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FSC Newsletter

Best Market Practice - MOD Pension Transfers

The Commissioner regards the issue of advising MOD employees on the subject of transfering out of an occupational pension scheme as one of utmost importance. In order to ensure that the individuals concerned are afforded the level of advice which the Financial Services Commission considers appropriate for this type of business, he has issued the following 'Best Market Practice' guidance note.

Final salary schemes and individual pension contracts have fundamentally different properties (as to the entitlements and prospects they offer, as to the forms of security they each provide, and as to the type of risk they each entail). The corresponding hazard is that transferors may be ill-informed about the nature and implications of the complete change of physical form and substance of their pension rights which a transfer involves. For example, the prospect of discretionary benefits may be overlooked, or dependents' benefits may be inadvertently or inappropriately given up. Or the transferor may have no feel for the likelihood of his or her personal pension matching or bettering the benefits to be expected from his or her occupational pension scheme.

All prospective clients who are approached by a licensee with a view to providing him or her with such advice should follow the same procedures as have been adopted in the UK with effect from 1st January 1995. Licensees should ensure that the proposed insurer is following the same procedures it is required to follow if it was to give the same advice to a resident of the UK. That is to say, the prospective insurer should provide the insured with a 'Transfer Value Analysis'. This is a comparison between the potential benefits under the scheme which the insured is currently in and the potential benefits under a 'personal pension' or 'buy out' contract. This comparison should show the rates of investment returns which would mirror the structure of benefits under their occupational scheme. Such an analysis should be prepared by the insurer whose policy is being proposed to the prospective client.

Each such recommendation should also be accompanied by a 'Reason Why' letter. That, and the analysis, must be properly and clearly explained to the prospective client. This 'reason why' letter may be prepared either by the prospective insurance company or the intermediary acting on behalf of the proposed client/investor. Its main purpose is to confirm the advice given to the customer and to explain why that advice is suitable. That explanation should take explicit account of the alternative of remaining within the occupational scheme. A real link between the circumstances, objectives and risk profile of the investor, and the recommendation made to him or her by the firm should be made clear. It should reiterate the tenor of the particular advice given and the main considerations which prompted that advice. It should not be a mechanistic recitation of stock motives applicable to any and every transaction. The letter should ask the investor to get in touch with the firm if there is something which needs to be clarified, or if further information is needed, or if the letter does not accord with the investor's point of view of the position. The letter may say that the adviser has relied on information supplied by the investor and the occupational pension scheme, but beyond that it should not contain disclaimers or exclusions clauses. Where a copy of the 'fact find' is given to the investor, the 'Reason Why' letter can take the form of a section in the factfind, provided that section is completed in a way that it meets the criteria set out above.

No person should be advised to transfer out of their existing pension arrangements until such time as the above has been obtained for the prospective client and all the matters contained therein have been properly and clearly explained to the client. Evidence that the above has occurred will be sought during the Commission's routine Inspection Team Visits made to applicable licensed institutions.

It is not the role of the Financial Services Commission to make judgements on the relative merits of occupational and personal pension provision, or to impose standards and controls in which such judgements are implicit. Nor is it the business of the Financial Services Commission to supersede individual freedom of choice and individual responsibility for choice in pension matters. It is, however, the business of the Financial Services Commission to foster the exercise of choice on an informed basis and, where an individual is reliant upon the advice of an 'agent' to require that the advice given is suitable.

Transfer Value Analysis

Some TVA systems operate (on the basis of hypothetical assumptions about future rates of investment return, inflation and interest) by putting a value on the benefits offered by an occupational scheme and calculating what rate of investment return the individual pension arrangement under consideration will need to achieve in order to provide actuarially equivalent benefits. Other systems generate a valuation (again on the basis of stipulated assumptions) of the benefits expected from the occupational pension scheme; this valuation can then be compared with the transfer value. TVA systems are analytical tools and do not in themselves generate an overall recommendation as to whether the transfer should proceed or not; but the result of the TVA is a useful pointer and an aid to well founded advice and decision making. In comparison, simply projecting possible benefits at the LAUTRO rates of 6% and 12% for comparison with the benefits expected from the occupational scheme is a somewhat less sophisticated technique.

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Financial Services Commission,
PO Box 940,
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Europort,
Gibraltar.

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