Pension benefits with a guarantee and the advice requirement

Department for Work & Pensions

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This factsheet is intended to help pension scheme providers determine:

- whether certain types of pension benefits which contain a promise, including those with a guaranteed annuity rate (GAR), are safeguarded benefits for the purposes of the new advice requirement
- when the exception to the requirement to take independent advice for those with safeguarded benefits worth £30,000 or less applies.

The factsheet summarises the principles for determining whether or not certain benefits with guarantees fall within the definition of safeguarded benefits. However, it is not intended as a substitute for legal advice. The Department for Work and Pensions cannot provide a definitive interpretation of legislation, as that is a matter for the courts. Providers should consult their legal advisers to clarify whether benefits under specific pension arrangements or policies are safeguarded, and how to value particular safeguarded benefits, if they are unsure.

Safeguarded benefits

Safeguarded benefits are defined in legislation as pension benefits which are not money purchase or cash balance benefits. In practice, safeguarded benefits are any benefits which include some form of guarantee or promise during the accumulation phase about the rate of secure pension income that the member (or their survivors) will receive, or will have an option to receive. These include:

1. under an occupational pension scheme, a promised level of income calculated by reference to the member’s pensionable service in the employment of the pension scheme’s sponsoring employer (for instance, under a final salary scheme)
2. a promised level of income (or guaranteed minimum level of income) calculated by reference to the contributions or premiums paid by or in respect of the member (for instance, under some older personal pension policies)
3. a promised minimum rate at which the member will have the option to convert their accumulated pot or fund into an income at a future point, usually on the member reaching a particular age (generally known as a guaranteed annuity rate, or guaranteed annuity option).

The advice requirement for safeguarded benefits

Safeguarded benefits offer additional security and often valuable guarantees that are lost if the member transfers or converts their benefits to acquire flexible benefits, or accesses their benefits using the new flexibilities. To ensure that individuals who are considering any of these options are fully aware of what they would be giving up, the Government introduced a new safeguard on 6 April 2015 requiring them to take appropriate independent financial advice before doing so.

Circumstances in which advice is required

Section 48 of the Pension Schemes Act 2015 and regulations made under it require pension scheme members who have subsisting rights in respect of safeguarded benefits worth more than £30,000 under the scheme to take appropriate independent advice from an FCA authorised adviser before:

- converting safeguarded benefits into flexible benefits (or in the case of benefits which are both safeguarded and flexible, into different flexible benefits)
- using a transfer payment in respect of safeguarded benefits to acquire flexible benefits under another scheme
- being paid an “uncrystallised funds pension lump sum” (UFPLS) in respect of their safeguarded benefits.

The following do not constitute transfers or conversions to which the advice requirement applies:

- payment of a pension commencement lump sum in respect of safeguarded benefits (that is, taking one-off tax free cash at the same time as starting to receive a pension)
- purchase of an annuity from another provider, rather than taking up a GAR offered by the member’s existing provider.

Pension benefits with a guarantee which are safeguarded

To qualify as safeguarded benefits under the legislation, the pension benefits must include some form of guarantee about the rate of secure pension income to be provided. A promise or guarantee about the rate of investment growth or future value of the pot is not sufficient for the pension benefits to qualify as safeguarded benefits under the legislation.

Guaranteed annuity rates

Pension policies with GARs are the most common type of safeguarded benefit which is not a salary-related benefit under an occupational scheme. Guarantees of this nature typically exist as an option, with the member free to choose to purchase an annuity from another provider, to take benefits as a lump sum, or to transfer to a drawdown product from another provider, and there may be multiple different guaranteed annuity rates available to the member at different ages. However, the benefits are safeguarded because the member has a right to convert their pot into an income in accordance with conversion factor(s) which are known during the accumulation phase.

The benefits are safeguarded even if the guaranteed annuity rate promised is below the rates currently being offered on the open market. This is because the open market rates may fall below the guaranteed annuity rate before the guarantee expires.

A pension plan with a GAR that expires at a specific point in the future (for example when the member turns 60) is a safeguarded benefit until the GAR expires. A pension plan with multiple GARs expiring at different specific points in the future is a safeguarded benefit until all the GARs have expired, at which point it ceases to be safeguarded, provided that there are no other safeguards attaching to the benefits.'

Guaranteed Minimum Pensions and section 9(2B) rights

Where a person has accrued a Guaranteed Minimum Pension (GMP) in respect of contracted-out employment between 6 April 1978 and 5 April 1997, this is a right to a level of pension income calculated by reference to their earnings in that employment, which is revalued either by a fixed revaluation rate or in accordance with national average earnings before coming into payment, and then inflation linked during payment. Pension benefits which represent, or include, a GMP are therefore safeguarded benefits. Similarly, pension benefits accrued after 1997 under a scheme contracted out under the "Reference Scheme Test" (also known as section 9(2B) rights) must guarantee a minimum level of annual income, calculated by reference to salary. Such benefits are therefore safeguarded.

However, there may be cases where liability for such contracted-out rights has been transferred from an occupational pension scheme under a buy-out policy and the member's fund under the policy is greater than the amount needed to provide the required minimum level of pension. In that case, if there are excess funds remaining after a pension at that level has been secured, the member's remaining benefits under the policy may be money purchase or cash balance benefits (and therefore not safeguarded), if there is no other income guarantee attached to them.

See also section on buy-out policies on p. 5 below.

