AF7 Pension Transfers
Part 5 Compliance issues

There will certainly be a question on compliance in the AF7 exam. It could come as a specific question in section A or as one part of the two case study questions

The milestones for this part are to understand:

- The difference between DWP and FCA rules
- The difference between safeguarded and flexible benefits.
- The **statutory** requirements in arranging a transfer of safeguarded benefits.
- The difference between guidance and advice regarding pension transfers
- The FCA definition of a pension transfer.
- The current FCA requirements for advising on pension transfers.
- The content of an Appropriate Pension Transfer Analysis (APTA)
- How the value of the pension in a Transfer Value Comparator is calculated.

Giving advice on transferring from a DB scheme is subject to rules and guidance from:

- The Department of Work and Pensions (DWP)
- The Financial Conduct Authority (FCA)

DWP rules

- These state when a client must receive advice before a transfer can be made
- They define “flexible” and “secured benefits”
- Lays down the timescales for making a transfer

Mandatory advice

The Pensions Act 2014 made it compulsory to obtain independent financial advice when considering a transfer from a DB scheme **where the CETV is more than £30,000**. The FCA has clarified that independent advice in this context means advice given independently of the scheme’s trustees or sponsoring employer. It can be given by an IFA or a restricted adviser provided they hold the necessary permissions.

The Act also issued minimum standards as to how trustees of the ceding scheme should deal with transfer requests and ensure that advice has been taken. These will be overseen by the Pensions Regulator.

Defining the terms

The Pensions Act 2015 introduced two new terms, **"safeguarded benefits"** and "**flexible benefits"** Flexible benefits were defined as those where the value of any pension is dependent on the value of the underlying fund. Safeguarded benefits were not defined as such but were considered as any benefits that are not considered flexible!

HMRC and the DWP have now drawn up their own definition of safeguarded benefits.

- The key point is that the benefits must include some form of guarantee about the rate of **secure income** that is provided by the scheme.
- However, a promise or guarantee about the rate on investment growth or future value of the pot is **not** enough for the benefit to qualify as safeguarded benefits

All DB benefits will be safeguarded benefits and most MP benefits will be flexible benefits. However, there are some previously grey areas that have now been clarified.

Guaranteed annuity rates.

These are the most common type of safeguarded benefits that are not salary related. The benefit will be safeguarded even if the GAR is below the rate being currently offered on the open market. If the GAR has an expiry date, the benefits are safeguarded up until that date and flexible after that. Should there be multiple GARs expiring at specific points in the future is a safeguarded benefit until the last one expires.

AVC schemes

It's a statutory right that a money purchase AVC scheme can be transferred separately from the main DB scheme. Should it contain a GAR it will become safeguarded benefits and in assessing the total value both the AVC and main benefits must be taken into account.

Guaranteed Minimum Pension and section (2b) benefits

These pensions are related to the member's salary and are therefore safeguarded. However, in a few cases where liability for these have been transferred to a S32 buy-out policy and the fund is greater than needed to provide the guaranteed amount, the excess is not a safeguarded benefit.

Pension review top up plans

These were put in place to compensate pension scheme members as a result of the misselling of transfers in the 1980's and 90's. These offer a guaranteed level of income and are therefore safeguarded

Income guarantees on drawdown plans

Occasionally the plan may include a guarantee that the value the member's fund will always be sufficient to provide a specified secure rate of drawdown for the member's lifetime then the benefits will be safeguarded.

Guaranteed Lump Sums

If a plan has a guaranteed amount of lump sum but no guarantees as regards pension income the plan will be **not** safeguarded and therefore flexible.

Scheme specific protected tax-free lump sum

As the guarantee does not relate to income this is not a safeguarded benefit.

