholders that the safeguarded-flexible benefits which are not GARs would have a significant impact on the costing of this policy change. However, we have carried out sensitivity analysis around this assumption.</p> <p>There is also uncertainty around the frequency that individuals with GARs will enquire about giving them up by accessing their safeguarded benefit flexibly and the cost of implementing the new risk warning requirement. Where there is uncertainty, we have sought to use the most appropriate data sources currently available including asking pension providers to provide estimates of costs involved. We have also carried out sensitivity analysis on the most uncertain assumptions; results are presented in the 'Risk and Assumptions' section.</p> | |

BUSINESS ASSESSMENT (Option 2)

| Direct impact on business (Equivalent Annual) £m: | | | Score for Business Impact Target £m |
|---|---------------|----------|-------------------------------------|
| Costs: 1.3 | Benefits: 2.9 | Net: 1.6 | -8.0 |

Evidence Base (for summary sheets)

Problem under consideration

1. When the pension freedoms⁴ were introduced in April 2015, the government put safeguards in place to make sure that individuals with “safeguarded benefits” (pension benefits with guarantees in relation to the level of secure pension income the member will or may receive) were fully aware of the potential value of their benefits before giving them up to take advantage of the new pension freedoms.
2. Individuals assessed as having a pension with over £30,000 of these safeguarded benefits are required to take Financial Conduct Authority (FCA) regulated financial advice before they can transfer or convert those benefits into a form that can be accessed flexibly.
3. Safeguarded benefits include traditional salary-related occupational pensions and some other (primarily contract-based) pensions (known as safeguarded-*flexible* benefits) where the member is guaranteed a particular level of secure pension income, or has an option to take or purchase a pension or annuity calculated at a guaranteed rate.
4. The most common types of safeguarded-flexible benefits are those with Guaranteed Annuity Rates (GARs). The member with a GAR has an option to purchase an annuity at a contractually guaranteed rate at retirement, or on reaching a particular age. The term GAR is used in the following discussion and the monetisation of costs and benefits to describe safeguarded-flexible benefits⁵.
5. Since April 2015, schemes have been required to value safeguarded benefits (including GARs) using the method for calculating cash equivalents of salary-related occupational pensions under the Occupational Pension Schemes (Transfer Value) Regulations 1996. This methodology requires benefits to be valued by determining the amount required to make provision within the scheme for the benefits. Schemes and providers offering GARs are required to calculate the amount needed to provide for the GAR in order to identify whether the member is required to take financial advice.
6. Table 1 provides an illustration of how the member’s pension is calculated (assuming the whole pension pot is used to purchase the annuity).

Table 1: How the current rules on the advice requirement calculate the value of a member’s safe-guarded pension and therefore determine whether advice is required, for different sized pension pots.

⁴ From April 2015 individuals aged 55 and over have been able to access their defined contribution pension savings as they wish, subject to their marginal rate of income tax (rather than the previous 55% charge which most faced for full withdrawal).

⁵ An impact assessment was published alongside the consultation in September 2016: (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555566/draft-impact-assessment-simplifying-advice-requirements-for-safeguarded-pension-benefits-and-introducing-new-consumer-protections.pdf). This stated that:

“There is uncertainty over the number of pension policies with safeguarded-flexible benefits, that is, safeguarded benefits that are not traditional salary-related (for instance final salary) pensions. We have used as a proxy the number of pension policies which offer members, whilst they are accumulating their pension benefits, a guaranteed rate at which they can convert their fund into a pension income at retirement, because we only have data on GARs and are not aware of any available data showing the incidence of other safeguarded-flexible benefits. We understand from insights from the industry that GARs are by far the most common type of safeguarded-flexible benefits in scope of this policy and therefore expect that data on GARs will be a reasonable proxy for safeguarded-flexible benefits as a whole.”

There were no responses or concerns raised at either the round table event or within consultation responses that this was not a realistic assumption. Therefore, even though it is acknowledged that there may be a small number of safeguarded-flexible benefits that are not GARs which are impacted by this policy change – meaning the costs and benefits might be slightly understated - we believe this will only be a small impact. This is explored further in the sensitivity analysis; see the Risks and Assumptions section.

| Pot size | Accrued Rights (Value of safeguarded benefits against which a member must take financial advice). | Is advice required? |
|----------|--|--|
| £10,000 | £30,000 (assuming GAR guarantee of 10% of pot value, and a life-of-payment for 30 years). | <p>No - even with the current method of calculation, where the value of the GAR is taken into account, the pension pot is not greater than £30,000, (and this is assuming a generous guaranteed annuity rate).</p> <p>If the individual goes ahead with a transfer, the transfer value will be £10,000⁶.</p> |
| £25,000 | £75,000 (assuming GAR guarantee of 10% of pot value and a life-of-payment for 30 years). | <p>Yes – although the pot contains less than £30,000, when using the existing method of valuation which takes account of the GAR, the pension is worth more than £30,000 and advice is required.</p> <p>However, if the individual goes ahead with a transfer, the transfer value will be £25,000.</p> |
| £40,000 | £120,000 (assuming GAR guarantee of 10% of pot value and a life-of-payment for 30 years). | <p>Yes – the value of the pension is greater than £30,000.</p> <p>If the individual goes ahead with a transfer, the transfer value will be £40,000.</p> |

7. The calculation method set out for estimating the current value of the GAR (by reference to the Occupational Pension Schemes (Transfer Value) Regulations 1996⁷) was previously used only by occupational defined benefit schemes. It had not formerly applied to most schemes under which members have GARs (the majority of which are held in personal pensions and other contract-based products). These schemes did not have standardised processes in place to value GAR benefits in terms of the current value of the future income that they offer. As a result, the government has been made aware that the requirements have been causing difficulties for schemes and providers, with personal pension providers reporting that the requirement to value the income promise element of GARs places potentially significant practical and financial burdens on them⁸.
8. The government also received representations from schemes and consumer bodies that the current approach is confusing for members, who are often given two values for their pension pot when they enquire

⁶ Personal pension providers have discretion in how they calculate members' transfer values, which may result in some variation in the transfer value figures quoted in this table.

⁷ The method used for calculating the value of GARs is equivalent to the existing method set out in the Occupational Pension Schemes (Transfer Value) Regulations 1996 for calculating the cash-equivalent value of salary-related benefits. This involves estimating the amount of money that would have to be invested to secure the same promised income guaranteed by the scheme, at the date the calculation is made. This is well-established for salary-related Defined Benefit schemes.

⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/505678/government-response-misc-regs-consultation-23-nov-2015-and-call-for-evidence-on-gar-valuation.pdf

about transferring their pension: one including the value of the guarantee, which is used to determine whether they are required to take advice, and another for the (lower) value they will be able to transfer, which is usually just the amount in their pot.

9. Finally, the government's Call for Evidence on the valuation of pensions with a Guaranteed Annuity Rate⁹ revealed that many members were not fully aware of the potential value of GARs. In addition, recent Pensions Ombudsman Service cases¹⁰ indicate that some members are unaware of the existence of a GAR.

Rationale for intervention

10. The pension freedoms were introduced in April 2015 to allow individuals to flexibly access their pension savings. Alongside this, the government introduced a consumer protection for members with valuable guarantees of a secure pension income (safeguarded benefits) because giving greater choice about how and when members accessed their pension benefits significantly increased the appeal of accessing safeguarded benefits flexibly. The detailed requirements which apply to schemes and providers when members seek to transfer, convert or otherwise flexibly access safeguarded benefits are set out in The Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) Regulations 2015¹¹.
11. As GARs constitute a guarantee regarding the rate of pension income a member can secure, they were categorised as a safeguarded benefit. It is especially important to make members aware of the benefits of GARs as they are found in pension schemes which otherwise look identical to schemes without any guarantees. This results in an information failure, where individuals lack full information about the fact that they have a GAR or of the conditions or value attached to it – for example due to the long term and complex nature of pensions contracts and a lighter disclosure and regulatory regime at the time consumers took out these benefits.
12. To ensure that individuals are fully informed before potentially giving up their GAR by accessing the pension freedoms, the government's safeguards require that individuals with benefits that contain a GAR valued at more than £30,000 seek financial advice. This is so they understand the implications of continuing with any decision that would result in them surrendering their GAR. However, the methodology currently set in legislation for determining the value of a member's GAR has put an excessive burden on schemes. Government intervention is therefore required to simplify the valuation process for assessing the value of members' 'GAR benefits' to reduce unnecessary burdens on pension schemes and providers.
13. However, not all members with pension benefits that contain a GAR will be covered by the advice requirement; those with a GAR valued at less than £30,000 are exempt as it would be disproportionate for those with very small pots to be required to seek and pay for FCA regulated financial advice. This means that, despite the advice requirement, there is still an on-going information failure whereby some individuals may not understand their GAR and the value it represents when making a decision about whether to make

⁹ <https://www.gov.uk/government/consultations/occupational-and-personal-pension-schemes-miscellaneous-amendments-regulations-2016>

¹⁰ PO 563 and 569 <https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-563.pdf>, <https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-569.pdf>

¹¹ SI 2015/742

use of the pension freedoms¹². Furthermore, the proposed simplification of the valuation process for pensions with GARs for the purpose of the advice requirement will mean that some members with GARs who previously would have received the protection of being required to take FCA regulated financial advice will no longer have to seek financial advice. Therefore, additional government intervention is required in order to make sure that all individuals understand the value of their GAR and can make an informed decision, even if they are not required to seek FCA regulated financial advice.

