Financial Services Authority

Quality of advice on pension switching: an update

Delivering higher standards through intensive supervision

April 2010

Contents

This report updates you on the findings from our work on the quality of pension switching advice. The report does not define the suitability standards for pension switching advice. Firms should regard this communication as FSA supporting material, which is intended to assist firms in complying with the FSA's Rules and Principles.

Other supporting material regarding pension switching advice is available at:

http://www.fsa.gov.uk/Pages/Library/Other_publications/pension_switching/index.shtml

There may be several ways of complying with a regulatory requirement. Following guidance or other material we publish is only one approach. For further information, please refer to:

http://www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2009/guidance.shtml

A firm's senior management remains responsible for establishing and implementing effective controls over the quality of advice given for pension switching.

1 Overview

Introduction

1.1 In December 2008 we published the findings from our thematic review into the quality of advice on pension switching.[1] We were concerned by the variable standards we found at the firms we visited and we committed to undertake a further programme of targeted action to deal with the risk of unsuitable advice. This report provides an update on this follow-up work and the resulting outcomes.

Summary results from our 2008 thematic review

1.2 We visited 30 firms giving advice and assessed 500 files. Unsuitable advice was found in 16% of cases reviewed; however, this was unevenly spread across the firms reviewed. We were concerned that 25% of the firms in our sample provided unsuitable advice in 33% or more of cases sampled. Four firms were referred for enforcement investigation and a further 15 either offered, or were required, to undertake reviews of past sales.

1.3 As part of our review we also assessed whether the actions of pension providers/Self Invested Personal Pension operators (providers) were affecting the quality of advice. We did not have any serious concerns about the ways the providers we visited were marketing their products to advisers through their literature and broker consultants.

1.4 However, we were concerned that some providers seemed unlikely to be complying with the requirement to use lower projection rates where the standard rates would overstate the investment potential of the product.[2] Of particular concern were those instances where providers had used the standard rates of 5%, 7% and 9% to project for cash funds.

1.5 Further details can be found in our original report *'Quality of advice on pension switching – a report on the findings of a thematic review'*.

1 http://www.fsa.gov.uk/pubs/other/pensions_switch.pdf

2 COBS 13 Annex 2, 2.4R (1)

Follow-up work on pension switching advice

1.6 Since the publication of our initial report, we have used a wide range of regulatory tools to deliver our objective of improving the quality of pension switching advice provided to customers. Further information on the work we have undertaken is provided in Chapter 2.

1.7 We have clearly set out our expectations of firms and provided tools to assist them in meeting those expectations. We have conducted further file reviews and firm assessments to find out how much firms have improved their practices.

1.8 We are pleased to see significant change within the industry as a result of our work. The majority of firms carrying out pension switching business have reviewed their processes and procedures to deliver improved outcomes for consumers. A number of firms have committed to substantial past business reviews, which will deliver large amounts of redress for customers.

1.9 There remains, however, room for improvement in the quality of pension switching advice overall. Our initial work on pension switching advice identified a segment of poor performing firms and our follow-up work looked at a further sample of 22 firms considered to pose a higher risk of poor advice. Unfortunately, in this sample (which included Independent Financial Advisers (IFAs) and banks), we continued to find high levels of unsuitable advice and little indication that these firms had embraced the need for change or dealt with any issues relating to past sales. We also found that some of these firms, particularly smaller ones, were not sufficiently challenging when conducting their own reviews and so they found little or no evidence of unsuitable advice. This was inconsistent with the findings of our own reviews.

1.10 This is not acceptable. We are committed to improving outcomes for customers and we will target firms who have not demonstrated improvements. We have already taken disciplinary action against one firm and the director of another for misconduct relating to pensions switching advice. Four further firms are currently under enforcement investigation. In addition, ten of the 22 firms involved in our follow-up work are being required to conduct past business reviews, with the remainder carrying out remedial action, including providing redress where appropriate.

