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Retail Advice and Regulation

**Assignment 4 Notes**

*(Part 5 – Pension Transfers, SIPPs & Drawdown and Current Developments)*

*Recommended Time: 3 hours*

1. **Outline the differences between capped drawdown, phased retirement, and flexible drawdown.**

**15 marks**

As only 15 marks are available, only a relatively brief answer is expected. However, answers should cover the main distinguishing features of each. The coverage of these variants is sufficient in the study manual.

Capped Drawdown, a tax-free Pension Commencement Lump Sum (PCLS), of 25% of the value of the fund (more than 25% if protected tax-free cash rights built up before April 2006 are available) can be taken, as a single lump sum or in tranches. Tax-free cash of less than 25% may be taken; it is an option, but it would be unusual to waive any tax-free cash. (If tax-free cash is not required immediately, then Phased Drawdown – see following description – was probably a better option, before Flexi Access drawdown appeared). The balance of the fund can then be drawn each month (or other frequency not exceeding one year) to provide a regular income: this income is subject to income tax. Alternatively, funds may remain invested, and withdrawals commenced at a later date.

Phased Retirement works as follows: all funds are consolidated into one personal pension plan, which consists of separate but identical segments, which can be drawn on separately as required. The member can decide whether to take income immediately and if so, how much. When that amount of drawdown has been chosen, a calculation is then done to find out how much of the total fund is needed to provide the first year’s drawdown. This drawdown will consist of a one-off tax-free lump sum from the segment, which is being crystallised, together with a taxed income based on GAD limits applied to the remainder of the vested segment.

Flexible Drawdown was only available to scheme members who made a declaration confirming that they satisfied the conditions for Flexible Drawdown and that the declaration was acceptable to the Scheme Administrator. Flexible Drawdown introduced a high degree of flexibility and access. But the major disadvantage was that it could very rapidly delete a person’s retirement income and in consequence it was very important for a client to recognise this risk and either accept this risk fully and consciously (and for the adviser to ensure that his client was in no doubt about this risk) or have other capital on which to draw to support the desired standard of living. This same risk remains with Flexi-Access Drawdown: a person’s retirement income can be very rapidly deleted.

(The relevant section of the Study Manual is Part 5, Chapter 2.1)

**15 marks**

1. **Outline some of the typical signs of pension scams.**

**5 marks**

Answers should cover the typical signs of pension scams, and these are covered in the study manual. As only 5 marks are available for this question, any 5 should be sufficient.

For example..

• the member may receive an unsolicited call or text message, see a magazine advertisement or may respond to an online advertisement • there may not be an obvious relationship between the ‘pension scheme’ concerned and its supposed sponsor • fraudsters may claim to have spotted a legal loophole

• the member may be appointed as a director of the company sponsoring the new scheme being proposed

• the proposal may involve onward investment in a single asset: IFAs will almost invariably seek to diversify and only where they have assessed client Attitude to Risk and Capacity for Loss issues might a single asset be chosen

• the process may involve transferring funds abroad arguably to a more benign tax regime – but that becomes largely irrelevant if the transfer out of the UK gives rise to an unauthorised payment charge

• the process may involve transfer to a seemingly bona fide occupational scheme which in reality has been set up specifically for the purpose of the scam

• fraudsters may claim that their proposals are entirely valid but they just do not happen to be authorised to advise in the UK – though they may be authorised by a foreign regime for other specified business

(The relevant section of the Study Manual is Part 5, Chapter 1.1.5)

**5 marks**

1. **Write brief notes on the following:**

* 1. **Pot Follows Member.**
  2. **Sale of Annuities.**

**10 marks**

As no mark split is shown, it can be assumed approximately equal marks are available for each part. There is sufficient detail included in the relevant section of the study manual and this could be supplemented by any other relevant points.