Timescales

- The member starts the process by requesting a transfer value. Within one month of receiving the request, the scheme must tell the member that independent advice must be taken unless the transfer value is less than £30,000.
- The scheme then selects the **guarantee date**. This is significant because it is the date from which all other deadlines will be determined. It must be within 3 months of the original request.
- The trustees must then give the member a statement of entitlement which summarises all the benefits they would get by staying in the scheme no later than 10 working days after the guarantee date. They must also inform the member that evidence that independent advice has been received must be produced before they can arrange the transfer.
- The CETV is guaranteed for three months from the guarantee and the member must confirm they wish to proceed by the end of this period. The member must also nominate the receiving scheme.
- The deadline for the member to provide proof of independent advice is three months after receiving the statement of entitlement.
- Finally, the deadline for the trustees making the transfer is 6 months after the guarantee date.

Before paying the TV the trustees must check that the authorised firm's FCA reference to confirm that the member has received independent advice. They also have a responsibility to check that the receiving scheme is a legitimate pension arrangement.

Joe sends a transfer request to his scheme on **1 May 2019**

By **1 June 2019** the trustees must inform Joe that he must take independent advice if the transfer is to proceed. (Assuming the TV is more than £30,000)

The guarantee date could not be later than **1 August 2019** but in this case the scheme selects **3 July 2019**.

By **14 July 2019** the trustees must give Joe his statement of entitlement. (weekends and bank holidays are excluded from the 10 day limit.) In fact he receives this on **7 July.**

The final date for Joe to confirm that he wishes to transfer is **3 October 2019** (3 months after the Guarantee Date) and he must provide evidence that he has received independent advice by **7 October 2019** (3 months after receiving the statement of entitlement)

The final date for the trustees to transfer the pension is **3 January 2020**

There is a 30 day cooling off period with a pension transfer but as the member cannot rejoin the scheme once they have transferred, most schemes will hold on to the payment until the 30 day period has expired. In that way if the member changes their mind, they won't have left the scheme.

The FCA requirements

The FCA consider transferring a DB pension could have severe adverse consequences for the client and therefore have additional rules and guidance.

- Only firms with the necessary permissions can give advice on transferring Safeguarded Benefits.
- Advice must be given or checked by an individual who is classed as a **Pensions Transfer Specialist (PTS)**

Types of transfer

The FCA has defined three types of pension transfer transaction.

- **Pension switching** is transferring an uncrystallised personal or stakeholder pension to another personal or stakeholder pension. The FCA regards this as the same as transferring any other existing investments and does not require any other permissions unless the transferred pension is classed as safeguarded benefits.
- **Pension conversion** is the conversion of safeguarded benefits into flexible benefits in the same scheme or the payment of a UFPLS from safeguarded benefits and advice can only be given by a Pension Transfer Specialist

- A **Pension transfer** is where individuals transfer deferred benefits from an occupational scheme or from an individual pension contract with safeguarded benefits to a stakeholder or personal pension scheme or a defined contribution scheme.

Guidance or transfer?

Giving advice on transferring a Defined Benefit pension is complex and can be expensive for the client. For that reason, some firms offer a **triage service.** This can be described as a less formal conversation which helps the client decide whether to proceed to the next stage and seek advice. The FCA considers that this can be useful for a client but care needs to be taken that this does not stray into advice.

The FCA considers that this initial discussion would not be considered regulated advice if:

- Only factual information is given about safeguarded and flexible benefits
- The client is told about the requirement to take advice on conversion or transfer of benefits, the cost and timescales involved
- The firm explains the features of schemes with flexible benefits and safeguarded benefits that make them more or less suitable for general groups of people
- An explanation of the cash equivalent transfer value
- The customer is told that the firm will not provide them with advice
- The firm signposts sources of information including an option to take advice.
- The firm leaves it to the customer whether or not to take advice

The following are examples where the conversation crosses into advice.

- The customer's circumstances are covered and the firm tells the customer that they should not proceed or take advice
- The customer is told that they would be unlikely to recommend a transfer if the customer took advice.
- A TVC is prepared using personal information

The FCA's requirements for the advice process

Following a consultation process the FCA revised its compliance procedures and these were introduced from October 1 2018.

