Financial Services Authority

Using the FSA's pension-switching advice suitability assessment template

February 2009

Contents

1 Introduction

We are publishing this template following the FSA review into pension-switching advice in 2008.[1] This document will help file reviewers complete the template to assess the suitability of pension-switching advice. Firms may wish to use it when carrying out their own compliance checking to help ensure that any past or future pension-switching advice is suitable.

The template will form the basis of the follow-up work we intend to undertake in the third quarter of 2009.[2] This work will include visits and desk-based file reviews, to check firms have acted on the findings of the thematic project. If we identify failings concerning the suitability of pension-switching advice and find that firms have not taken appropriate action, they may be subject to regulatory action. This could include, where appropriate, referral for further investigation with a view to possible enforcement action.

Limitation of scope

This template applies only to advice on switches from all types of money purchase pensions, including personal and occupational pensions, to a Personal Pension Plan (PPP) or Self-invested Personal Pension (SIPP). It does not cover the requirements for transfers from defined benefit occupational schemes or switches to use drawdown flexibility immediately.

Note that this suitability assessment template relates only to whether the advice is suitable; hence it should only form a part of an overall file review process. It should not replace in full any existing file review checks firms have in place and other issues (such as disclosure, needs analysis, money laundering etc) should also be checked.

1 *Quality of advice on pension switching: A report on the findings of a thematic review*, December 2008

2 Please note that this timeline is merely indicative and does not in any way limit our right to take regulatory action against firms sooner, where we consider this appropriate in light of any failings we have identified.

Answering the questions in the template

There is certain functionality in the Excel version of the template that is not available in the PDF version:

- All yellow-shaded cells provide a drop-down menu of possible answers.
- Grey-shaded cells are completed automatically when you, the reviewer, answer questions elsewhere in the template. These grey-shaded cells flag if an unsuitable outcome has materialised. Generally, if this has happened, the overall rating of the advice is likely to be Unsuitable. If you disagree with an automatic rating, review your answers to earlier questions to check accuracy. And if you disagree that a particular unsuitable outcome leads to the advice being Unsuitable overall, you do not need to follow this assumption but should explain why you have taken this approach.
- There are blue markers next to each question. Once you have answered the question, the blue marker will disappear. Once you have completed the template, look at the box at the top or bottom of the template; this will tell whether you have answered all the questions. If you have missed any, look for the blue markers. Some of the answers in drop-down menus depend on answers to earlier questions. So if you change an answer, check to see whether you need to review answers to other questions. The blue markers will reappear for questions where this is the case.

Comments are essential to the review, especially to help in quality assurance and moderation.

Guidance on rating a case

The following notes include guidance on how to use this template to rate a case as Suitable, Unsuitable or Unclear. These notes are not a comprehensive list of issues to consider but give some idea of the kind of situations that might lead to certain assessments.

The questions in the template highlight a series of issues that you should consider when assessing advice to switch pensions. Disadvantages of a recommended transaction must be disclosed to the customer, but note that disclosure of all relevant downsides cannot make unsuitable advice suitable. If the right advice is not to switch to another scheme, this should be the advice that is provided to the customer. When reviewing the file, you must objectively assess all the facts to decide whether the adviser's recommendation is suitable.

Important legal note

This template does not constitute Handbook guidance: it does not define the suitability standards for pension-switching advice. Firms should have regard to this communication as 'FSA supporting material', which is intended to help firms comply with the FSA's rules and Principles.

There may be several ways of complying with a regulatory requirement and following guidance or other material we publish, such as this, is only one approach. A firm's senior management remain responsible for establishing and implementing effective controls over the conduct of pension-switching advice.

For further information, please refer to the section on FSA guidance and supporting materials in our Enforcement Guide, paragraphs 2.22 to 2.27.

2 Questions section

Section 1: File-specific information

This section is for administration purposes, to identify the details of the case and the reviewer.

Section 2: Customer needs analysis

A You should record the reasons given by the adviser for the switch. If Other is chosen, add notes to qualify the other reasons.

Comments box — Record thoughts on how well the adviser has assessed the customer's needs and whether the needs appear to be genuine. If the suitability report cites customer requests (e.g. that the customer 'wants to move to gain access to externally-managed funds'), has the adviser provided an objective assessment of the suitability of this? If the right advice is not to switch to another scheme, this should be the advice that is provided to the customer even if they have asked to move scheme.

Section 3: Unsuitable outcomes

Based on our Principles and rules, we have identified four key outcomes that would indicate customers had received unsuitable advice. This section asks questions to test for these. There may also be other unsuitable outcomes, so there is also space to note down other sources of possible detriment to customers.