Pension review top-up plans

Benefits under these plans, which were put in place to compensate pension scheme members who suffered as a result of the misselling of personal pension plans in the 1980s and early 1990s, offer a guaranteed level of income and are therefore safeguarded.

Pension benefits which are not safeguarded

Guaranteed lump sums

Pension benefits which offer a guaranteed lump sum but no guarantee about the rate of income that may be provided are not safeguarded. For example, death benefits which promise a lump sum on the member's death are not safeguarded benefits.

Guaranteed investment returns during the accumulation phase

The existence of a promise about the rate of investment income or growth that will applied to the member's pot or fund during the accumulation phase (for instance, under a with profits policy) does not mean that the pension benefits are safeguarded, unless they also include a promise about a rate of pension income (such as a GAR).

Scheme specific protected tax-free lump sums

Members who had a right to more than 25% tax-free cash on 6 April 2006 may still have their tax-free cash entitlement protected. However, as this relates to a lump sum rather than a secure retirement income, it does not constitute a safeguarded benefit, provided that there are no other safeguarded benefits attached to the policy.

Guarantees held under a separate insurance policy (third party promises)

The government is aware of certain exceptional circumstances in which benefits including a guarantee such as a GAR may not be safeguarded benefits, because in some cases the presence of a third party promise results in the benefits being money purchase benefits, despite the existence of the guarantee.

In order for the benefits to be money purchase benefits, and therefore not safeguarded, they must satisfy the definition set out in legislation (see sections 181 and 181B of the Pension Schemes Act 1993). One of the conditions which must be satisfied is that the rate or amount of the benefits is calculated solely by reference to "assets which (because of the nature of the calculation) must necessarily suffice" for the purposes of their provision. For example, this may be the case where the trustees of an occupational pension scheme hold, as an asset of the scheme, an insurance policy which includes the GAR, and the scheme rules provide that the member is entitled to the benefits that the policy will provide (but the scheme rules do not themselves promise the GAR).

If a scheme or provider is unsure whether particular benefits fall into this category, they will need to consider the specific details of the scheme or policy under which the benefits are provided, and take legal advice if necessary, to determine whether the benefits satisfy the definition of money purchase benefits, and so are not safeguarded.

Pension benefits which may or may not be safeguarded, depending on the terms of the policy in question

Benefits under the following types of policies may be safeguarded or not, depending on whether they offer an income guarantee (safeguarded) or purely a guaranteed investment return or lump sum, or no guarantee (not safeguarded).

Retirement annuity contracts

Benefits under retirement annuity contracts will be safeguarded if the terms of the contract include a guarantee, such as a Minimum Income Guarantee, or option of a rate of pension income or a conversion rate of a fund or pot into an income.

Buy-out policies (including Section 32 policies)

Where a member's accrued benefits under an occupational pension scheme have been "bought out" (i.e. the scheme's liability has been discharged by the purchase of a deferred annuity or insurance policy), the benefits under the contract or policy will be safeguarded if an amount of pension income is secured, or if a liability in respect of contracted out rights (such as a Guaranteed Minimum Pension) has transferred under the contract or policy to the provider, or if the terms of the contract or policy otherwise include a guarantee about an amount of pension income or a rate of conversion into an income.

See also section on Guaranteed Minimum Pensions and section 9(2B) rights on p. 3 above.

Hybrid policies

Pension schemes and policies may include more than one type of benefit, some of which may be safeguarded while others are not.

A "hybrid" policy is one where a person has a single policy under which a guarantee (such as a GAR) is available in respect of only a portion of the benefits under the policy. The government's view is that in such a case the portion of the benefits to which the option of the GAR applies will be safeguarded but the remainder will not. So if, for instance, a person wished to take an UFPLS under the policy, the advice safeguard would apply to the extent that the payment of that lump sum would reduce the funds in relation to which the person could exercise the GAR at some future point. If there are multiple safeguarded parts to the policy, these benefits should be added together for the purposes of the advice safeguard.

Additional Voluntary Contributions (AVCs)

Where a member has both a traditional defined benefit occupational pension and flexible benefits in respect of AVCs under the same scheme, they have a right to transfer the AVCs separately from the main pension, as the statutory right to transfer applies at benefit category level rather than at scheme level.

However, if the flexible benefits in respect of the AVCs are safeguarded (for example because they include a GAR) then, because the £30,000 exception threshold is applied to the total value of the member's safeguarded benefits under the scheme, advice may be required even if the value of the AVC benefits alone is less than £30,000.

Income guarantees on drawdown plans

If the plan includes a guarantee that the value of the member's fund will always be sufficient to provide a specified secure rate of drawdown income for the member's lifetime, then the benefits will be safeguarded. However, if the guarantee is only about the rate of investment return or growth that will be generated on the drawdown fund, and not that a particular level of drawdown income will be secured, then the benefits will not be safeguarded.

The valuation process for safeguarded benefits

Currently the law sets out a single process for valuing safeguarded benefits, which applies both to traditional salary related pensions and to all other safeguarded benefits (including those with a guaranteed annuity rate), for determining whether or not their value exceeds the £30,000 threshold above which advice is required. For this purpose all safeguarded benefits (including those with a guaranteed annuity rate) are regarded as "salary related benefits" (defined in the Regulations as any benefits which are not money purchase benefits). As safeguarded benefits are not cash balance benefits, the relevant method is that set out in regulations 7A, 7B and 7E of the Occupational Pension Schemes (Transfer Values) Regulations 1996.

This factsheet is available at www.gov.uk/government/publications/pension-benefits-with-a-guarantee-and-the-advice-requirement

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