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Defined benefit pension transfers

In the spotlight

September 2019

Transfers of Defined Benefit (DB) pension schemes to Defined Contribution (DC) plans are big business and they're in the spotlight. This paper explains what firms should be doing and how we can help.

For advisers, the keys to great customer outcomes are education (so-called 'triage'), precise fact-finding and – above all – making your advice about more than simply deciding between remaining in the DB scheme and transferring out.

Providers may not responsible for advice but they do need to identify and manage their risks, understand where new business comes from and be comfortable that their products meet the needs of an appropriate target market.

An opportunity and a potential threat – for customers and firms

The Office of National Statistics estimates that since the pension freedoms changes in 2015, more than £92bn has been transferred out of DB schemes, with £33bn being withdrawn in 2018. Although this was down on the estimated £36.9bn withdrawn in 2017, and the FCA's July 2019 Consultation Paper (CP19/25) proposing a ban on contingent charging noted its expectation that the market would contract, we anticipate that DB transfers will remain an important part of the retirement planning landscape, at least in the medium term. A transfer can potentially provide greater and more flexible income and capital for a customer's retirement. But by transferring out, customers take on the investment risk and responsibility to fund their retirement that previously sat with the DB scheme.

So advice on the merits of a DB transfer is likely to be complex and profound, and the regulators are concerned. Against the backdrop of the British Steel Pension Scheme debacle, the Financial Conduct Authority's (FCA) recent supervisory work suggests that advisers give suitable DB transfer advice less than half the time (48%), compared with 90% in other areas. This is concerning, especially given the likely impact on the quality of people's lives in retirement. In CP19/25, the FCA estimated that customer harm from poor advice amounted to £1.6bn – £2bn per year. The FCA has also made clear that providers should identify and manage and risks of customer harm that arise from business they accept.

What is the FCA doing?

New FCA rules and guidance aiming to improve advice on DB pension assets – set out in Policy Statement 18/6 – became effective in October 2018. In the December 2018 notice publishing its latest supervisory findings, the FCA warned that "Any firm that is active in this market can expect to be involved in our work in 2019. We will not hesitate to use our investigatory powers where we identify evidence of serious misconduct which could have caused harm to consumers." And then came CP19/25 in July 2019, proposing a ban on contingent charging for DB advice, a requirement to explain why a workplace pension (if discounted) is not appropriate, and new cost and charges disclosure rules.

So, if you give or have given DB pension transfer advice, or accept DB transfer monies, not reflecting on all this is not an option. What can you do to make sure that your DB pension activity leads to great customer outcomes, and is recognised as such by the FCA?

What should I be doing?

At some point you are likely to be challenged to demonstrate that your advice, products or services lead to good customer outcomes.

So what should you be doing? Here are a few challenges to consider:

Strategy and Governance

- It is essential to have a clear articulation of your strategy for DB advice / transfer customers, including what constitutes a good outcome and how the firm intends to achieve them.

Advisers

- **Education or 'triage'** – what steps do you take to explain what the process will involve to potential customers, without giving advice?
- Will you offer 'abridged advice,' proposed by CP19/25?
- **Make sure advice files tell the story** – in our experience, advice is deemed unsuitable or unclear because the richness and detail of interactions advisers have with customers is not reflected in their records. So, make sure that you are not only having probing conversations with customers to establish their true retirement needs, but also that your documentation does them justice
- **Identifying and meeting need** – does your advice process consider the bigger picture of identifying true retirement income needs, and how the DB assets can be used to meet them, rather than narrowly focusing on whether to transfer DB assets?
- **Quality of advice checks** – we see firms testing 100% of DB pension recommendations, internally and/or externally, before they are made to customers.
- Prepare for the implementation of CP19/25 proposals – a ban on contingent charging, new disclosure requirements and changes to the APTA and TVC

Providers

In March 2019 the FCA wrote to product providers setting out what it sees as the major drivers of customer harm when designing, marketing and providing products that accept DB transfers.

