

**SCOTTISH WIDOWS**

*official pensions and investment provider*



# Pension switching

Your Six Step Guide to pension switching



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This guide is intended for financial advisers only. It is not intended for use with retail clients.

# Introduction

Whether you're dealing with new or existing customers, this quick start guide is designed to help you focus on key issues that need to be considered and evidenced when conducting a client review.

A simple six step process will help you to map out and manage the review process, giving you the opportunity to add value to your clients by reviewing their arrangements and transferring to an alternative plan where it is beneficial for your client to do so.



## Step 1: Advice considerations

The last few years have seen significant changes to the pension landscape. Any review process needs to be carried out against a backdrop of a range of complex issues which may affect not only the review considerations themselves, but also the process that should be followed, the documentary evidence that should be produced, and even the design of product solutions recommended.

The FSA's thematic review on the 'Quality of advice on pension switching' in December 2008 has firmly set the standard of what is expected when pension reviews are carried out. While it hasn't raised any new regulatory requirements, it has underlined the need to fully evidence and justify the recommendations that you make. You should be questioning your processes to ensure that they're robust and will provide suitable evidence.

And don't forget RU64, which remains as applicable now as it was when it was introduced. Any recommendation to switch to a personal pension product will need to explain why it is considered 'at least as suitable' as a stakeholder pension.

While RU64 and the thematic review may drive you towards considering a stakeholder pension, a client review should be about more than just price. The FSA's Occasional Paper 18 in September 2002 was clear that pension transfers are about value to the client. For example, if the client wants direct investment in commercial property, while being the cheapest product, a stakeholder pension would fail to meet the client's requirements and would be of no value.

It's not just about those changes to the environment that have already happened. Following the publication of the FSA's RDR proposals, you need to consider the design of the product solutions that you're recommending, and whether they will continue to be appropriate in the future.

The following checklist covers some of the key considerations that could impact the review process:

### Thematic Review

- Have you completed a full review of the features and benefits of both the ceding and receiving products against the client's needs? Will they lose any benefits that won't be replaced by the receiving product? Is it important, or do the benefits of the receiving product outweigh the ones they'll lose?
- Have you justified and explained any increase in product costs? What is the additional cost paying for? How will it benefit the client?
- If on-going investment reviews are required, has the need for these been explained and suitable arrangements put in place?
- Have you carried out an assessment of the client's current attitude to risk and their investment objectives? Are their current investments of asset allocation still appropriate? Will they deliver the client's objectives? Could they achieve better results within their attitude to risk?

### Evidencing RU64

- Are your processes clearly evidencing this analysis?
- Can the product you're recommending be accurately compared against a stakeholder plan? Does it disclose the effect of deductions and/or reduction in yield figures?
- Does it have exit charges or other penalties built in?

### Retail Distribution Review

- Is the product you're recommending free from product provider influence over the cost of advice? Can you agree your own level of remuneration with the client?
- Have you considered how your clients will pay for advice in the run up to, and after the final RDR proposals are implemented? If the product you're recommending still pays initial commission, will this create an advice conflict in the future?
- Are the costs for advisor remuneration and product management/administration disclosed separately?
- Is the product charging structure free from bias – even on investment selection? Is there additional commission on certain options? Can you prove that investment advice is based on client need and completely uninfluenced by provider remuneration models?

## Step 2: Prioritise client base

Reviewing your entire client base could take a great deal of work. It's therefore important to have an efficient process to establish where you can add the most value so that you can concentrate on a manageable number of cases.

There are a number of ways of identifying these cases. Options include prioritising by current product type (focusing on products most likely to need updating), or by client circumstance (focusing on need, demographics, plan size etc.). The following lists, although not exhaustive, may help you to segment and prioritise your clients, by identifying areas where current solutions may be unsuitable going forwards (for example, due to product features or cost, or inability to support agreed servicing propositions) or where the client's needs may have changed.