There are six pillars to ensuring the advice is appropriate:

1. There has been a full analysis of the client's needs and this should be part of a wider financial planning service.
2. The adviser has a full knowledge of the ceding scheme and the benefits to which the individual is entitled.
3. The Transfer Value Comparator and Appropriate Pension Transfer Analysis has been produced and explained to the client.
4. The adviser adopts a **compare and contrast** approach to the benefits from both the ceding scheme and the receiving arrangement. The adviser must stress that if the client leaves the scheme the risk is being transferred from the employer to the client.
5. The client gets a personal recommendation
6 The advice is given by or checked by a Pension Transfer Specialist

Getting the evidence

The adviser should have written evidence of all issues that are likely to be relevant in making a recommendation.

Tania seeks advice on transferring her pension. It is public knowledge that the employer is in financial trouble and the scheme is in deficit. This is her main motivation to transfer.

- The adviser should get evidence of the employer's position, e.g. articles from the financial pages of a quality paper
- The current funding position of the scheme including any recovery plans should be obtained.
- The adviser should establish the client's likely benefits if the scheme entered the PPF

All this must be retained on the file.

Compare and Contrast

This is arguably the most important section in ensuring the advice is appropriate and compliant.

The adviser must consider and explain how both arrangements meet the client's needs for:

- The level of income the client needs
- Any unplanned capital withdrawals
- Income sustainability
- When benefits can or will be taken
- Capital Benefits
- Death Benefits
- Tax situation including any potential LTA charges

Any trade-offs for example between flexibility and guarantees must be identified and explained. The adviser must show how both options match the client's ATR and capacity for loss.

The FCA requirements in detail

The FCA states that a firm should start by assuming that a transfer, conversion or opt-out will not be suitable. It can only be considered suitable if it can clearly demonstrate, on contemporary evidence, that the transfer, conversion or opt out is in the client's best interests.

Before making a recommendation the firm must:

- Determine the flexible benefits arrangement to which the client will be transferred
- AND carry out the **Appropriate Pension Transfer Analysis (APTA)** which will include the **Transfer Value Comparator (TVC)**. This isn't required if the only safeguarded benefit is a guaranteed annuity rate.
- Take reasonable steps to ensure the retail client understands how the key outcomes from the APTA and the TVC contribute towards the recommendation.

COBS 19.1.C

To prepare an **APTA** a firm must:

- Assess the benefits likely to be paid and options available under the ceding scheme.
- Compare these with the benefits and options available under the proposed arrangement.

COBS 19.1.2B

Appropriate pension transfer analysis

This must be personalised to each customer's needs and objectives. The FCA gives guidance on the factors that must be considered and documented.

- Full personal details; marital status, health, client objectives and needs
- The client's attitude and understanding of the risk of giving up safeguarded benefits for flexible benefits taking into account the following factors
    - The risks and benefits of staying in the ceding arrangement
    - The client's attitude to certainty of income in retirement
    - Is the client likely to access funds in a unplanned way?
    - If funds are accessed in an unplanned way how would this affect the sustainability of the income?
    - The client's attitude to and experience of managing investment or paying for advice on investments.
    - The client's attitude on any restrictions on their ability to access funds in the ceding arrangement
- The client's attitude to, and understanding of investment risk.
- The client's realistic income needs including:
    - How they can be achieved
    - The role played by safeguarded benefits in achieving them
    - The impact of those needs of a transfer including any trade offs
- Alternative ways to achieve the client's objectives instead of transferring
- Consider the likely pattern of benefits that might be taken from both the ceding and proposed arrangement

COBS 19.1.6

In simpler English the adviser should:

- Consider how each of the arrangements would play a role in meeting the client's income needs throughout retirement.
- Provide comparisons on a fair and consistent basis for death benefits between the ceding and proposed arrangements both at present and at various future points in time.
- Undertake any comparisons of benefits and options consistently
- The impact on the proposed transfer on the tax position of the client and their access to state benefits
- Consider the charges for the product, investment and advice.
- It must document alternatives.
- It must consider a reasonable period beyond normal life expectancy

Transfer Value Comparator

This compares the transfer value with the estimated value needed to replace the client's DB income through the purchase of an annuity.

