

## Personal Pension Fund Withdrawals

### *Background*

Prior to publishing guidance notes on the continuing professional development requirements that apply to those advising on pension fund withdrawals, PIA carried out a number of themed visits to firms with the objective of gathering information on the way in which this business was being sold.

A report on the findings of those visits was presented to the PIA Board. The visit findings did not lead PIA to conclude that there was any systemic failure to give suitable advice. But the Board was very concerned to note that, as a direct result of the poor quality of some firms' records of pension fund withdrawal business, no definite conclusions could be reached on whether or not:

- firms were providing an adequate explanation to investors of the inherent risks of opting for withdrawals rather than a guaranteed annuity or other options available
- the advice given by firms on pension fund withdrawal business complied with the standards set out in PIA's Rules
- those advising on pension fund withdrawals had sufficient awareness and understanding of this type of business to ensure that suitable advice was given.

The PIA Board has therefore decided that further guidance on pension fund withdrawal business, in the form of this article, should be issued to firms. This guidance is intended to emphasise the importance of:

- keeping records that are sufficient to show that a firm has complied with PIA's Rules
- providing investors with a clear explanation of the nature of the risks involved in such a transaction
- undertaking appropriate continuing professional development

#### **This article also contains important information on:**

- the types of risk warnings that PIA expects firms to include in all reason why letters issued in respect of pension fund withdrawal business, and specimen wordings for those risk warnings
- learning material issued by the Chartered Insurance Institute, entitled "*Planning for a Flexible Retirement: a guide to pension fund withdrawal and other retirement options*" with which all firms engaging in pension fund withdrawal business will be expected to be familiar.

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## *Record-keeping*

### *Information obtained from investors (“fact-finding” information)*

Sufficient details of the information which the investor has been willing to provide about his personal and financial circumstances, investments and other assets, investment objectives and attitude to risk must be kept to provide evidence that recommendations made to that investor are suitable. Where a recommendation is made to enter into a complex and inherently high-risk arrangement such as a pension fund withdrawal contract, the extent and quality of the information which must be obtained and recorded will necessarily be greater than that required in respect of a more straightforward transaction.

However, the themed visits carried out by Supervision staff indicated that the standard of records kept in respect of pension fund withdrawal business was poor. In particular, the client files examined often failed to record the investor’s:

- investment objectives, need for tax-free cash and state of health
- current and future income requirements, existing pension assets and the relative importance of the plan given the investor’s financial circumstances
- attitude to risk. (Where the investor’s attitude to risk was recorded, it was sometimes at odds with the risk profile of investments already held by the investor, but the discrepancy was not explained).

PIA accepts that there is no direct correlation between poor record keeping and the provision of unsuitable advice. Nevertheless, in the Regulator’s experience, poor record keeping is frequently a good indicator of wider failings in a firm’s compliance procedures. In addition, the failure to keep sufficient records is a breach of PIA’s Rules, which may be judged to be significant.

Accordingly, PIA wishes firms to be in no doubt that failure to comply with PIA’s record keeping Rules (whether in respect of pension withdrawal business or any *relevant* business) may, in itself, be sufficient to render a firm liable to disciplinary action by PIA.

### *Information given to investors on risk factors*

When a recommendation is made, a clear explanation of the nature of the risks involved in the transaction must be provided to the investor. However, several of the client files examined by Supervision staff indicated that the risks connected with pension fund withdrawal business had not been adequately explained. For example, risks were often described, both in key features documents and in reason-why letters:

- in a superficial manner
- in terms that the investor would not have been likely to understand.

### *Reason-why letters*

PIA's Rules state that the reason why letter must include an explanation of why the transaction is believed to be suitable for the investor having regard to his financial and other circumstances.<sup>1</sup> In the case of a recommendation to enter into a pension fund withdrawal contract, the reason why letter should include, among other things, a statement of:

- the purpose of the contract for the investor concerned
- the relative importance of the contract given the investor's financial circumstances
- the investor's attitude to risk.

The reason why letter should contain evidence that the risk factors involved in entering into a pension fund withdrawal contract have been considered in the light of the investor's attitude to risk. It should also demonstrate that those risks have been drawn to the investor's attention.

**PIA considers that this can best be achieved by the inclusion of appropriate risk warnings in the reason why letter itself, and expects firms to adopt this practice with immediate effect.**

Firms are recommended to use the specimen risk warnings which have already been published in Regulatory Update 55 (paragraph 3.2) and which are repeated below for ease of reference.

1. High income withdrawals may not be sustainable during the deferral period
2. Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken. This could result in a lower income when the annuity is eventually purchased.
3. The investment returns may be less than those shown in the illustrations.
4. Annuity rates may be at a worse level when annuity purchase takes place.

All the above risk warnings should be included where maximum withdrawals are being made. Where this is not the case, risk warnings 2, 3 and 4 should be included.

### *Continuing professional development*

Guidance notes on the continuing professional development requirements that apply to designated individuals (and their supervisors) who advise on business in pension fund withdrawals were published in Regulatory Update 55.

Since that guidance was issued, learning material entitled "*Planning for a Flexible Retirement: a guide to pension fund withdrawal and other retirement options*" has been published by the Chartered Insurance Institute. PIA considers that an appropriate programme of study and training for those individuals engaging in pension fund withdrawal business should include a requirement to be familiar with this learning material.<sup>2</sup> When this requirement is met, and when the individual has demonstrated that he or she has fully understood and assimilated the material, the record of continuing professional development should be updated accordingly.

<sup>1</sup> Guidance on the requirements for reason why letters (including several examples of good and bad extracts from reason why letters) was published in Regulatory Update 43.

<sup>2</sup> Copies of this learning material can be obtained from The Chartered Insurance Institute, Customer Service Centre, 32 Hillcrest Road, South Woodford, London E18 2JP (Tel 0181-989 8464) at a cost of £25 per copy. The CII is also able to provide tutor marked assignments at a cost of £20.

### *Further action*

A further series of visits, to assess firms' compliance with PIA's Rules on pension fund withdrawal business, and the extent to which firms have implemented the guidance issued in this Regulatory Update, and in Regulatory Updates 10, 19 and 55, will be carried out in due course.

At present, PIA does not propose to require designated individuals engaging in pension fund withdrawal business to obtain a qualification specific to that activity. PIA has, however, encouraged the Chartered Insurance Institute to provide an examination based on the learning material referred to in this article, so that firms will be able to obtain an independent assessment of the competence of individuals advising on pension fund withdrawal business. In the meantime, the Chartered Insurance Institute is able to offer tutor marked assignments drawing on the learning material, and firms are encouraged to make use of this facility.

Nor does PIA, at this stage, plan to introduce a new permitted activity for pension fund withdrawal business. **This decision will however be kept under review in the light of findings from future visits.**