Financial Services Authority

Quality of advice on pension switching

A report on the findings of a thematic review

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1 Executive summary

Introduction

1.1 This report summarises the findings from our thematic review of pension-switching advice. It also provides examples of the good, compliant and poor practices we found[1].

1.2 There were two parts to the project:

- one assessed the quality of advice given to customers since pensions A-day[2] to switch their existing pensions into a personal pension plan (PPP) or self-invested personal pension (SIPP) and firms' systems and controls relating to this advice; and
- the other assessed whether the actions of pension providers/operators (referred to as 'providers' in the remainder of the report) were affecting the quality of this advice (based mainly on the regulatory guide: The responsibilities of providers and distributors for the fair treatment of customers (RPPD[3])).

Firms giving advice

1.3 We visited 30 firms giving advice and assessed 500 of their files. These firms represented a broad cross-section of the market and accounted for around 10% of pension-switching sales since A-day. Results were variable: while we considered that some firms were consistently giving suitable advice, we were also concerned to find that other firms were giving advice we assessed as unsuitable in a high proportion of the cases we sampled. In around a quarter of firms none of the cases we sampled were assessed as unsuitable sales. However, we assessed around a quarter of firms as providing unsuitable advice in a third or more of the cases sampled. Overall, we assessed advice to be unsuitable in 16% of cases.

1 By 'good practice' we mean situations where the adviser or firm has gone beyond our rules and principles. By 'compliant practice' we mean the practice meets our rules and principles. By 'poor practice' we mean failing to meet our rules and principles. These terms may be used differently in other FSA publications.

2 On pensions A-day (6 April 2006) the government introduced a simplified set of rules on pension schemes.

3 http://fsahandbook.info/FSA/extra/4720.pdf.

1.4 The main reasons we considered the advice to be unsuitable were[4]:

- the switch involved extra product costs without good reason (79% of unsuitable cases);
- the fund(s) recommended were not suitable for the customer's attitude to risk and personal circumstances (40% of unsuitable cases);
- the adviser failed to explain the need for, or put in place, ongoing reviews when these are necessary (26% of unsuitable cases); and
- the switch involved loss of benefits from the ceding scheme without good reason (14% of unsuitable cases).

1.5 We are putting in place a range of measures depending on the extent of each firm's failings and requiring them to address their unsuitable sales. Several firms will be subject to enforcement investigation as a result of significant failings identified during the review.

1.6 We are also writing to over 4,500 firms, responsible for the majority of pension-switching business, asking them to consider their past and future sales in the light of this review and to take remedial action where necessary. We will follow this up in 2009 with a series of firm visits and desk-based file reviews, to assess whether firms have taken sufficient action in response to our communication. Any firm that has not taken appropriate action may face further action.

1.7 Our actions are designed to address the problems we have identified in the pension-switching market. We are also dealing with problems in the wider advice market through the Retail Distribution Review[5] (RDR).

Pension providers and SIPP operators

1.8 We did not have serious concerns about the ways the pension providers we visited were marketing their products to advisers through their literature and broker consultants.

1.9 But we were concerned that some seemed unlikely to be complying with the requirement to use lower projection rates where the standard rates would overstate the investment potential[6]. In particular, we saw cases where providers used the standard 5%, 7% and 9% rates of return to project for cash funds. We will be pursuing this with the firms concerned and are also considering more widely firms' compliance with our projection and illustration rules.

4 These categories are not mutually exclusive and many files were unsuitable for several reasons.

5 For the most recent RDR publication, see www.fsa.gov.uk/pages/Library/Policy/DP/2008/fs08_06.shtml.

6 COBS 13 Annex 2, 2.4R(1).

1.10 We were disappointed to note that despite our publishing the RPPD in July 2007, providers' systems and controls for reviewing the distribution of pension products[7], and reviewing the assumptions, performance and use of products, had mainly been introduced quite recently (typically as part of firms' work on the Treating Customers Fairly (TCF) project deadlines[8]) and were still bedding in, such that their practical effectiveness remains to be demonstrated.

