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Defined Benefit Pension Transfers

With increased regulatory focus, how do firms ensure that historic advice was suitable?

What's the problem with Defined Benefit ("DB") pension transfer advice?

In 2015 we saw the introduction of Pension Freedoms. Gone were the restrictions on how Defined Contribution (DC) pension accounts could be used, instead allowing consumers to access their funds at a level and frequency which worked best for them.

The changes, combined with significant values on offer from Trustees, made for some, the prospect of transferring to a personal pension more appealing than ever.

The FCA, however, has long held the view that the decision to transfer out of a DB scheme is complex and transferring out is unlikely to be suitable for most people. It should come as no surprise then, that the Regulator is carefully monitoring both the volume and value of funds leaving DB schemes.

The conduct issue around the suitability of DB pension transfers is clearly going to be with us for some time.

In a recent survey of firms the FCA found that, in the 18-month period to March 2020, 87,000 consumers received advice on their DB pensions; with 57% being recommended to transfer £20.1bn in assets. The FCA believes that this is simply too many people transferring their DB pensions.

Since 2015 the FCA has been busy looking at the suitability of DB advice being provided. They have carried out four phases of thematic work; looking at 85 firms responsible for nearly half of the DB advice market. The FCA felt that only 55% of the files reviewed were suitable, with the remaining 45% being either unsuitable or holding insufficient evidence to justify the advice. Clearly for some, transferring out of a DB pension into a DC pension can be beneficial, but the advice process and the rationale must be robust and evidenced on client advice files. Generic objectives such as 'flexibility', 'higher tax-free cash', and 'greater death benefits' are not enough to justify the transfer. The FCA has cited these generic objectives, or lack of detail, as the core drivers for their unsuitable and unclear outcomes.

Whilst it is accepted that the substantial transfer values coupled with the flexibility offered by DC pensions has proven to be attractive, the continued decline in interest rates has subsequently resulted in many consumers suffering reductions in the buying power of their funds. As a result of reduced annuity rates, consumers potentially need twice as much money today as they did five years ago to secure the same level of income. This variance is not lost on the FCA or consumers and is responsible for driving significant levels of consumer detriment.

In addition to the FCA's work on suitability, the Work and Pensions select committee is now conducting a review into the impact of Pensions Freedoms. The high number of consumers transferring out of DB schemes coupled with the low levels of suitability identified by the FCA and the propensity for detriment, may play a major role and influence their conclusions.

> *"Overall the FCA continues to believe that **for the majority of people it is not in their interest to transfer out of a DB pension**. Where an individual seeks advice to transfer it is important that advice given is suitable and appropriate for their needs and situation. Where we find that firms are not meeting our expectations we will take action to ensure firms put things right."*
>
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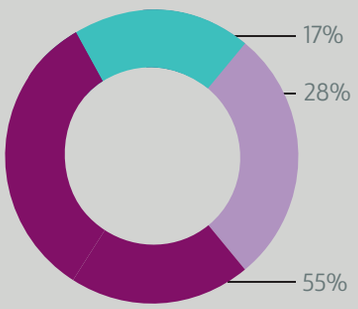
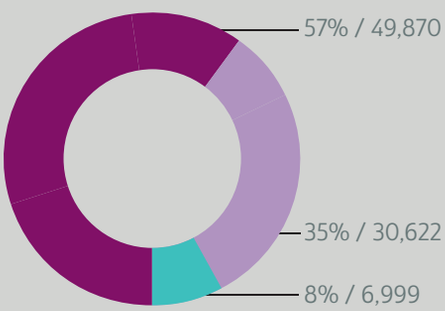


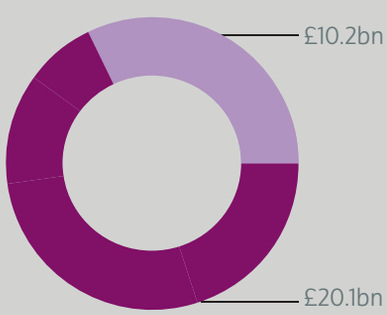
FCA Thematic: Case Findings

- Suitable
- Unsuitable
- Unclear (material information gaps)



FCA Survey: Recommendation

- Recommended
- Transferred against advice (insistent)
- Recommended not to transfer



FCA Survey: Assets Transferred £bn

- Recommended to transfer
- Recommended not to transfer

Should firms be concerned about their historic DB advice?