Wider issues

1.11 Although the failings we saw in our follow-up review were generally consistent with those found in our original work[3], some additional concerns were identified. These are:

- advisers recommending ‘portfolio advice services’[4] with insufficient justification that the additional costs genuinely added value for customers; and

3 The findings from our original report are not repeated here but can be viewed at: http://www.fsa.gov.uk/pubs/other/pensions_switch.pdf

4 Ongoing investment advice services (that do not amount to discretionary portfolio management) which typically involve recommending a range of investments to meet an asset allocation and reviewing this on a periodic basis.

- firms operating tied advice models that prevent their advisers considering a customer's existing pension arrangements – which we consider to be in breach of our COBS rules. Firms must consider the customer's existing wider pension arrangements (and options available within those arrangements) and whether they would result in any recommendation to switch to a product within the adviser's range being unsuitable and not in the best interests of the customer.

These issues have wider implications for financial advice generally and we will be conducting further work in these areas.

Next steps

1.12 As part of our programme of intensive supervision, we will continue to:

- focus on those firms that pose the highest risk of providing poor advice by reviewing both pension switching and other investment advice (past and ongoing) – we will test suitability as part of ARROW assessments, where appropriate, and through our small firms' supervision programme;
- assess providers' compliance with our projection and illustration rules; and
- carry out further supervisory work on wider advice issues, including those arising in the lead up to the implementation of the Retail Distribution Review.[5]

We will use our full range of regulatory tools with firms that do not meet the required standards. We have clearly set out these standards and firms can be in no doubt about what we expect of them. We will hold firms to account and, as we have demonstrated, we will also not hesitate to take action against Significant Influence Function holders for unacceptable failings.

5 http://www.fsa.gov.uk/pubs/policy/ps10_06.pdf

2 Our approach

2.1 The purpose of our follow-up work was to improve the quality of pension switching advice provided to customers and also to assess the extent that firms had improved their practices since the publication of our original findings.

2.2 There are over 4,500 firms in the pension switching advice market – including many firms carrying out relatively small volumes of business. Our follow-up work took this into account by using appropriate tools to achieve the maximum possible coverage of the firm population. In Chapter 3 we have set out our assessment of the impact our actions have had on the market.

Dear Compliance Officer/Proprietor letter (Dear CO letter)

2.3 In December 2008, we wrote to over 4,500 firms responsible for the majority of pension switching advice.[6] In this letter we set out the findings of our review and requested firms to consider whether they needed to take action regarding their past and future sales. The letter stated that we expected firms would need to:

- consider the approach they had taken in their past pension sales and, if necessary, look at a sample of individual files on past sales, as well as at sales processes and systems and controls in this area;
- take appropriate remedial action if failings were identified, including providing redress to customers where necessary;
- consider whether they should change their approach (including sales processes and systems and controls) to future advice and sales; and
- consider whether their management information informs senior management of whether or not they are delivering fair customer outcomes in this area.

2.4 We required 59 relationship-managed firms to respond to us outlining the results of their assessment. For smaller firms, we sent a questionnaire to a sample of 250 firms[7] to assess the extent of the follow-up work undertaken.

6 http://www.fsa.gov.uk/pubs/other/letter_pension-switching.pdf

7 These firms were considered to pose the highest risk based on analysis of data reported to us.

Publication of suitability assessment template

2.5 In February 2009, we published our pension switching advice suitability assessment template and accompanying guidance.[8] The template sets out the approach we use to assess pension switching advice and provides firms with a resource to assist them in this area.

2.6 Firms can use the template to help assess whether their sales processes and compliance monitoring arrangements deliver suitable advice. They may also want to use it to review files and assess whether any past or future pension switching advice is suitable. We used the template as the basis of the follow-up file reviews we carried out in 2009.

Smaller firms roadshows

2.7 Between February and April 2009, we hosted 18 regional roadshows on pension switching advice. We asked the 1,500 small firms conducting the highest volumes of pension switching business to attend. The objective of the roadshows was to reiterate the main findings from the review and provide further guidance and technical support to help firms deliver suitable pension switching advice.

2.8 A large number of attendees fed back that they appreciated that we were clearly expressing our expectations regarding pension switching advice, supporting a 'no surprises' regulatory environment. There were also a number of positive statements in the trade press.