Policy objectives

14. The government intends to amend the valuation process for safeguarded benefits. This will have the effect of simplifying the calculation method used to value members' GAR benefits. For the purpose of determining whether members are required to take financial advice and in the case the safeguarded benefit is flexible, schemes can calculate the realisable transfer value of a member's benefits, rather than carrying out a different more complicated calculation to assess who is required to seek financial advice. The realisable transfer value is an established and widely used calculation methodology. The aim is to reduce the burden on schemes.
15. The policy to simplify the advice requirement will remove the requirement for some individuals to take financial advice. However, it remains important that these individuals and all other individuals with GARs are informed that their pension contains valuable guarantees before they give them up. Therefore, the policy should also ensure that all individuals with GARs are informed both that their pension contains potentially valuable guarantees, and of the value of those guarantees, before they proceed with any decision to transfer, convert or otherwise flexibly access their pension pot, and thereby give up their GAR.

Description of options considered

16. In March 2016, the government committed to simplifying the valuation process for the purpose of determining who is required to take financial advice and proposed that the value of safeguarded benefits, including those with a GAR, be treated as equal to the transfer payment¹³. In the case of pension benefits with a GAR, this may mean using the actual pot size rather than carrying out a complex actuarial calculation, to identify the amount required within the scheme to make provision for the member's accrued benefits and options.
17. This measure will make it simpler for providers and members to identify which members with GAR benefits are required to take advice. It will also have the incidental effect of reducing the number of GAR-holders required to pay for FCA regulated financial advice.
18. A non-regulatory approach is not viable as the current rules around advice requirements are already in regulation and only further regulation can amend the rules.
19. Since the requirement to seek financial advice will still be based on a threshold, not everyone will be required to seek FCA regulated financial advice. It would be disproportionate to require those with a very

¹² Responses to the government's Call for Evidence on the Valuation of Pensions with a Guaranteed Annuity Rate raised concerns that members are often not fully aware of the potential value of GARs attached to their pension benefits.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/505678/government-response-misc-regs-consultation-23-nov-2015-and-call-for-evidence-on-gar-valuation.pdf. Similarly, cases brought to the attention of the Financial Ombudsman have shown that individuals do not always have complete information about their GAR – e.g. <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/115/115-annuities.html>

¹³ Government response to: Occupational and Personal Pension Schemes and the Pension Protection Fund (Miscellaneous Amendments) Regulations 2016 and the call for evidence on the valuation of pensions with a guaranteed annuity rate - <https://www.gov.uk/government/consultations/occupational-and-personal-pension-schemes-miscellaneous-amendments-regulations-2016>

small pot to obtain and pay for FCA regulated financial advice before being able to access their pension flexibly. However, this means those below the advice requirement threshold (whose safeguarded-flexible benefits are valued at £30,000 or less) may not have clear information about the potential value of their guarantees, before they decide to give up their GAR by accessing their pension flexibly. Members with a pot size in excess of the £30,000 threshold will still benefit from information about the GAR before they make a decision to incur the costs of regulated financial advice. Therefore, the government intends to ensure that all individuals with a GAR, regardless of pot size, are sent a risk warning.

20. This communication would be tailored to reflect the nature of any guarantee(s), designed to inform members about their value, and sent when the member seeks to transfer, convert or directly access their flexible benefits and therefore risk giving up the guarantee. Risk warnings should be sent in a timely fashion by the ceding provider at least 14 days before any 'live' request completes, so the member considers this information whilst there is a "live" request in place.

21. The risk warning would contain a written element that sets out -

- that their pension contains potentially valuable guarantees;
- the key features of those guarantees, and the circumstances in which they can be exercised (for example when) and any other important conditions or restrictions;
- text signposting the member to free and impartial guidance (the Government's Pension Wise service); this replicates part of the existing "signposting" letter, that schemes must send members as part of their retirement "wake-up" pack;
- that the guarantees will be lost if the member proceeds with the proposed transaction; and
- two income projections showing the income that the member could receive with and without the guarantee.

22. Simplifying the advice requirement without introducing risk warnings would mean there is an on-going information failure, as not all individuals with safeguarded-flexible benefits would be informed about the value of their benefits. This would mean that the policy objective of ensuring that all individuals are well-informed about their guarantee before potentially giving up valuable benefits when seeking to transfer, convert or flexibly access their pension savings would not be met.

23. For the production of risk warnings a voluntary approach has been considered, but discounted for the following reasons.

- It would require all providers to adhere to a voluntary code - but informing individuals about their GARs would represent a cost to providers and so there is a risk that some providers will not comply. Compliant providers would incur costs in producing disclosure material, whilst non-compliant providers would incur a cost-saving. Furthermore payment of guarantees, irrespective of investment market returns, presents a financial liability for providers. There is an implicit incentive not to voluntarily inform members before they give up their GAR-benefits. There is therefore a risk that some consumers would not be informed of the value of their guarantee before they gave it up.

- There have been recent cases determined by The Pensions Ombudsman, such as PO 563¹⁴ and 569¹⁵, where firms and scheme administrators did not inform members of their GARs before they surrendered them.
- There will be a significant cohort of GAR holders approaching, or already at an age, at which they can access the pension freedoms. Standardised and comparable risk warnings, including projections, may be expected to achieve faster and more complete consumer protection. The development and implementation of a voluntary approach may risk delay, and therefore incomplete coverage, just as this cohort reach retirement.

24. The options therefore being considered are:

- Option 1: Do nothing. This would mean providers and schemes will continue to be required to carry out the complex calculation. Certain members with GARs will be required to seek financial advice, and providers will have to check that they have received financial advice, but providers will not have to supply information on the value of the GAR to other members.
- Option 2: Simplify advice requirements for pensions with GARs, basing the current £30,000 threshold at which members are required to take advice on the transfer value of the benefits, rather than the existing calculation of the future income the GAR could provide. Also introduce a requirement for providers to provide personalised risk warnings to all members with GARs.

25. Table 2 sets out what each of these options would mean in terms of who is required to take financial advice and the tailored communications that members with different pot-sizes would receive.

| <i>Table 2: Illustration of impact of policy options for members with different-sized pension pots</i> | | | |
|--|---|---|---|
| Member pot size | £10,000 cash value (But with £30,000 of accrued rights even assuming a GAR of 10% and payments for thirty years). | £25,000 cash value (£75,000 of accrued rights even assuming a GAR of 10% and payments for thirty years). | £40,000 cash value (£120,000 of accrued rights even assuming a GAR of 10% and payments for thirty years). |
| Option 1 | Member is not required to take advice. Provider is not required to send a risk warning with projections before the member transfers. | Member needs to obtain financial advice. Provider is not required to send a risk warning with projections before the member transfers. | The member needs to obtain financial advice. Provider is not required to send a risk warning with projections before the member transfers. |

¹⁴ <https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-563.pdf>

¹⁵ <https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-569.pdf>

| | | | |
|----------|---|---|---|
| Option 2 | Member is still not required to take financial advice. The member will receive tailored risk warnings with projections before they transfer. | The member is not required to take financial advice. The member will receive tailored risk warnings with projections before they transfer. | The member is still required to take financial advice. The member will also receive tailored risk warnings with projections before they make the decision to pay for financial advice in the process of pursuing the transfer. |
|----------|---|---|---|

Monetised and non-monetised costs and benefits

26. The following section sets out the estimated costs and benefits arising from Option 2, compared to the baseline (Option 1 – Do nothing).
27. Overall the measure would represent a net benefit to businesses over a ten year period. There will be costs to pension providers in familiarisation with the new rules, producing and sending the new risk warnings and complying with transitional arrangements. These costs will be outweighed by the benefits from pension providers no longer having to do complex valuations to determine advice requirements for individuals with GARs and no longer having to check that advice requirements for certain members have been fulfilled.
28. There will also be a saving to individuals who no longer need to pay for FCA regulated financial advice (and a corresponding indirect cost to financial advisors).
29. There will be a benefit to members from the provision of fuller information about the value of their GAR at the point when they are making a decision which may result in those guarantees being surrendered. Receiving the risk warning at this point will allow individuals to make more informed decisions when planning their retirement. This benefit has not been monetised.

