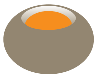

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The FCA and advice on defined benefit transfers

Transfers out of defined benefit schemes continue to grab headlines, as people's desire to transfer shows no sign of abating.

In June 2017, the FCA published a consultation paper (CP17/16) outlining how advice on defined benefits transfers could change. At the end of March 2018, it published two new papers:

- PS18/6 – a policy statement giving some final rules following the previous consultation; and
- CP18/7 – a new consultation on some aspects of pensions transfers advice.

Both are shaped by the feedback on the first consultation, the FCA's own supervisory work in the intervening period, and the concern this subject has provoked in both the public and the MPs sat on the Work and Pensions Select Committee.

This factsheet outlines the new rules, when they come into effect and what advisers must do to comply, as well as considering the questions the new consultation raises.

The new guidance – giving advice and assessing suitability

The FCA's policy statement (PS18/6) feeds back on the previous consultation (CP17/16), published in June 2017. The policy statement sets out some new rules and guidance. Most of these came into force on 1 April 2018, although the new analysis rules are effective from 1 October 2018.

Chief among the new rules is that with immediate effect advice on transfers of safeguarded rights must include a personal recommendation. In practice, most advisers are complying with this already, but it makes sense for the FCA to include it in its handbook.

Interestingly, despite consulting on whether to change the starting assumption to a more neutral position, the FCA has retained the starting point that a transfer isn't in the best interests of a client. This decision has been influenced by its recent supervisory work which showed a significant proportion of transfer advice given is unsuitable.

In its new guidance on suitability the FCA emphasises the firm must obtain all the necessary information about the client to make a suitable recommendation – including their financial situation, investment objectives, and investment knowledge and experience. If they can't get all the information, they can't make a personal recommendation. Advisers must also consider alternative ways of meeting the client's objectives – for example by buying life cover if the client is concerned with passing wealth onto their family.

The role of the PTS

The FCA was concerned the role of the pensions transfer specialist (PTS) was often restricted to checking the numerical analysis. It has therefore changed the handbook guidance to make it clear the PTS must check the entirety of the advice process (not just the transfer value analysis (TVAS)) and confirm the personal recommendation is suitable. The PTS cannot know if a transfer will be suitable without understanding the implications of the destination for transferred funds.

A PTS should:

- review the proposed destination and investment considering both the client's attitude to transfer risk and to investment risk;
- make sure the potential returns and all relevant charges have been considered in the appropriate pensions transfer analysis (Apta) (see below); and
- consider whether there are alternative solutions that could meet the client's needs and objectives, either with less risk or without giving up the safeguarded benefit.

The FCA is now consulting whether the PTS should be qualified up to Level 4 on giving investment advice, given its role. If so, then all PTSs must hold the qualification by October 2020.

The new guidance – effective from 1 April 2018

- Advice must be a personal recommendation.
- The starting assumption remains that a transfer will not be in the best interests of a client.
- Advisers must obtain all necessary information about the client – if they don't have it all they cannot make a personal recommendation.
- Advisers must consider alternative ways of meeting clients' objectives.
- The PTS is responsible for checking the entirety of the advice process and confirming that the personal recommendation is suitable.

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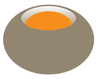

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The new analysis

The FCA has announced that from 1 October 2018 it will replace the TVAS with a mandatory transfer value comparator (TVC) and an Apta.

The TVC

The TVC is a mandatory requirement. Its purpose is to compare the transfer value offered with the cost of securing the same benefits through an annuity in a defined contribution (DC) scheme. The TVC cannot be personalised for the client – for example, if the scheme offered a spouse's pension but the client was single, the TVC still has to show the cost of buying a DC annuity assuming a spouse's pension.

The FCA has been prescriptive about growth and charges assumptions. The TVC:

- must use a DC growth rate in accumulation based on a risk-free return using gilt yields;
- must assume product accumulation charges of 0.75% (regardless of actual charges);
- must make no explicit allowance for adviser charges during accumulation;
- must assume the cost of buying the annuity is 4%, including advice charges;
- can allow for defined benefit pension benefits payable from different ages.

Because of these assumptions – and in particular the DC accumulation growth rate – the difference between the two figures compared in the TVC (the transfer value and the cost of securing the benefits in a DC plan) could be relatively small if the client is close to retirement, but quite big if the person is several years away.

The Apta

As well as the TVC, the adviser can provide an Apta to demonstrate the suitability of the personal recommendation. This is personalised to the client's needs and objectives. In the policy statement, the FCA discusses what the Apta can include. However, it has stopped short from prescribing the exact contents.

In its feedback, the FCA has said the Apta:

- can include behavioural and non-financial analysis as well as numeral analysis;
- can include a critical yield if the firm thinks it is valid;
- can include cashflow modelling;
- should assess the relative value of death benefits in the different types of scheme and over different points in the future;

The FCA is going to make the following changes to the handbook:

- a new rule requiring advisers to consider the impact of tax as well as access to state benefits;
- a new rule to clarify the Apta must consider a reasonable period beyond average life expectancy – particularly when a longer period would better demonstrate the risk of the funds running out;
- a revised rule that the adviser must consider trade-offs more broadly (for example between income and capital); and
- new guidance on including safety nets – the PPF and FSCS – as long as it's in an unbiased way.

The FCA considers the Apta can be adapted to cover the personal circumstances of clients based overseas, and it should also be possible to modify an Apta for self-invested clients.

