HINDSIGHT

Collegiate

Pension Transfer Special

March 2018

Welcome to the latest edition of our Hindsight publication

Once again Pension Transfers are THE hot topic amongst financial advisers so we have decided to focus this edition on recent communications from the regulator.

The new(ish) pension freedoms, along with the increased transfer values being offered by many schemes, have given fresh impetus to the pension transfer market. The extent is such that we are seeing a sharp uplift in the number of transfers from defined benefit occupation pension schemes. The numbers are now similar to those seen when the freedom to transfer out of occupational pension schemes was first introduced back in April 1988.

When the freedom to transfer out of occupational pension schemes were first introduced it took the regulator (of the day) 6 years before they set out in any kind of detail what they considered "suitable advice" should look like. They then instigated a review of the advice that had been provided. The financial advice industry then spent the next 10 years paying out billions of pounds to review and compensate consumers who were mis-sold personal pensions in that 6 year period.

The legacy of the Pension Review has not been forgotten by most insurers but it remains to be seen whether history will repeat itself. The FCA has regularly issued alerts and warnings in respect of advice provided with regards to pension transfers, but have they made clear their expectations and has the financial adviser community reached a common understanding of what they may be?

The FCA has now opened a consultation on "***Advising on Pension Transfers***" and the hope is that this will provide financial advisers and their insurers sufficient clarity on what is considered "suitable advice" by the regulator.

Once assumptions on life expectancy, growth rates, annuity rates and the consumers ability to manage the freedom to dip into their pension whenever they like starts to be tested against actual reality, it will be much easier for the regulator and FOS to draw the line more clearly but the concern is that the easy wisdom of hindsight will be used to judge the advice given.

The regulators assertions that this will not be the case would be more creditable if a few worked examples of an appropriate transfer were published alongside their guidance. The excuse in the past for not providing case studies was due to any decision being "***highly dependent on an individual's personal circumstances***". Yet when it comes to carrying out past business reviews or assessing complaints, that individualised approach to customers tends to rapidly wilt under a Skilled Persons review methodology or FOS complaint assessment template.

So what do we know so far?

The default starting position has almost always been that the customer is relatively unsophisticated and financially naïve, will be naturally cautious and risk averse, and have limited capacity or appetite to sustain losses to funds which cannot easily be replenished. The FCA have already stated that "***it remains our view that keeping safeguarded benefits will be in the interest of most consumers***" and whilst they have conceded that "***for some consumers a transfer may now be suitable when it wasn't previously***" they still do not give a single example of the circumstances in which that may be the case. They go on to further state "***Firms should challenge the realism of a client's objectives… A recommendation is unlikely to be suitable if it meets the client's objectives but not their needs***".
This is consistent with the regulators paternalistic approach but is in direct contrast to the current governments approach when they dropped the requirement to buy an annuity.

In other words flexibility and control of investments or IHT planning benefits are nice "***add ons***" but are vulnerable to being seen as devices to support a transfer rather than adequate justification for recommending a transfer. Given the fund transferred will in most cases go on to generate fees for the adviser there may be some scepticism as to whether these "***add ons***" were really justification over the peace of mind that comes with a secure index linked pension until death.

In the consultation paper the FCA is proposing that advisers should consider the following:

i. The client's income needs and expectation and how these can be achieved, the role safeguarded benefits play in providing this income and the impact and risk if a conversion or transfer is made.
ii. The specific receiving scheme being recommended following the transfer and the investments being recommended within that scheme to ensure that it is appropriate for the risk profile of the client
iii. The way in which funds will be accessed, either immediately or in the future, including follow-on arrangements.
iv. Alternative ways of achieving the client's objectives. For example, there may be ways for a client to provide death benefits which can be funded from income rather than a lump sum funded by a pension transfer, and which does not carry so much risk
v. The relevant wider circumstances of the individual

Once again the FCA does not propose to list any examples of "***relevant wider circumstances***" in the rules so we are to assume that this will include such things as tax issues, death benefits, interaction with means tested benefits, state of health, family situation and other sources of retirement income.

It is clear from the guidance that the FCA fears that consumers are not understanding the true value of the benefits being given up and the existing transfer analysis needs modification to make it much clearer by the introduction of a transfer value comparator (TVC). This essentially looks at the cost of purchasing an annuity to match, as far as possible, the ceding scheme, discounting that cost to present day value and then comparing this to the transfer value offered.

The requirement to clearly state e.g. "***This means the same retirement income could cost you £20,000 more by transferring.***" Is clearly designed to highlight a "cost" to flush out from the customer how much they value the identified drivers for the transfer.

If the drivers are in fact just "***whistle and bells***" that, whilst nice to have, may not be as important to the customer as their initial enthusiasm may have suggested, this should put a break on those proceeding who's main need is just a steady reliable income to see out their days.

The FCA hopes this will result in "***a significant shift in the quality of pension transfer advice***" which clearly points to them being unimpressed with much of what they have seen to date. Given the FCA estimate 100,000 transactions per year are taking place with a cost of getting it wrong at £40,000-£60,000 a pop it is as well they are getting their act together a little quicker than their predecessors did 25 years ago.

With no sign that the FCA or FOS are embracing the concept of customer responsibility, if a customer ends up with an income materially less than that which they could be enjoying from their erstwhile occupational scheme, expect them to receive a sympathetic hearing when they then claim what they really needed was a secure indexed pension until their death.

Business owners should carefully reflect on their appetite for this area of business. We still see claims from transfers carried out in the 90's and we would see much more had not so many businesses gone bust. Making hay whilst the sun shines in the area may not be a sound long term strategy.

Hindsight Claim Alert

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My thanks go to Martin Archer, our Legal Director, for producing this newsletter.

We hope that you find the content informative and useful. If you have any comments on the content, or suggestions for future issues, please write to us or e-mail on newsletter@collegiate.co.uk.

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