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Finance
Society

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FCA focus on pension transfers and the decumulation market

Rory Percival

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Introduction by Mark MacLean FPFS
Essex Region Chair

DB Transfers and Retirement Income Advice

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Agenda

- Regulatory context
- DB transfer suitability
- What can we learn from DB transfers?
- Behavioural biases
- Centralised retirement propositions
- ~~Summary~~ Actions

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Learning objectives

By the end of this session you should …

- Understand the FCA's view on suitability of DB transfers
- Understand the likely FCA concerns about the retirement income market
- Understand the problems that exist in many firms currently
- Consider changes, developments and good practice

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21 January 2020

Dear CEO/Director

Portfolio strategy letter for financial advisers

As set out in our Approach to Supervision, we assign firms to a portfolio based on their primary business model. We regularly analyse each portfolio and agree a strategy to take pre-emptive action on the firms and issues posing the greatest harm.

Your firm is part of the portfolio of firms categorised as financial advisers. I am writing to all firms in the portfolio to set out our approach to tackling key areas of concern with financial advice firms and summarise the action we expect you to undertake.

Why financial advisers are a key FCA priority

Regulatory context

- Senior Managers and Certification Regimes (SM&CR)
- PROD
- Assessing Suitability Review 2 (ASR2)

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https://www.fca.org.uk/publication/guidance-consultation/gc20-01.pdf

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GC20/1

Guidance consultation
Advising on pension transfers

June 2020

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DB transfer suitability

- Ill health - yes
- Younger clients – no, unless ill
- Schemes in trouble – ‘overplayed’
- High transfer values – ‘sceptical’
- Death benefits - maybe
  - You can’t have your cake and eat it (unless you are ‘lucky’ and die young)
  - Other alternatives (life cover?)
  - Prioritise income need
- Flexibility - maybe
  - Really? What for and when?
  - Prioritise income need
- Workplace pensions

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If any of the following statements are true, you may be more likely to have received poor advice.

Your adviser did not ask you for **all of the following**:

- information about you and your family, and how much income you need to support your family during your retirement
- information about you and (if relevant, your spouse/partner's) employment, current income and spending, tax position, entitlement to state pension or state benefits
- information about your health (and partner's health, if relevant)
- your and your spouse's other pensions and assets or debts, and any dependency on state benefits (and partner's details, if relevant)
- your priorities and spending plans for your retirement
- how much risk you felt comfortable with and the extent to which you were prepared to accept a reduced lifestyle in retirement if investments performed poorly

Your adviser did not consider how you could achieve the retirement you wanted by keeping your DB scheme.

The pension you transferred was your only or largest guaranteed pension, and you had few other assets to support yourself in retirement, apart from the state pension.

Your adviser did not show how you could meet at least your essential income needs such as paying bills and rent from your DB scheme for your lifetime because they focused on **one or more of the following**:

- giving you flexibility and control of your pension
- maximising the death benefits payable in the event of your death
- helping you achieve early retirement
- helping you take a larger tax-free lump sum

You did not believe the DB scheme employer would continue in business, and your adviser did not show how your retirement needs might be met if the DB scheme was taken over by the Pension Protection Fund.

It’s not the client’s choice …

Poor Practice – balancing needs and objectives

Firm A gathers the client's needs and objectives, prioritises them, undertakes appropriate pension transfer analysis (APTA) and then forms their recommendation to achieve the priority. Even where the analysis indicates it's not in the client's best interest to transfer, the firm still recommends a transfer because the client wants it. The firm believes it was acceptable for them to follow such a process as that was the objective of the pension freedoms.

Where there are conflicts, the firm ignores the client's identified **needs** and forms a recommendation that simply meets the client's **objectives**. The firm is unable to demonstrate that their recommendation is in the client's best interests.

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What can we learn from DB transfers?

Record-keeping: Personal information

Good Practice – gathering personal information

- Aged 52 and started out as a car mechanic before moving to building cars at the car plant; subsequently progressed to quality controller.
- Marital status: Married for 5 years to Marie, a nurse in the NHS.
- Children: 4 children from former marriage, shared parental responsibility for dependent children:
  - Claire, 26, a teacher, financially independent and engaged to Kwame with a wedding planned for 2 years' time
  - Toby, 21, just graduated and due to start work in a graduate role, but has substantial student debt
  - Oliver, 17, accepted a provisional university place with bursary from the armed forces
  - Sophie, 15, still in school and hoping to go to university
- Health: mostly good but slightly overweight and suffered knee problems in the past; tries to play 5-a-side football once a week and is a summer cyclist.
- Both parents still alive but showing signs of frailty.
- Non-smoker and modest drinker.
- Not paying maintenance to former spouse.