Further assessments

2.9 In 2009 we undertook a programme of desk-based reviews, and in some cases visits, involving 22 firms. This work focused on firms considered to pose a higher risk of poor advice. Further information on our findings is detailed in Chapter 3.

Enforcement action

2.10 We are committed to ensuring the fair treatment of customers and reducing the risk of them receiving unsuitable advice. Where we find that firms or individuals have fallen below the required standards, we will take disciplinary action as appropriate.

2.11 Accordingly, as a result of our work on pension switching advice, we have recently announced the following penalties:

- a £700,000 fine for RSM Tenon Financial Services Ltd for having poor systems and controls to prevent unsuitable advice in its pension switching and structured product business[9]; and

8 http://www.fsa.gov.uk/Pages/Library/Other_publications/pension_switching/index.shtml

9 http://www.fsa.gov.uk/pubs/final/tenon.pdf

- a £49,000 fine for Charles Palmer, a director of IFA network, Financial Ltd for management failings that resulted in poor compliance monitoring of pension switching advice.[10]

2.12 Both of these firms are undertaking past business reviews to pay redress to any customers who were given unsuitable advice.

2.13 As part of our credible deterrence strategy, we will continue to take action against firms and Significant Influence Function holders where they fail to maintain required standards and/or treat customers fairly.

Consumer information

2.14 We also published information on our Moneymadeclear website to assist consumers who may be considering switching their pension in the future[11] or are concerned about pension switching advice that they have already received.[12]

Projection rates

2.15 In our December 2008 report we advised that we would be considering more widely providers' compliance with our projection and illustration rules.

2.16 We subsequently held telephone interviews with a sample of firms and conducted desk-based reviews of the projection rates used by a further sample of firms. We looked specifically at cash or fixed interest funds, where we would expect firms to use lower rates.

2.17 While the majority of firms interviewed indicated that they had a process for assessing the appropriateness of our standard rates for their funds and products (although the rigour with which this process was applied varied considerably) – firms rarely concluded that lower rates might be more appropriate. In addition, some firms indicated that their illustration systems lack the flexibility to project at different rates for different funds.

2.18 In October 2009 we issued a Dear CO letter to all investment provider firms setting out our findings, reminding firms of our rules and their obligations to their customers.[13] In addition, our letter rescinded any existing individual guidance that firms might have received permitting them to use the standard rates with a caveat that these may overstate the potential for certain products or funds.

2.19 We will conduct a further sample review this year to ensure that providers are complying and take appropriate action where we find non-compliance.

10 http://www.fsa.gov.uk/pubs/final/charles_palmer.pdf

11 http://www.moneymadeclear.fsa.gov.uk/products/pensions/transferring.html

12 http://www.moneymadeclear.fsa.gov.uk/news/product/pension_transfer.html

13 http://www.fsa.gov.uk/pubs/other/co_letter_projections.pdf

3 Our findings

Our follow-up assessment in 2009

3.1 We reviewed 251 files from 22 firms. The sample comprised 12 smaller firms and ten relationship-managed firms (including two major banks).We assessed:

- 85 cases (34%) as unsuitable;
- 78 cases (31%) as unclear[14]; and
- 88 cases (35%) as suitable.

3.2 As with our original review, levels of unsuitability were variable between firms. The greatest degree of variability was found in smaller firms.

3.3 The overall level of unsuitable advice was higher than in our original thematic review (16%). However, this assessment specifically targeted higher risk firms and the results are broadly consistent with the worst performing firms from our original sample (where we found that a quarter of firms provided unsuitable advice in 33% or more of cases).

3.4 Unfortunately, these results indicate the worst performing firms have taken no or little remedial action in response to the findings of our original review and subsequent mitigation work. We have therefore taken appropriate action to ensure these firms treat their customers fairly:

– RSM Tenon Financial Services Ltd has been fined £700,000 and is now undertaking a past business review.

