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Further Detail on the Pensions Advice Allowance

The government has introduced a pensions advice allowance, from 6 April 2017, for members of defined contribution pension schemes and hybrid pension arrangements with money purchase or cash balance pension savings.

This new allowance, along with the employer-arranged pensions advice tax exemption, is intended to give members support in accessing financial advice when making decisions about their pension savings, and follows a recommendation from the Financial Advice Market Review (FAMR).

Background

The FAMR found that an 'advice gap' existed in terms of retirement advice for people without significant wealth, and set out a strong case for introducing the pensions advice allowance. High quality financial advice can have a significant impact on retirement incomes, and people often increase their savings rate as a result of taking advice. For example, research has found that those who sought retirement advice increased their retirement savings by an average of £98 a month. However, less than a third of people have accessed financial advice on their pension. The FAMR found that many people perceive financial advice to be unaffordable or 'not for people like them'.

The allowance is intended to increase the accessibility and affordability of financial advice about retirement in a number of ways:

1. It will be more affordable due to tax relief.
2. There will be less need to pay large fees out of current income.
3. It will act as a nudge for people to consider taking financial advice.

The Main Points to Note

As set out in the consultation run by HM Treasury last year, the government has now implemented the pensions advice allowance by introducing a new authorised payment, for funds withdrawn from a registered pension scheme that are used to pay for pensions advice or retirement advice.

(This is necessary because without specifically prescribing this as an authorised payment, members would incur unauthorised payment tax charges, with a scheme sanction charge being levied on trustees/providers.)

Following the consultation, the government has modified the pensions advice allowance in two key areas. Firstly, while the allowance had previously been intended to be a once-only event close to retirement, members can now use it on three separate occasions (although not more than once in any tax year). Secondly, the government will not be imposing any minimum or maximum age restriction on when the allowance can be used.

Further details about the allowance are summarised below:

- It is now limited to a maximum of £500 per use.
- On withdrawal from the pension scheme, it will be tax-free, regardless of the individual's income.
- It can be withdrawn from defined contribution pensions and hybrid pensions with a money purchase or cash balance element. It is not available in respect of defined benefit accrual.
- Payment of the allowance must be made direct from the pension scheme to the financial adviser and will only be available for regulated financial advice.
- It can be used alongside the tax exemption for employer-arranged pensions advice.
- The Financial Advice Working Group, established by the FAMR will publicise it, and the allowance will also be signposted by Pension Wise.

HMRC is intending to publish full guidance on the allowance shortly.

A New Authorised Payment

HMRC has published amending regulations that provide for a new authorised payment, known as the pension advice allowance payment.

This is defined as a payment made by a registered pension scheme not exceeding £500, in respect of a member of that scheme, which is:

- made either for retirement financial advice provided to the member, or the implementation of such advice;
- requested in writing by the member; and
- made by the registered pension scheme directly to the financial adviser.

The member's request must include declarations that:

- no more than two pension advice allowance payments have previously been paid in respect of them;
- no payment has been paid in respect of them in the same tax year as the request is made; and
- the advice is regulated financial advice, provided by an adviser regulated and authorised by the Financial Conduct Authority.

The amending regulations came into force on 6 April 2017, so pensions advice allowance payments can be made from that date.

What is meant by 'advice'?

This is intended to include a consideration of other factors, including other assets, which are relevant to an individual's retirement planning. The scope of the pensions advice allowance reflects the fact that it is not possible to make decisions about pensions in isolation from other aspects of an individual's finances.

Retirement advice does not only refer to advice given immediately before pension benefits are crystallised. It can be given at any stage before or during retirement.

The sorts of scenarios that are in scope of the allowance are advice on:

- how to draw an income for retirement from all of an individual's pension savings, and from a stocks and shares ISA;
- whether income from a pension will be sufficient for an individual's retirement, or whether they may want to supplement this income by releasing equity from their house;
- whether the asset allocation of a drawdown product is appropriate given the individual's exposure to certain asset classes within other financial products they own; and
- how to use assets to fund care in old age.

The allowance will not include advice that is not strictly related to retirement. Scenarios might include:

- advice on inheritance tax planning; and
- advice solely on an investment fund that will not be used for retirement income.

The allowance can be used for implementation and administration costs associated with the advice given. For example, if an adviser recommends that their client switch to a new pension fund, and implements the switch on their behalf, the adviser may charge for carrying out that work using the allowance.

