



Importance ★★☆☆

Pension flexibility: DB to DC conversions and transfers

If a member with DB benefits wants to convert them into flexible form by transferring out, the trustees must check she has had *appropriate independent advice (AIA)* before they can make the transfer.

This is so whether it would be a statutory transfer or one made under the scheme rules.

It is also the case if the scheme offers an internal option to convert accrued DB benefits to flexible benefits.

But there is no *AIA* requirement in any of these circumstances where the value of the member's DB rights is £30,000 or less (on a CETV basis).

It is important for trustees to read the [Regulator's Guidance on DB to DC transfers and conversions](#).

If trustees fail to check for *AIA*, they are open to civil fines from the Regulator. But the transaction remains valid if it goes ahead.

We have a separate briefing on transfers generally *Pension flexibility: transfers*.

Flexible benefits

Among the new statutory concepts from April are *flexible benefits* and *safeguarded benefits*.

Flexible benefits are, broadly, money purchase (DC) benefits and cash balance (CB) benefits. These are the benefits that can be drawn under the flexi-access rules.

Safeguarded benefits means benefits other than DC or CB benefits. In the main, these are likely to be DB but can include benefits that look close to being CB but fall outside the technical definition. This briefing uses "DB" for all *safeguarded benefits*.

Safeguarded benefits cannot be drawn under the flexi-access rules, unless first converted into DC or CB benefits. In members' interests, this doorway to early access is being regulated.

Appropriate independent advice

Trustees must check a member has received *AIA* before:

- making a transfer payment (whether under a statutory right or under the scheme rules) to another scheme that would turn DB benefits into flexible benefits,
- converting DB benefits into flexible benefits within the scheme. This would require a power in the scheme rules and there might be hurdles (statutory and under the rules) in the way of creating such a power, although member consent could help clear the path in some respects or
- in what would be an unusual transaction, paying an uncrystallised funds pension lump sum.

AIA is advice to the member from an independent financial adviser who is authorised by the FCA to advise on turning DB benefits into flexible form. Trustees check by seeing a written statement from the adviser to the member that covers specific points, including:

- the name of the member and the scheme,
- the adviser's FCA reference number and that they have the correct authorisation and
- confirmation the adviser has given advice that is specific to the transaction the member is planning.

Having received this statement from the member, the trustees must verify the adviser's details against the Financial Services Register kept by the FCA.

Similar *AIA* requirements apply to survivors who want to switch from DB to flexible benefits.

If trustees find the member has not received *AIA*, they are not required to comply with any statutory transfer request. The same applies if are unable to carry out the *AIA* check through no fault of their own.

Most scheme transfer rules allow trustees to make a transfer but do not oblige them to. If the rule is mandatory, the trustees are potentially caught between that obligation and the prohibition on making the transfer without *AIA* confirmation. To resolve this, a statutory power of amendment is available (exercisable by trustees' resolution) to make the transfer rule permissive where *AIA* is required and the trustees either find it

has not been given or, through no fault of their own, are unable to establish whether it has been given.

Action: trustees to decide (generally after consulting the employer) what options, if any, they will allow *under their scheme rules* e.g. conversion from DB to flexible form. They should then consider what rule changes are necessary or desirable e.g. to transfer rules. Communication materials will also need attention, as may the wording of discharges for the trustees.

Information for members

With limited exceptions, trustees must give a member with accrued DB benefits certain written information within one month of her or him:

- making a written request for information about how to convert their benefits into flexible benefits,
- making a written request for information about how to apply for a *statement of entitlement* to a CETV,
- applying for a *statement of entitlement* or
- making a written request for a valuation of their DB benefits.

Where the value of the member's benefits is £30,000 or less, the trustees must tell the member that confirmation of AIA is not required.

The information the trustees must give the member in writing is:

- unless the member tells them otherwise, they will assume the purpose of any transfer of DB benefits is to turn them into flexible benefits,
- they are required to check the member has had AIA before they can carry out the transaction,
- the member must provide them with written confirmation of AIA in the form of a statement from their independent financial adviser saying:
 - advice has been given that is specific to the transaction the member plans,
 - the adviser is authorised to advise on switching DB benefits into flexible benefits,
 - the adviser's reference number for FCA purposes and
 - the name of the member and of the scheme holding the DB benefits,
- this confirmation must be provided within three months of:
 - the member receiving a *statement of entitlement* or, if no such statement is being provided,
 - the day the trustees agree in principle to carry out the transaction or, if later, the day the trustees provide the member with a valuation of their DB benefits.

Trustees must provide other specified information in certain circumstances e.g. where a CETV is to be increased or reduced.

In general, these information requirements are the same whether the member is looking to use a statutory transfer right, or a transfer or conversion option under the scheme rules.

Lines of communication

Recognising the confidential relationship between adviser and client, the legislation anticipates that only the member will communicate with the adviser. The member will pass on benefit information from the trustees and the adviser will send advice to the member, along with the statement described above for the member to pass to the trustees.

Trustees should insist these lines are observed. As a minimum they should try to ensure the adviser does not communicate with them directly. For example, if the adviser wants more information, it should make the request via the member and the trustees should reply by the same route.

Overall, the less the trustees know about the substance of the advice, the better from their point of view.

Paying for advice

The general rule is that the member must pay for AIA. But the employer must pay where it instigates a transfer or conversion. Where it is paying, it can also elect to arrange the advice on the member's behalf.

What counts as instigation by the employer is defined widely, to deter avoidance.

There is instigation where:

- by or on behalf of the employer
- a written communication is sent to two or more members setting out options in terms that "encourage, persuade or induce" them – that is wide language, covering presentation as well as content – to request a transfer or conversion.

"Employer" is also widely defined. It includes any entity that is or was an employer in relation to the scheme, any entity that has taken over a company or business in which scheme members are or were employed, and parent and subsidiary bodies of these entities.

Routine communications from the trustees are unlikely to count as "on behalf of" the employer e.g. where information is required by the disclosure regulations. But trustees and employer should consider the implications of any communication that is out of the ordinary, including in particular any the employer has influenced. The thinking behind the voluntary *Code of Practice on Incentive Exercises for Pensions* may be helpful here.

Guidance

On the role of trustees, the Regulator's *Guidance* says:

- it is likely to be in the interests of most members to retain their DB benefits but that there can be exceptions depending on individual circumstances,
- it is not the trustees' role to second-guess the member's personal circumstances or their choice to transfer or convert their DB benefits,
- trustees should not ask to see the advice to the member,
- as underlined in the Regulator's recent **Annual defined benefit funding statement 2015**, they should monitor the impact of outflows on funding and on investment strategy,
- a timeline for the main steps in a statutory transfer and a table setting out the information trustees must provide,
- a recommended procedure for verifying a financial adviser's status on the Financial Services Register and the records trustees should keep around *AIA*,
- urges trustees to be alert to possible fraudulent activity around *AIA* as well as the general risk of scams on transfers and
- reminds of the scope in the legislation to apply to the Regulator for extra time to carry out a transfer.

The *Guidance* applies to all full and partial transfers and conversions from DB to flexible benefits under statutory rights or scheme rules.

More information

If you would like more information, please get in touch with your usual contact in our pensions team or:



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