14 These are cases where we were unable to make a definitive assessment of suitability. The main reason for this was due to inadequate customer records on file and a lack of clarity as to how recommendations met the customer's needs, objectives or financial circumstances. These may indicate procedural rather than suitability failings, but we were unable to form a view on whether or not the advice given was suitable. Where such cases have been found, we have asked the firm to provide further information as necessary to satisfy us that the case is suitable. Where we are not satisfied that information justifies the case as suitable, firms will be required to take remedial action.

– Ten other firms are also being required to conduct past business reviews, of which four are being carried out by skilled persons.[15] A further eleven firms have been told they must review those files assessed as unsuitable or unclear and pay redress as appropriate. Those firms will also be required to assess the wider implications of our findings for the rest of their business, which in due course could lead to further past business reviews.

Impact of our work

3.5 Although there remains a segment of poor performing firms, our work to improve the quality of pension switching advice has driven significant change within the sector.

3.6 The majority of relationship-managed firms have confirmed that they have amended their pension switching advice processes and significant numbers of smaller firms have also confirmed their commitment to improving their practices.

3.7 We believe our programme of risk mitigation has had a significant effect in delivering fair outcomes for customers regarding both past and future advice, as explained below.

Past advice

3.8 In response to our Dear CO letter, 97% of the relationship-managed firms contacted undertook a sample review of pension switching business. This resulted in over 3,000 files being reviewed to establish whether advice was suitable. Over 70% of relationship-managed firms used our suitability assessment template to conduct their reviews.

3.9 A number of firms have committed to substantial past business reviews. As a result of our work to date, over 10% of the total pension switching advice cases written since A-day[16] will be reviewed. We believe this will deliver redress in the region of £150m for customers. However, as we are currently in discussions with a number of firms on the format of further remedial work, these figures are likely to increase.

3.10 We are pleased to see some firms proactively identifying and addressing failures relating to their provision of advice and associated systems and controls. We will continue to provide support to firms – for example, through the publication of further suitability assessment templates – to assist them in doing this.[17]

3.11 However, we found that some firms, particularly smaller ones, were not sufficiently challenging when conducting their own reviews and found little or no evidence of unsuitable advice. In a number of firms we subsequently conducted our own review of files and did not agree with their ratings of individual files or their assessment that no further action was required.

15 FSMA s.166

16 6 April 2006 – the effective date of a simplified set of tax rules relating to pension schemes.

17 Structured product assessment template:
http://www.fsa.gov.uk/Pages/Library/Other_publications/structured/index.shtml
Investment advice and platforms suitability assessment template:
http://www.fsa.gov.uk/Pages/Library/Other_publications/platform_thematic_review/index.shtml

3.12 We would consider it to be particularly serious if we subsequently find mis-selling in firms that have conducted their own reviews and confirmed to us that they have no issues. We have clearly outlined our expectations and ignorance is not a defence – failure to take this issue seriously would raise significant questions about the fitness and propriety of firms and their senior management and we would take tough action as appropriate.

3.13 Where we find significant instances of unsuitable advice or failings in systems and controls that could result in unsuitable advice, we will require firms to review past business and compensate customers as appropriate. If we are not confident that the firm has the capability, competence or independence to carry out such a review then we may require it to be conducted as part of a skilled persons report under section 166 of FSMA.

Future advice

3.14 We are encouraged that firms have committed to improve advice going forward. For example:

- over 80% of relationship-managed firms said that they have amended their advice processes and/or compliance monitoring procedures as a result of our work;
- 98% of roadshow attendees said their firms were committed to taking further action and changing business practices as a result; and
- many firms, compliance consultants and pension switching software providers have incorporated our suitability assessment template into their methodologies or products.

Of the responses to the small firms questionnaire (see para 2.4):

- 93% of respondents confirmed that they will be conducting ongoing reviews (64% of which will be conducted, in whole or in part, by third parties);
- 69% of respondents have made/are making procedural changes to pension switching advice processes; and
- 52% of respondents have also reviewed processes for other advice areas.

3.15 We believe that the changes firms are introducing will lead to improved outcomes for customers. We will maintain the pressure on firms to deliver on these commitments through our ongoing supervisory work.

