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# A quick guide to financial services regulatory risks for occupational pension schemes

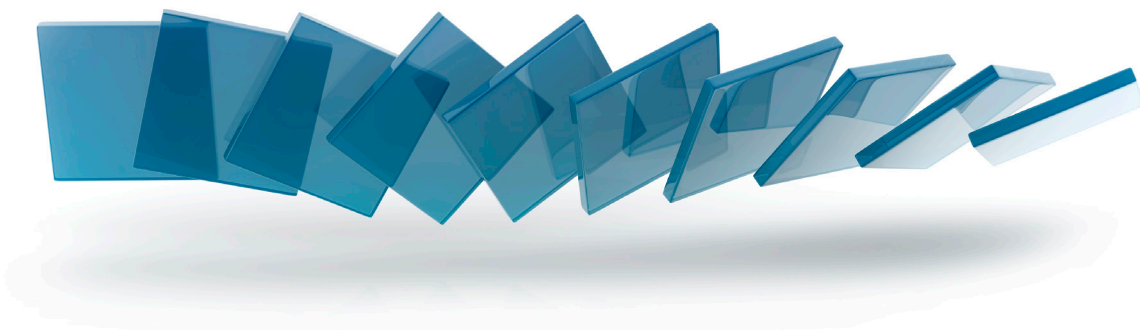
DC pension savers now have much greater flexibility as to when and how to access their pension savings. However, the new freedoms can create risks for employers and trustees, through an increased potential overlap between their actions and certain types of regulated financial services activities. In many cases, the risk of breaching the rules can be mitigated through relatively straightforward controls and checks, but employers and trustees need to be aware of the regulatory boundaries and consider carefully whether to take or avoid specific steps.

This guide highlights some of the key issues, to help employers and trustees to identify potential risks, but you should always seek specific advice on any areas of concern.

## Key concepts of financial services regulation for pension schemes

Under the Financial Services and Markets Act 2000 (FSMA), it is a criminal offence for an individual to undertake particular 'regulated activities' relating to investments (including insurance contracts) in the UK without being authorised (or exempt). Generally, authorisation is required only where the activity is carried on 'in the course of business'. The 'business test' is complex and applies in different ways to particular regulated activities. For example:

– A trustee making day-to-day investment decisions on behalf of the scheme (other than decisions to invest in pooled funds and unit-linked insurance products on the advice of an authorised person, which are not caught by the 'day-to-day' restriction) is regarded as managing the scheme's assets by way of business. Whether the trustee earns any remuneration or derives any benefit from this activity is not relevant. This is why standard practice is to delegate day-to-day investment management to an authorised person (for example, a professional investment manager), with the trustee role limited to strategic or policy decisions about the level of investment in different market sectors, rather than specific decisions to buy or sell particular investments. However, some trustees adopt a more 'interventionist' approach, in which case care must be taken to avoid straying into day-to-day decision-making unless authorised to do so.



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- In respect of other activities (such as investment advice), a trustee is caught only if it 'carries on the business of engaging in such activity'. In the FCA's opinion, professional corporate trustees and other persons who provide professional services to pension schemes are likely to do so by way of business (that is, they are likely to be caught by FSMA), while unpaid individual trustees and in-house trustee companies set up by the employer to operate an occupational scheme are not likely to be caught. However, this is not always clear-cut, so trustees (as well as employers) should exercise extreme caution to avoid committing a criminal offence by breaching the rules. Employers and trustees should, in any case, avoid giving advice to members (even where FSMA rules do not apply) as they are unlikely to have full information about a member's personal circumstances.
- Any communication which 'invites or induces' someone to engage in investment activity may only be made if it is approved by an authorised person. However, providing factual information about a member's rights under an occupational pension scheme is not a financial promotion (because this is not an investment for FSMA purposes); and a special exemption covers employers communicating with workers about membership of a group personal pension plan to which the employer contributes (subject to certain conditions).

## Implementing drawdown: additional risks to consider

Since April 2015, it has been possible for individuals to access their DC pension savings from age 55 via 'flexi-access drawdown' – that is, by crystallising some or all of their DC savings and designating them as drawdown funds. These funds remain invested indefinitely, but in principle (subject to any rules for the particular arrangement) members can 'draw down' funds (take them as occasional lump sums or as an income stream) at any time.

Both in-scheme drawdown and linking with an external provider present potential additional risks for trustees and employers. Some of these relate to basic trust law concepts such as acting in members' interests; others come from aspects of financial services regulation, which may be unfamiliar to trustees.

Some schemes which offer drawdown as an in-scheme option impose restrictions, for example on how frequently a member may use the facility, and on the amount which can or must be drawn down on any request. Drawdown may be used to support flexible retirement, which has workforce management implications, and in a DC scheme the employer may ultimately bear any additional costs – so in some cases, employer consent is a condition for use of the facility.

Another possible route is to establish a link with an external provider as a 'bridge' to a drawdown facility, if trustees prefer not to offer in-scheme drawdown – in many cases, a scheme's existing DC platform provider will offer this facility. Trustees may view this as a way of providing the flexibility that members seek without the additional responsibilities and costs of an in-scheme facility.