1.11 We suggest some ways in which providers should consider further strengthening and embedding their approaches to delivering fair outcomes. We expect all providers to review their own practice in the light of this report. These are issues supervisors may take up with them in due course, for example, in the context of their TCF assessments during ARROW visits[9].

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7 The responsibility for the suitability of advice provided to customers remains squarely on the firm giving advice, rather than providers. Providers are not required to 'police' the performance of individual distributors.

8 www.fsa.gov.uk/pages/Library/Communication/PR/2007/058.shtml.

9 www.fsa.gov.uk/pages/Library/Communication/PR/2008/130.shtml.

2 Our approach

2.1 The purpose of this thematic project was to assess the suitability of the advice firms give to customers to switch their existing pensions into PPPs and SIPPs. The project was undertaken because we were concerned about the risk that consumers may have been switched into higher charging pensions with features or additional flexibility they did not need. This concern was heightened by the significant growth in switches into PPPs and SIPPs since pensions A-day.

2.2 This thematic project is aligned with the TCF outcomes, especially outcome four[10] – the suitability of advice. We also assessed outcomes one[11], three[12] and five[13] to the extent they had an impact on the quality of pension-switching advice.

Firms giving advice

2.3 We visited 30 firms giving advice and assessed 500 of their files. These firms represented a broad cross-section of the market, accounting for around 10% of pension-switching sales since A-day and included small, medium and large firms; national and network organisations; and tied, multi-tied and independent financial advisers. We selected firms that were undertaking significant levels of pension-switching business. Our assessment covered post-April 2006 advice on switching from any occupational or individual pension scheme to an individual PPP or SIPP[14]. Most of the files we reviewed involved switches from PPPs. We selected files to be broadly representative of each firm's pension-switching business.

10 'Where consumers receive advice, the advice is suitable and takes account of their circumstances.'

11 'Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.'

12 'Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.'

13 'Consumers are provided with products that perform as firms have led them to expect and the associated service is both of an acceptable standard and as they have been led to expect.'

14 We excluded switches to group personal pensions, group SIPPs and stakeholder pensions. SIPP transfers from occupational schemes arranged prior to April 2007 were also excluded where the investment held by the SIPP was unregulated (for example, direct holdings in commercial properties). In April 2007 we started regulating SIPPs.

2.4 We assessed advice as unsuitable when the outcome was the customer switching into one of the following:

- A pension incurring extra product costs without good reason (this outcome involved assessing cases where, for example, the reason for the switch was for investment flexibility, but this was not likely to be used; the reason was fund performance, but there was no evidence the new scheme was likely to be better; or the reason was flexibility of a drawdown option, but there was no evidence that this option was needed).
- A pension that was more expensive than a stakeholder pension, but a stakeholder pension would have met the customer's needs.
- A more expensive pension in order to consolidate different pension schemes, but where the extra cost was not explained or justified to the customer.
- A new pension and the customer had lost benefits from their ceding pension (for example, guaranteed annuity rates) without these being explained or justified.
- A pension that did not match the customer's attitude to risk and personal circumstances.
- A pension where there was the need for ongoing advice, but this had not been explained, or offered, or put in place.

2.5 We assessed firms' systems and controls concerning pension-switching advice by analysing documented procedures in place at the firms and interviewing key members of staff. We used the file review results to test whether advisers were following these procedures in practice.

Providers and SIPP operators

2.6 We also looked at whether the actions of pension providers were affecting the quality of the pension-switching advice given by advisory firms. This work involved:

- visits to five insurers and one non-insurer SIPP operator, and a desk-based review of material on their SIPP/PPP business; and
- a review of the literature that 20 providers supply to distributors on their SIPP products.

3 Firms giving advice

3.1 This chapter reports on the findings from our visits to firms providing advice.

Quality of advice

3.2 Results were variable: while we considered that some firms were consistently giving suitable advice, we were also concerned that some firms were assessed as giving unsuitable advice in a high proportion of the cases we sampled. In around a quarter of firms none of the cases we sampled were assessed as unsuitable sales. However, we assessed around a quarter of firms as providing unsuitable advice in a third or more of the cases sampled. Overall, we assessed advice to be unsuitable in 16% of cases[15].

