

Pension Transfers – Changes to FCA Advice Rules

The introduction, in 2015, of the pension freedoms in relation to defined contribution (DC) pensions has increasingly encouraged those with defined benefit (DB) pensions (or other safeguarded benefits) to transfer their benefits to DC arrangements.

According to the Office for National Statistics, transfers between all types of pensions tripled in 2017 to £34.2bn, the biggest annual jump since pension freedoms came into effect.

The Financial Conduct Authority (FCA) has expressed concern about the significant proportion of unsuitable transfer advice it has seen and, following a consultation paper published in June 2017, has published [new rules](#) on pension transfer advice. It has also published a further [consultation](#) paper proposing more improvements in the quality of advice.

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Background

In 2014, the year before the pension freedoms were introduced, £5.4bn was transferred between all types of pension arrangements. By 2017 this had risen to £34.2bn. The advice requirement - that before a member can make a transfer of a DB pension (or other safeguarded benefit) valued at more than £30,000 to a DC arrangement, the trustees have to check that the member has taken advice from a suitably authorised financial adviser - means financial advisers are at the very heart of this transfer boom.

With the Financial Services Compensation Scheme revealing it is beginning to see claims relating from “bad advice”, and the FCA admitting its concern over the proportion of unsuitable advice it has uncovered, the FCA has acted now to try to improve the quality of pension transfer advice, enabling individuals to make informed decisions about giving up their safeguarded benefits.

The New Rules and Guidance

From 1 April 2018

Unsuitability assumption

The FCA is maintaining the position that an adviser should start from the assumption that a transfer of a DB pension to a DC arrangement is unsuitable, rather than moving to a statement that for most people keeping safeguarded benefits is likely to be in their best interests. There will be cases, however, where such a transfer is suitable, and in such cases, an adviser recommending a transfer should be able to demonstrate its suitability for

the individual concerned. The burden of proving the suitability rests with the adviser making a recommendation to proceed with a transfer. Advisers should also consider alternative ways of meeting the individual's objectives. The FCA says that it considers that part of this advice would involve the adviser checking to see if the ceding scheme offers a partial transfer option.

Personal recommendation

All advice on the conversion or transfer of DB (or other safeguarded) benefits to a DC pension arrangement will require the adviser to give a personal recommendation, to either transfer or remain in the current scheme, based on the individual's needs and circumstances.

Pension transfer specialist

Only a pension transfer specialist can give or check transfer advice. Checking must go beyond checking the numerical analysis and must also:

- Consider whether the advice is sufficiently complete;
- Confirm that the personal recommendation is suitable; and
- Inform the adviser in writing that they agree with the advice, including any recommendation, before the report is given to the client.

The further consultation paper will look at the qualification requirements amongst other matters in relation to the quality of pension transfer advice.

From 1 October 2018

Replacing the transfer value analysis

The new rules introduce a requirement to undertake a personal and appropriate pension transfer analysis (APTA) of the individual's options, replacing the current transfer value analysis, which is based on the critical yield needed to match a guaranteed income. The FCA believes an effective APTA would help demonstrate the suitability of the personal recommendation.

Other matters advisers must also consider include:

- the impact of tax and access to state benefits;
- how the Pension Protection Fund and the Financial Services Compensation Scheme cover both the current and receiving schemes;
- if information is provided on scheme funding or employer covenants, it should be balanced and objective.

Introducing a mandatory transfer value comparator

The APTA includes a prescribed comparator which indicates the value of the benefits being surrendered. The comparator will show in graphic form:

- the cash equivalent value offered by the DB scheme; and
- the estimated cost of acquiring the same promised income in a DC environment.

The rules explain the workings (including the format and wording) of the comparator and the assumptions. Changes to the assumptions to use when revaluing benefits come into force on 6 April 2019.

Other issues

The FCA has also commented on a number of other issues that arose as part of last year's consultation. This briefing note does not attempt to cover them all but a couple are of relevance to trustee boards and their service providers.

Dealing with schemes

The FCA comments that it is aware of the ‘frustrations’ advisers face in getting relevant data from the DB scheme and that the amount of data required can be ‘significant’. It advises that it is working with the Pensions Regulator to set out its expectations and refers to the industry working group that has been set up to look at this issue.

Overseas transfers

The FCA comments that overseas transfers are ‘often complex, that advice needs to be detailed and that it will often involve working with an overseas adviser’. There are issues that make it different to a UK pension transfer and which should be included in the APTA (for example, the possible 25% tax charge on a transfer to a Qualifying Recognised Overseas Pension Scheme introduced in March 2017). Advisers may need to point out the limitations in any advice and consider whether they are able to provide advice.

In March, the Department of Work & Pensions issued its [response](#) to a call for evidence on the advice requirement and overseas pension transfers. This looked at how the advice requirement was working for non-UK residents with safeguarded benefits and whether an easement would be appropriate for overseas transfers. In its response, obviously timed to coincide with the FCA’s new rules and guidance, reference is made to the personal recommendation and the APTA as well as the FCA’s further consultation paper. The conclusion is that the advice requirement for overseas transfers will be retained.