Pot follows member… when a member leaves a pension scheme with accrued pension rights below a set threshold (a figure of £10,000 has been mooted) their pension rights will be automatically transferred to the scheme of their next employer. This proposal, commonly known as ‘pot follows member,’ is intended to allow accrued pension rights to aggregate into a single pension scheme. This would keep a member’s fund in one place and where appropriate allow an annuity to be bought on more favourable terms than would apply in the case for a series of smaller funds and so improve individuals’ retirement outcomes.

Sale of Annuities consumers being able to sell their annuities even if they were in payment. This was regarded as part of pensions freedom: if people coming up to retirement were able to surrender all their pension for a cash sum (subject to tax) then why not persons who had already set up annuities or even persons in receipt of DB pensions:

(The relevant sections of the Study Manual are Part 5, Chapter 3.2.1 and Chapter 3.2.2)

**10 marks**

1. **Outline the FCA rules around pension transfer and explain briefly in an email to a client how a pension transfer is calculated.**

**30 marks**

Your answer should be in two parts. As the second part of the question requires a specific format, 2 or 3 marks are available for that aspect.

FCA Rules – COBS states that “ A firm must

1. compare the benefits likely (on reasonable assumptions) to be paid under a defined benefits pension scheme or other scheme with safeguarded benefits (safeguarded benefits were introduced from April 2015 meaning “benefits which include some form of guarantee or promise during the accumulation phase about the rate of secure pension income that the member (or their survivors) will receive, or will have an option to receive” with the benefits afforded by a personal pension scheme or stakeholder pension scheme, before it advises a retail client to transfer out of a defined benefits pension scheme or other scheme with safeguarded benefits;

2. ensure that the comparison includes enough information for the client to be able to make an informed decision.

3. give the client a copy of the comparison, drawing the client’s attention to the factors that do and do not support the firm’s advice, no later than when the key features document is provided; and

4. take reasonable steps to ensure that the client understands the firm’s comparison and its advice.

In particular, the comparison should:

1. take into account all of the retail client’s relevant circumstances.

2. have regard to the benefits and options available under the ceding scheme and the effect of replacing them with the benefits and options under the proposed scheme.

3. explain the assumptions on which it is based and the rates of return that would have to be achieved to replicate the benefits being given up.

4. be illustrated on rates of return which take into account the likely expected return of the assets in which the retail client’s funds are invested.

5. where an immediate crystallisation of benefits is sought by the retail client prior to the ceding scheme’s normal retirement age, compare the benefits available from crystallisation at normal retirement age under that scheme

Part of your answer should cover the particular requirements around:

* + - Record keeping
    - Recommendations
    - Insistent customers
    - TVAS

In the second part of your answer, given the context of the question a brief explanation of a transfer should be included in a full answer.

Mention of recent developments, such as transfer incentives and pension liberation could be appropriate in a very full answer but is not necessary.

(The relevant sections of the Study Manual are Part 5, Chapter 1.2 and Chapter 1.5)

**30 marks**

1. **Outline the issues associated with pension transfer incentives and the Pensions Regulator’s Principles.**

**15 marks**

Answers should include coverage of the Code of Practice and the 5 Principles. Sufficient detail is included in the relevant section of the study manual. Given 15 marks available there is scope for a full answer that could be supplemented by examples and/or any current developments.

The Code of Practice seeks to ensure that all incentive exercises enable members to make informed decisions and better choices and be: • done fairly and transparently; • communicated in a balanced way and in terms that members can understand; • available with appropriate regulated and qualified independent financial advice that is paid for by the employer; • able to achieve high levels of member engagement; • be provided with regulated access to the independent complaints and compensation process.

Principle 1: Clear, fair, and not misleading. An offer should be made in a clear, fair and not misleading way, to enable members to understand the implications and make decisions that are right for them.

Principle 2: Open and transparent. The offer should be open and transparent, so that all parties involved in the process are made aware of the reasons for the exercise and the interests of the other parties.

Principle 3: Manage conflicts of interest Conflicts of interest should be identified and appropriately managed in a transparent manner and, where necessary, removed.