Summary of costs and benefits

30. The following table summarises the impacts of the policy, split into the two elements of the policy; the simplified advice requirement and the introduction of risk warnings.

| <i>Table 3: Summary of impacts</i> | | | | |
|--|---------------------|-------------------------------|-----------------------------|------------------------------------|
| <i>Impact</i> | <i>Cost/benefit</i> | <i>To who?</i> | <i>One-off or on-going?</i> | <i>Monetised or non-monetised?</i> |
| 1. Amendment of advice requirement valuation method | | | | |
| Familiarisation costs | Cost | Pension providers and schemes | One-off | Monetised |

| | | | | |
|--|-----------------|-------------------------------|----------|---------------|
| No longer need to estimate value of GAR (using complex method of estimating total of “promise” to pay income in 1996 Transfer Regulations) when determining whether advice requirement applies | Benefit | Pension providers and schemes | On-going | Monetised |
| No longer need to check whether certain members have taken advice | Benefit | Pension providers and schemes | On-going | Monetised |
| Reduced number of people seeking financial advice | Cost (indirect) | Financial advisors | On-going | Monetised |
| Reduced number of people seeking financial advice | Benefit | Members | Ongoing | Monetised |
| 2. Impact of new risk warning rules | | | | |
| Cost of familiarisation | Cost | Pension providers and schemes | One-off | Monetised |
| Upfront cost of implementing risk warning changes | Cost | Pension providers and schemes | One-off | Monetised |
| Cost of producing risk warnings | Cost | Pension providers and schemes | On-going | Monetised |
| Cost of sending risk warnings | Cost | Pension providers and schemes | On-going | Monetised |
| Transitional costs | Cost | Pension providers and schemes | One-off | Monetised |
| Members more informed about value of their GAR | Benefit | Members | On-going | Non-monetised |

Volumes affected

31. Number of schemes with GARs:

- We have estimated that there are 16 contract-based providers who have members with GARs. This is based on data from the Financial Conduct Authority (FCA)¹⁶, which covers 95% of the contract-based providers and finds 15 providers have GARs (so we assume 100% would mean 16 providers have GARs).

¹⁶ FCA Data Bulletin - Issue 7, <https://www.fca.org.uk/publications/data/data-bulletin-issue-7>

- For trust-based schemes, we have used latest available data from the Pensions Regulator’s (TPR) 2014 Governance survey¹⁷ which provides the percentage of schemes with GARs, by scheme size, as shown in the following table:

| <i>Table 4: Proportion of trust based schemes with GARs, by scheme size (TPR 2014 Governance survey)</i> | | | |
|--|-------|--------|-------|
| Proportion of schemes offering a guaranteed annuity rate | Small | Medium | Large |
| 2014 | 16% | 8% | 2% |

- Applying these proportions to the number of schemes, as reported in TPR’s latest scheme return data¹⁸ (January 2017) gives 280 trust-based schemes with GARs.
- The TPR data on the proportion of schemes with GARs¹⁹ does not include micro schemes (those with less than 12 members). In the absence of any data on the prevalence of GARs in micro trust-based schemes, we have used the closest available approximation, namely the proportion of small schemes with GARs, which is 16%. We then apply this to the number of micro schemes, based on TPR’s scheme return data²⁰. We have excluded Small Self-Administered Schemes (SSASs) as they are a particular type of scheme where all members are trustees and it is highly unlikely that such a structure would have been set up only to then buy a GAR from an insurer. This leaves 818 micro schemes with GARs²¹.
- The TPR Governance Survey estimate volumes of GARs offered for trust-based schemes. However, a significant proportion of benefits with GARs in occupational schemes will not be affected by these changes because they fall within the definition of “money purchase benefits” and so are not safeguarded benefits. This is the case where the GAR is a feature of an insurance policy held as an asset of the scheme, rather than being promised in the scheme rules. Therefore these money purchase GARs need to be excluded from our analysis. Although it is understood that a significant proportion of GARs in trust-based schemes may be money purchase GARs, there is no robust data on this point. As a central estimate, we have assumed that only 50% of the GARs in the survey are non-money purchase; this leaves 549 trust-based schemes, made up of 140 non-micro schemes and 409 micro schemes. Given the lack of evidence around what proportion of trust-based GARs are non-money purchase, we have conducted sensitivity analysis

¹⁷ TPR Governance Survey 2014, <http://webarchive.nationalarchives.gov.uk/20150703133738/http://www.thepensionsregulator.gov.uk/docs/governance-survey-report-2014.pdf>

¹⁸ DC trust: presentation of scheme return data 2016 – 2017, TPR <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2017.aspx>

¹⁹ TPR Governance Survey 2014, <http://webarchive.nationalarchives.gov.uk/20150703133738/http://www.thepensionsregulator.gov.uk/docs/governance-survey-report-2014.pdf>

²⁰ DC trust: presentation of scheme return data 2016 – 2017, TPR <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2017.aspx>

²¹ Where SSAS status is unknown, we have applied the proportion of SSAS and non-SSAS schemes to ascribe the unknowns to a category.

around this assumption (see Risks and Assumptions section). This shows that the overall costs and benefits are not sensitive to this assumption.

- The combined number of trust-based schemes and contract-based providers with GARs is estimated to be 565.

32. Number of individuals with GARs accessing the pension freedoms:

- Based on FCA data, we know the number of people in contract-based schemes that accessed their pension and gave up their GAR between Q2 and Q4 of 2015/16²². Pension freedoms were introduced in April 2015 and pent up demand from the announcement in March 2014 means that take up of the freedoms in the first two quarters of 2015/16 is likely to be higher than would be expected going forwards²³. Therefore we only use the latest two quarters available, October-December 2015 and January-March 2016; this shows that 17,814 members gave up a GAR – which is equivalent to 35,628 members annually.
- We do not have equivalent data showing the number of individuals with GARs in trust-based schemes who have given up their GAR. The evidence on the prevalence of GARs in trust-based pension schemes is limited to the data on the number of schemes with GARs, split by scheme size (from TPR's governance survey²⁴). We use this to estimate the number of members with GARs, by multiplying the estimated number of small, medium and large schemes with GARs by the average number of members (from TPR data²⁵). This gives an estimate of 218,520 members. To estimate the number of GAR-holders in micro schemes, we have applied the average number of members in non-SSAS micro schemes (four²⁶) to the

²² FCA Data Bulletin Issue 7, <https://www.fca.org.uk/publications/data/data-bulletin-issue-7>. Note that the most recent two quarters have been chosen as the most representative quarters of the data to date, as the initial quarters are likely to have been affected by pent up demand prior to the introduction of the pension freedoms in April 2015. The FCA statistics show the highest number of pots was accessed for the first time in the first quarter after the freedoms were introduced, with a 10% fall between Q1 and Q2 and a 36% fall between Q2 and Q3. Between Q3 and Q4 the trend appears to have stabilised, with only a 0.2% fall in the number of pots accessed.

²³ FCA Data Bulletin Issue 7, <https://www.fca.org.uk/publications/data/data-bulletin-issue-7>. Note that the most recent two quarters have been chosen as the most representative quarters of the data to date, as the initial quarters are likely to have been affected by pent up demand prior to the introduction of the pension freedoms in April 2015. The FCA statistics show the highest number of pots was accessed for the first time in the first quarter after the freedoms were introduced, with a 10% fall between Q1 and Q2 and a 36% fall between Q2 and Q3. Between Q3 and Q4 the trend appears to have stabilised, with only a 0.2% fall in the number of pots accessed.

²⁴ TPR Governance Survey 2014, <http://webarchive.nationalarchives.gov.uk/20150703133738/http://www.thepensionsregulator.gov.uk/docs/governance-survey-report-2014.pdf>

²⁵ TPR scheme returns data 2016/17, <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2017.aspx>

²⁶ TPR scheme returns data 2016/17, <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2017.aspx>

number of micro-schemes with GARs, estimated above (818); this gives 2,949 members with GARs in micro schemes.