Key unsuitable outcome 1: The customer has been switched to a pension that is more expensive than their existing one(s) or a stakeholder pension (because of exit penalties and/or initial costs and ongoing costs of the receiving scheme versus the old scheme or a stakeholder pension) without good reason.

If a number of schemes are being consolidated into one plan, check that the adviser has considered the merits of switching each ceding scheme. Looking only at the overall position may hide cases where it is better for the customer to switch some of the ceding schemes but to retain others.

The Data section of the template is included as a working space to help record the charges that apply on the ceding and receiving schemes. It may help you answer the following questions.

You should consider the total costs of the receiving scheme (including initial and ongoing fees) to be able to judge how these compare with the receiving scheme.

1.1 The first question asks simply whether the receiving scheme is more expensive than the ceding scheme.

Check that the personalised Key Features Illustration (KFI) accurately reflects the recommendation. For example, if it is based on different funds (with lower charges) this may give the customer a misleading impression of the value for money of the receiving scheme.

Note that it is important to consider by how much more expensive the receiving scheme is than the ceding scheme. Generally, the smaller the difference in price, the more likely the benefits are to outweigh the costs of switching.

Where a number of ceding schemes have been consolidated into a single receiving scheme, answer this question on the basis of the least expensive ceding scheme (you can use the comments area to note information on the other schemes).

1.2 Next perform a similar analysis of the cost of the receiving scheme against a stakeholder pension.

1.3 There should be evidence that the effect of penalties has been taken into account in advising the switch to proceed.

Where a number of ceding schemes have been consolidated into a single receiving scheme, answer this question by focusing on any ceding scheme where penalties applied (you can use the comments area to note information on the other schemes).

A note on value for money for questions 1.4, 1.5, 1.6 and 1.7

When switching to another scheme, the default should always be to move to a low-cost option, e.g. to a stakeholder pension, a stakeholder-charged personal pension or by consolidating to one of the existing schemes if it offers relevant plan features at a low charge.

When reviewing a switch to a more expensive scheme, make an objective assessment about whether there are benefits to the customer in doing so. For example, reviewers are unlikely to find it sufficient for the adviser simply to have noted that the receiving scheme offers a choice of 500 funds, especially if one of the ceding schemes has a choice of 100 funds. The customer must have a clear need for those funds and receive a real benefit from having them. You should look to see that the benefit to the customer of the additional fund range out-weighs the additional charges. Some questions to ask include:

- What precisely does the receiving scheme offer that a less expensive alternative does not?
- And what value does the customer get by paying more? Does that value at least make up for the additional charge?
- Are the receiving scheme's funds likely to be able to out-perform the cheaper scheme options by at least the amount of the additional charge? How has this been analysed?
- Will the customer's use of active online fund switching really make up for higher charges to access such a feature when ceding schemes only offer offline switching?

If the file does not contain sufficient information to be able to tell whether the additional charges can be out-weighed, then the answers to questions 1.4 to 1.7 are likely to state that there is not enough information to assess the answer completely. This may make the final rating of the advice Unclear. In this case, you should ask the adviser to provide further information to show that the advice is suitable. You should check that this further information addresses your concerns adequately. If not, the case rating is likely to change to Unsuitable.

Note that consolidation of pension schemes can be more to the advantage of the adviser than to the customer (by reducing the administration involved), so there should be a demonstrable advantage for the customer if schemes are to be consolidated to a more expensive policy. Do customers have a real demand for less paperwork (via consolidation) that is enough to justify a more expensive scheme?

Clear disclosure of additional charges on the receiving scheme is not sufficient to over-turn these requirements. Reviewers should check that more expensive schemes are truly in the customer's best interests. Otherwise, the advice should be not to switch.

1.4 Consider how well the receiving scheme meets the customer's needs identified earlier (bearing in mind how genuine those needs appear to be). Does the product meet the customer's needs adequately? Does it offer them more than they need?

For example, if the customer is moving to a more expensive scheme partly because it allows the flexibility to use drawdown at retirement but the customer still has 15 years until retirement, it is unlikely that they are receiving value for money by paying more for this feature before they actually come to retire.

1.5 Was the method used to select the product and provider appropriate? Could the customer's needs have been met adequately by a less expensive alternative? Is the customer being exposed to higher costs than are necessary?

You should also consider the amount of remuneration that the adviser has taken. Inducements should not impair compliance with the firm's duty to act in the best interests of the customer. Consider the amount of commission or fees in relation to the work undertaken and whether it could have impaired compliance with this duty. Has it encouraged advice to switch pensions when the customer would have received better value for money in the ceding scheme or a cheaper replacement that offered less commission?