- **Product design and target market** – you must be able to show how you have taken the needs of customers transferring from DB schemes into account – particularly if the products were developed before pension freedoms in April 2015
- **Management Information** – this should identify target audiences appropriately and any weaknesses in support services. It should also be sufficiently detailed to enable management to fully understand and manage the risks from DB pension transfers, using metrics that allow meaningful oversight, specifically on customer/adviser behaviour
- **Product reviews** – are your products achieving the good outcomes you expect, and performing as customers were led to believe? How do you know? What action have you taken it not?
- **Information for distributors** – the documentation and tools for advisers and other third parties should be balanced, clear and accurate
- **Due diligence** – do you understand and manage any risks stemming from the intermediaries advising customers to transfer to you?

Whether your firm is an adviser or a provider (or both), you need to understand and apply FCA rules and guidance to meet expectations. We have analysed FCA output on DB pension transfers and used our technical expertise and experiences of working with both firms and the FCA to develop some insights on how to do this, which are set out below.

All firms

Focus Area	Regulatory expectations	Grant Thornton insight
Business model, strategy and governance	A clear articulation of the firm's strategy, including how the firm intends to achieve fair outcomes and avoid harm	• There should be a well defined and embedded strategy for all customers • The FCA expects firms to nurture and sustain a culture whereby the interests of all customers is central to the business model, with the status quo open to challenge, including via external review • You need to be able to demonstrate that your advice, product or service offering is appropriately targeted at people likely to benefit from it, and that steps are taken to avoid it being targeted at people for whom it is unlikely to be suitable • The FCA expects firms to have absolute clarity over what constitutes good or poor customer outcomes for all products and customers. This should be clearly documented, consistently understood throughout the firm, and used to benchmark performance • The FCA expects firms to identify gaps against its expectations and implement plans to address them. This may include proactive management action on improving the quality of communications – including digital – and advice or product reviews • Firms need to integrate the fair outcomes governance into wider governance so there are no major overheads or duplication • Remedial action which seems expensive should be considered carefully to ensure it will enhance customer outcomes and reduce regulatory and conduct risk.

Providers

Focus Area	Regulatory expectations	Grant Thornton insight
Product design and target market	Show how you have taken the needs of customers transferring from DB schemes into account – particularly if the products were developed before pension freedoms in April 2015	• Providers must be able to show that they know for whom their products are more and less likely to be suitable, and that their approaches to the design, marketing and distribution of products is such that they reach those for whom they are intended. Any exceptions or trends in this respect should be identified and addressed • Where DB to DC transfer advice is given by an intermediary, that intermediary is responsible for the advice to the customer, rather than the provider. However, providers cannot absolve themselves of responsibility. The guidance contained in the FCA's Responsibilities of Providers and Distributors ("RPPD") document specifies a number of important regulatory expectations. An inability to demonstrate appropriate consideration in this respect would be a significant risk https://www.handbook.fca.org.uk/handbook/document/RPPD_FCA_20130401.pdf • It is important for providers to be comfortable that they are accepting good quality DB to DC transfer business. It is good practice to have policies and procedures governing the acceptance of new business, clearly articulating a target market and any circumstances under which business would be declined. It is also important to collect management information regarding the intermediaries who refer DB to DC business, to manage risks in this respect and to be able to take action to protect customers' interests if necessary • Can you demonstrate that products developed before April 2015, but which still receive DB pension transfers, remain able to meet customers' needs and goals in light of the pensions freedoms?

Providers (continued)