- In total, this gives an estimated 221,669 trust-based members with GARs. Again, assuming that 50% of these will be in money purchase schemes which are not covered by these policy changes, we are left with 110,834 members in trust-based schemes with non-money purchase GARs²⁷.
- In order to estimate how many of these GAR holders would choose to give up their GAR per year, we have used FCA data²⁸ showing that 1,534,890 policies with GARs exist in accumulation and compared this to the number of these given up (35,628 per year). This gives a rate of 2% of GARs being given up per year. Applying this to the number of GARs that exist in trust-based pensions gives an estimated 2,573 members of trust-based pensions seeking to give up a GAR per year.
- Overall across trust-based schemes and contract-based schemes, there are an estimated 38,201 individuals who have GARs and would choose to access their pension and give up their GAR, per year.
- This estimate only covers those who have actually given up their GAR. It does not account for those who may have enquired about accessing their pot but then decided not to at that time. In this way, these volumes may under-estimate the number of people for whom the advice requirement calculation is currently required and for whom risk warnings will be required. In order to estimate what proportion of those who enquire about accessing their GAR go on to give up their GAR, we asked a number of providers for information. Two providers responded; we have used an average of their responses, which suggests that 62.5% of those enquiring about accessing their pension subsequently go on to access it²⁹. Since the 38,201 members only includes those who actually give up their GAR, we have up-rated by 1.6 in line with discussion with providers and assumed that 61,122 members per year would enquire about accessing their GAR³⁰.

Amendment of advice requirement valuation method

Cost to businesses:

- *Cost of familiarisation:*

33. The transfer value of the benefits is a well-understood concept, as it is the amount which the scheme would pay to the member's receiving scheme when they transferred. Therefore the time needed for familiarisation is expected to be fairly short. We have assumed that a pension professional from each of the 565 schemes and

²⁷ In the absence of any evidence on the distribution of non-money purchase GARs by scheme size, we have assumed that the proportion of schemes with GARs that are money purchase or non-money purchase is 50% across all schemes, regardless of scheme size.

²⁸ FCA Data Bulletin July – September 2015, <http://www.fca.org.uk/static/documents/retirement-income-market-data-july-september-2015.pdf>

²⁹ This is also supported by similar figures published by FCA in their Data Bulletin Issue 7 (<https://www.fca.org.uk/publications/data/data-bulletin-issue-7>). They show that, of those accessing their pension, 63% in Q4 2015 and 61% in Q1 2016 gave up their GAR; the remainder took up their GAR. The statistics are not directly comparable as they *will not* capture those who enquired about accessing their GAR but then took no action, i.e. did not give up their GAR or take up their GAR (but still would have required a risk warning), and they *will* include any individuals who chose to take up their GAR without asking about other flexible options (and so would not have required a risk warning).

³⁰ This is made up of 57,005 members in contract-based schemes and 4,117 members in trust-based schemes.

providers with GARs will need to read and digest around two pages of guidance³¹. This is estimated to take around 5 minutes (based on an average reading time of 300 words per minute) plus an additional ten minutes to digest the information. Based on an average hourly wage of £25.08³² this gives a total cost of £3,543, which would occur only in the first year.

Benefit to businesses:

- *Firms no longer need to adopt a different valuation method when determining whether advice requirement applies:*
34. We assume that pension providers would only need to carry out the complicated calculation to see if the advice requirement applies if the individual's pot is greater than £10,000 (as with very small pots, even with the GAR, the value is highly unlikely to be above £30,000³³) and less than £30,000 (because if the individual's pot were £30,000 or more, the firm would know that advice would be required, regardless of how much extra value was added by the GAR). The FCA data³⁴ provides a breakdown of pots with GARs accessed by pot size, showing that 27% are over £10,000 but less than £30,000. This data only covers contract-based schemes, but in the absence of an equivalent breakdown by pot size for trust-based pensions, we have applied it to the number of GAR holders expected to enquire about accessing their GARs, across both trust-based and contract-based schemes (61,122). This suggests that providers would have to do the calculation for 16,480 individuals per year.
35. We assume that the cost of the calculation is around £188 per individual. This is based on taking an average from estimates of the cost provided by pension schemes in response to a request for information from DWP³⁵. Therefore we estimate that the total savings to businesses from no longer being required to calculate the value of GARs for those seeking to transfer, convert or otherwise flexibly access their benefits is around £3,090,000 per year.
- *Firms no longer need to check if advice has been sought:*
36. There will be additional savings to providers and schemes as at present they are required to check whether advice has been taken by all those who are required to do so. As the advice threshold will now be based on

³¹ This may over-estimate the number of trust-based schemes who face familiarisation costs as the TPR data (TPR Governance Survey 2014, <http://webarchive.nationalarchives.gov.uk/20150703133738/http://www.thepensionsregulator.gov.uk/docs/governance-survey-report-2014.pdf>) shows that small schemes are more likely to have GARs and in these schemes the work of familiarisation and implementing changes will typically be carried out by an administrator or another other service provider. In practice many schemes use the same service provider, so the number of distinct firms who need to familiarise themselves with the change would likely be less than 565. Furthermore, this estimate includes 409 trust-based micro schemes; these schemes will have a very low number of members with GARs and, in any one year, only a minority are likely to have a member who wishes to give up their GAR. Given the infrequency that schemes will be required to understand these rules, arguably they are likely to only familiarise themselves if and when the need arises.

³² The gross median hourly rate for a professional is £19.75. This has been increased by 27% in line with the Green Book to account for non-wage costs, which gives £25.08. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2016. <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2>

³³ Insight from providers suggests that the annuity rates offered by GARs tend to be around double the typical annual rate for annuities.

³⁴ FCA Data Bulletin Issue 7, <https://www.fca.org.uk/publications/data/data-bulletin-issue-7>

³⁵ When asked for a rough indication of the unit cost of valuing a GAR, two providers responded, giving a range of estimates: one estimated a cost of £50 per transaction; the other estimated £250-£400 per transaction. In the absence of any better data, we have used a mid-point.

the transfer value of the pot, not taking into account the value of the GAR, those individuals whose GAR is worth more than £30,000 but whose transfer value is £30,000 or less will no longer be required to seek advice.

37. While the FCA data³⁶ provides a breakdown of GARs by pot size, we do not have any data showing the distribution of pension size including the value of the GAR. Insight from providers suggests that the annuity rates offered by GARs tend to be around double the typical annual rate for annuities. Therefore as a rough estimate we have assumed that a £15,000 pension pot with a GAR would be equivalent to a £30,000 pension pot without a GAR.
38. We estimate that, of the 61,122 individuals with GARs who would choose to access their policy, 20% would have a pot that is less than £30,000 but above £15,000. This is based on FCA data³⁷ and assumes that the distribution of pot sizes is even, so that 75% of those with a pot size between £10,000 and £30,000 have a pot that is greater than £15,000. This gives an estimate of 12,360 individuals who would no longer need to seek advice.
39. Checking if advice has been taken requires checking the written statement from the FCA authorised adviser and confirming that it reports that:
- the advice is in relation to the member;
 - the advice is specific to the type of transaction proposed by the member; and
 - the adviser has permission to carry on the regulated activity (and the trustees or managers must verify this through checking the Financial Services Register).
40. We have assumed that checking if advice has been taken takes up to an hour of an administrator's time with an average wage of £19.05 per hour³⁸. This is in line with the assumption used in the DB transfers Impact Assessment where an equivalent requirement was introduced³⁹. Applying this to the 12,360 individuals who would no longer seek need to seek advice each year gives a total cost saving of £235,458 per year.

Benefit to individuals:

41. The 12,360 individuals per year who will no longer need to seek advice will benefit from no longer having to pay for advice (unless they voluntarily choose to seek advice). This is estimated to save £900 per person⁴⁰.

³⁶ FCA Data Bulletin Issue 7, <https://www.fca.org.uk/publications/data/data-bulletin-issue-7>

³⁷ FCA Data Bulletin Issue 7, <https://www.fca.org.uk/publications/data/data-bulletin-issue-7>. In the absence of equivalent data for trust-based schemes, the proportions provided in the FCA data for contract based pensions have been applied for both contract-based and trust-based members.

³⁸ The gross median hourly rate for an associate professional is £15.00. This has been increased by 27% in line with the Green Book to account for non-wage costs, which gives £19.05. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2016. <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2>

³⁹ In order to test this assumption, we sought input from a number of providers around the cost of checking whether advice had been taken. Only one provider provided an estimate; they suggested it would cost around £15 to check that advice had been taken.