Reasons for unsuitable advice

3.3 We considered advice as unsuitable for four main reasons, set out below.

Unnecessary additional costs

3.4 This was by far the most common reason for unsuitable advice, accounting for 79% of unsuitable cases. The main problems found were[16]:

- extra product costs were incurred without good reason (65% of unsuitable cases);
- a switch to consolidate different pension schemes where the cost was not explained or justified to the customer (35% of unsuitable cases); and
- the new pension was more expensive than a stakeholder pension, but a stakeholder pension would have met the customer's needs (21% of unsuitable cases).

15 In a further 7% of cases we were unable to make a decision on whether we considered the case suitable or not as there was not enough information on file.

16 These categories are not mutually exclusive and many files were unsuitable for several reasons.

Good and poor practice: cost comparisons

Good practice

The firm set out a section in its template suitability report outlining any switch penalties on the ceding scheme and clearly explained the impact of charges of the switch. They did this by comparing the reduction in yield (RIY) figures for the ceding and new scheme (they used a software system to calculate the RIY of the ceding scheme).

The firm also had guidelines around the level of additional charges that were considered acceptable and although these could be exceeded, this could only be done with head office agreement.

Another firm had a similar process but used projected fund values instead of RIY figures.

Poor practice

The firm included a table in its suitability reports setting out and comparing the projected retirement fund value from the ceding scheme and the new scheme. These typically showed that the new scheme had lower charges. The advisers indicated that the new scheme involved lower costs and therefore this formed part of the reason for switching.

However, the projection of the new scheme was often on the basis of 100% investment in a cash fund (which had no charges) where the fund was to be managed by a discretionary fund manager. The projections left out the cost of the discretionary management service and any underlying funds. Therefore the comparative table and the advice were misleading.

Attitude to risk

3.5 Advisers must assess the customer's attitude to risk (ATR) and personal circumstances and recommend funds that are suitable. In 40% of unsuitable cases the fund(s) recommended were not suitable for the customer's ATR and personal circumstances. In 22 cases this was because the fund(s) recommended were too high risk. In two cases the fund(s) recommended were too cautious. The reasons for the advice being unsuitable included cases where the adviser had taken insufficient account of:

- the nature and overall risk level of the investment(s) recommended;
- the impact the term of the policy has on the choice of funds. For example, in some cases there was little understanding that a fund that is suitable over a term of ten years is unlikely to be suitable for a term of three years for a customer with the same ATR;
- the customer's investment knowledge and experience; and
- the benefits of diversification – sometimes the adviser did not appear to appreciate that investing in a single area or asset class (for example, property) is more risky as the customer has 'all their eggs in one basket'.

Good and poor practice: matching the recommendation to the customer's ATR and personal circumstances

Good practice

The firm used a risk profiling tool to make an initial assessment of the customer's ATR. They then used a stochastic modelling tool to create a series of model portfolios, with the individual funds selected by an independent fund research company.

Although systematised, the approach was not used as a 'black box' – the tools were used as a basis for discussion and the process was adapted, when merited, for individual customers.

Poor practice

The customer had previously been invested in with-profits and property funds and originally had a low/medium ATR. The file recorded that the customer now wanted to take a medium/high risk approach to investment in order to achieve better returns.

The adviser recommended a new pension investing in ten different external funds, all equity-based. The selection included 60% in specialist and overseas funds and a further 30% in more adventurous UK equity funds. We considered this fund selection to be too high risk for this customer given that they intended to retire and take benefits in around five years.

Ongoing investment advice

3.6 Where an 'asset allocation' approach[17] has been recommended, the scheme needs to be reviewed periodically and rebalanced where necessary, to ensure it continues to be suitable. Otherwise, a portfolio made up of individual funds to meet a certain asset allocation will become unbalanced over time and this may mean the solution no longer meets the customer's attitude to risk and personal circumstances. The same risk applies when funds with different risk profiles are used. In order to be suitable in these cases, the adviser has to explain the importance of such reviews, or offer them, or put them in place. In 26% of unsuitable files, none of these had been done.

