Response to CP19/25

Pension transfer advice: contingent charging and other proposed changes

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Background to O&M

O&M, in various forms, has been involved in the occupational pension transfer market for over 25 years. We have provided TVA software and services since 1992.

Response to the Questions Raised in the Consultation

The remainder of this document provides responses to the specific questions raised in the consultation paper.

Q1: Do you have any comments on the intended commencement dates of our proposals or the draft Handbook text set out in Appendix 1?

We have no comment regarding the intended commencement date.

Some of our responses below raise issues which we believe should affect amendments to the Handbook text; these are detailed in the individual question responses.

Q15: Do you agree with our proposals to introduce a onepage summary at the front of a suitability report? If not, please indicate what alternatives should be considered to improve disclosures to consumers.

We agree with the introduction of a summary at the beginning of suitability reports.

Whilst we agree that the layout of the Pension Transfer Summary charges tables in Annex 1 would provide a clear understanding of the relative differences in charges between each alternative under consideration in the advice, there is one element that we believe has a risk of being misunderstood, or misrepresented.

The element in question is the “Current value of my pension income” field for “Stay in my current scheme”. In the examples this is shown as £833 per month.

The proposed amendments to the handbook that cover this element are:

- 9.4.11 R(2)(e): ….”a comparison to the charges and <u>revalued income</u> in the existing safeguarded benefits scheme..”

and

- 9.4.11 R(6)(b): “as a percentage of the client’s safeguarded benefits’ income (revalued to the date of the summary)”

Our concerns and queries are as follows:

1) How should this number be calculated?

It appears to be the intention to show the current value of the pension income that the member would be giving up; however the handbook only specifies revaluing to current date.

Where members have some time to normal retirement age this could misrepresent the full current value of the pension, as it relies on the assumption that pension revaluation would be broadly in line with future inflation.

For example, GMP pension that attracts fixed rate revaluation would have a higher real current value than that represented by revaluation to current date.

Also, where a member has a tranche of benefit subject to equalisation that would receive a late retirement factor at normal retirement age, the current value could be understated.

Pensions that have elements which start later than normal retirement age, or have temporary pensions and state pension deductions, would further cloud the member’s understanding of the full value.

For example the Barclays Pension Scheme has many sections with a normal retirement age of 60 and, for male members retiring at 60 only the un-revalued GMP as at date of leaving is paid; members often have a large step up applied at age 65 due to the way the GMP anti-franking test is applied. This would not be present in the pension revalued to current date.

2) Who should produce this number, the Scheme or the advising firm?

> We have seen vast differences in the methodology that schemes apply when supplying a current pension; with some schemes ignoring GMP revaluation until GMP age, others applying full GMP revaluation to a future retirement date; temporary pensions not included; AVC pensions included; DB transfers-in excluded etc.
>
> Where a member is at a permitted retirement age, schemes will often apply early retirement factors.
>
> In addition, schemes rarely provide information on how current pension figures have been calculated. We have seen schemes project to retirement with inflation adjustment but using different assumptions to those in the FCA handbook, for both future revaluation and inflation adjustment.
>
> If the figure is to be provided by the advising firm, there would be the same inconsistencies in how it could be arrived at unless more clarification is provided than in the proposed rules.

We believe the intention is to provide the member with a meaningful comparison between the charges that would currently be applied to any transaction and the current value of the pension income from the scheme.

The proposed rules would introduce a new pension figure not likely to be used elsewhere in the APTA, which does not necessarily represent what the member would receive at Normal Retirement, nor what the member would receive immediately. Where the figure is understated, it would suggest the charges on transferring are a higher percentage of current income than they would be, whilst at the same time providing the member with an expectation that their current scheme income is lower than reality. There is also no proposed explanatory information on the summary regarding this figure.

Therefore we would suggest the rules be amended as follows:

- Calculate the current value of the safeguarded benefits scheme pension as
    - I. Where the member is before Normal Retirement age,
      a) the projected pension at Normal Retirement, using normal FCA assumptions for future revaluation, discounted to current date using the normal inflation assumption (currently 2%)
      b) add a note below the summary table explaining that the "current value of my pension income" figure has been calculated as the pension projected to Normal Retirement Age, discounted back to current date in line with inflation at x%
    - II. Where the member is at or past Normal Retirement age, the current retirement pension available from the scheme

An alternative would be to provide a projection to the member's selected retirement age, discounted to current date.

One further element to consider is how to represent the current value of any pension commencement lump sum that a safeguarded benefit scheme may provide where this is an accrued additional benefit rather than one obtained by pension commutation.

Q24: Do you agree with our proposed changes and clarifications to the TVC rules? If not, please indicate how we should change our approach.

We note that the amendments to the rules for TVC calculation appear to be a move toward making this universally consistent and emphasising the need to ensure they are not personalised, instead reflecting the basis of the Transfer Value calculation. We welcome the clarification regarding provision of TVC for members past the Normal Retirement date.