The Apta should include charges whether or not the client pays them through the receiving scheme. Where an adviser charge is payable by an employer or regardless of whether a transfer takes place, advisers will not have to include the charges in the Apta

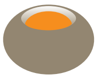
The annuity interest rate will now be based on an average of the most recent three yield calculations (rather than an average of 12 months as currently).

Where an adviser uses growth rates for a receiving product that are greater than those used in the TVC, the adviser should explain the differences.

A stochastic model can be used as part of an Apta.

Free analysis software

Since last year's consultation the FCA has modified the rules on inducements for non-MiFID business to mirror the new MiFID II inducement rules. Non-monetary benefits are now included, and so providing or accepting free TVC or Apta software is now considered to be an inducement. Consequently, many providers have reviewed their current position on free software.



The FCA and advice on defined benefit transfers

The new analysis – effective from 1 October 2018

- A TVC must be provided comparing the transfer value with the cost of providing the same benefits as the scheme through an annuity. A risk-free growth rate must be used for the DC benefits in accumulation.
- An Apta can also be provided to demonstrate the suitability of the personal recommendation. The FCA has not been prescriptive in outlining what exactly must and must not be included in the Apta.
- Providing or accepting free analysis software is an inducement.

A new consultation

As well as a host of new rules, the FCA launched a new consultation (CP18/7) on some areas of transfer advice covered in the previous consultation, but also covering new issues raised during the consultation and through its recent supervisory work.

The consultation closes 25 May 2018.

Two advisers working together

The FCA is proposing new guidance about the role of the PTS. A PTS has to understand the implications of the destination of the transferred funds before they can say whether a transfer is suitable or not. If the PTS is different from the adviser giving the investment adviser, the two advisers must work together.

The information set out in a fact find and risk profile may not always be sufficient to allow a PTS to say if the transfer is suitable or not. If not, the PTS should liaise with the investment adviser to get the missing details, or speak to the client directly.

When two advisers work together they should make sure that the roles responsibilities and liabilities are clear, maybe outlining them in contractual arrangements. They should also make sure the client understands what each adviser's role is.

The FCA expects all parties to work together to collect the necessary information, undertake risk profiling (both transfer risk and investment risk), and investment advice considers the impact of the loss of any safeguarded benefits on the client's ability to take on investment risk.

Self-investor

The transfer advice should take account of the proposed destination of the funds. Where the client proposes the destination themselves, the client needs to provide the full information.

If the transfer is unsuitable specifically because of the proposed destination, the adviser should explain a transfer may be suitable if there was a different destination.

Triage services

Many advisers currently offer a triage service – an initial interview with the client to give them sufficient information to decide whether to take advice on a pension transfer.

The FCA is worried about triage services crossing the advice boundary. It therefore proposes triage is a non-advised service. Advisers can educate clients about the process and charges involved, but they cannot comment on a client's personal circumstances and whether they should consider a transfer or not.

Client's attitude to transfer risk

The FCA wants transfer risk to be considered independently from investment risk. It has proposed the assessment of the client's attitude to the risks associated with transfers should consider:

- both the risks and benefits of staying in the scheme and of transferring;
- the client's attitude to certainty of income throughout retirement;
- whether the client is likely to access flexible benefits in an unplanned way, and the impact of that on the sustainability of the funds over time;
- the client's attitude to having access to funds in the scheme restricted; and
- the client's attitude to and experience of managing investments or paying someone to manage them.

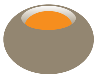
Contingent charging

Following growing concern about the practice, the FCA is considering banning contingent charging – where an adviser is only paid if a transfer goes ahead.

It is asking for views on whether it can ban contingent charging for transfer advice only due to the special circumstances involved (for example, the irrevocable decision, the potential loss of safeguarded benefits, and the lack of investment expertise).

However, it is worried if contingent charging was banned on the transfer advice, then some advisers would repackage their fees to charge more for the destination and investment advice (the non-contingent element), backloading this element, and still creating a potential bias to encourage people to transfer.

The FCA is also concerned whether banning contingent charging will have implications for consumers' ability to access advice.



The FCA and advice on defined benefit transfers

Other issues

Other issues being consulted on are:

- whether a suitability report should be provided even when the recommendation is not to transfer;
- the assumptions used for retail prices index (RPI) and consumer prices index (CPI) rates applied to scheme increases;
- whether a PTS must hold the Level 4 qualification for advising on investments before they can advise on or check pension transfer advice; and
- whether the pension transfer definition is widened.

The main issues the FCA is consulting on:

- How a PTS adviser and an investment adviser can work together and clarify their different roles and responsibilities.
- If triage services should be non-advised and not take account of personal circumstances.
- The elements that must be considered when assessing a client's attitude to transfer risk.
- Whether contingent charging should be banned.
- Whether a suitability report should be provided if the recommendation is not to transfer.
- Whether a PTS must hold the Level 4 qualification for advising on investments.

If you only read one thing read this:

The new rules on pension transfer advice, including the new format for analysis, will give advisers welcome clarity about the FCA's expectations in this area. Hopefully, it will also mean more clients understand better the implications of transferring, and what they stand to lose – and gain – by giving up their safeguarded benefits.

The FCA's work is not yet complete. There are still several areas of guidance to be signed off – for example how a PTS and investment adviser work together, and whether contingent charging should be banned.

The recent interest in defined benefit transfers shown by MPs sitting on the Work and Pensions Select Committee demonstrate the subject of defined benefit transfers is still evolving, and looks likely to continue to be a topic of debate.

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