Focus Area	Regulatory expectations	Grant Thornton insight
Product reviews	A well-defined and effective product review process is in place to ensure that products reach their intended target market, achieve good outcomes and perform as customers have been led to expect	• The product review process should establish the extent to which good, indifferent and poor outcomes – as defined – are being achieved, and customer harm avoided. Reviews should focus not just on T&Cs but also establishing evidence that the firm's and FCA expectations have been met • Providers should continuously ensure that their products are reaching those for whom they were intended, and avoiding those for whom they were not • Reviews should be of a sufficient standard to provide the appropriate senior manager function holder with the information they need to be confident they are dealing with incoming DB business appropriately • Reviews should be dynamic, data-driven and analytical, with qualitative inputs and commentary to provide context and texture • Product reviews need to incorporate the impact of all fees and charges on customer outcomes in addition to qualitative features • Reviews should demonstrably drive outputs, e.g. new products and product updates, improvements to communications, decisions on charging structure and poorly performing funds.
Due diligence of intermediaries / advice	Understand and manage the risks from DB pension transfers, using metrics that allow meaningful oversight, specifically on customer/adviser behaviour	• Providers should ensure that intermediaries from whom they receive advised DB transfer business have the appropriate regulatory permissions, and have not been subject to (relevant) regulatory censure • It is good practice for providers to have a policy and procedures governing the acceptance of new DB to DC business. What are the key criteria for acceptance of the business? Who approves the acceptance? How is adherence to the policy and procedures monitored? • Are there prescribed circumstances under which you would refuse business from an intermediary? How often has this happened? Are there any examples of intermediaries being taken off an 'approved' list? How have controls evolved? • It is also good practice for providers to satisfy themselves that intermediaries' advice is subject to robust suitability checking, internally and/or externally; and that intermediaries have controls regarding insistent customers.
Management Information		It is good practice to gather, analyse and act on MI to manage risks associated with intermediaries. For example, do you know: • that intermediaries that refer DB transfer monies to you were and remain authorised and regulated by the FCA, with permission to advise on DB to DC transfers • the proportion of small transfer values and insistent customer business you have accepted • the proposed business referred to you that you declined, and why • the proportion of an intermediary's advice that is DB to DC transfer business • the proportion of an intermediary's DB to DC transfer business that is referred to you • the volumes and proportions of your DB to DC transfer business that come from individual intermediaries, and the extent to which this is increasing or decreasing?
Provision of information – to intermediaries and customers	Provide accurate and timely information, that is clear, fair and not misleading, to facilitate good customer outcomes	• Providers should ensure that intermediaries have sufficient and accurate information to facilitate suitable advice, in particular regarding the nature of the risks inherent in a DB to DC transfer, product features and the associated costs and charges • Providers should also ensure that pre-sale information provided to customers about the receiving DC products is clear, fair and not misleading • Post-sale, providers should ensure that customers and their advisers receive communications that are sufficiently timely, accurate and meaningful to enable good decisions, including with regard to investment performance and charges. This should have regard to the likely needs and capacity of the target market.