Poor Practice – gathering personal information

- Age: 52
- Occupation: factory floor worker/car industry
- Marital status: remarried
- Children: 4 – 2 financially independent, 2 still at home
- Health: average
- Parents status: alive – possible inheritance

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Record-keeping: financial assets

Good Practice – gathering detail of client's other assets

- Mr B: Has 2 deferred DB pensions:
  - scheme 1 is currently worth £8,500 a year, with a protected retirement age of 62
  - scheme 2 is currently worth £1,500 a year
- Mr B: scheme 3, a current workplace pension, has a fund value of £185,000, invested in default arrangement, not contributing enough to maximise employer contribution or to reduce tax below upper tax band level, despite spare income.
- Mrs B: a deferred member of scheme 4, currently worth £4,500 a year.
- Mrs B: currently contributing to scheme 5, default arrangement, standard minimum auto-enrolment contributions.
- Joint with-profits mortgage endowment, arranged by mortgage adviser, projected to pay £30,000 pounds in 3 years' time – earmarked for special anniversary holiday.
- Expected state pensions worth a combined £15,000 a year due from their 66th birthday.
- Cash ISAs worth £55,000.
- Other miscellaneous savings in bank accounts of £20,000.
- Mr B: possible inheritance of around £80,000, parents both alive and currently in late-eighties but father may have to go into a care home within the next 12 months.
- Mrs B: no inheritances due.
- Mr B: a handful of shares from a demutualisation.
- No other debts.

Poor Practice – gathering detail of client's other assets

- Client has got several other occupational and personal pensions but details not provided as we are only advising on transfer of this particular DB scheme.
- Wife has modest pensions from her current and previous job.
- Both expect full state pension but there are no estimates on file.
- Small amount of other assets held.

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Record-keeping: objectives

Good Practice – examples of establishing client objectives

- 'To what extent are you prepared to live on a lower income so that you can leave assets to your children?'
- 'How important is it for you to retire early even if this could mean running out of money later in life?'
- 'Why do you want the higher amount of tax free cash that a flexible arrangement could offer you?'
- 'Why do you want to draw out higher amounts of income in the early years of retirement?'
- 'How comfortable are you with the risk of running out of money in later years, and having to potentially rely on state benefits, if you have drawn higher income from your pensions in early years?'

Poor Practice – establishing client objectives

Objectives questionnaire:

- Would you like to retire early?
- Do you want to maximise your lump sum?
- Do you want to try to increase your pension income?
- Do you want flexibility?
- Do you want to control your own money?

Most people will answer 'yes' to these questions if they are not made aware of the implications of taking this course of action

Advice based on the following objectives:

- Mr D: early retirement, bigger lump sum, increase pension, flexibility, control
- Mrs E: early retirement, bigger lump sum, increase pension, flexibility, control
- Mr F: early retirement, bigger lump sum, increase pension, flexibility, control

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Record-keeping: expenditure

Good Practice – understanding expenditure

A firm collected detailed expenditure that showed what a couple was spending on their existing lifestyle and what the survivor would need. The firm showed how the expenditure was expected to change at their selected retirement age, and again as the clients aged. It then collated the detailed information into categories that it used to identify essential, lifestyle and discretionary expenditure. The firm collected information in a form that clearly showed expected changes in the clients' expenditure on retirement. It also collected information on the frequency of ad hoc purchases.

Taxonomy of income

- **essential** expenditure reflects the bills that the client must pay and which they would find very hard or impossible to reduce
- **lifestyle** expenditure supports the client's expected standard of living, such as holidays and eating out that the client may not wish to compromise on
- **discretionary** expenditure covers luxury items and gifts that the client may want to make, or current savings such as to a workplace pension scheme

Suitability reports

From a content perspective, your suitability reports should be personalised so they:

- give plenty of detail about the client's circumstances
- confirm specific, client-focused objectives and needs and the relative importance of these to each client
- provide explanations of why the recommendation meets the client's objectives and needs, given their circumstances
- contain detailed and in-depth information on any compromises and trade-offs for the specific client
- contain only sections and clauses that are relevant to the client
- contain client-specific risk warnings, rather than generic risk warnings

A good suitability report is a coherent summary of how the client's circumstances, objectives and needs, together with the right analysis and research, are pulled together to become a suitable personal recommendation. Your suitability report should tell the story of your client – who they are, their approach to their financial life and their hopes and ambitions for retirement. Then it should show how your advice demonstrates what can realistically be achieved and the best way to achieve it.