⁴⁰This is based on an estimate of the cost of financial advice for an individual with a £30,000 pension with a GAR, from Unbiased (<https://www.unbiased.co.uk/cost-of-financial-advice>). This is similar to the estimate used in the DB transfers impact assessment (<http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf>) based on previous discussions with the Pensions Regulator and the Association of Professional Financial Advisers which suggested that an average cost of financial advice is £156 per hour, and the average time required for advice is 7.5 hours, giving a total of £1,170. As the Unbiased estimate is more specifically focussed on those with GARs worth £30,000, we have used £900.

Assuming none of the 12,360 voluntarily seeks advice, this gives a maximum total saving of around £11,123,999 to individuals with GARs per year.

Indirect cost to Financial Advisers:

42. There will be an indirect cost to financial advisors which is equal to the size of the savings to the group of individuals who no longer need to seek advice (a maximum of £11,123,999 per year). The impacts on financial advisors are assessed to be indirect as they rely on members changing their behaviour as a result of no longer being mandated to take advice.⁴¹

Introduction of risk warnings

Cost to businesses:

- *Cost of familiarisation:*

43. We assume that each of the 565 schemes and providers with GARs has to familiarise themselves with the new rules⁴². Although these risk warnings include the production of projections, all schemes are required to produce Statutory Money Purchase Illustrations (SMPIs) as part of members' annual benefit statements⁴³. In addition, the methodology that should be used for producing risk warnings projections is largely the same methodology already used by schemes, to fulfill their statutory requirement to produce SMPIs under the Disclosure of Information Regulations 2013 as part of the requirements set by the Financial Reporting Council's statutory guidance for SMPIs (i.e AS TM1).

44. While risk warning illustrations of a projected income adopt a number of assumptions used within existing requirements to produce illustrations (SMPIs), it is understood that the equivalent assumptions specified in the

⁴¹ The impact on financial advisers is assessed to be indirect as the duty applies primarily on pensions businesses without a direct requirement for financial advisers. This approach is consistent with that taken in the DB transfers IA where the financial benefit to advisors as a result of the advice requirement being introduced was deemed to be indirect and was not counted as part of the EANC calculation (<http://www.parliament.uk/documents/impact-assessments/IA14-13A.pdf>).

⁴² This may over-estimate the number of trust-based schemes who face familiarisation costs as the TPR data (TPR Governance Survey 2014, <http://webarchive.nationalarchives.gov.uk/20150703133738/http://www.thepensionsregulator.gov.uk/docs/governance-survey-report-2014.pdf>) shows that small schemes are more likely to have GARs and in these schemes the work of familiarisation and implementing changes will typically be carried out by an administrator or another other service provider. In practice many schemes use the same service provider, so the number of distinct firms who need to familiarise themselves with the change would likely be less than 565. Furthermore, this estimate includes 409 trust-based micro schemes; these schemes will have a very low number of members with GARs and, in any one year, only a minority are likely to have a member who wishes to give up their GAR. Given the infrequency that schemes will be required to understand these rules, arguably they are likely to only familiarise themselves if and when the need arises.

⁴³ See Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013

FCA's rules about producing projections do not differ significantly or in any material respects. Most contract-based providers will:

- be familiar with the FCA's rules - so the familiarisation costs are not expected to be large; and
- have systems in place that produce projections using the same methodology that they use to fulfil other existing statutory requirement.

45. As schemes can choose their preferred methodology they will most likely choose whichever provides the lowest cost for adjustment and familiarisation.

46. We have assumed 30 minutes reading and digesting time for a professional with an average wage of £25.08 per hour⁴⁴ in each of the providers or schemes affected. This assumption is consistent with a previous impact assessment for a requirement to provide a type of risk warning to members⁴⁵. The total familiarisation costs are estimated at £7,086 (which would occur in the first year).

- *Upfront cost of implementing changes:*

47. The costs of producing risk warnings will depend on how the change is implemented. For contract-based providers we assume the change is implemented via a system change, with minimal on-going costs. However for trust-based schemes, we assume that costs are on-going but with no upfront costs as member numbers are so small that a system amendment is likely to be disproportionate⁴⁶.

48. The change required – either through manual intervention or through a system amendment – would be:

- The insertion of semi-standard paragraphs into the statement of entitlement or other product. The text would need to be different for each different guarantee, but there would be a limited number of different guarantees, and the same text could be used for all members with the same guarantee.
- The calculation of two analogous projections that illustrate the annual income the member would secure by using their pension pot to exercise the guarantees (GAR) available within the scheme/contract, and what the same pension pot would secure by purchasing an equivalent annuity on the open market. The illustrations would be new but use an established methodology, already used by schemes and providers to illustrate projections of annual income at a future date. This established methodology will be used to determine the value of the member's pot in both projections, and estimate the "open market annuity" rate for the second 'comparison' projection.

⁴⁴ The gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs, is £25.08. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2016.

<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2>

⁴⁵ "A 'risk warning' provision for members of occupational pension (trust-based) schemes" Impact assessment, 2016,

<http://www.legislation.gov.uk/uksi/2016/294/impacts>

⁴⁶ We base this assumption on earlier estimates of members and schemes/providers in contract-based and trust-based schemes. The 16 contract-based providers communicating with 57,005 members with GARS each year would be very likely to view a system change as a value for money investment. The 549 trust-based schemes communicating with just 4,117 members each year would be very unlikely to find a system change proportionate.

49. As part of the government's *Consultation on valuing pensions for the advice requirement and introducing new consumer protections*⁴⁷, we asked respondents to provide evidence on the likely costs associated with providing risk warnings, publishing our initial estimates in order to test our assumptions with industry⁴⁸. A number of contract-based providers responded. Their responses supported our assumption that contract-based providers would incur upfront costs to enable the production of risk warnings via a system change, followed by low costs to produce the risk warnings on an on-going basis.
50. Providers' responses also suggested a preference for more flexibility. Schemes requested the flexibility to use FCA's methodology when producing income projections as part of GAR risk warnings. Allowing schemes the freedom to choose their own methodology would mean significantly lower upfront costs than if a different approach had to be adopted for the GAR risk warnings. In response to these representations, we have adapted the regulations so that schemes can choose their preferred methodology; this will help ensure that the added member protection introduced by the risk warnings can be implemented without putting an undue burden on the pensions industry.
51. The responses suggested that, even after allowing providers to follow the FCA methodology, upfront costs would be higher than we had initially estimated. We received estimates from four providers. However, the responses varied significantly, ranging from £50,000-65,000 to £450,000. This suggests that the costs of implementing system changes to enable the production of the risk warnings are highly dependent on how the particular systems are set up and how easily they can be changed. Given the wide range of estimates, we have taken the median value, £175,000, for the upfront costs incurred by providers. Based on 16 contract-based schemes having GARs, the estimated total cost is £2,800,000. This would occur only in the first year of the policy.
52. There would also be an additional cost associated with ensuring that the risk warnings are sent a minimum of two weeks before the transfer of the pension goes ahead, to ensure that individuals have time to consider the implications of the information contained in the risk warning. This will require an additional requirement to be put into the transfer process to ensure transfers are paused until this two week period has elapsed. Since 100% of the contract based providers use the same not-for-profit transfer system called Origo, we consulted Origo to understand the impact of this change. Origo confirmed that this change would be low cost and completed as part of wider system updates. This cost has not been monetised.
- *On-going cost of producing risk warnings*
53. After these one-off costs, we assume that contract-based schemes then only face small on-going costs to produce the risk warnings. These are estimated at £15 per individual requiring a risk warning, based on the median estimate of costs per risk warning, submitted by contract-based providers in response to the consultation. With 57,005 individuals in contract-based schemes requiring risk warnings each year, the estimated on-going cost for contract-based schemes is £855,075 per year.
54. For trust-based schemes, we assume the cheapest option to comply with the legislation would be to manually change existing documentation rather than amend bespoke computer systems since they do not have the scale of the contract-based schemes. Therefore we assume no upfront system change costs but have larger on-going costs for each time a risk warning is produced. We assume a pension administrator would need to manually over-ride the system to insert appropriate standard text for a member's policy from a database. The

⁴⁷ Consultation on valuing pensions for the advice requirement and introducing new consumer protections, DWP
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555564/consultation-valuing-pensions-for-the-advice-requirement-and-introducing-new-consumer-protections.pdf

⁴⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555566/draft-impact-assessment-simplifying-advice-requirements-for-safeguarded-pension-benefits-and-introducing-new-consumer-protections.pdf

two comparable income projections would then be inserted based on fairly standard calculations. Trust-based schemes would need to ensure that the risk warning is produced and sent two weeks before the transfer goes ahead; since we assume that trust-based schemes will produce the risk warnings manually, we do not expect that a system change would be required, it would just form part of the manual process used by the scheme. In light of these requirements, we have assumed it would take three hours of a pension administrator's time⁴⁹, costing £57.15. Based on the assumption that 4,117 members with trust-based schemes who have GARs will require risk warnings each year, this gives a cost of £235,287 per year.