Good and poor practice: explaining and providing ongoing advice

Good practice

One firm had a very clear explanation in the template suitability report describing why ongoing reviews and rebalancing were needed for their portfolios (where an asset allocation approach had been recommended). Their standard service for customers also incorporated a full annual review and biannual rebalancing.

17 We use the expression 'asset allocation' approach to cover the situation where the adviser recommends a spread of individual funds (each usually investing in a single asset class or sector) to meet an asset allocation profile that is suitable for the customer's ATR and personal circumstances.

Poor practice

Many firms had not clearly established the risk of investments becoming unbalanced over time without readjustment back in line with the customer's risk profile, and had not explained this to customers[18]. Although in most cases advisers had ongoing relationships with customers, it was not clear that these arrangements addressed the issue of rebalancing on a consistent basis.

Loss of benefits

3.7 Where an existing scheme has particular product features or benefits that are of value to the customer and are not replicated in the new scheme, then there needs to be a good reason why the switch is suitable, despite the loss of these features or benefits. For example, an existing scheme may have a guaranteed annuity rate (GAR) that is higher than is likely to be available on the open market. Other examples include loss of guaranteed benefits in with-profits policies and guaranteed minimum pensions in occupational schemes. In 14% of the unsuitable files, the customer had lost valuable features or benefits without good reason.

Good and poor practice: loss of benefits

Good practice

When recommending switching from a pension with a GAR (for valid reasons which benefited the customer) one firm would quote the current market annuity rate alongside the guaranteed annuity rate (on a like-for-like basis) in the suitability report. This helped the customer understand the value of the GAR.

Poor practice

The adviser did not adequately consider the nature of the existing with-profits policy. The policy included a significant guaranteed sum assured and also a GAR. The with-profits fund was highly rated. The new pension would have had to provide a net return of over 5% per annum just to match the scheme's existing guaranteed benefits, ignoring any future bonuses.

Procedural failings when giving advice

3.8 We saw a wide range of procedural failings, including rule breaches, across the sample of files we assessed. In many cases these did not result in unsuitable advice[19], but they did increase the risk of unsuitable advice being given. These included[20]:

- failing to adequately evidence the customer's needs (20% of all cases);
- failing to adequately consider the ceding scheme, its options and whether it was able to meet the customer's needs (for example, by means of a fund switch) (26% of all cases);

18 A requirement under COBS 9.4.7R(3).

19 For example, an adviser may have failed to check whether the new scheme was more expensive than the old scheme, but our research showed that the new scheme had lower charges.

20 These failings are not mutually exclusive and many files included a number of failings.

- failing to ascertain whether the new scheme was more expensive than the old scheme(s) (26% of all cases);
- failing to explain why the product or the provider was recommended (22% of all cases); and
- failing to consider or discount a stakeholder pension[21] (19% of all cases).