### By current product type

More detailed product suitability considerations are detailed in step 4 of this process; however we feel that certain products may be more in need of review than others:

- Executive pensions
- Section 32 (S32)
- Section 226/Retirement Annuity Contracts
- Free-Standing AVC
- Personal pensions/stakeholder
- Deferred SIPPs
- SSAS or SIPP clients with existing borrowing or loan agreements.

### By client circumstance

Segmentation by client circumstance can be done in addition to the product prioritisation shown above, to create a more focused group of clients, or as a first stage of segmentation.

#### Consider segmentation and prioritisation using the following:

- Fund value – does it exceed or is it approaching their available lifetime allowance? Is it insufficient to meet the client's investment objectives?
- Clients with a number of separate arrangements who could benefit from consolidation through lower charges, better fund choice or product features?
- How long since the last investment review? Are the investments performing as expected and do they still meet the client's attitude to risk?
- Whether they are going to be impacted by the measures announced in the 2009 budget limiting tax relief for high income individuals. If they are, we have a range of additional support material for pension planning for impacted individuals.

#### If you need to further sub-divide your client base, you could use the following criteria:

- Longer terms to retirement – offering greater potential for client gain.
- Older products where charges are likely to be higher.
- Clients invested in with-profit funds, particularly closed funds where the asset allocation may now be significantly different from when the investment was first made.
- The service proposition agreed with the client going forwards – focus on customers where ongoing advice required, but with existing product solutions that are unable to support the advice cost going forwards (and client doesn't want to pay directly).

## Step 3: Initial assessment checklist

Once you've prioritised your clients, you need to determine which cases require a detailed review.

The following quick checklist can help to identify key considerations that may prompt a full review. This is not an exhaustive list, there may be other factors to consider specific to your client's individual circumstances.

	Yes	No
Does your client have existing policies that may be, or have been, impacted by legislation and tax regime changes?		
When your client comes to take benefits, will the value of their fund be above their available lifetime allowance?		
Will the benefits provided by the projected fund leave your client with an expected shortfall of income in retirement?		
Could your client contribute more to their pension?		
Is your client paying for product features they don't use? Is there a cheaper and simpler alternative?		
Could your client benefit from starting to take income?		
Has your client received all the necessary information about their plan?		
Has the product been explained in a way that has been understood by your client?		
Does the product still meet your client's needs and objectives?		
Does the investment strategy/asset allocation still meet your client's attitude to risk?		
Are the investments still performing in line with expectations?		
Has more than 12 months elapsed since the last investment review?		
Is the client likely to be impacted by the measures to limit tax relief for very high earners announced in the 2009 Budget?		

**If you have ticked any of the above shaded boxes, a more detailed product review is required.**

## Step 4: Product suitability review

When reviewing a client's existing pension plans, there are likely to be a number of technical issues that will need to be considered before making a decision to transfer.

These will often depend both on the type of contract and legacy issues relating to pre A-Day (6 April 2006) rules. Sometimes the design of older products may include valuable contractual features that should be carefully considered before making a decision to transfer.

The main consideration should be whether the product is still suitable for your client. Other considerations are the support available from the provider and the investment options. Should you decide to transfer, you may also want to consider any factors that set the potential product providers apart from the competition, such as service standards and technical support pre and post-sale.

The following checklist can be used to help review product suitability considerations. More detail on each consideration is given below in the checklist, in the section noted in the right hand column.

**Please note:** except where indicated, some or all of these issues may apply to all registered pension schemes post A-Day.

