Protecting their Nest Egg

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At a recent event, a special advisor to the Financial Conduct Authority (FCA) stated that: “More than half of the defined benefit transfers which the Regulator looked at where the recommendation was to move the retirement pot were unsuitable or unclear.”

Why do insurers have such a problem with defined benefit (DB) pension transfers? As insurance brokers we discuss this with clients and non-clients on a regular basis. The headline reason is simple: insurers are concerned that FCA focus (including past issues like the pensions review back in the 1990s) and the values involved in a claim arising from unsuitable advice will cost a lot to rectify. However, like any simple issue there are a number of underlying points which makes this considerably more complex.

Best practice advice
The problem stems from two individual issues.

The first is that when George Osborne, as Chancellor of the Exchequer, announced pension freedoms and more particularly the ability for individuals (where invited by employers or trustees) to take their funds from their defined benefit schemes; this was as much a surprise to the regulators as to the rest of the population. The FCA has maintained their position that swapping certainty, i.e. a guaranteed income (matched by some sort of index linking) for life against a tax-free lump sum and an investible amount to tide the individual over for the rest of their life, is a risky proposition. Their position, it would appear, is faced with the opportunity to transfer or not, that ‘probably not’ is the right answer.
The FCA are also concerned, rightly, about ‘scammers’, (The Pensions Regulator has used enforcement powers on suspected scams some 281 times since 2012*). They are also worried that a subsequent investment could end up in unsuitable property funds, for example in Cape Verde or storage pods.

The second point concerns the position the Financial Ombudsman Service might take when faced with a complaint. This should be a very serious part of the advisers thought process when providing advice in this area. Clearly, the FOS will look at the experience of the individual, whether they might be considered vulnerable in any way, and marrying up the attitude to risk and the investment proposition advanced. There may be some unpleasant outcomes for advisers, and ergo Insurers, who don’t follow best practice guidelines or are cavalier in this regard.
The FCA have been conducting reviews, particularly for firms which have been undertaking large numbers of DB transfers and it is well known that a number of firms have had their permissions removed or suspended. The FCA’s practice note of 24 January 2017 sets out their expectations clearly.

So, how can we translate the above into some practical guidance for advisers operating in this area? Before we do this, we must re-emphasise that insurers do have concerns, so if you are going to provide advice in relation to DB transfers, you

will need to be prepared to (probably) pay more for your insurance in terms of both premium and excess.
On the plus side, fees for this work should be good, so you can afford to invest in developing a robust approach to risk management.

Practical advice for advisors includes:

- Ensure your advisers are appropriately qualified.
- Ensure your insurers know you are operating in this area and how you are going about it.
- Ensure you have a fully documented process.
- Ensure the advice is holistic and in-line with the FCA Practice Note as referenced above.
    - Look carefully at other assets,
    - Understand the client’s requirements for funds in retirement.
    - Do look at death benefits and inheritance tax planning (but these in isolation may not be sufficient in a subsequent review);
- Ensure you gather all relevant information and that you document this – it will be helpful to summarise this information for insurers at your next renewal.
- Document fully the mathematical calculations, demonstrating the differences between taking early retirement and the cash-free sum and pension by remaining in the scheme from the opportunity to transfer – the calculations can be very persuasive.
- Document the number of transfers you discuss but reject early.
- Keep up-to-date with any information from the FCA and be prepared to tweak processes.

In addition, insurers will want to know whether:

- you have ever given pension transfer advice to a third-party independent financial advisor
- you have ever outsourced pension advice and/or;
- you have undertaken pension transfers on an execution only or insistent client basis.

Other areas for consideration:

- Where the individual has an impaired life expectancy client’s attitude to risk. Clearly if the client moves into an investment portfolio and they are ultra cautious, any sort of short-term loss is going to be difficult to defend.
- Point out the risks of short term capital expenditure, eroding the value of their investable sum.
- Helping children or grandchildren onto the property ladder should only be considered for those with considerable assets.
- Buying a Lamborghini or a yacht may not be the most sensible investment proposition.
- A client’s concern over the ongoing viability or indeed any press articles over the ongoing viability of a scheme could be important risk mitigation factors.

*Maggie Craig, special adviser to the FCA made this comment at 'FT Advisers Unpackaging Pensions' event on 4th October 2017. It appears that this comment was based on a sample of 88 cases.
*Money marketing, 5th October 2017, as a result of a Freedom of Information Act request.

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