Financial Advisers

Focus Area	Regulatory expectations	Grant Thornton insight
Triage	Making sure potential customers understand what the process will involve – but without crossing the advice boundary	A DB transfer – or even getting advice to evaluate the possibility – isn't for everyone. Potential customers should be encouraged to think carefully before investing significant time and money for advice – especially given that the FCA compels advisers to start with an assumption that a transfer is unsuitable. It is good practice for advisory firms to undertake some form of 'triage' before beginning an advice process 'proper.' Triage is the provision of information about DB and alternative DC arrangements, and what a transfer will involve, to help someone decide whether to proceed to advice. Done well, triage means that people unlikely to benefit from advice on the potential merits of a DB transfer will opt themselves out, before both they and the adviser incur any significant risks or costs. The FCA recognises the benefits of triage – but beware crossing the advice boundary. Any reference to how a customer's personal circumstances may influence advice, or guidance (express or implied) either towards or away from a transfer, is likely to constitute a personal recommendation. So, triage services should: • Be non-advised, educational, factual and neutral – clearly and straightforwardly explaining the differences between DB and DC schemes, and what a transfer is • Present a generic, balanced view of the potential advantages and disadvantages of a DB transfer • Explain the likely significance, complexity, timelines and cost of advice, and the starting assumption that remaining in the scheme is the best course of action for most people. Triage can be done using written materials, a conversation or both. It is important that a decision to proceed to getting advice is the customer's, and recognised and recorded as such.
Fact-finding and meeting the challenge of the APTA requirements	PS18/6 confirmed that the Appropriate Pension Transfer Analysis (APTA), including the Transfer Value Comparator (TVC) would be mandatory from October 2018	**Don't think of the advice as simply remain vs. transfer – and be proud of the service you're providing** The APTA – a requirement since October 2018 – is more than a list of prescriptive requirements; it is a concept. Your goal as an adviser is to identify and quantify a customer's true, realistic income and capital needs in retirement, and then to determine how best these can be met – considering all their available assets. Crucial to meeting the APTA challenge is an understanding that recommending either remaining in a DB scheme or transferring out is only one part of this bigger picture. A DB transfer is not an end in itself, it is one possible means, among a number of options, to realise a customer's retirement needs. So do not underestimate the value of the service you provide. A customer may have sought advice looking for a DB transfer, or thinking that the advice would not go further than recommending staying in or leaving the scheme. But the customer should emerge from the advice process understanding what their retirement needs really are, whether and how they can be met and the role their DB assets can play. The peace of mind this provides is invaluable and well worth paying for – whether they transfer out or not. **If there is a 'silver bullet' it is great fact-finding** Poor fact-finding is arguably the biggest or most likely cause of poor DB pension transfer advice. So what does good fact-finding look like? It comes down to being comprehensive, precise and frank with the customer. The first thing to consider is a customer's **attitude to transfer risk**. On transfer to a DC scheme, the scheme member voluntarily accepts the investment risk, and the responsibility for providing an income for life, that was previously borne by the scheme. The member also accepts responsibility for choosing what to do with the scheme proceeds and managing them going forward, or engaging – and paying for – someone else to do so. Explaining this and gauging the customer's attitude to this transfer risk are crucial elements of DB pension advice. If someone does not understand, or is not willing or able to take the transfer risk involved, a DB transfer should not be recommended, unless there is another over-riding good reason (a life-limiting health condition, for example). We see firms articulate customers' **goals** using vague, high-level terms such as 'flexibility,' 'maximising income' or 'as much growth as reasonably possible.' But what does flexibility mean to an individual customer? Do they really need it? Why? Can it be quantified? How much income and growth does the customer actually need in order to meet their individual retirement income needs? And can this be achieved, taking into account their **attitude to investment risk** and **capacity for loss**? You should establish, objectively and in detail, **how much a customer will actually need in retirement** (and for what) in order to achieve their expected or desired standard of living. Only then can you work out how to facilitate this. You need to keep probing until you get the level of detail you need. If you think someone's goals are unrealistic, or that they are trying to guide your advice in a particular direction, you should challenge them. It's also essential to properly **contextualise your questions** about a customer's needs and goals. For example, if asked 'would you like to leave some of your pension as a legacy to your children?' many people would say 'yes.' But you need to establish how important this is, how much the customer would like to leave behind and why; and you should explain that the more left over at the end of the customer's life, the less there will be to fund their retirement – and maybe that of a spouse or partner – while they are still here. Placed in this context, the customer's answer may well be different. Which brings us to **trade-offs**. In many cases it will not be possible to meet, fully, all of a customer's needs and goals, whilst being appropriately mindful of their attitudes to transfer and investment risk and capacity for loss. If so you should be open about this, and challenge the customer to prioritise. Where are they willing and able to compromise? None of this is new or surprising. But it is clear that as a result of its supervisory work the FCA believes that too many advisers are not doing this well enough when giving DB pension advice. The APTA is part of the FCA's attempt to focus minds and raise standards.

Financial Advisers (continued)

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<tr><th>Focus Area</th><th>Regulatory expectations</th><th>Grant Thornton insight</th></tr>
<tr><td>Fact-finding and meeting the challenge of the APTA requirements (continued)</td><td>PS18/6 confirmed that the Appropriate Pension Transfer Analysis (APTA), including the Transfer Value Comparator (TVC) would be mandatory from October 2018