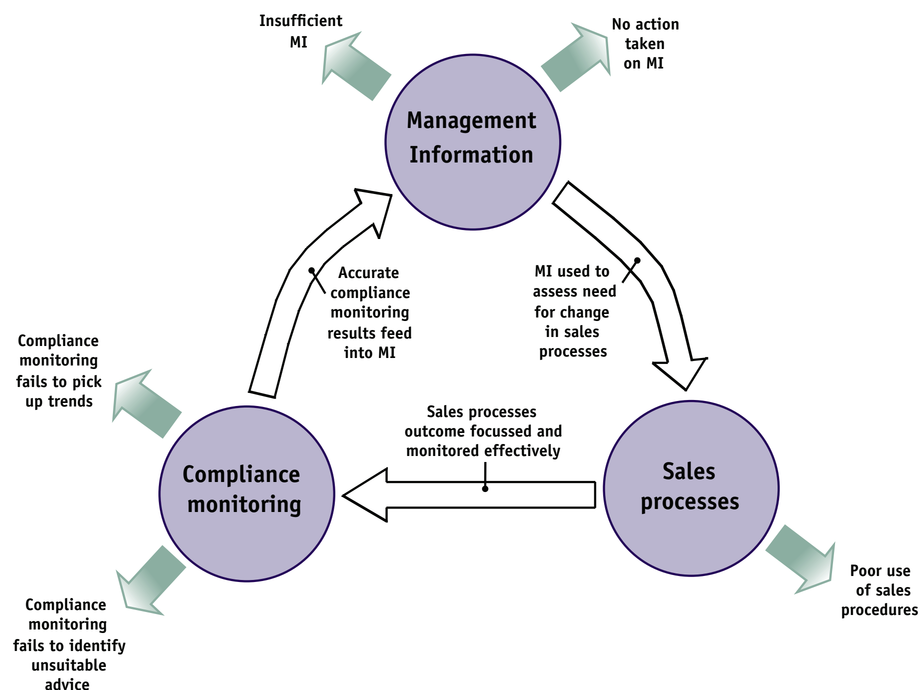
Many of these issues were also raised in our review of investment advice processes earlier this year, which provides further examples of good and poor practice[22].

Systems and controls

3.9 We assessed firms' systems and controls relating to pension switches, in particular their sales processes, compliance monitoring and management information (MI)[23]. Our assessment focused on whether firms' controls would prevent unsuitable advice and ensure fair outcomes for customers. Most firms' controls were not well suited to this and were overly focused on procedural aspects, not outcomes (see, for example, our comments on file checking processes below). Also, the elements of control were generally not consistent. Figure 1 summarises our findings.

Figure 1: Systems and controls – a summary of our findings

The inner links illustrate a firm whose systems and controls are integrated and working effectively, the outer arrows illustrate how firms were failing to achieve this.



21 COBS 19.2.2R: this requirement is commonly known as RU64 (in reference to the PIA Regulatory Update 64 in which it was introduced).

22 www.fsa.gov.uk/Pages/Doing/small_firms/advisers/quality_advice/index.shtml.

23 The project focused on systems and controls in connection with pension-switching advice. Our comments, therefore, relate solely to the firms' procedures for this area of their business.

3.10 In the better firms, there was a clear link between the way the sales processes had been set up, how they were monitored and how the results were captured through MI. This included senior management making necessary changes to the sales or compliance processes on the basis of the issues highlighted by MI. Some smaller firms we visited had a simpler process but achieved the same effect.

Sales processes

3.11 The degree of sales process and procedural documentation varied between firms. Some had a standard fact-find for gathering 'know your client' information and a template suitability report. Others had long sales manuals covering issues such as how to review ceding schemes, how to undertake cost comparisons and the approach to recommending investments.

3.12 In general, we found that the larger the firm, the more processes and procedures they had in place. But this did not prevent poor outcomes for customers, as some advisers used them poorly in practice. For example, some firms had specific procedures for cost comparisons when switching pensions. When used well, these procedures could help advisers achieve good outcomes for customers, but in some cases the figures the advisers used were inaccurate and potentially misleading. All firms had sales processes to some extent, whether written or otherwise, but their effectiveness was down to how well they were used as much as what exactly they covered.

Compliance monitoring

3.13 The main form of monitoring undertaken by firms was file-checking. Some firms checked files pre-sale and others post-sale; some checked 100% of pension-switching files and others just a sample. We saw no clear link between the firm's precise approach and its customer outcomes. More important was how well monitoring was done in practice.

3.14 We were concerned that our file review results differed significantly from those of some firms. This seemed to reflect the following.

- Firms' approach to file checking tended to focus on the procedural aspects of the sale, such as whether initial disclosure was undertaken and whether the key features document was provided. Although these are important regulatory requirements, they do not assess the suitability of the advice. A more realistic assessment of unsuitable cases would be achieved if the file checking procedures were focused more on the outcome.