It must be undertaken on a fixed basis prescribed by the FCA using the following assumptions;

- No tax-free cash is taken at the scheme's NRD
- The annuity purchased at NRD is always on a joint life basis regardless of the member's marital status. It must also be on the same escalation rate as the scheme pension
- The cost of the annuity is discounted back to the date of calculation at a risk free net rate of return (gilt returns)
- No adviser charges are deducted from the personal pension but an allowance of 0.75% pa is factored in together with annuity purchase charges of 4%

If this is prepared more than 12 months before retirement the calculation follows a slightly different process to the CETV calculation.

1. Start with pension at date of leaving
2. Revalue to TVC calculation date using known factors. i.e what the level of inflation has been between leaving and today
3. Revalue from TVC calculation date to Normal Retirement Date using FCA prescribed assumptions
4. Capitalise the pension using FCA prescribed assumptions
5. Discount back to date of calculation

The difference is that the assumptions at stage 3, 4 and 5 will be lower than the scheme actuary would have used.

Where the client has less than 12 months there is no requirement for revaluation to take place.

The FCA requires that it must be given in a "durable format" and prepared to a set format. (see following page)

Table 1

This table belongs to *COBS* 19 Annex 5 1.1R.

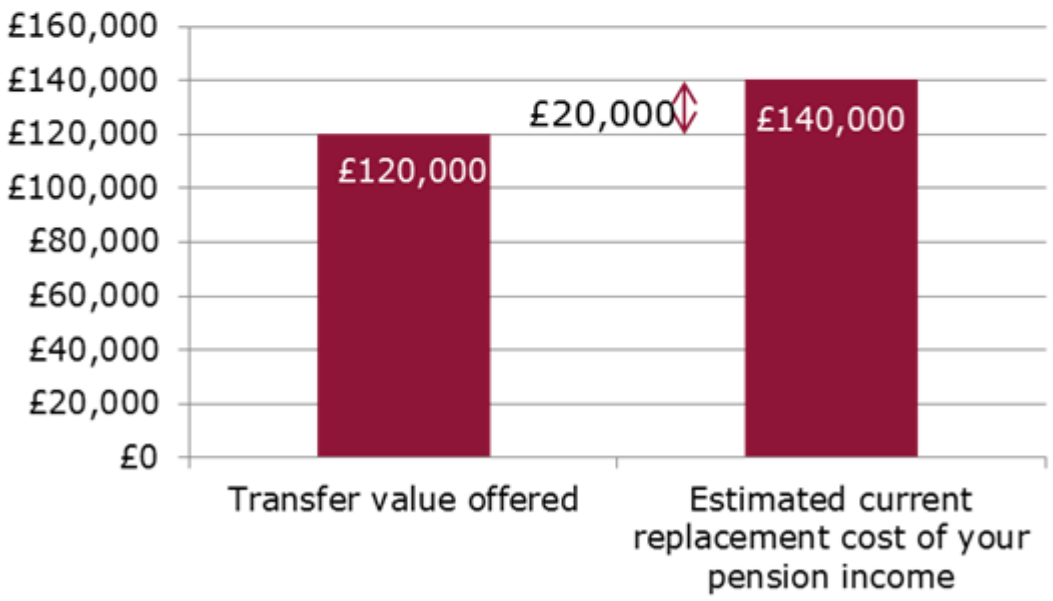
You have been offered a cash equivalent transfer value of £120,000 in exchange for you giving up any future claims to a pension from the scheme.

Will I be better or worse off by transferring?

- We are required by the Financial Conduct Authority to provide an indication of what it might cost to replace your scheme benefits.
- We have done this by looking at the amount you might need to buy the same benefits from an insurer.

It could cost you £140,000 to obtain a comparable level of income from an insurer.

This means the same retirement income could cost you £20,000 more by transferring.



See 'Notes' on the next page for a detailed explanation of this information.

The suitability report

This must be a personal recommendation and must be prepared even if the the recommendation is to stay in the scheme.