Principle 4: Trustee consultation Trustees should be consulted and engaged from the start of the process, with any concerns arising through the exercise alleviated before progressing.

Principle 5: Independent financial advice Fully independent and impartial financial advice should be made accessible to all members and promoted in the strongest possible terms. In almost all circumstances, the structure of the offer should require that members take financial advice. In some circumstances (such as some Pensions Increase Exercises) financial advice may not be required; however, the structure of the offer should provide detailed guidance instead.

(The relevant section of the Study Manual is Part 5, Chapter 1.6)

**15 marks**

1. **Write brief notes on the following types of annuity:**

* 1. **Single-life or joint-life;**
  2. **Level or escalating lifetime; and (iii) Impaired life and enhanced.**

**15 marks**

Approximately equal marks are available for each section of this question. Therefore, answers are only required to be brief, with 5 marks available for each. Examples would be helpful.

Single-life or joint-life. Unless there is a guaranteed payment (see Guaranteeing Annuity Payments below), a single-life annuity will only pay out during the client’s lifetime. A joint-life annuity will continue to pay an income to a client’s partner or dependant after death. If the client is not married or is in a civil partnership, further questions need to be raised with the new provider to ascertain that the partner or dependant will be eligible to receive an income from a joint-life annuity: this would mean the annuity would then be set up on a named dependant basis. It may also be possible to obtain a better rate by setting up a joint life annuity for a legal spouse on a named dependant basis. This is because an “any spouse” joint-life annuity could be paid either to the legal spouse to whom the client was married at the date the annuity was set up or to any subsequent spouse following, say, remarriage on the premature death of original spouse. Joint-life annuities will be more expensive than single-life annuities as the insurer will expect to continue payment of the annuity for a longer period. The amount of the joint life annuity which is received by the spouse can be arranged to reduce on the client’s death. This will mean that a higher starting pension will be available for both the client and his spouse to enjoy. The amount of the reduction is usually one-half, but other reduction factors are readily available. The reduction amount should be agreed with the client. Note that the age of the spouse/ dependant will affect the amount of joint-life annuity: a younger spouse will be assumed to live longer; hence the starting pension will be lower. If an “any spouse” joint-life annuity is set up then the insurer is likely to reduce the contingent pension if the surviving spouse is ten or more years younger than the client.

Level or escalating lifetime annuities. A level lifetime annuity pays the same income every year for the rest of the client’s life. This will produce a higher starting income than an escalating annuity but what the client can buy with the income will fall as inflation increases prices over time. This may suit clients who wish to have more money in the earlier stages of retirement to enjoy holidays and hobbies but for clients wishing to protect income from rising prices (concerned about rising home care costs perhaps), the client can opt for an escalating annuity which pays a lower initial annuity but then increases each year.

Impaired life and enhanced annuities. If a client has a health problem that threatens to reduce lifespan, it is increasingly likely that providers will offer an impaired life annuity. Some providers have recently (within the last decade or so) entered the annuity market specifically to provide impaired/enhanced terms. Relevant health problems may include cancer, heart attack, high blood pressure, stroke, chronic asthma, diabetes, kidney failure or multiple sclerosis. An enhanced annuity can be offered if the client is overweight or has smoked within the last ten years. Or even if the client has worked in certain occupations or lives in a certain part of the country (postcode information is used by the provider in this). The adviser should not overlook such factors if setting up an annuity is an option being considered. Even taking regular medication may be a factor which means an annuity rate could be enhanced.

(The relevant section of the Study Manual is Part 5, Chapter 2.2.1)

**15 marks**

1. **Describe the Pension Dashboard project and the relevance for individuals.**

**10 marks**

A relatively brief explanation is all that is required given the marks available. Answer should include mention of some of the following:

* + - The involvement of Government and DWP
    - Individuals can see all pension entitlements in one place
    - Private pensions and State pensions
    - 2019 target launch date which has now not been achieved

(The relevant section of the Study Manual is Part 5, Chapter 3.1)

**10 marks**