- There were also instances where the same issue that caused us to rate the file as unsuitable was only rated as a procedural failing by the firm. For example, in one case the funds recommended were not in line with the customer's ATR and personal circumstances. The firm had checked this case and identified the same issue, but they wrongly concluded that it was only a procedural failing of the adviser not explaining the risks to the customer.

3.15 When we highlighted the unsuitable files to the firms in our sample, in nearly all cases they agreed with our conclusions, having reconsidered the files in the light of our assessment.

MI

3.16 The collection and use of MI in firms was variable across our sample. Two-thirds of firms had adequate MI on pension switching. The rest collected insufficient MI (or none) and/or MI from which it was difficult (or impossible) to identify trends. Some firms collected MI that showed the need for action, but did not then act on it.

3.17 Many of the smaller firms had poor or no MI, but some were collecting and using it well. Others had weak MI but were, nevertheless, dealing with issues effectively on a day-to-day basis. A toolkit on MI for smaller firms was published in June 2007 and provides information and practical ideas on its collection and use[24].

24 www.fsa.gov.uk/pages/Doing/small_firms/advisers/pdf/MI_monitoring.pdf

4 Pension providers and SIPP operators

4.1 This chapter reports on the findings from our work with pension providers, which assessed whether their actions affect the quality of the pension-switching advice given by advisory firms.

4.2 Our assessment was based mainly on TCF and the other Principles for Businesses, as set out in the RPPD. Specifically, we looked at how providers:

- limit and monitor adviser remuneration drawn from the pension product;
- market the pension product to advisers (through literature and brokers);
- review the distribution by advisers of the pension product; and
- review the performance and use of the product.

Limiting and monitoring adviser remuneration

4.3 In the recent RDR Feedback Statement, FS08/06, we said that we intend to consult on rules requiring advisers to set their own charges and providers to stop offering pre-determined commissions for sales of investment products. In preparing these Handbook changes for consultation, we will also consider the role and impact of providers' controls (for example 'decency limits') on the amounts that can be taken from products to pay advisers' charges.

4.4 In the light of this ongoing work, we do not comment here on the adequacy (or otherwise) of the approaches taken to limiting adviser payments. Our findings in this area have informed the RDR so far, and will continue to do so. In particular, in the coming months, as part of the Retail Distribution Implementation Programme, we plan to conduct workshops to discuss the roles and responsibilities of product providers with regard to adviser payment, including the detail of new requirements to be included in the RDR Consultation Paper in June 2009.

Marketing to advisers

RPPD 1.18: when providing information to distributors a firm […]: (2) should ensure the information is sufficient, appropriate and comprehensible in substance and form, including considering whether it will enable distributors to understand it enough to give suitable advice (where advice is given) and to extract any relevant information and communicate it to the end customer. […]

Quality of marketing literature for advisers

4.5 The adviser-focused literature on SIPPs supplied by providers was generally good enough to allow the adviser to work out the potential risks and benefits to the customer and the remuneration available[25].

4.6 However, in general, there was still scope for providers to consider whether their literature could offer advisers more helpful and descriptive commentary on the likely effects of the levels and 'shapes'[26] of remuneration chosen on the likely yield (either on average, or on particular types of customer; for example, those that do not persist, or who hold the product for a very long time).

Quality of illustrations

4.7 We were concerned that some providers seemed unlikely to be complying with the rule requiring lower projection rates to be used where the standard rates in the Conduct of Business Sourcebook would overstate the investment potential. In particular, we saw cases where the provider used the standard 5%, 7% and 9% rates of return to project for cash funds.

4.8 Issuing such projections for transfer comparison purposes is likely to overstate the potential growth (where an investment in a cash fund is expected to be short-term). The poor practice example in paragraph 3.4 shows how this kind of projection can be misused by advisers. Even if advisers request projections on this basis (for example, because they have not finalised the fund selection) the responsibility for ensuring that projections supplied to advisers are compliant clearly remains the responsibility of the provider.