The FCA and consumers are becoming acutely aware that historic transfers are appearing poor value in the context of current low interest rates, which leaves firms open to regulatory enforcement and consumer complaints. This has been compounded by less than optimal market performance, increased consumer awareness around mis-selling and the rise of claims management firms.

Thanks to recent FCA guidance, firms have been able to ensure that their current approach to DB transfer advice meets regulatory expectations, however, there is a clear vulnerability for many firms where historic advice cannot be demonstrated as aligning with these expectations.

Following the FCA's thematic work, there were around 60 firms who were required to undertake reviews of their past DB transfer advice to ensure the advice provided was appropriate. This has increased further, following the FCA's announcement regarding a redress scheme for British Steel transfers. DB Pension transfers remain a top priority for the FCA, with more thematic work planned. Given the developments with British Steel, further planned thematic work, and the low levels of suitability (55%) identified for across the industry to date, it is inevitable that some other firms will have to follow suit in reviewing their past advice.

Many firms don't accept that there could be an issue with their past advice, or worse see it as a can of worms not to be opened. With individual accountability now far more prominent under the SMCR and the forthcoming introduction of a new consumer duty, it is even more important than ever that firms and their senior management take responsibility for historic advice standards. Identifying any problems proactively and self-reporting will allow firms to retain control of any remedial action.

Given the increased focus on DB transfers, it would be prudent for any firm offering advice in this area, and those that have provided advice historically, to understand the strengths and weaknesses of their past advice.

> *"Our work on defined benefit (DB) transfer advice shows **many firms are struggling to give consistent, suitable advice**. This is largely due to poor practices or weak record keeping. As a result, too much of the DB transfer advice we see is either unsuitable or we were unable to assess its suitability due to material information gaps (MIGs)."*
>
> **Financial Conduct Authority**

How to approach a review of historic advice?

The FCA has published a tool for assessing the suitability of DB transfer advice. However, when reviewing historic advice it is important to focus on the consumer outcome, rather than follow a tick-box process. Therefore assessing advice requires skill and judgement, and often is finely balanced decision considering the advantages and disadvantages in the contact of a member's objectives.

Historic advice must be assessed robustly and competently to ensure that both the consumer and the firm are treated fairly. An overly commercial stance is unfair on consumers and will attract even greater regulatory scrutiny. By contrast, a consumerist stance will only serve to err in the consumer's favour, underwriting present-day low interest rates and setting unwanted precedents.

> *"The proportion of customers who have been advised to transfer out of their DB pension is unacceptably high."*
>
> **Financial Conduct Authority**

In our experience, there are five key stages in assessing historic advice:

Identify the population

- Analyse records to establish potentially impacted clients
- Qualify the population with a client mailing exercise, these test and gain client engagement, and also serve to limit future complaints
- Consider detriment and exclude where detriment is unlikely

Close information gaps

- The FCA cited information gaps as the primary reason that suitability cannot be justified
- These gaps need to be approached objectively, to ensure that files can be reliably closed and that files can be assessed for suitability

Assess suitability

- The FCA has released guidance and assessment tools. Skill will be required to pass cases through this process to ensure that they are assessed fairly and aligned with regulatory expectations

Establish a causal link

- Processes and records can be imperfect, therefore, it is important to determine whether shortcomings resulted in an unsuitable client outcome or unduly influenced the outcome
- If there is no demonstrable link between the shortcomings and the client's course of action, then the case can be closed

Calculate redress

- This is a complex and costly area and it is important to ensure it is conducted in the most efficient manner. Consumer circumstances can be considered, to ensure that any redress is aligned with a consumer's tax status to ensure that redress is fair for all parties.

How we can help

Our Financial Services team has extensive experience of undertaking suitability reviews, specifically DB pension transfers and the FCA's expectations in this regard. We are also supported by a global network of legal and compliance colleagues.

We can assist you in any of the following ways:

Consultancy / Advisory

We can advise you on how to approach a review of historic advice standards and at each stage of the process.

Oversight / Assurance

We can provide oversight and quality assurance to deliver comfort to the firm and the Regulator that the outcomes being reached are correct and in line with regulatory expectations.

Managed Service

We can take responsibility of the entirety of the review and remediation programme; from the design of policies and procedures, to review, resource, and regulatory reporting.

Interim Resource

We can provide you with resource to undertake a past business review. This can include resource such as case handlers, quality assurance, and project managers.

Get in touch

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