It should include:

- A summary of the advantages and disadvantages of the personal recommendation
- An analysis of the financial implications (if the recommendation is to opt out i.e to leave the scheme while still an active member)
- A summary of the key outcomes from the appropriate pension transfer analysis if the recommendation is to transfer
- A summary of any other relevant information.

Good practice should include:

- Avoid standard terms and a lack of personalisation.
- The advice needs to be clearly stated.
- It must demonstrate that that it is in the best interests of the client.
- The advice should not be shaped to fit a client's wishes
- The evidence should be presented to the client
- The client's needs must be matched to the evidence
- The adviser should check that the client understands the recommendation
- The importance of ongoing reviews should be emphasised

If drawdown is being recommended for immediate vesting the recommendation must show why it is appropriate for the client. This should include:

- The immediate income required
- The client's income and capital needs for the next five years. (with evidence).
- The strategy for income drawdown
- Where the funds will be invested

The role the Pension Transfer Specialist

Advice on pension conversions, opt-outs must be given or checked by a Pension Transfer Specialist. This does not apply if the only safeguarded benefit is a guaranteed annuity rate.

Whilst the advice can be given by someone who is not a PTS, the PTS must:

- Check the entirety and completeness of the advice

- Confirm that any personal recommendation is suitable for the client.
- Inform the firm in writing before the report is given to the client
- Settle any disagreements between the PTS and adviser before the client is given the suitability report.

In other words the PTS must not be just a "box ticker" but must check that the proposed recommendation is suitable.

Split advice

It is permissible for a PTS to restrict advice to whether of not to transfer and for another adviser (or even another firm) to give advice on where the money should be invested. The FCA would expect them to liaise with each other

Self investors

Whilst it is mandatory to get advice on transferring from a safeguarded benefit, there is no obligation to get advice on investing the transfer value.

The FCA's expectations are that:

- Advisers should take into account the proposed destination of the transferred funds so the adviser should make it clear that the client needs to provide the necessary information about the scheme and its underlying investments.

- If the proposed transfer is unsuitable specifically because of the proposed destination, the adviser should explain that a transfer may be suitable if the client selects a different destination for the funds. If the adviser gives an opinion on how to amend the proposed destination it is likely to be investment advice.

Insistent clients

Occasionally a client may wish to go against the adviser's recommendation, usually when the adviser recommends the client to stay and the client still wishes to transfer. The FCA has laid down three steps in dealing with insistent clients.

- The adviser must provide advice that is suitable and clear to the client.
- The adviser must make it clear with the client what the risks of the alternative course of action.
- The adviser should make it clear that the client's actions are against the advice being given by the adviser.

The FCA have raised other concerns, in particular

- The risks of the client's preferred course of action were not clearly explained.
- The client was advised not to transfer out of the DB scheme (although the client insisted) but was then recommended a product that was unsuitable.

In practice as a result of recent cases where the Ombudsman has upheld the client's complaint that they were badly advised even though they had gone against the advice given has resulted in many firms declining to proceed with the demands of an insistent client.

Conflicts of interest

The FCA has highlighted a potential conflict of interest in dealing with transfers. The recommendation to stay will probably bring in lower fees than a recommendation to transfer. They see this a potential conflict of interest that must be managed. This is particularly relevant if the firm uses contingent charging, that is a fee is only payable if the recommendation is to transfer.

Advice on transfers to overseas schemes.

The FCA has stated that non-UK residents considering a pension transfer are likely to need advice from both an overseas adviser for the investment advice and a UK adviser for advice on the transfer. The UK adviser should take into account the specific receiving scheme including:

- The likely expected returns on the assets in which the client's funds will be invested.
- The associated risks.
- All costs and charges that would be borne by the client.

This means liaising with the overseas adviser.

You should now understand:

- The difference between DWP and FCA rules
- The difference between safeguarded and flexible benefits.
- The **statutory** requirements in arranging a transfer of safeguarded benefits.
- The difference between guidance and advice regarding pension transfers
- The FCA definition of a pension transfer.
- The current FCA requirements for advising on pension transfers.
- The content of an Appropriate Pension Transfer Analysis (APTA)
- How the value of the pension in a Transfer Value Comparator is calculated.