Broker consultants

4.9 The firms we visited had high-level controls over their broker consultants which appeared broadly adequate. Recent changes included:

- greater links between broker consultant incentives and persistency of business and/or key behaviours, and reduced links with the sale of specific pension products;
- increasing broker consultant qualifications, professionalism and greater specialist technical support; and

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25 We are separately considering the quality of firms' *consumer*-focused literature concerning SIPP charges.

26 Differently 'shaped' effects on yield over time arise, for example, where the adviser's remuneration is paid for by an upfront deduction, or deductions spread over the first few years, or by deductions throughout the term. Similarly, such effects arise where the limits on adviser remuneration vary with term and/or trade-off initial and ongoing remuneration.

- increasingly sophisticated controls over the time, expenses and hospitality that broker consultants can give to advisory firms.

Reviewing distribution

RPPD para 1.20: 'When selecting distribution channels […] a firm […] (2) should review how what is occurring in practice corresponds to (or deviates from) what was originally planned or envisaged for the distribution of its products or services given the target market. This involves collecting and analysing appropriate MI such that firms can detect patterns in distribution as compared with the planned target market, and can assess the performance of the distribution channels through which its products or services are being distributed; (3) should act when it has concerns, for example, by ceasing to use a particular distribution channel'.

4.10 We saw some evidence of a more formal approach to providers' monitoring of MI concerning the distribution by advisers of their pension products. But such systems and controls had mainly been introduced recently (typically as part of the firms' TCF project work) and so were still bedding in. Therefore their practical effectiveness remains to be demonstrated.

Examples

One firm had recently established a quarterly pension forum to receive and review detailed adviser-specific data on persistency, identify cases for investigation and decide on appropriate responses. For example, it noticed that one adviser was moving pensions to annuities very quickly and, after investigation, suspected the adviser was splitting the remuneration with the customer to get cash out of the pension in breach of tax rules. The firm rejected further business from this adviser and produced a factsheet to alert its broker consultants to this practice.

We would wish to receive intelligence from a provider concerning such potential behaviour by a distributor.

A second firm had recently acquired a system that could generate persistency figures per product per adviser (including within networks), which a Retention Steering Group then reviewed. Any issues were raised with the advisory firm by a specialist team. The firm was beginning to work with larger networks who had expressed interest in this data, to identify problems with persistency for individual advisers.

A third firm had recently established a forum with senior sales, marketing, actuarial and compliance representation to review the quality of the distribution channel, identify trends and take action as appropriate. It had overseen the investigation of several dozen cases flagged to it by broker consultants suspecting for example, churning, money laundering, or fraud. The forum reviewed MI on these cases, the current state of the investigation into them and the advisory firm and product involved. The forum had also been defining limits for persistency and had started to receive and review monthly persistency data by advisory firm (and broker consultant). This showed for the last few years the percentage of policies/funds under management surrendered by firm, flagging on a traffic-light basis the past and current rates and the direction of trend. The forum looked at this in conjunction with MI on the remuneration taken by each adviser firm.

4.11 Most firms in our sample stated the importance of 'bottom-up' intelligence and impressions gathered by their broker consultants; for example, concerning distributors whose behaviour might be unusual compared to their peers, or concerning particular transactions that might be doubtful. However, despite the importance they attached to this, no firm had spelled out the responsibility formally and, as a result, the broker consultants themselves did not always seem as aware of it as their management implied.

4.12 We suggest firms could develop more systematic and explicit guidance to broker consultants in this regard; for example, revising their job descriptions and/or key performance indicators to reflect the importance of this intelligence function.

Reviewing the performance and use of the product

RPPD para 1.17: 'When undertaking product or service design providers [a provider] should: 1) identify the target market, namely which types of customer the product or service is likely to be suitable (or not suitable) for;[…]

RPPD para 1.21: a provider should:[…] (2) periodically review products whose performance may vary materially to check whether the product is continuing to meet the general needs of the target audience that it was designed for, or whether the product's performance will be significantly different from what the provider originally expected and communicated to the distributor or customer at the time of the sale. If this occurs, the provider should consider what action to take […];

4.13 Most of the firms sampled had formally committed to conducting such product reviews in their product design procedures. Again, such a commitment had only recently been introduced (typically as part of the firms' TCF project work).

