[In summary]

For UK Financial Adviser use only

FCA CP 18/7 Improving the quality of pension transfer advice

The FCA published *CP18/7: Improving the Quality of Pension Transfer Advice* on 26 March 2018. The consultation period closed on 25 May 2018 and we expect the FCA to issue the Policy Statement in Autumn 2018. This paper is designed to summarise the key themes and issues raised in the consultation.

Background

Defined benefit pensions and other safeguarded pensions provide valuable benefits, and the FCA's view is that most consumers will be best advised to keep them. In 2017, the FCA consulted on proposals in CP17/16 and have now published PS18/6, aimed at providing advisers with a framework which better enables them to give good quality advice so that consumers make better informed decisions. Respondents raised a number of issues not considered in the paper, and so this feedback, as well as findings of our ongoing supervisory work, has informed the proposals in CP18/7.

"If the interventions set out in this CP and in PS18/6 are successful, consumers should be more likely to receive suitable advice about whether or not to transfer based on their personal circumstances. This will help them to make informed decisions and give them confidence in the advice that is being provided".

(CP18/7 Section 1.12)

Who's it for?

This FCA consultation will primarily be of interest to financial advisory firms advising on:

- ✔ Pension transfers
- ✔ Those acting as pension transfer specialists
- ✔ Pension providers receiving pension transfers and;
- ✔ Employer sponsors of DB schemes
- ✔ Employee benefit consultants

The benefits, risks and potential solutions are summarised on the following pages

"This will not be the final piece of the jigsaw as the FCA has already stated there is more supervision work to come. Providers will be increasing their understanding of adviser transfer processes and we at LV= see this as healthy way to build strong symbiotic market relationships".

Phil Brown, Head of Policy, LV=

The FCA are consulting on changes to:

- Raising qualification level for PTS
- Clarifying clients' attitude to risk
- How to carry out an appropriate triage service
- Suitability reports for negative recommendations
- PTS and the two adviser models

LV= Insights

1) Standards to meet before giving advice

- **The qualifications required to advise on or check pension transfers:** requiring all Pension Transfer Specialists (PTS) to obtain the investment advice qualification by October 2020. While a PTS may not always be giving the investment advice, the FCA's view is that they need to be able to identify whether a proposed investment solution is consistent with the client's needs and objectives for the proposed transfer. There will be no grandfathering, ie all PTSs without the investment advice qualification must achieve it in order to continue practising.
- **PTS exam qualification standards:** changing the exam standard for ApEx 21 to take account of developments in the pensions landscape following the introduction of the freedoms and the mandatory advice requirement, as well as the rules and guidance in PS18/6 and proposed in this CP. The exam standard will, therefore, cover personal recommendations and advice boundary issues, appropriate pension transfer analysis (APTA) and transfer value comparator (TVC), overseas advice and taxation.
- **The definition of a pension transfer:** amending the pension transfer definition so that it is drafted with reference to safeguarded benefits and flexible benefits. The proposed amendment will mean that the definition will only cover advice on transactions where flexible benefits are given up when the cancellation rules apply, ie in the same way as other pension switches. They have also amended the existing references to an 'individual pension contract providing fixed or guaranteed benefits' and to a 'deferred annuity policy' with an overarching term of 'deferred annuity contract'. The proposed amendment will mean that the definition will continue to include advice on transactions where safeguarded benefits are being given up for another form of safeguarded benefits.

  The proposal will have an impact on data that firms report in Product Sales Data (PSD). PSD requires pension providers to separately identify product sales that result from an 'individual pension transfer'. If the proposal goes ahead, firms will only be required to report transfers of safeguarded benefits in this category. All other pensions business, including pension switches, will be reported in the relevant product category, eg self-invested personal pension, personal pension.

2) Preparing to give advice

- **Taking account of the proposed destination of a client's transfer funds:** The FCA are clarifying the role of the PTS in relation to the proposed destination of a client's transfer funds. This includes the relationship the PTS has with another adviser firm that provides the investment advice.