We also welcome the clarification the proposed rules provide regarding the TVC rate of return that is applicable; in terms of the fixed coupon yields to use, the date of their publication and the date from which it is to be applied. We agree that using the 3-year age difference between member and spouse will provide a more consistent approach to TVC and is in line with the non-personalised approach.

There are some areas which we would suggest amendments be considered:

TVCs within 12 months of retirement or for late retirement
Regarding paragraphs 8.15 and 8.16, we believe that it is more representative of the value of the scheme benefits to apply the current method, which adjusts the capitalised value of the benefits for the error seen in the current FCA generic rates compared to the current market rates.

This is in keeping with the rules in COBS 13 Annex 2, which only allows the FCA rates to be used (if less than 12 months to retirement) where they are at least as favourable as current market rates.

Currently the generic rates are providing a less generous value than market rates, which means the TVC is being reduced to reflect market conditions.

We believe that the vast majority of providers will supply a quote in which the only element that is personalised is the postcode. We propose that a postcode is selected which is deemed “typical” and this postcode should be used for all TVC quotes.

The “typical” postcode could be updated periodically, to align with market movements.

Early retirement without actuarial reduction
For the changes proposed in 8.20 and 8.21 regarding favourable early retirement, there is an issue we would like to raise:

Where the scheme permits early retirement with no actuarial reduction at an age prior to GMP age, some members with GMP will be granted a considerably lower pension from GMP age if they take early retirement than they would receive had they retired at NRA.

This is due both to the anti-franking legislation which allows **full** franking of excess pension where the member retires early, but only permits franking of increases in payment if retirement is at NRA, and also because pensions (particularly GMP) often grow in deferment quicker than they escalate in payment.

Consider the following simple example:

- Male with Normal Retirement at 65;
- GMP which revalues at fixed rate 7.5%;
- Excess pension revalues in line with statutory orders (assume 2% for future increases);

- Excess Pension does not increase in payment (as it is pre 6th April 1997 accrual);
- The scheme permits unreduced early retirement at age 60;
- On early retirement, the scheme revalues the GMP to age 60 at 7.5% per annum for each tax year from date of leaving;
- Excess pension revalued to age 60 = £1,000;
- (notional) GMP revalued to age 60 = £1,000;
- The statutory GMP at GMP age 65 would have 5 further revaluations resulting in a GMP of £1,436.

Member retires at earliest unreduced age 60:
The pension would be £2,000 pa on retirement (£1,000 notional GMP and £1,000 excess).

On reaching age 65 the scheme would check the total pension of £2,000 was greater than the GMP of £1,436. This would replace the notional GMP of £1,000. A further £436 would be franked out of the excess pension so that the total pension remained at £2,000 (£1,436 GMP + £564 excess).

Member retires at NRA 65
The excess pension of £1,000 would receive a further 5 revaluations: £1,000 * 1.02 ^ 5 = £1,104
Total pension at 65 would be £2,540 (£1,436 GMP + £1,104 excess)

So where the member takes the early **unreduced** pension, their scheme income upon reaching age 65 would be £540 per annum (21%) lower than it would be when taking the pension at 65.

This is not an uncommon scenario therefore, we would suggest that it is not necessarily correct to assume that taking benefits at the earliest unreduced retirement age would almost always be in members' best financial interests, particularly where there is GMP, and early retirement would be prior to GMP age.

We would, therefore, suggest either

a) the following amendments;

> i) add additional wording to the notes in COBS 19 Annex 5 1.2R to highlight this possibility. This wording could be conditional on there being GMP, the member retiring early unreduced, and this retirement age being before GMP age. Alternatively, there could be generic wording for all cases;
> or
> ii) only permit the TVC to be calculated at early retirement age, where it can be demonstrated that the pension from GMP age after early retirement would not be significantly less than they would receive from GMP age after/at normal retirement. Clearly, this would need some consideration as to what constitutes significant reduction.

or b) remove the ability to use the unreduced early retirement age as the TVC age. The facility to take favourable early retirement terms should be covered elsewhere in the APTA.

Alternative TVCs

It is our understanding that there should only ever be one TVC included within the APTA and that this should be on the statutory basis set out by COBS, with the specific format and wording this specifies. We understand the intention is that the TVC should not be personalised; this position is already reinforced by the proposed changes within this consultation.

We understand that some firms are producing alternative TVCs to reflect different circumstances for members, for example post commutation and alternative retirement ages.

We would suggest that the rules be amended to prevent the provision of further alternative TVCs, in other words reports that use personalised data.

We would further suggest that the provision of alternative comparisons that look similar to the statutory TVC ought to be discouraged to avoid member confusion.

Q25: Do you agree with our proposals when cashflow modelling is used in an APTA? If not, how do you suggest we amend it?

We agree with all the proposals regarding cash flow modelling