Wider issues

3.16 The failings we identified in our follow-up assessment were generally consistent with those found in our original review.[18] However, two additional issues gave us cause for concern.

18 The findings from our original report are not repeated here but can be viewed at: http://www.fsa.gov.uk/pubs/other/pensions_switch.pdf

Portfolio advice services

3.17 There has been an increase in advisers offering 'portfolio advice services'. By this, we mean an ongoing investment advice service that does not amount to discretionary portfolio management, but typically involves recommending a range of investments to meet an asset allocation and reviewing this on a periodic basis. This move is to be expected as firms change to advice models more aligned to the Retail Distribution Review.[19]

3.18 We saw examples where the additional costs of portfolio advice services were not justified for the particular customer and were, therefore, unsuitable. As we highlighted in our work on '*Investment advice and platforms: Project findings*'[20] there may be customers whose best interests are served by having a simpler, lower cost solution (often on a transactional basis).

3.19 We expect firms to consider the total cost of the solution they are recommending to the customer when assessing suitability. This includes product charges, adviser charges (initial and ongoing) and any platform charges. Advisers must demonstrate that additional services add genuine value for that customer.

Restricted advice relating to customer's existing arrangements

3.20 In the course of our review we identified an issue regarding tied advice that caused us concern. Firms should note that, irrespective of the adoption of a tied advice model, there is a duty on the firm to act in the best interests of the customer and to take steps to ensure that a recommendation is suitable. Advice should not be treated as confined to a consideration of the advantages or disadvantages of a particular investment without reference to the wider financial or investment context in which the advice is given. The issues discussed here are equally applicable to other areas of advice.

3.21 So, we were concerned to find cases where tied firms prevent their advisers from investigating a customer's existing pension arrangements, where those pension arrangements are outside the firm's product range.

3.22 Firms' processes should ensure that advisers consider the customer's existing wider pension arrangements (and options available within those arrangements). Failure to consider these appropriately could result in any recommendation to switch to a product within the adviser's range being unsuitable and not in the best interests of the customer. If this is the case, no recommendation should be given. While we accept that recommendations from tied advisers in relation to new pension schemes are restricted to a certain range of products, this restriction does not limit the standard of advice and the consideration that should be given to the benefits of a customer's existing pension arrangements.

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19 http://www.fsa.gov.uk/pubs/policy/ps10_06.pdf. The RDR seeks to:

i) improve the clarity with which firms describe their services to consumers;

ii) address the potential for adviser remuneration to distort consumer outcomes; and

iii) increase the professional standards of advisers.

20 http://www.fsa.gov.uk/pubs/other/iap_findings.pdf.

4 Next steps

4.1 As part of our intensive supervisory approach we will continue to focus on those firms that pose the highest risk of providing poor advice, reviewing both pension switching and other investment advice, past and ongoing. We will continue to test suitability, where appropriate, as part of our ARROW assessments.

4.2 Intensive supervision also applies to small firms who will continue to see increased levels of contact as part of our assessment programmes. Quality of advice will be one of the three key risks we will focus on as part of our small firms' strategy.[21] We will also be undertaking further thematic supervision as part of our pre-emptive supervisory strategy ahead of the implementation of the Retail Distribution Review.[22]

4.3 Our initial thematic review considered how providers were marketing their products to distributors. We will be undertaking more work in this area, placing greater focus on provider responsibilities, including product design, for a wide range of products. In respect of our work on projections, we will conduct a further sample review this year to ensure that providers are complying with our requirements.

4.4 Our expectations regarding pension switching advice have been clearly set out and we have given firms adequate information and support to assist them in meeting the necessary standards. We will challenge firms to demonstrate improvements and to evidence that they are treating all their customers fairly.

4.5 If we identify that firms have failed in their duty to act in the best interests of their customers we will use our full range of regulatory tools. As part of our credible deterrence strategy, we have already demonstrated our willingness to discipline both firms and individuals for unacceptable failings.

21 The others being: i) the sustainability of business models and ii) the standard of management and controls.

22 http://www.fsa.gov.uk/pubs/policy/ps10_06.pdf

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