The Scope of the Allowance

The pensions advice allowance is available in respect any pension savings that are not defined benefit. For this reason, the government response to last year's consultation confirmed the expansion of the allowance's scope to include both defined contribution schemes and hybrid arrangements with a money purchase or cash balance element. This is meant to reflect the desire of defined benefit pension schemes wishing to offer the allowance to members with additional voluntary contribution funds (although how many schemes actually do so is unclear).

The allowance is only available in relation to the provision of advice. There were arguments for also making it available for guidance services. However, while guidance providers are permitted to charge for their services, most offer these services for free. The government is clear that it does not want to encourage firms currently offering guidance for free to begin to charge for these services. In light of this it is not thought appropriate to allow the allowance to apply to guidance services.

Tax Treatment

The £500 will not be taxed on withdrawal from pension savings, regardless of the individual's income for that tax year.

In addition, using the pensions advice allowance will not affect a member's ability to take up to 25% of the remaining funds as a pension commencement lump sum when they ultimately come to take their retirement benefits. Payment of the allowance will not count as a benefit crystallisation event for lifetime allowance purposes. There is also no restriction on taking the allowance based on the crystallisation status of the fund.

The government is unable to exempt the allowance from VAT however, as this is an EU requirement, rather than being subject to purely domestic legislation. This means that while the £500 is not taxed on withdrawal from the pension, the adviser must still charge VAT on their services where applicable.

Specific Issues for Providers and Trustees

Trustees and providers do not have to offer members the option to use the pensions advice allowance. It remains to be seen exactly how popular the allowance will be.

Providers

The withdrawal of the allowance from a member's pension savings must be executed in line with the existing rules for adviser charging set out in FCA rules. This does not stop providers from applying their own 'reasonability' checks if they wish to do so, such as capping the percentage of an individual's pension fund that can be withdrawn to pay for advice, and the government will not change this. Providers may act to prevent withdrawals that would not represent good value for money if they wish to do so. However, there is no obligation on providers to determine what is an acceptable level of adviser charges.

Trustees

Should trustees decide to offer the allowance, their scheme rules will need to be reviewed first to check whether any amendments are required. Concern has been expressed that scheme rules may require amendments to include explicit permission for trustees to make deductions from members' funds to cover charges for advice, which would obviously incur a cost. This had led to the government being asked to consider a statutory override that would allow any occupational pension scheme to offer the allowance, regardless of their scheme rules. However, it is not felt that there is sufficient evidence to justify a statutory override, although this will be kept under review.

Interaction with the Employer-Arranged Pensions Advice Exemption

The pensions advice allowance isn't the only means by which the government is seeking to make it easier to access financial advice. The employer-arranged pensions advice exemption, announced in last year's Budget and also recommended by the FAMR, is a new income tax exemption to cover the first £500 worth of pensions advice provided to an employee in a tax year. This covers advice not only on pensions, but also on the general financial and tax issues relating to pensions. The changes replace existing provisions which limited the exemption solely to pensions advice and was capped at £150 per employee per tax year. Like the pensions advice allowance, it came into force on 6 April 2017.

This tax exemption will be available for salary sacrifice arrangements between an employer and employee. Additionally, where an employer reimburses an employee for pensions advice they have arranged, this will be covered by the exemption. HMRC is also expected to publish further guidance on this exemption.

The government has confirmed that it will be possible to combine this tax exemption with the pensions advice allowance to enable individuals to access more tax-advantaged financial advice. The use of one exemption will not prevent an individual from accessing the other.

In Closing

The pensions flexibilities have given members with defined contribution pension savings far more options at retirement in terms of how they use their pension savings. However, while Pension Wise can give members guidance on their options, there has never been a greater need for members to consider seeking advice.

While the changes to the pension advice allowance now mean that members and beneficiaries can use the allowance up to three times, when seeking advice, concerns must surely remain about how much the allowance will be used. The Treasury's own analysis suggests that on average, face to face advice costs around £150 per hour, with pensions advice alone taking far longer than the 2-3 hours that would be covered at this rate by the allowance.

It is clear that only a small percentage of people crystallising their defined contribution retirement benefits are currently taking advice. Will the pensions advice allowance encourage more people to consult an FCA registered adviser, or will it be seen by members and beneficiaries as insufficient to prompt people to take a step that can significantly improve their income in retirement?

The government is also assuming that trustees and providers will decide to offer members the option to use the pensions advice allowance. Although the allowance may well be made available in most contract-based arrangements, many trustees may well conclude that the additional administration cost, and extra work involved in introducing and administering the allowance, outweighs the benefits.

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