“to switch or not to switch, that is the question”
Introduction

Having provided a freelance Paraplanning service to a number of directly regulated and network member IFA companies since 2003, Paraplanning Online are ideally placed to observe and react to any industry trends and regulatory directives. In February 2008, we enhanced our offering to the financial advisory community, by releasing our groundbreaking online Suitability Report writing software.

Rather than you having to trawl through, and select, a series of standardised paragraphs, our Suitability Report writing software uses highly intuitive “wizard” technology and asks carefully targeted questions to automatically generate and format the report. This ensures it is quick and easy to use, and most importantly the resultant output is compliant. Moreover, every license holder is allocated their own Admin Centre, which allows them to tailor their reports to reflect their own personal requirements and house style. As part of our commitment to ensure that we continue to provide the most innovative Paraplanning and Suitability Report writing solution available on the market place, our software is constantly updated to reflect changes in taxation, legislation, compliance and regulatory directives as well as industry trends.

As you are no doubt aware, The FSA have recently published their report entitled ‘Quality of Advice on Pension Switching’. The report makes it very clear that the regulator has some serious issues with the quality of advice being given in this area. Although, we do stress that there is a lot more to ensuring your overall compliance where pension transfer advice is concerned than simply providing your client with a compliant Suitability Report, we have compiled this straightforward quick reference guide which not only explains how the PPOL Suitability Report writing software deals with the various issues raised in the FSA report, but also provides some additional handy hints on the processes to follow to ensure your overall compliance.

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Summary of the FSA's Findings

Following their review, the main reasons why the FSA considered the advice to be unsuitable were:

The switch involved extra product costs without good reason (79% of unsuitable cases)

What the FSA said
This was by far the most common reason for unsuitable advice, accounting for 79% of unsuitable cases. The main problems found were:

- Extra product costs were incurred without good reason (65% of unsuitable cases)
- A switch to consolidate different pension schemes where the cost was not explained or justified to the customer (35% of unsuitable cases)
- The new pension was more expensive than a stakeholder pension, but a stakeholder pension would have met the customer's needs (21% of unsuitable cases).

PPOL Comment / Recommendation
One of the FSA's main concerns is that clients are being persuaded to transfer to more modern, flexible plans with more investment or benefit options but are paying unnecessarily high charges for features that are not actually needed. For example, a SIPP may on the face of it provide many more investment options for a client, and may also include more flexibility at retirement, but for the average client who is still many years from retiring these features may not be needed. This is especially true if these additional options or features incur an additional cost to the client. For example, a plan that includes the option for Unsecured Income will not be relevant for a client who is still several years from retirement. In summary therefore it is imperative that you detail in the Suitability Report how any additional features / options reflect the client's current needs and objectives.

We would suggest that the best way to compare the underlying charges of two different pension arrangements is through a comparison of their projected benefits. However, when requesting illustrations and projections, it is important to ensure that both sets of illustrations are obtained on a like-for-like and wholly accurate basis eg the illustration should be written to the age the client actually wishes to retire at, and reflect the actual funds being recommended. The use of cheaper default funds will not provide an accurate reflection of the charges associated with the pension being recommended. To assist in the process of undertaking a detailed analysis of a client's pension options, you may wish to consider using specialist pension transfer analysis software such as that provided by Selectapension or O&M Systems. In summary, it is worth bearing in mind that recommending a new contract where the charges are greater than the existing contract is not wrong per se, however, you must provide justifiable reason in the Suitability Report for these additional charges.

It should also be remembered that it is still an FSA rule that a stakeholder pension plan is considered as the default option for a client, and if an alternative plan has been recommended, the reasons why the stakeholder plan has been discounted should be clearly evidenced in the Suitability Report.

How is this addressed by PPOL
Feedback suggests that one of the biggest failings with people using our software is the omission of a Pension Review section within the Suitability Report. It is imperative that a Pension Review section is included within every pension transfer report. It is within the review section that the details of the existing pension arrangement together the reasoning as to why you have recommended the transfer are included. A selection of the most common reasons for transferring are included for your convenience in the wizard. However, you may need to add your own personalised reasons using the Add Additional Option feature. Please note – You should ensure that you retain adequate evidence on file to justify the reasons selected.

If more than one pension is being transferred, these should be considered individually. You should create a separate Pension Review section for each pension, and undertake a separate comparison of charges and projection of benefits in the Pension Transfer section as facilitated and directed by the PPOL system.

As highlighted above a stakeholder pension should always be considered the default option. There should always be good reason why you are not recommending a stakeholder pension, and this must be evidenced within the report. The PPOL software covers this under the question “Which of the following alternative pension vehicles have you considered and discounted and why?” Again you may wish to include your own personalised reasons for discounting this option using the Add Additional Option feature in the wizard.