55. Combining the on-going costs faced by contract-based and trust-based providers from producing the risk warnings gives a total cost of £1,090,362.

- *On-going cost of sending risk warnings:*

56. Providers will also need to send the risk warnings to individuals once created. We assume 61,122 individuals need to be sent a risk warning each year as a result of the policy, at a cost of £1.02 for sending a letter⁵⁰. This gives an estimated cost of £62,487 per year.

- *Transitional costs*

57. When the policy comes into force there is a sub-group of GAR holders for whom the requirement to take advice would apply differently now there is a new valuation method. This sub-group would have been assessed as having more than £30,000 when the value of the GAR was taken into account. However, now the valuation method only requires the transfer value of their benefits to be considered, they would no longer be assessed as above the £30,000 threshold.

58. In order to avoid the situation where an individual pays for advice where they would not have to if they had enquired at a later date, the regulations stipulate that any individual who is;

- a) informed in the period of just over six months from 1st October 2017 until 6th April 2018 (when the regulations come into force) that they are required to take advice, and
- b) would be required to take advice under the old rules but not the new rules,

must be informed within 20 days after the regulations come into force that they are no longer required to seek advice (provided that they have not informed the scheme that they have already taken advice). However the requirement does not apply if the scheme informed the individual about the change in advance.

59. During the consultation process providers warned that the transitional requirement would impose practical difficulties to implement if firms did not have sufficient time to prepare as a cohort of individuals who had already been told to seek advice would have to be identified and told separately about the new rules. This would be complex and costly for schemes. On the other hand, if there was sufficient notice, providers would be

⁴⁹ We did not receive any consultation responses providing further insight into the costs for trust-based schemes and, as these risk warnings are a new requirement specific to members with GARs, we do not have historic evidence on the costs of producing them. The on-going cost of £15 per individual risk warning for contract-based schemes represents approximately one hour of an administrator's time. In the consultation impact assessment we estimated a higher on-going time required for trust-based schemes than for contract based and this was not challenged. Therefore we believe that, given the tasks listed above, three hours is a sensible assumption. Given the lack of evidence around the likely on-going costs for trust-based schemes with GARs, we have conducted sensitivity analysis around this assumption (see Risks and Assumptions section). This shows that the overall costs and benefits are not very sensitive to this assumption.

⁵⁰ This covers the postage costs and is based on previous consultation with the pensions industry around changes to disclosure of information regulations. Department for Work and Pensions (DWP), July 2013, The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013: Government response, <https://www.gov.uk/government/consultations/occupational-and-personal-pension-schemes-disclosure-of-information-regulations-2013>. The 2013 estimate has been converted into 2016 prices, using the CPI index published by the Office for National Statistics <https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/d7bt/mm23>.

able to inform such individuals in advance of the regulations coming into force that they would no longer be required to take advice after the coming into force date.

60. In order to reduce the business impact of these regulations, there will be a delay in between the laying date and the start of the transitional period to allow schemes time to prepare for these changes.
61. When estimating the costs of complying with the transitional arrangements, we have assumed that providers will adopt the lower cost option and inform members -
- in advance of the coming into force date
 - by amending the wording of the communications that they send to members telling them they are required to take financial advice.
62. Pension providers will need to identify that someone falls within the sub-group by comparing the value of the member's benefits taking into account of the GAR with the transfer value of those benefits, to check for cases where the former exceeds £30,000 but the latter does not. At that point in time, the provider will still be required to calculate the GAR and the transfer value is a known value - so this comparison should be relatively easy. We expect that providers will insert a standard paragraph into the existing communication informing individuals that they are required to seek advice, explaining that the rules around the advice requirement for those with safeguarded flexible benefits are changing and that if they wait until the date that the regulations come into force then they may no longer be required to seek advice.
63. The transitional period will cover the six months preceding the date at which the policy comes into force. The number of members affected by these transitional arrangements is therefore estimated at six twelfths of the annual estimate of the number of GAR holders seeking to access the freedoms and who have a pot size of less than £30,000 but a value including the GAR of more than £30,000 (12,360 members). This gives an estimate of 6,180 members who will be affected by the transitional requirement. Assuming that it will take providers around ten minutes to identify such a case and copy and paste a standard piece of text into an existing communication – and assuming an average annual wage of £19.05 for a pensions administrator⁵¹ - gives a total cost to providers of £19,622 for adhering to these transitional arrangements.

Benefit to members:

64. Members with a GAR will receive a tailored risk warning before making the decision to give up their GAR, by say accessing the pension freedoms. This will contain projections of the income they would receive with and without their GAR. This will help to improve the low awareness of, and understanding of the GARs that such members hold in their pension. It is expected to benefit members by making them less likely to give up potentially valuable benefits without being fully aware of the implications of doing so.
65. It is also expected to benefit those who are also required to take financial advice before giving up their GAR – the cost of accessing this advice is expected to be around £900 per person, and these risk warnings will help ensure that members are well-informed before making the decision to incur the costs of financial advice.
66. These benefits have not been monetised.

⁵¹ The gross median hourly rate for an associate professional is £15.00. This has been increased by 27% in line with the Green Book to account for non-wage costs, which gives £19.05. The hourly rate data are taken from the Annual Survey of Hours and Earnings (ASHE), 2016.

<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2>

Summary of monetised costs and benefits

67. Table 5 summarises out the costs and benefits to businesses that arise from the simplified advice requirement and the introduction of risk warnings. It assumes that the regulations come into force in April 2018 (and the transitional arrangements begin in October 2017). From October 2018, we assume annual costs of £1.15m and annual benefits of £3.33m. In year 1 (from October 2017 onwards) we assume that, prior to the regulations coming into force in April 2018, providers will incur familiarisation costs, the upfront costs of implementing the new risk warnings and transitional costs. Between April 2018 and September 2018 (inclusive) after the regulations have come into force, there will then be a six month equivalent of the annual on-going costs and benefits to providers.

| | | Year 1 | Subsequent years |
|-----------------------|---|-------------|------------------|
| One-off costs | Familiarisation with amendment of advice requirement valuation method | 0.00 | - |
| | Familiarisation with new risk warning rules | 0.01 | - |
| | Upfront cost of implementing risk warning changes | 2.80 | - |
| | Transitional costs | 0.02 | - |
| On-going costs | Cost of producing risk warnings | 0.55 | 1.09 |
| | Cost of sending risk warnings | 0.03 | 0.06 |
| Total costs | | 3.41 | 1.15 |
| On-going benefits | Simplified advice requirement | 1.55 | 3.09 |
| | No longer need to check if certain members have received advice | 0.12 | 0.24 |
| Total benefits | | 1.66 | 3.33 |
| Net costs | | 1.74 | -2.17 |

68. Table 5 shows that in year 1 (October 2017 to September 2018), this policy will have a net cost to business, largely due to the upfront costs for contract-based providers to make the necessary system changes enabling them to provide the risk warnings. However, in subsequent years, the policy is expected to have a net benefit to businesses, arising from the simplified advice requirements. Over a period of ten years, the policy would have a net benefit to business of £17.81m.

69. Table 6 summarises the impact on members. From year 2 onwards, members would save £11.12m per year; these savings occur as a result of fewer members being required to pay for financial advice. We have assumed that the regulations come into force in April 2018, meaning six months of savings to members would occur in year 1 (in the six months from April 2018).

| | Year 1 | Subsequent years |
|-------------------------------|--------------|------------------|
| Cost to individuals | 0 | 0 |
| Benefit to individuals | 5.56 | 11.12 |
| Net costs | -5.56 | -11.12 |

Risks and Assumptions

70. There is uncertainty around the estimated costs and benefits of these regulations due to limited data on the incidence of safeguarded-flexible benefits, the frequency that individuals will enquire about giving them up and the processes and costs involved in implementing the changes.
71. To understand the risk that we are over or under-estimating the policy impact as a result of this uncertainty, we have conducted sensitivity analysis on the most influential assumptions that we have the least confidence in:
- The proportion of trust-based GARs which are money purchase
 - The proportion of those who proceed to give up GAR after enquiring
 - The proportion of safeguarded flexible benefits which are GARs
 - The cost of the current calculation method
 - The upfront costs of implementing risk warnings in contract-based schemes
 - The on-going cost per Risk Warning for contract-based schemes
 - The on-going cost per Risk Warning for trust-based schemes
72. The following section explains the basis for our current assumptions and the impact of adopting more optimistic or pessimistic assumptions. Table 7 at the end of this section summarises the findings.