1.6 The answer to this question is also likely to tie back to the earlier needs analysis.

- Where the adviser has said that investment flexibility is important to the customer, does the ceding scheme have only a limited range of investments? In some cases the receiving scheme may offer hundreds of funds where the existing scheme 'only' offers 50 or so – in this case, how would the customer benefit from access to more than 50 funds?
- Similarly, where the adviser has said that poor performance in ceding schemes is an issue leading to the advice to switch, do the circumstances of the case justify this assessment? And is it likely that the receiving scheme can offer better performance? Is that better performance likely to be enough to make up any additional charges?
- Where an adviser has recommended a switch out of a policy because it invests in a with-profits fund, we would expect the adviser to provide analysis of the ceding with-profits fund beyond simply noting the existence (or lack) of MVA penalties, terminal bonuses and the recent reversionary bonus history.

Where a number of ceding schemes have been consolidated into a single receiving scheme, answer this question by focusing on any ceding scheme where problems were identified (you can use the comments area to note information on the other schemes).

1.7 If the receiving scheme is more expensive than a stakeholder pension, is there a good reason for this additional cost?

For example, if a more expensive scheme has been recommended because it allows access to externally-managed fund links, has the adviser recommended externally-managed funds or is the customer paying for features that they are not using and do not need? Do they really need access to externally-managed funds? Does the extra flexibility provide value for money? Could the customer have achieved suitable results in a cheaper stakeholder pension?

Comments box — If the poor outcome has materialised, explain why this is the case. Is this a significant problem? Are there any mitigating circumstances? If one of the poor outcomes has materialised, we would expect the overall advice to be unsuitable.

Key unsuitable outcome 2: The customer has lost benefits (e.g. guaranteed annuity rates) in the pension switch without good reason.

2.1 One very important consideration is whether the adviser has checked whether each ceding scheme has a guaranteed benefit (especially for older personal pensions, S226/retirement annuity contracts or with-profit policies).

If such a benefit applied on a ceding scheme, you should assess whether this has been disclosed adequately by the adviser and whether the advice to lose it by switching to another scheme is suitable.

If the file does not include confirmation of guarantees one way or another, mark this as 'no evidence of guarantees checked'.

Comments box If the poor outcome has materialised, explain why this is the case. Is this a significant problem? Are there any mitigating circumstances? If one of the poor outcomes has materialised, we would expect the overall advice to be unsuitable.

Key unsuitable outcome 3: The customer has switched into a pension that does not match their recorded attitude to risk and personal circumstances.

3.1 Record the customer's attitude to risk (ATR) as shown in the 'know your customer' document/ factfind.

3.2 Now record the customer's ATR as shown in the suitability report. If there is a difference between the customer's ATR in the know your customer document and in the suitability report, is there an adequate reason for it and has this been adequately explained and the implications made clear to the customer?

3.3 Are the investments recommended to the customer suitable for their ATR and personal circumstances?

This decision is not limited just to the customer's attitude to risk. Reviewers also need to think about such issues as the term until retirement (investments that are suitable for someone with a medium-risk profile and 30 years until retirement will be different from investments that are suitable for someone with a medium-risk profile but three years from retirement). Also look to see if the customer's other investments or pensions have been taken into account – for example, if the customer has a substantial exposure to property in the rest of their portfolio it may not be suitable to have further exposure to property here.

Comments box If the poor outcome has materialised, explain why this is the case. Is this a significant problem? Are there any mitigating circumstances? If one of the poor outcomes has materialised, we would expect the overall advice to be unsuitable.

Key unsuitable outcome 4: The customer has switched into a pension where there is a need for ongoing investment reviews but this is not explained, offered or put in place.

4.1 In the absence of ongoing reviews, a portfolio made up of funds to meet a certain asset allocation (i.e. a spread of individual funds, each usually investing in a single asset class or sector, to meet a certain asset allocation that is suitable for the customer's attitude to risk and personal circumstances) will become unbalanced over time and there is scope for the solution no longer to meet the customer's risk profile and personal circumstances in the future. If riskier equity funds outperform other funds in the long term, for example, the risk rating of the portfolio will increase.

Advisers should, at the least, make it clear to customers both the importance of ongoing reviews and the reason for them. The adviser does not need to offer these reviews – they could be undertaken by the customer or by another adviser – but the customer should understand why the policy needs to be reviewed to make sure that it continues to meet their needs.

This may not be an issue if there are mitigating circumstances, such as cases where the customer makes use of a product's automatic rebalancing facility.

4.2 Has the customer been led to expect that the adviser will conduct these reviews? Have they been carried out or arranged for a future date (within the agreed timeframe)?