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## Frequently asked questions

### *Does FSMA allow trustees to link up with an external drawdown provider?*

FSMA rules differ depending on whether the drawdown product is insurance-based or not, but in broad terms it's important to ensure that there is no commercial benefit to the scheme or sponsor from linking up with the product provider. For example, the scheme should not receive a reciprocal discount on other services in return for signposting the drawdown product. The rules are particularly tight if the product is insurance-based – in that case, if there is any financial benefit at all, then the commercial impact of the activity would need to be considered.

In addition to the FSMA aspect, and without endorsing a product or providing advice, trustees would need to consider reviewing the market for drawdown products before establishing a link with a provider and (from a trustee governance perspective) should consider ongoing monitoring responsibilities. For other factors to consider, please see the table below.

### *What can we say to members about our link with an external drawdown provider?*

Member communications about a particular drawdown product could potentially breach the rules on making financial promotions (that is, they could be an invitation or inducement to engage in investment activity). Financial promotions by an employer to its employees or by a trustee to the scheme's beneficiaries may well breach this provision. Purely factual information will not normally be a promotion, but there is a risk that the existence of a link between the scheme and the product provider could be seen as an invitation.

All communications should be made directly or approved by the product provider (or another authorised person). Ensure that any additional statement by the trustee/employer (for example, in the covering letter alongside an approved promotion) does not contain an invitation or inducement element (that is, it does not constitute a separate financial promotion). To reduce the risk of a recommendation being inferred, remind members that other providers are available.

### *What can we say to members about transferring to a drawdown product?*

There is a risk that communications about member decisions could cross the line into 'advice on investments'. Only authorised persons can move beyond factual information into detailed guidance on the merits and disadvantages of a particular investment or insurance product. You should ensure that any statements are factual, generic (not linked to a specific product) and neutral. Communications should signpost Pension Wise and recommend that members seek independent advice; you should also include express disclaimers stating that no advice is being given. Remember that there are also specific disclosure rules around the provision of information and risk warnings to members who request information about, or seek to use, their flexible access options.

### *What about signposting pensions advice?*

Some schemes facilitate access to pensions advice (for example, signposting an approved panel of advisers). This may become more common following the introduction of the tax-free 'pensions advice allowance' from April 2017, which allows members and beneficiaries to withdraw up to £500, tax-free, from DC funds in a registered pension scheme to pay for regulated advice on pensions/retirement on up to three separate occasions. Schemes which offer this authorised payment pay the funds directly to the adviser. The pensions advice allowance can also be combined with the tax-free allowance for employer-arranged pensions advice.

In general, trustees are not liable for advice given by a third party. Advising members that independent advice is available on investment matters from an authorised person comes within a special exemption from the regulated activity of arranging deals, so authorisation is not required provided that there is no financial benefit to the scheme or employer. The FCA and the Pensions Regulator are expected to issue further clarification on this issue shortly. However, from an ongoing governance perspective, trustees should review membership of any adviser panel regularly to ensure that the individuals or firms represented continue to be appropriate and provide good value for members.

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## Providing drawdown via an external provider: risks and mitigation

It is possible to manage financial services risks by putting in place simple controls and checks, but trustees should consider wider trust law and governance risks in combination with FSMA issues before deciding to proceed, and also on an ongoing basis. The table below indicates key risks and possible mitigation.

| Risk issue | Mitigating action |
|---|---|
| **Pre-implementation** | |
| Consider FSMA risk (see previous pages) | Choosing a drawdown provider is a regulated activity if the appropriate tests are met |
| Are you acting in members' interests? | Compare drawdown providers and ensure any product selected is competitive and appropriate for members<br><br>Remind members of their right to shop around and that other products may be more appropriate for their specific circumstances |
| Will members shop around and compare drawdown facilities, or 'trust the trustees'? | Ensure that any drawdown provider you choose will also remind members of their right to shop around |
| Is there any financial benefit to the scheme or sponsor? If so, this could represent a conflict of interest under trust law and could also breach FSMA restrictions on regulated activities | The scheme and sponsor must not benefit financially from the facility (for example, by receiving a discounted rate on other services or products from the drawdown provider) |
| **Ongoing processes** | |
| How is the option communicated? Language which recommends the product – even an implication of an endorsement – could breach FSMA restrictions on financial promotions | Product information must come from the provider. Consider whether to provide information automatically or only on a member's request to the provider. Keep all other language factual and avoid any separate 'inducement' or 'endorsement'<br><br>Remind members to shop around and seek independent advice; signpost Pension Wise and include a 'no advice' disclaimer |
| Comply with requirements to provide information and risk warnings to members who request information about, or seek to use, their flexible access options | Consider how this information fits together with other communications and whether it is easy for members to understand what their options are, including the availability of independent advice and (if relevant) any scheme-specific ways in which they can access this |
| **Monitoring and review** | |
| From an ongoing governance perspective, how will you ensure that your drawdown product/provider continues to provide good value for members? | Keep the product and provider under review<br><br>Ensure that you are able to change provider (for example, separating the drawdown facility from the investment platform), if appropriate |


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