The proportion of trust-based GARs which are money purchase

73. In the absence of any quantitative evidence on the breakdown of money purchase and non-money purchase GARs, there is a great deal of uncertainty around the estimate of the proportion of members and schemes with trust-based GARs that are non-money purchase (and thus in scope for these regulations). Our central estimate is 50%; if this is an under-estimate of the proportion that are non-money purchase, we will be under-estimating the number of GARs in scope for this policy. A lower number of trust-based schemes and individuals in scope would mean a lower benefit for providers (as a result of the simplified advice requirement), but this will be off-set by even lower costs as a result of fewer schemes facing familiarisation costs (in year 1 only) and schemes having to produce fewer risk warnings. Therefore a lower percentage of GARs being non-money purchase would mean we are currently over-estimating the cost to business. With no data to guide our assumption, we have tested a wide range around the central assumption; as an optimistic assumption we have assumed that 10% of GARs are non-money purchase; our pessimistic assumption is that 90% are non-money purchase.
74. Sensitivity analysis around these assumptions shows that the overall costs and benefits to business are not very sensitive to this assumption. Increasing the proportion of schemes that are non-money purchase to 90% only increases the net costs to business by £0.02m in year 1 and £0.01m in subsequent years. Reducing the proportion to 10% on reduces the net costs by £0.01m in each year. Therefore, although there is no evidence to support the assumption that 50% of trust-based schemes and members with GARs are non-money purchase, the assumption does not represent a significant risk to our estimate of the net cost of this policy.

The proportion of those who proceed to give up GAR after enquiring

75. We have assumed that 62.5% of those with GARs who ask about transferring or accessing their pension benefits flexibly proceed with that action. We have used this percentage to translate the estimated number of people who actually give up a GAR per year to the number of people enquiring (which is the total number that will require risk warnings). Our assumption is based on responses from two providers about the proportion of those with a GAR who enquire about flexibly accessing those benefits and then that go on to give up their GAR. One provider gave an estimate of 35% and another indicated a majority of theirs which we have interpreted as 90%; this gives an average of 62.5%. If the true proportion of individuals who go on to access their GAR after enquiring is actually higher than 62.5%, it means that we will currently be over-estimating the total number who enquire – and as a result over-estimating the costs to business from producing the risk warnings and over-estimating the benefits to businesses from the simplified advice requirement. Overall we would currently be over-estimating the net cost to business.

76. To test how sensitive the estimated business impacts are to this assumption, we have assumed a pessimistic assumption of 90% and a most optimistic assumption of 35% (assuming our two responses are the upper and lower bounds). The results show that, if 90% of those members who enquire about accessing their GAR go on to give it up, the net costs to business will be 0.33m higher than we have estimated in year 1 and 0.66m higher in subsequent years. On the other hand if only 35% go on to give up their GAR; the net costs to business will be 0.83m lower in year 1 and 1.71m lower in subsequent years.
77. This suggests that the cost benefit analysis is reasonably sensitive to this assumption. Although there is uncertainty due to the low number of providers that responded to our request for information and the wide range in responses given by the providers that did give an estimate, we have sought to further test our assumption. The FCA⁵² publishes statistics showing the proportion of those giving up their GAR out of the proportion taking some action with their pot (either giving up their GAR or taking up their GAR). Of those accessing their pension, 63% in Q4 2015 and 61% in Q1 2016 gave up their GAR. These statistics are not directly comparable as they will not capture those who enquired about accessing their GAR but then took no action (i.e. did not give up their GAR or take up their GAR) but would require a risk warning. Similarly, they would include any individuals who chose to take up their GAR without asking about other flexible options and so would not require a risk warning. Therefore the FCA statistics cannot be used as a direct substitute for the proportion of members who enquire about giving up their GAR and then subsequently give it up - but they do provide some support for our central assumption that 62.5% would give up their GAR after initially enquiring.

The proportion of safeguarded flexible benefits which are GARs

78. The policy applies to all safeguarded-flexible benefits but we only have data showing the incidence of GAR benefits, a particular type of safeguarded-flexible benefit (where members have a guaranteed rate at which they can convert their fund into a pension income at retirement). From consultation with industry throughout the policy development process, we understand that GARs are, by far, the most common type of safeguarded-flexible benefits in scope of this policy. Furthermore, in the impact assessment accompanying the consultation in September 2016, we assumed that the number of GARs could be used as a proxy for the number of safeguarded-flexible benefits and there were no concerns raised by stakeholders about this assumption. Therefore our central estimate is that the estimated number of GARs is a reasonable proxy for safeguarded-flexible benefits as a whole. However, if other types of safeguarded-flexible benefit do exist in non-negligible numbers, we may be under-estimating the number of firms and individuals affected by this policy.
79. As part of our sensitivity analysis, we have increased the estimated number of individuals and firms affected by the policy, to account for an unknown quantity of safeguarded-flexible benefits which are not GARs. While we believe that the number of additional safeguarded-flexible benefits will be very low for the reasons explained above, we do not have any data on the number of safeguarded-flexible benefits which are not GARs to guide our assumptions. It would be very difficult to gather robust evidence about the volumes of safeguarded-flexible benefits which are not GAR benefits. We understand from stakeholder forums that they are likely to be concentrated in particular types of scheme such as small schemes or older schemes. These account for a relatively small proportion of pension scheme members and have, historically, tended to be less engaged with the Department, recording lower response rates to surveys. We would therefore need to communicate with a very large number of schemes to robustly estimate the frequency of such benefits, which would be time-consuming and costly. Moreover, schemes may not be able to access this information easily. The information that we require will be held in individual contracts and in a lot of older and smaller schemes this information may not be digitally available. Safeguarded-flexible benefits that are not GARs can potentially vary substantially in design which means trustees and scheme managers may have to seek legal advice on a case-by-case basis to establish if the benefits they provide to members qualify as safeguarded and flexible. Therefore obtaining this information may be burdensome for schemes.
80. As an upper estimate of the additional number of safeguarded-flexible benefits, we have tested the impact of assuming that only 80% of safeguarded-flexible benefits are GARs - therefore increasing our volumes by a

⁵² FCA, Data Bulletin Issue 7, <https://www.fca.org.uk/publications/data/data-bulletin-issue-7>

factor of 1.25. The results show that this would mean higher costs for providers in producing and sending risk warnings, but also higher benefits as a result of the changes to the existing advice requirement. Overall the net costs to business would increase by £0.44m in the first year but fall by £0.55m in subsequent years.

81. This suggests that, even if there are an additional 25% of individuals and providers affected by the policy – and we think this is unlikely given that the insights provided during the consultation process suggested that GARs represent the vast majority of safeguarded-flexible benefits – the net costs to business would only fall by around half a million pounds per year in steady state. For this level of sensitivity it would be disproportionate to undertake further work to estimate of the precise number of safeguarded-flexible benefits which are not GARs, given the cost that this would represent for government and industry.

The cost of the current calculation method

82. As our central estimate we have assumed that the cost that schemes currently incur to carry out the complicated calculation to assess the value of a member's GAR is £187.50. This is based on the average of estimates given by two providers in response to a request for information by DWP; one gave an estimate of £250 to £400 (average=£325) and the other gave an estimate of £50. Given the range in their responses, there is uncertainty around the cost that the current method of calculation represents to providers. If we over-estimate the current cost, it means we will over-estimate the benefits to providers arising from the simplification of the advice requirement rules.
83. In order to test the impact on the net costs to business if we over- or under-estimate the current calculation costs per case, we have conducted sensitivity analysis around this assumption, using £325 as the most optimistic assumption and £50 as the most cautious. Sensitivity analysis shows that if the current calculation method only costs schemes and providers £50 per case, the net costs to business will be £1.14m higher in year 1 and £2.26m higher in subsequent years. If, on the other hand, the true cost were as high as £325, the net costs to business would be £1.13m lower in year 1 and £2.27m lower in subsequent years⁵³. This shows that the analysis is quite sensitive to this assumption. However, we believe that £50 would be a very cautious estimate; firstly it is significantly lower than the estimate provided by the other provider, but secondly because, during the consultation process to determine whether the calculation method should be altered, schemes reported that applying the specified calculation method gave rise to 'significant practical and financial burdens'⁵⁴. Thus £187.50 remains our central estimate.