4.14 As a result, some pension products had not yet been reviewed at all, while the reviews that had been conducted were mostly patchy. For example, they focused on important but narrow aspects, such as marketing literature and customer understanding of the product, or the commercial implications of market penetration. They did not, therefore, provide a rigorous comparison of the original assumptions about the product's features, target market and usage by customers, with subsequent actual experience.

4.15 Only one firm in the sample had progressed some way down this path.

The firm had identified some gaps in its product development process, including a need for a formalised review of the product through its lifecycle. This has been built into the product development process, with the Marketing Director accountable for ensuring product monitoring and reviews determine whether the product was still viable, meeting customer expectations and delivering the right customer outcomes. An early version of such a review had been carried out for its PPP, including comparing assumptions against actual performance in respect of the:

- age of new customers;
- extent of top-up activity;
- target minimum fund values;
- persistency;
- complaints;
- embedded profit;
- outflows; and
- investment in internal and external funds.

One finding from this review was that switching between funds was undertaken relatively little and by only a minority of customers, even though a key part of the product's design and marketing had been its fund range and the scope for customers to change funds to meet changing circumstances.

4.16 This example illustrates the importance of ongoing product reviews that can test and challenge whether assumptions made pre-launch about customer outcomes and use of the product are actually being proved correct. Overall, we felt providers should consider strengthening their approach to such reviews, not only with regard to average customers' experience, but also with regard to non-average customers.

4.17 Our sample indicated that the impression of customer needs underlying providers' design of recent pension products had mostly come from the views they gathered from advisers. This approach risks mis-identifying customer needs. Therefore, providers should consider the potential importance of consumer-focused research during product design.

5 Reducing the risk of unsuitable advice

Actions with adviser firms we visited

5.1 We reported our findings to each firm individually, followed by appropriate action with each firm. The firms fall into three broad categories:

- some firms are required to undertake only minor actions (or none);
- some are required to address specific, significant failings; and
- some will be subject to enforcement investigation.

5.2 For each case where we identified unsuitable advice, we have required the firm to examine it and, where necessary, provide compensation to the customer. We also required firms to take further action for each customer where we assessed that it was unclear whether the customer had received suitable advice (and, if the advice was unsuitable, provide compensation to the customer where appropriate). For firms where we identified process-related issues, we have required them to address these, so as to reduce the risk of future unsuitable advice. Lastly, we will be requiring some firms to undertake a wider review of past pension-switching business and in some cases this will extend to other investment business.

Actions with other firms giving pension-switching advice

5.3 We are undertaking a range of measures to reduce the risk of unsuitable advice across the industry. This includes:

- writing to over 4,500 firms (responsible for the majority of pension-switching business) to summarise our findings, to ask them to consider past and future sales in the light of the findings and to take remedial action where necessary;
- holding regional workshops for smaller firms in early 2009 to provide practical support in raising standards; and

- assessing a range of firms in the third quarter of 2009 to review the action they have taken following our letters and workshops to test the quality of their advice on pension switching. Firms that have not taken appropriate action upon our findings may face further action.

Actions with pension providers and SIPP operators

5.4 We are pursuing our concern about the potential mis-use of standard projection rates with the firms concerned and are also considering more widely firms' compliance with our projection and illustration rules.

5.5 From the perspective of provider/distributor responsibilities, providers should consider further strengthening and embedding their approaches to delivering fair outcomes for pension customers by ensuring:

- more helpful and descriptive commentary in literature for advisers on the likely effects of the levels and 'shapes' of remuneration chosen on product yield and consumer outcomes;
- more rigorous and formal reviewing of the business from distributors (for example, its persistency) and clearer description of broker consultants' role in this; and
- more systematic testing of customer needs, usage and outcomes within product development and ongoing product reviews.

5.6 We would expect all pension providers to reflect on their own practice in the light of this report. These are aspects that supervisors may take up with providers in due course, for example, in the context of their TCF assessments during ARROW visits.

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