CP19/25 proposed changes to expense allocations and other assumptions in TVC</td><td>Using the Transfer Value Comparator (TVC)
The TVC is a mandatory element of the APTA. It aims to show the customer the current cost of replacing what their DB scheme provides on the open market. You should use the TVC to explain two things:
• The features and benefits of the customer's DB scheme that they would relinquish on transfer
• That by showing the difference between the transfer value and the current cost of replacing the scheme's benefits on the open market, the graph effectively puts a monetary figure on the transfer risk.
• CP19/25 proposed changes and simplification to the product charge assumptions that apply before future income benefits come in to payment. Will you be ready for these?
Using cash flow modelling
Advisers are increasingly using cash flow modelling to help them compare what a DB scheme can provide with viable alternatives, in the context of considering how all a customer's assets could be used to fund their retirement. Fundamentally, cash flow modelling:
• Is a detailed picture of assets, investments, debts, income and expenditure, projected forward, year-by-year, using assumed rates of growth, income, inflation and interest rates
• Can be used as a means of assessing current and forecasted wealth, along with income and expenditure, to create a picture of current and future finances
• Allows a comparison between the current position and alternative solutions.
There are two types of cash flow modelling commonly used by advisers: stochastic and deterministic modelling. Stochastic tools use lots of historical data to illustrate the likelihood that something will happen, such as the customer running out of money. This means the tools will not produce a specific number but a range of possible outcomes. Deterministic tools arrive at a specific conclusion based on the values put in by the adviser.
There is no requirement to use cash flow modelling. However, it is a useful way of meeting the APTA goal of analysing the respective impacts of remaining in the DB scheme or transferring out, and which option best enables the customer's needs.</td></tr>
<tr><td>Considering charges</td><td>Conduct of Business (COBS) requirements</td><td>Existing rules make clear that customers must be made aware of how much they will be charged for the advice, separately from all product/fund/platform charges, before they are incurred.
It was already good practice to make the cost of the advice non-contingent on the purchase of a product, i.e. the customer is charged a fee irrespective of whether or not they transfer their DB scheme. In CP19/25, the FCA proposed banning advice paid for only on implementation of a transfer (or conversion), except in specific circumstances – serious ill health, shortened life expectancy or as a means of avoiding serious financial hardship.
Firms already charging on a non-contingent basis should nevertheless review their business models to ensure they will be compliant should the proposals be implemented; firms charging on a contingent basis face a major project to redesign and test their business models, or even to consider exiting the market altogether.</td></tr>
<tr><td>Abridged advice</td><td>CP19/25 (July 2019) proposed a short form advice resulting in a recommendation not to transfer, outside a ban on contingent charging</td><td>• Abridged advice is intended as an additional mechanism to filter out consumers for whom a DB transfer is unlikely to be suitable, before they pay for full advice. The only permissible recommendation is no transfer.
• Initial fact-finding should take place, sufficient to make a recommendation compliant with COBS (and other) rules – but there is no need to gather and analyse scheme data, or undertake the APTA and TVC.
• Firms should consider whether this is a viable option for their target customers, and whether to offer it alongside or instead of triage and/or full advice.</td></tr>
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How can Grant Thornton help?

Grant Thornton's team of specialists has deep knowledge and experience of working for and with firms across the industry and the FCA. Our market knowledge, experience and understanding of the issues you face allows us to provide pragmatic guidance and support on these complex issues, whilst also accounting for your strategic and commercial objectives.

Our market-leading team can help you by:

- Analysing your business model, past and/or present
- Diagnosing the nature and extent of any past or current issues indicating the possibility of customer harm
- Designing, reviewing or assuring the effectiveness of your:
  - Advice process
  - Product design and review processes
  - Distribution channels
  - Outcomes testing, including quality of advice checks
  - Governance, controls and risk mitigation infrastructure, including internal audit reviews

If redress and remediation is being considered, we have extensive experience of both conducting and independently assuring:

- Initial sampling and testing to determine the appropriate nature and extent of any remediation exercise
- Setting up and running a Past Business Review (PBR), end-to-end – including running it alongside BAU
- PBR population identification and sampling
- Redress calculations and other actuarial methodologies

We can also help with:

- Managing your relationships and communications with customers and the FCA
- Resource augmentation – we have a network of highly qualified, mobile and experienced staff and contractors, who can assist you conduct larger PBRs.

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