  When advising on a pension transfer, the advice must take account of the proposed destination of the transfer funds if a transfer proceeded. The FCA's rules do not prevent pension transfer advice and investment advice from being provided by two separate advisers, however they are proposing Handbook guidance to make clear their expectations where one firm (or employee) advises on the transfer and another firm (or employee) advises on the proposed investments. The intent of the proposed guidance confirms they expect all parties to work together to: collect necessary information, to inform both the pension transfer advice and the associated investment advice; undertake risk profiling, which assesses both the client's attitude to transfer risk and attitude to investment risk, and; recognise that the investment advice should take into account the impact of the loss of any safeguarded benefits on the retail client's ability to take on investment risk.
- **Advising a self-investor:** Self investors in this instance are clients who choose their own proposed scheme and investments. The FCA confirm in the paper that they think their expectations are clear on the following:
  - They expect advisers to advise on a pension transfer taking into account the proposed destination of the funds. Where the destination is put forward by the client themselves, the situation is no different except that the adviser will have to make clear that the client needs to provide the necessary information about the scheme and its underlying investments.
  - Where a transfer is unsuitable in principle, but not specifically in relation to the proposed destination, the adviser should explain the basis for the recommendation. Where the transfer is unsuitable specifically as a result of the proposed destination, the adviser should explain that a transfer may be suitable if a different destination for the funds was selected. If the adviser expresses an opinion on how to amend the proposed destination, it is likely to be investment advice.
- **Triage services:** The FCA note that many advisers operate a triage service as part of their DB transfer advice process whereby firms have an initial conversation with potential customers. The purpose of triage is to give the customer sufficient information about safeguarded and flexible benefits to enable them to make a decision about whether to take advice on the transfer or conversion of their pension benefits. The FCA do see some benefits of such a service (including preventing customers paying unnecessary charges) however they found that some forms of triage may be crossing the boundary into advice. They are therefore consulting on new guidance in PERG on how firms can provide an appropriate triage service that gives factual and generic information without stepping across the advice boundary.

  In the FCA's view, if triage is to be a non-advised service, it should be an educational process so that consumers can decide whether to proceed to regulated advice. Firms can achieve this by providing generic, balanced information on the advantages and disadvantages of pension transfers. Specific guidance on the triage service for pension transfers is proposed for inclusion in PERG 12.6 and PERG 12 Annex 1G.

See next page for more benefits, risks and potential solutions

3) Providing advice

- **Assessing a client's attitude to transfer risk:** New guidance is proposed confirming that when firms are considering the client's attitude and understanding of giving up safeguarded benefits for flexible benefits, they should take into account:
  - the risks and benefits of staying in the safeguarded benefit 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 client's attitude to any restrictions on their ability to access funds in a safeguarded benefits scheme
  - the client's attitude to and experience of managing investments themselves or paying for them to be managed in a flexible benefit scheme.

  The proposed guidance also sets out that the FCA expect firms to consider the client's attitude to transfer risk:

  - in a way which is fair, clear and not misleading, and
  - irrespective of whether or not relevant factors are included within risk profiling tools or software
- **Suitability reports for negative recommendations:** The FCA's rules do not currently require firms to provide suitability reports when they give a recommendation not to transfer. They are now proposing that firms provide a suitability report regardless of the outcome of advice. This proposal applies to transfers and conversions.
- **Pension increase assumptions:** The TVC (as detailed in PS 18/6) requires assumptions to be made regarding increases applied to scheme benefits. In CP17/16, the FCA asked for views on the relative level of the Retail Price Index (RPI) and Consumer Prices Index (CPI) assumptions used to project future benefits (in the TVC) between the date of the employee leaving the scheme and the date on which the benefits commence. They also asked for views on the level of the current assumption for certain limited pension increases offered by the ceding scheme. The assumption is needed for the TVC when determining the cost of replicating the ceding scheme benefits in a DC environment. These are pension increases that grow in line with an inflation index, such as the RPI or CPI, but also have both upper and/or lower limits (caps and collars). The FCA had previously been told that their existing assumption for these types of increases may overvalue pension increases where there is a high cap.
- Based on the feedback received, the FCA propose a change to the existing assumption. They propose that firms should use fixed rate increases at the collar for collars above the relevant RPI/CPI rate, and at the cap for caps below the RPI/CPI rate. All other increases should be valued at RPI/CPI.

The FCA will issue their final Policy Statement in Autumn 2018

To find out more about PS18/6, take a look at our 'At a Glance' paper here

The FCA are also seeking feedback on:

Charging structures associated with advising on pension transfers: Despite not commenting on it in CP17/16, the FCA note that respondents to the consultation provided significant feedback on contingent charging and its potential for consumer harm. Respondents highlighted the conflict of interest in the model (the misalignment of incentives between advisers and consumers). Given the potential for harm to consumers the FCA are considering whether they should intervene in the way charges are levied for pension transfer advice. This could mean a ban on contingent charging.

The FCA recognise that there are a number of complexities in determining how any ban on contingent charging might work in practice. This is because advice to a consumer usually involves two key services: a) advice to transfer and, b) advice on investments (ie advice on the proposed destination scheme and investments within that scheme). In addition, advisers often charge implementation fees (covering the adviser's time in ensuring that the transfer is processed) if a transfer proceeds. There are further complexities if the advice model is an outsourced model with two advisers or more. The FCA have therefore been seeking feedback from firms on a number of questions on this topic.

Liverpool Victoria Friendly Society Limited, Tilehouse Street, Hitchin, Herts SG5 2DX.

24507-2018 09/18