Consultation Paper – Improving the quality of pension transfer advice

This new consultation runs until 25 May 2018 and seeks comments for a number of proposals to further amend the rules and guidance on pension transfers. The FCA is committed to finalising its rules in a policy statement no later than early Autumn 2018.

Pension transfer specialist (PTS) qualification

FCA rules require all advice on pension transfers to be given or checked by a PTS.

The FCA is proposing to toughen the PTS qualification to require all PTSs to obtain the investment advice qualification by October 2020. It stresses that in giving pension transfer advice the adviser must take into account the investments in which the individual’s assets would be placed if a transfer takes place. This must be done whether or not a separate advice is being given on the investments by the same or a different adviser.

FCA rules do not prevent pension transfer advice and investment advice being given by two separate advisers. In the past, the adviser giving advice on the suitability of a transfer of DB (or other safeguarded) benefits may not have enquired about where the benefits were going to be subsequently invested. Going forward, the FCA will expect the adviser giving advice on the transfer to take account of the proposed destination of the funds. This will include situations where a second firm is involved in giving investment advice or where the individual is a self-investor. The PTS will be expected to consider whether there are alternative solutions that could meet the individual’s needs and objectives, either with less risk, or without giving up the DB (or other safeguarded) benefits.

The individual’s attitude to transfer risk should affect both the transfer advice and the associated investment advice. This means the transfer advice should take account of the risks of giving up valuable benefits and the investment advice should take into account the fact that the individual would no longer have any form of guarantee or promise should the transfer proceed.

Triage services

Some advisers operate a triage service as part of a DB transfer advice process. They will have an initial conversation with potential customers to give them sufficient information on the transfer to enable them to make a decision about whether to take advice on the transfer or conversion of their benefits.

The FCA is concerned that this triage service may inadvertently cross the advice boundary. For example, saying it is unlikely a transfer will be recommended is likely to be seen as a recommendation to stay in the existing scheme. Triage advice should be confined to an educational process providing generic, balanced information on the advantages and disadvantages of pension transfers. No comment should be made about whether or not a recommendation for or against a transfer is likely to be made on the facts known at that point.

Transfer risk

The FCA is proposing to introduce guidance on assessing an individual's attitude to transfer risk. It is concerned that many advisers rely on software to assess the consumer's attitude to risk. It considers that an adviser should explore each individual's attitude to the general risks associated with a transfer, as well as their attitude to investment risks.

The risk assessment should consider:

- The risks and benefits of staying in the existing scheme
- The risks and benefits of transferring to a flexible benefits scheme
- The client's attitude to certainty of income throughout retirement
- Whether the client is likely to access funds in flexible benefits in an unplanned way, and the impact of that on the sustainability of the funds over time
- The individual's attitude to any restrictions on their ability to access funds in their existing scheme
- The individual's attitude to and experience of managing investments themselves or paying for them to be managed in a flexible benefits scheme

Negative transfer recommendations

Currently, when advising against a transfer, advisers do not need to give reasons. The FCA is proposing to introduce a requirement for firms advising against transfers to provide a suitability report. Setting out the reasons why an individual should not make a transfer can be just as valuable as a recommendation to transfer. Such a report will give reasons why an individual should not make the transfer and will set out the individual's objectives and issues which have been taken into account and how they have led to the recommendation not to transfer. In addition, the FCA is proposing that firms provide an advice confirmation in the case of both positive and negative recommendations.

Pension increase assumptions

In making a recommendation on a transfer, the adviser will make assumptions regarding increases to be applied to benefits in the existing scheme. The FCA proposes that advisers should use fixed rate increases at the collar (lower limit) for collars above the relevant RPI/CPI rate and at the cap (upper limit) for caps below the RPI/CPI rate. All other increases should be valued at the RPI/CPI rate.

Problems with contingent charging structures

Generally, contingent charging arrangements are ones where an adviser is only paid by the individual if a transfer takes place. The FCA is consulting on whether it is necessary to intervene in the way charges are levied for transfer advice. In particular it asks whether contingent charging should be banned. It notes that the

Work & Pensions Select Committee specifically called for a ban based on the evidence it gathered during its inquiry into the British Steel Pension Scheme.

Comment

With the FCA's supervisory work on pension transfer advice suggesting only 47% of advice to transfer from a DB to a DC scheme could be shown to be suitable, and only 35% of the products and funds recommended for the new scheme being deemed suitable, the FCA was under pressure to make changes.

Frank Field, the chair of the Work & Pensions Select Committee, which had called for urgent action after it was alleged large numbers of British Steel workers had been wrongly advised to transfer their pension benefits, does not consider these FCA proposals go far enough. The pensions industry as a whole is less critical.

With transfers of DB (and other safeguarded) benefits to DC arrangements hitting an all-time high, we must wait and see whether any changes will stem the tide, or increase the suitability of the advice that is being given.

In the meantime, trustee boards and sponsoring employers of affected pension schemes may wish to consider whether selecting and appointing a preferred financial adviser to provide members with appropriate independent advice, may result in members having access to advice that already meets the FCA's new rules and its further proposals to improve the quality and suitability of advice.

Authors

Gary Crockford, Head of the Knowledge Resource Centre
Nikki Williams, Senior Technical Consultant

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