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Suitability reports: poor practice

Poor Practice – credible suitability reports

To clients with little or no knowledge of assets and investment markets:

- 'You are considering transferring out of your final salary scheme now as you feel the transfer value is high due to low gilt yields and you don't think this will be the case going forwards.'
- 'You expressed a specific preference for our investment proposition because of the due diligence that goes into choosing fund managers.'
- 'You felt the equity content of the XYZ fund was enough to give the right level of capital growth potential, and that the geographical location of the fund was more appealing than the higher risk ABC fund.'

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Attitude to transfer risk (COBS 19.1.6(4)(b) G)

(b) the *retail client's* attitude to, and understanding of the risk of giving up *safeguarded benefits* (or potential *safeguarded benefits*) for *flexible benefits*, taking into account the following factors:

(i) the risks and benefits of staying in the ceding arrangement;

(ii) the risks and benefits of transferring into an arrangement with *flexible benefits*;

(iii) the *retail client's* attitude to certainty of income in retirement;

(iv) whether the *retail client* would be likely to access funds in an arrangement with *flexible benefits* in an unplanned way;

(v) the likely impact of (iv) on the sustainability of the funds over time;

(vi) the *retail client's* attitude to and experience of managing investments or paying for *advice on investments* so long as the funds last; and

(vii) the *retail client's* attitude to any restrictions on their ability to access funds in the ceding arrangement;

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Annuities:

- Provide secure, level or increasing pension for life
- Uses the pension fund to buy (ie no fund left)
- Can opt to include spouse's pension on death (amount optional)
- Tax-free lump sum (up to 25%) available if you want
- Doesn't require managing or reviewing
- Generally, benefits and taxation position less likely to change
- Higher income available if in poor health or have certain lifestyle (eg smoker)

Flexible personal arrangement

- No security of income; income depends on investment returns and charges
- Tax-free lump sum (up to 25%) can be taken without having to take income
- Flexibility to take further (taxed) lump sums
- Flexibility to increase, decrease, stop and start income
- Hence, need to review and manage income, lump sum and investment return levels to ensure income is sustainable throughout life
- Unused fund passed to beneficiaries on death (usually tax-free if taken as a fund)

	What is your view now?	What do you think your view will be in your later years, say 80s and 90s?
What is your view on the risks and benefits of having an annuity?		
What is your view on the risks and benefits of having a flexible personal arrangement?		
What is your view on the certainty of income in retirement?		
You have outlined what additional amounts you will need in the future, over and above your regular income. Do you think there is the possibility that you will need to access further funds from a flexible personal arrangement? If so, please provide details		
What is your experience of, and attitude towards, paying for advice on investments so long as the funds last?		
What is your view on the limitations of access from an annuity (ie that you can have a tax-free lump sum and secure income but no further access or flexibility)		
Would you like to leave assets to your children? If so, how much? Does this include the value of your pension scheme? How important is this given that this will reduce the level of benefit you can have in retirement?		

Behavioural biases

Annuities

- Criticised as poor value – what does this mean?
- Investment v insurance
- What value security?
- Diversification

Retirement income strategies

- Annuity/safety first
- Sustainable withdrawal rate (SWR)
- Buckets
- Natural income
- Security and flexibility
- Or mix

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Centralised retirement proposition (CRP)

- Firm-level framework
- Segmentation
- Sub-segmentation (security v flexibility)
- Formality

Actions … 1

- Read GC 20/1 (advisers: chapters 3 – 6)
- Benchmark against good and poor practice
- Agree/record views on suitability
- Training
- Set up a project to create or review your approach to retirement income advice – your CRP
- Report to Board with initial plans and subsequent recommendations, for sign off

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Actions … 2

- Review fact-find:
    - Questions about security v flexibility
    - Detail about income needs – essential, lifestyle, discretionary
    - How income needs will vary
    - Format of questions on objectives
- Sub-segment retirement income clients
- Build framework for what type of retirement income solution meets the different sub-segments (recognise outliers)
- Research and due diligence on solution products and providers
- Training
- Documentation – new or refresh
- Manage adviser biases
- Manage client biases
- Implementation

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Questions …

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Next Essex Event

Tuesday 20 October 8am
New Professionals 'Breakfast' Meeting with Adam Owen

Booking soon at www.cii.co.uk/chelmsford

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Thank you for attending