Note that, if the answer to question 4.1 is 'Not an issue: explain why', the only answer available to question 4.2 in the Excel version of the template is also 'Not an issue: explain why'. In this case, the fact that there is no need for regular ongoing reviews means that this outcome has not materialised, whether or not reviews have been offered, carried out or arranged.

Comments box — This outcome will not have materialised if one of the following factors applies:

- there is no need for ongoing reviews;
- the need for reviews and the reason for that need has been explained;
- reviews have been offered and carried out (or declined by the customer); or
- reviews have been arranged for the future (within the timeframe agreed).

Unless there are any mitigating circumstances, this outcome will materialise if there is both a need for ongoing reviews and a failure to explain that need or to introduce a mechanism to deliver reviews within the timeframe agreed. In this case, the advice may lead to customer detriment in the future. If any of the poor outcomes has materialised, we would expect the overall advice to be unsuitable.

Other unsuitable outcomes

5 There may be other sources of customer detriment and other unsuitable customer outcomes beyond those considered so far. Are there any? If so, record them here.

3 Rating a case

As a general rule, the advice should only be marked as Unsuitable if the failings involved have a high potential for customer detriment. So, as an example, failure to discuss why the recommended scheme is at least as suitable as a stakeholder pension in the suitability report is less likely to lead to customer detriment if the recommended scheme is charged at stakeholder rates (or better).

Process failings are important and may give rise to learning points for the adviser but should not, on their own, lead to the conclusion that the advice is rated Unsuitable. However, if the failings are of sufficient magnitude or several of them have occurred, they may lead to the case being rated Unsuitable overall.

If the case is rated as Suitable or Unsuitable, this is the final rating (subject to any quality assurance or moderation process). Cases rated Unclear have one further step.

Unclear cases are those where key information has not been supplied in the file and it is impossible to reach an accurate conclusion about the case at this stage. Examples include the following:

- It may be that it is impossible to tell whether the receiving scheme is more or less expensive than the ceding scheme (for example because the personalised KFI is based on low-charged funds but the recommendation is for more expensive, externally-managed funds). You may feel that the overall rating of the case hinges on this fact. To rate the case as either Suitable or Unsuitable would be unfair, so the Unclear option should be selected.
- If the customer has switched to a scheme that is more expensive than the ceding scheme or a stakeholder pension for reasons like consolidation, investment flexibility or performance, you should check that the benefits to the customer of the receiving scheme out-weigh the additional cost. If this information is missing from the file, rate the case Unclear (unless other substantial problems exist that make the advice Unsuitable).

You should go back to the adviser for more information to allow a final rating of the case as Suitable or Unsuitable (subject to any quality assurance or moderation process). The adviser will be expected to supply any additional information on these points, ideally dating from the time of the advice (as subsequent file notes may be misleading as to the actual considerations discussed when the advice was provided). You should check this additional information objectively to make sure it addresses your concerns sufficiently. If the additional information demonstrates that the benefits of the recommended scheme out-weigh its detriments adequately, the final rating for the case is Suitable. If this information cannot be provided, the final rating for the case should be Unsuitable.

4 Data section

This section is included as a working space to help record the charges that apply on the plans.

Ceding schemes

This section captures information on the ceding schemes. Completion should simply be a matter of recording information from the file.

Policy-specific data for the receiving scheme

This section allows you to record information about the receiving scheme. The next section captures information on the investments used within the product; here there is a focus on the charges that apply at product level (ignore charges on the investment funds for the time being).

Again, completing this section should simply be a matter of recording information from the file.

Fund-specific data for the receiving scheme

This section captures information about the investments used within the receiving scheme and the costs of doing so. Again, completion of this section should simply be a matter of recording information from the file.

In some cases the adviser may have provided the customer with a personalised KFI based on funds with lower charges than the funds ultimately recommended to the customer. Depending on the circumstances of the case, this may show that there is a procedural failing in disclosing charges properly to the customer or it may demonstrate that the customer has been misled as to the full charges they will incur on the receiving scheme. For example, if a customer's objective is to move to a cheaper scheme and the receiving scheme is more expensive but the KFI disguises or obscures this fact, this is likely to mean that, overall, the advice is unsuitable.

Note in particular that a KFI projection using a cash fund that carries no annual charges but still uses the standard projection rates is misleading (especially if the actual advice is to make use of expensive, externally-managed funds). If the adviser has not yet selected the final fund choice, a representative sample of funds should be illustrated to give a fair reflection of the possible costs of the scheme.

If the fund choice was not decided at the time the adviser discussed the switch with the customer but it had been finalised by the time the suitability report was produced, you should assess the suitability of the switch on the basis of the correct charges.

The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: http://www.fsa.gov.uk
Registered as a Limited Company in England and Wales No. 1920623. Registered Office as above.