The upfront costs of implementing risk warnings in contract-based schemes

84. We have assumed a one-off cost of £175,000 for providers to implement the system changes needed to produce tailored risk warnings. This is based on the median response given by providers in response to question 5 in the consultation⁵⁵ which requested 'information on the likely costs of the provision to issue risk warnings, both the initial transition and on-going costs'. Four providers gave numerical estimates of the set up costs that they expected to incur to meet these requirements. These estimates ranged from £50,000-£65,000 to £450,000.
85. Sensitivity analysis of these assumptions shows that the estimated net costs to business in year 1 are very sensitive to this assumption; adopting £57,500 as a most optimistic assumption and £450,000 as the most

⁵³ The asymmetry between £2.26m higher and £2.27m lower is due to rounding in the final costing tables.

⁵⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555564/consultation-valuing-pensions-for-the-advice-requirement-and-introducing-new-consumer-protections.pdf

⁵⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555564/consultation-valuing-pensions-for-the-advice-requirement-and-introducing-new-consumer-protections.pdf

pessimistic leads to net costs that are £1.88m lower and £4.40m higher respectively. As this assumption relates to upfront costs, the costs in subsequent years are unaffected.

86. Given the risk around our estimated business impact as a result of this uncertainty, we sought to further test the assumption with other providers and industry stakeholders. This suggested that costs would be dependent on the complexity of the systems used by providers and so will vary – but that £450,000 is likely to be an outlier and does not reflect the costs that most providers would incur. This provided us with additional reassurance that taking the median estimate, £175,000, is appropriate.

The on-going cost per risk warning for contract-based schemes

87. We have assumed that after having made system changes in year 1, contract-based providers will only incur additional costs of £15 per risk warning produced. This is based on taking the median of the estimates provided in response to the consultation⁵⁶. Estimates ranged from £0 to £60-£100. Adopting an optimistic assumption that providers would incur no on-going costs would mean that net costs were £0.42m lower in year 1 and £0.86m lower in subsequent years. Alternatively using the most pessimistic assumption of £80 per risk warning would add £1.86m to the net cost in year 1 and £3.70m per year in subsequent years.
88. This suggests that the overall costs are sensitive to this assumption. However, the pessimistic scenario is based on an estimate from the provider who gave the lowest estimate of the upfront costs, perhaps suggesting that such high on-going costs would only occur where less comprehensive system changes were implemented. Given that we have assumed upfront costs of £175,000, it seems reasonable to assume that only limited on-going additional work would be required.
89. Furthermore, during the consultation process, providers did not raise concerns about the on-going financial burden that the new risk warnings would represent. Alongside the consultation, we published our initial estimates⁵⁷ of the policy impact in order to seek providers' views on our assumptions; we had assumed only ten minutes of an administrator's time per case would be required to produce the risk warnings on an on-going basis – the equivalent of £3.26. In their formal consultation responses, the majority of providers did not provide any alternative estimate of the on-going costs or make any comments suggesting that our estimates were too low. Similarly, during stakeholder roundtable events held as part of the consultation process, we sought views on the likely impacts of these measures and explicitly asked for feedback on our estimated costs. The events did not raise concerns that the risk warnings would lead to high on-going costs for providers.
90. Therefore, although the sensitivity analysis showed that net costs were sensitive to the estimate of the on-going costs incurred by contract-based providers in producing risk warnings, the median figure remains our best estimate.

The on-going cost per risk warning for trust-based schemes

91. In the absence of any robust evidence about the on-going costs that would be incurred by trust-based schemes, we have made an estimate according to the processes that we expect that schemes would be required to carry out in order to comply with the regulations. Based on the activities described in the 'Monetised and non-monetised costs and benefits' section of this Impact Assessment, we have estimated that trust-based schemes would spend three hours per risk warning, at a cost of £57.15.
92. We did not receive any consultation responses providing further insight into the costs for trust-based schemes and these risk warnings are a new requirement specific to members with GARs so we do not have historic evidence on the costs of producing them. Given the uncertainty, we have conducted sensitivity analysis around

⁵⁶ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555564/consultation-valuing-pensions-for-the-advice-requirement-and-introducing-new-consumer-protections.pdf

⁵⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555566/draft-impact-assessment-simplifying-advice-requirements-for-safeguarded-pension-benefits-and-introducing-new-consumer-protections.pdf

this assumption and have tested an optimistic assumption of on one hour of work being required (with a corresponding cost of £19.05) and a pessimistic assumption of 5 hours work (with a corresponding cost of £95.25). The results show that using the optimistic assumption would only make net costs £0.07m lower in year 1 and £0.16 lower in subsequent years, while the pessimistic assumption would only make net costs £0.08m higher in year 1 and £0.15 higher in subsequent years. Therefore, although we do not have robust evidence to guide our assumption, it represents a low risk as it does not make a big difference to the overall net costs.

Summary

93. Table 7 summarises the results of the sensitivity analysis.

Table 7: Change in net costs to business if optimistic/pessimistic assumption used instead of central estimate (£ millions)

| | Year 1 | | | Subsequent years | | |
|---|---------------------------------------|------------------|--------------------------------------|---------------------------------------|------------------|--------------------------------------|
| | Change if pessimistic assumption used | Central estimate | Change if optimistic assumption used | Change if pessimistic assumption used | Central estimate | Change if optimistic assumption used |
| Proportion of trust-based GARs which are money purchase | +0.02 | 1.74 | 0.01 | +0.01 | -2.17 | 0.01 |
| Proportion of those who proceed to give up GAR after enquiring | +0.33 | 1.74 | -0.83 | +0.66 | -2.17 | 1.71 |
| The proportion of safeguarded flexible benefits which are GARs | | 1.74 | +0.44 | | -2.17 | -0.55 |
| Cost of current calculation method | +1.14 | 1.74 | 1.13 | +2.26 | -2.17 | 2.27 |
| Upfront costs of implementing risk warnings in contract-based schemes | +4.40 | 1.74 | 1.88 | +0.00 | -2.17 | 0.00 |
| On-going cost per risk warning - contract-based schemes | +1.86 | 1.74 | -0.42 | +3.70 | -2.17 | 0.86 |
| On-going cost per risk warning - trust-based schemes | +0.08 | 1.74 | -0.07 | +0.15 | -2.17 | 0.16 |

94. Table 7 shows that the assumptions which have the largest impact on the estimated net costs to business are those relating to the upfront and on-going costs for contract-based schemes in producing risk warnings, particularly the latter as this would have an on-going effect over a ten year period. However, having sought inputs from providers through formal consultation, as well as making direct requests for further evidence to

consolidate our assumptions, we are confident that we have made the best possible estimate of the costs that these regulations will impose on contract-based providers.

95. The assumptions relating to trust-based schemes have the least evidence behind them but, as the results in Table 7 show, these assumptions do not have a significant impact on our overall estimate of the net costs to business and therefore do not represent a significant risk in our analysis.

Direct costs and benefits to Business

96. The proposal imposes a burden on businesses and is within the scope for one-in, three-out and the Business Impact Target (BIT). For the purposes of the BIT, net costs to business are to be presented in 2014 prices and discounted to 2015, in order for all policies to be compared using consistent pricing and discounting. Using a one year appraisal period from October 2017 and 3.5 per cent discount rate in line with the Treasury's Green Book, we estimate that as a result of the increase in these direct costs to providers there is an Equivalent Annual Net Direct Cost to Business (EANDCB) worth -£1.6 million (2014/15 prices).

Wider impacts

97. N/A

Small and Micro Business Assessment

98. We do not expect that these regulations will have a disproportionate impact on small and micro businesses. Only a minority of small and micro pension schemes are expected to have non-money purchase GARs, and for many of these the work of familiarisation and implementing changes will typically be carried out by an administrator or another other service provider. Those small and micro schemes that do carry out the familiarisation and implementation costs in-house will typically have very few members who actively seek to give up a GAR. The numbers will be even smaller on a per year basis. We therefore assume small and micro pension schemes will be able to meet these requirements manually, and we estimate that the costs of complying with these regulations will be low. Small and micro businesses affected would also benefit from the simplification of the advice requirement.
99. The policy intent for tailored risk warnings is to ensure that all individuals with GARs are well-informed about their value before they make the decision to transfer or convert their pension pot and give up their GAR. Exempting any subset of pension providers from this requirement would risk some consumers not being informed of the value of their guarantee before giving it up. Granting small and micro businesses that offer safeguarded-flexible benefits a full exemption from the proposed cap would not be compatible with the aims of the policy.
100. The consultation did not provide any evidence that this policy would have a disproportionate impact on small and micro-businesses.

Implementation of preferred options

101. The preferred option is Option 2 - to simplify advice requirements for safeguarded pensions benefits so that the £30,000 threshold for seeking advice is based on the transfer value of the benefits (as opposed to the amount required to provide for the member's accrued benefits), and introduce a requirement for firms to provide tailored risk warnings.