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The fund(s) recommended were not suitable for the customer’s attitude to risk and personal circumstances (40% of unsuitable cases)

What the FSA said
Advisers must assess the client’s attitude to risk and personal circumstances and recommend funds that are suitable. In 40% of unsuitable cases the fund(s) recommended were not suitable for the customer’s attitude to risk and personal circumstances. The reasons for the advice being unsuitable included cases where the adviser had taken insufficient account of:

- The nature and overall risk level of the investment(s) recommended
- The impact the term of the policy has on the choice of funds. For example, in some cases there was little understanding that a fund that is suitable over a term of ten years is unlikely to be suitable for a term of three years for a customer with the same attitude to risk
- The customer’s investment knowledge and experience
- The benefits of diversification – sometimes the adviser did not appear to appreciate that investing in a single area or asset class (for example, property) is more risky as the customer has ‘all their eggs in one basket’.

PPOL Comment / Recommendation
The fact that the proposed plan has a better / wider fund range is one of the most widely used reasons for transferring a client’s pension fund. In isolation, however, the range of funds under a particular contract is not relevant, unless the actual funds considered suitable for the particular client are only available under the new plan, and there are no similar funds to choose from within the existing pension plan or a cheaper alternative. We would certainly recommend that you do not use this as the sole reason for transfer, and then recommend the monies are switched into one or two generic funds or even worse 100% cash.

Including an additional reason for transfer along the lines that “the existing plan has only 10 funds to choose from, and their general performance has been poor over the past five years” is fine, but ensure you retain adequate evidence on file to justify this statement.

The actual fund(s) be recommended must be suitable for the client’s attitude to risk and circumstances and must match the attitude to risk recorded in the Suitability Report. You may wish to consider using one of the many risk profiling tools that are available to make an assessment of the client’s attitude to risk, and again we would suggest that this is retained on the client file.

Some such tools even include a portfolio modeling tool which can create a suitable asset allocation, and even assist in the selection of the individual fund(s).

How is this addressed by PPOL
The PPOL system allows you to personalise the attitude to risk definitions used within your report through the My Info function. If you do use a risk profiling tool you may wish to add a standard paragraph to your template, within the Introduction section, explaining which tool you use and how this works etc. This could be achieved using the Admin Centre – Edit Your Report Template function. For further information on how to edit your report template, please refer to page 18 of the User Guide, which can be found on the PPOL website.

The reasons as to why the selected funds have been recommended is covered under the question “Why has the selected fund / funds been recommended?” Again a number of standard reasons are included for your convenience, but you may wish to include your own personalised reasons for discounting this option using the Add Additional Option feature in the wizard.
The adviser failed to explain the need for, or put in place, ongoing reviews when these are necessary (26% of unsuitable cases)

What the FSA said
Where an ‘asset allocation’ approach has been recommended, the scheme needs to be reviewed periodically and rebalanced where necessary, to ensure it continues to be suitable. Otherwise, a portfolio made up of individual funds to meet a certain asset allocation will become unbalanced over time and this may mean the solution no longer meets the customer’s attitude to risk and personal circumstances. The same risk applies when funds with different risk profiles are used. In order to be suitable in these cases, the adviser has to explain the importance of such reviews, or offer them, or put them in place.

PPOL Comment / Recommendation
In light of the principles of the Treating Customers Fairly initiative, “client reviews” are very much the buzz words of the moment. We would suggest that you not only need to be able to demonstrate that you have robust systems in place to carry out regular client reviews, but that these reviews are actually taking place.
In terms of having systems in place to ensure a client’s asset allocation is regularly reviewed and rebalanced, you may wish to consider the outsourcing of a client’s investment portfolio to an investment professional through a Multi-Manager fund, or via Discretionary Fund Management.

How is this addressed by PPOL
A paragraph regarding the need for regular client reviews has been added to the Introduction section of the PPOL global template. Each recommendation section within the PPOL Suitability Report includes the following statement after the recommended funds.

“Please bear in mind that the outlook for market sectors can change, certain asset classes and funds will perform better than others, and as a result your asset allocation will become unbalanced over time. To this end, I strongly recommend that you contact me regularly to review the performance, and continued suitability of the recommended investment portfolio.”
The switch involved loss of benefits from the ceding scheme without good reason
(14% of unsuitable cases)

What the FSA said
Where an existing scheme has particular product features or benefits that are of value to the customer and are not replicated in the new scheme, then there needs to be a good reason why the switch is suitable, despite the loss of these features or benefits. For example, an existing scheme may have a guaranteed annuity rate (GAR) that is higher than is likely to be available on the open market. Other examples include loss of guaranteed benefits in With Profit policies and Guaranteed Minimum Pensions in occupational schemes.

PPOL Comment / Recommendation
Any pension transfer requires the careful analysis of the features, benefits and options of the existing pension plan, and there must always be a clear explanation in the Suitability Report as to what benefits will be lost, and despite this, why a transfer is still appropriate.

If you are recommending the transfer of a pension with a GAR, you should include details of the GAR, how these compare to the current annuity rates available on the open market, whether there are any restrictions as to the basis on which the GAR's will apply (e.g single life, no escalation etc) and why the GAR's are deemed to be of no benefit to the client in that instance.

