Hogan Lovells

The new pension advice allowance: implications for trustees

March 2017 Pension briefing

HIGHLIGHTS

As announced in the 2016 Autumn Statement, pension schemes may (but will not be required to) allow members to withdraw up to £500 from their defined contribution (DC) pension pots to pay for financial advice about retirement. The payment will be known as a "pension advice allowance".

The government has recently issued final regulations, which come into force on 6 April 2017.

Details of the allowance, and the conditions which will apply to it, are set out below.

BACKGROUND

The introduction in 2015 of pension flexibilities and the greater choices available to individuals have focussed attention on the importance of taking financial advice. Unfortunately, experience has shown that many people are reluctant to pay the fees which come with such advice.

In response, the government is introducing two measures to ease the pain of paying for advice:

- increasing the tax allowance for employer-funded advice (please see the box on the next page); and
- allowing members to take up to £500 (known as a "pension advice allowance") from their money purchase pots to pay for financial advice.

DETAILS OF THE PENSION ADVICE ALLOWANCE

What funds may be used to pay a pension advice allowance?

The allowance may only be drawn from defined contribution (DC) pensions and from hybrid pensions with a money purchase or cash balance element.

How much may be withdrawn?

An individual may take up to £500 from his or her DC pension pot to pay for retirement advice.

The government intends to review the level of the allowance as part of the three year review of the Financial Advice Market Review (FAMR) (whose final report was published in March 2016).

When can a pension advice allowance be taken?

An individual may take a pension advice allowance up to three times in his or her lifetime (using up to £500 each time), with no more than one use in any tax year. There will be no age restriction on using the allowance, and the government comments that an individual may want to take advice on more than one occasion and at different stages of life (for example, during the accumulation phase, when starting to draw benefits, and during a period of drawdown).

What may the allowance be used for?

The allowance must be paid direct from the pension arrangement to a financial adviser regulated by the Financial Conduct Authority, for the provision of "retirement financial advice".

"Retirement financial advice" is intended to include consideration of other factors, including the individual's other assets, which may be relevant to his or her retirement planning. It is not intended to cover advice on non-retirement matters, such as inheritance tax planning. The allowance may also be used for implementation and administration costs associated with the advice given.

In addition, the allowance must be spent on advice which is "fully regulated". The consultation response points out that, in general, advice on money purchase funds held within an occupational pension scheme is not fully regulated. However, advice on buying an annuity or income drawdown product from a personal pension provider is likely to be regulated.

Following consultation, the final regulations require the individual requesting the allowance to confirm in writing that the advice it pays for will be fully regulated advice. However, on a strict interpretation of the regulations, an allowance will be an unauthorised payment if it is not used to provide regulated advice, regardless of what the member has declared. Given this uncertainty, we recommend that before paying an allowance trustees should seek written confirmation from the adviser that it will be used for the provision (or implementation) of fully regulated advice.

Employer-arranged pension advice

Employers will be able to procure "relevant pensions advice" for their employees (or former employees) worth up to £500 per year. The payment will be free of income tax, regardless of the level of the individual's income, provided certain conditions are met.

Individuals with more than one employer or former employer may receive up to £500 of relevant pensions advice paid for by each employer/former employer.

Salary sacrifice arrangements will be allowed in relation to employer-arranged advice. The tax exemption will also apply if the employer reimburses an employee for pension advice arranged by the employee.

"Relevant pensions advice" must be advice or information in relation to:

- the individual's pension arrangements; or
- use of the individual's pension funds

For the tax exemption to apply, the provision of advice must be open to either:

- all the employer's employees generally (or generally to employees at a particular location); or
- to all an employer's employees who meet the ill health condition or who are within five years of normal minimum pension age (or their protected pension age, if lower).

The £500 tax exemption will replace the existing £150 exemption for employer-arranged advice.

The pension advice allowance may be used alongside employer arranged advice.

How will the pension advice allowance be treated for tax?

Provided the conditions set out in the regulations are met, a pension advice allowance will be an authorised payment for tax purposes.

In addition, the withdrawal from the individual's pension fund will not be subject to income tax, regardless of the level of the individual's income in the tax year.

Using the allowance will also not be a benefit crystallisation event for lifetime allowance purposes, nor will it affect an individual's ability to take 25% of their remaining pension funds as a pension commencement lump sum.

What compliance requirements will apply?

Providers and trustees will not have to report the number of times individuals use the pension advice allowance. Instead, before an allowance can be paid, individuals will have to declare to the trustees that they have not used the allowance more than three times in total. The response comments that providers and trustees should consider making individuals aware that there could be a 55% tax charge if they are found to have misused the allowance.

Will trustees have to offer the pension advice allowance?

Trustees and providers will not have to offer payment of the pension advice allowance from their arrangement. Where trustees decide to allow members to take the allowance, they should check whether the scheme rules will need to be amended. The government has rejected calls for a statutory override to enable scheme rules to be amended to provide for payment of the advice allowance, but says it will consider any new evidence at the three year review.

The response to consultation comments there is no barrier to offering members a tie-in arrangement with a third party adviser. It adds that the Pensions Regulator is expected to release a factsheet in early 2017 which will clarify that, generally, trustees will not be liable for advice given by a third party.

Next steps for trustees

As payment of a pension advice allowance is allowed from 6 April this year, trustees should decide soon whether to offer the allowance to members and, if so, under what conditions. Even where employer's consent is not needed, it would be appropriate to seek the employer's views as, in many cases, the employer will be ultimately liable for any additional costs or liability arising out of paying the allowance. If, having done this, you decide to offer the allowance then you should:

- amend your scheme rules if necessary;
- update your administration processes to include the self-declaration by members;
- consider requiring financial advisers to confirm that the allowance will be used for the provision of fully regulated advice; and
- prepare appropriate communications to members and beneficiaries to explain that the allowance is being offered and how it may be accessed.

HMRC is expected to publish guidance on the pension advice allowance shortly after it comes into force.

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