Even after A Day occupational plans such as Section 32’s and executive pension plans may still provide a Pension Commencement Lump Sum (tax free cash) at retirement in excess of 25% of the fund value. We would suggest that you do not recommend a transfer which will result in a reduction in the tax free cash, unless this has been carefully considered and justified and explained to the client. You will need to consider the client’s attitude to risk and choice of funds when considering whether 25% of the fund value may be larger than the protected tax free cash payment, and these reasons and justifications should always be fully documented in the Suitability Report.

How is this addressed by PPOL
This is addressed in the Pension Review Section. One of the questions posed by the wizard in this section is “Are any of the following features incorporated within this pension plan?” The selection of the relevant feature will result in the system automatically inserting the relevant text in the resultant Suitability Report explaining how the loss of the selected feature could potentially disadvantage the client. However, please note, on subsequently downloading the report to word you may still need to add some freeflow to the report to ensure that the reasons why the potential loss of benefits is not important is reflective of that individual situation.
Other Issues

The FSA also suggested that there were also a number of procedural failings highlighted, including rule breaches. In many cases these did not result in unsuitable advice, but they did increase the risk of unsuitable advice being given. These included:

Failing to adequately evidence the customer’s needs
Where an existing scheme has particular product features or benefits that are of value to the customer and are not replicated in the new scheme, then there needs to be a good reason why the switch is suitable, despite the loss of these features or benefits. For example, an existing scheme may have a guaranteed annuity rate (GAR) that is higher than is likely to be available on the open market. Other examples include loss of guaranteed benefits in With Profit policies and Guaranteed Minimum Pensions in occupational schemes.

Failing to adequately consider the ceding scheme, its options and whether it was able to meet the customer’s needs (for example, by means of a fund switch)
As previously highlighted, it is essential to obtain sufficient information about the existing pension plan to enable a full and considered analysis of the advantages and disadvantages associated with a possible transfer to take place. At PPOL we have constructed an Existing Pension Information Collection Form (which can be downloaded from the member’s area of our website) to assist in this process. Once obtained, the information contained within this form will form the basis of the Pension Review section of the Suitability Report.

Failing to explain why the product or the provider was recommended
Although the PPOL wizard prompts you to include the relevant reasoning as to why the recommended product and provider has been selected, it is essential that you have the relevant back up research on file to justify the reasoning provided and the choices made. There are a number of “whole of the market” research tools available, such as Aequos or Synaptics, which allow the user to rank the providers of any given product based on a selection of predefined search criteria, which can aid with this process.

Failing to provide sufficient analysis of the ceding With Profit fund beyond simply noting the existence (or lack) of MVA penalties, terminal bonus and recent reversionary bonus history
The FSA have suggested that they expect the analysis of the old With Profit fund to include at least the following:
1. A history of the recent interim bonus rates of the fund. (This helps to provide evidence of the fund being cautious in nature.)
2. A look at the asset allocation of the With Profit fund

You may also wish to consider:
• Whether the fund is open or closed to new business, and what the Free Asset Ratio of the fund is. (This is how the level of the assets compares to its liabilities).
• The Principles and Practices of Financial Management (PPFM). This describes how each With Profit fund operates.
These can be found easily by doing a Google search.

If you have access to the O&M system you can use this to access the AKG actuarial reports. These are very useful for seeing how high the ratings are (out of 5) for Financial Strength, Future Performance and Transparency. These also detail whether With Profit funds are open or closed to New Business, and normally give a breakdown of assets within the fund. The Selectapension system also offers the facility to create a comprehensive report which provides a thorough analysis of an existing With Profit fund.

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Conclusion

There is little doubt that the regulator has some serious issues with the area of pension transfers, and most worryingly it has already started to use phrases such as “review of past business” and “enforcement action” in relation to its findings and the actions it requires firms to be made. However assuming the advice provided is perfectly sound and in the best interest of the client, and you have robust systems in place to justify (e.g research tools) and document the reasons for any transfer (e.g an innovative and easy to use Suitability Report writing system such as that provided by Paraplanning Online) then there should be no reason why you should ever fall foul of compliance or the Regulator.

It is also worth highlighting that, as demonstrated in this guide, although there are many more aspects to ensuring your overall compliance where pension transfers (or any other aspect of financial advice) are concerned than solely those relating to the Suitability Report, the ONLY document that can be used to judge the suitability of your advice after the event is the Suitability Report.

This document is only a very brief overview of the FSA's report entitled “Quality of Advice on Pension Switching”. The report can be viewed in full at:
http://www.fsa.gov.uk/pubs/other/pensions_switch.pdf

The FSA have also issued a template which can be used to assess the suitability of, and ensure that you have addressed all of the areas associated with a pension transfer, this can be found at:
http://www.fsa.gov.uk/pubs/other/Pension_switching_template.pdf

Should you wish to discuss any of the issues raised in this report, or our range of Paraplanning solutions in more detail please do not hesitate to contact our Customer Services Team on one of the following

Telephone: 0845 055 328 Or Email: Info@ppol.co.uk

Why not try the free online demo at: www.ppol.co.uk