Product suitability consideration	Adviser guide section	Issue reviewed?
Tax-free cash	4.1	
OPS including EPP, SSAS & S32	4.1.1	
AVC, FSAVC, PP	4.1.2	
RAC	4.1.3	
Low retirement age	4.2	
Guaranteed minimum pension (GMP)	4.3	
Protected rights/safeguarded rights	4.4	
Death benefits	4.5	
Pension term assurance	4.6	
Waiver of contribution benefit	4.7	
Guaranteed annuity rates (GARs)	4.8	
Guaranteed growth rate	4.9	
Investment options	4.10	
Contractual retirement date/early exit penalties	4.11	
Other contractual features/options	4.12	
Demutualisation or orphaned assets windfall	4.13	
Divorce earmarking order	4.14	
Administrative duties (A-Day/Pensions Act 2004)	4.15	
Refund of contributions	4.16	
Loans/borrowing	4.17	
Consolidation of funds	4.18	
Transfer to current employer's pension scheme	4.19	
Closed life office	4.20	

## 4.1 Tax-free cash

### 4.1.1 Occupational Pension Schemes (OPS) including Executive Pensions Plans (EPP), Small Self Administered Schemes (SSAS) and Section 32 (S32) buyout plans.

Before A-Day many members of these schemes will have been entitled to take more than 25% of their fund as tax-free cash. This entitlement can be protected, even if the benefits are transferred to another plan. However, the protection will be lost if 'block transfer' rules are not observed. This can be particularly significant for one-member schemes who may only be able to retain protection on one transfer post A-Day – and only then if the existing scheme is 'wound-up' and benefits 'bought out' – effectively ruling out transfer to a personal pension.

### 4.1.2 Additional Voluntary Contribution (AVC), Free-Standing Additional Voluntary Contribution (FSAVC) arrangements or Personal Pensions (PP).

Before A-Day an AVC or FSAVC could not pay any tax-free cash (unless it had received a transfer from a PP) or, in the case of an AVC arrangement, it started before 8 April 1987. PPs could also face restrictions on tax-free cash below 25% of the fund, if they had received transfers from an OPS for a controlling director or high earner. Or if the plan included protected rights in respect of a period of contracting out of the State Earnings Related Pension Scheme (SERPS) or State Second Pension (S2P) (see 4.4).

Post A-Day, these restrictions were removed by the new legislation. However not all scheme trustees and providers may have reflected the new legislation in their scheme rules and the old restrictions may persist. A transfer to another provider in these circumstances may open up the potential for additional tax-free cash.

### 4.1.3 Retirement Annuity Contracts (RACs)

Prior to A-Day the tax-free cash was calculated as three times the residual pension. This could come to more than 25% of the fund when annuity rates in general were high (or where guaranteed annuity rates applied) but will generally now be less than 25%. Higher than 25% amounts cannot be protected in a RAC so there should be no issues on transfer relating specifically to tax-free cash. But see section 4.8 for other issues relating to guaranteed annuity rates.

## 4.2 Low retirement age

Prior to A-Day some scheme members in 'special' occupations may have had a contractual entitlement to take benefits sooner than normally permitted under HM Revenue & Customs rules. This includes some public service occupations (police, fire service etc) as well as professional sports people with a specified retirement age eg age 35 for footballers. This can also be protected on transfer to another scheme but, similar to the position for greater than 25% tax-free cash, only on the proviso that block transfer rules are observed. Some scheme members will also have a contractual right to take benefits between 50 and 55, but this will be lost on transfer to a personal pension.

## 4.3 Guaranteed Minimum Pension (GMP)

### OPS including S32 buyout plans

Where a pension scheme holds benefits derived from a period when the member was contracted out of SERPS, it may include a GMP. A GMP represents a fixed amount of pension payable at 65 (males), 60 (females) that the scheme must provide. If the scheme has insufficient funds to provide the GMP then the provider will be forced to top up to the GMP level. GMPs must include survivors' pensions and will be inflation-proofed in payment, through a combination of provider and state sourced increases. GMPs cannot provide tax-free cash.

Depending on the amount of GMP and the circumstances of a particular client, this guarantee may be important and worth retaining. The adviser will probably have to include a full critical yield based analysis of the value of the GMP and the advantages and disadvantages of giving this up, in the context of the option to transfer and the circumstances and objectives of the client. It is worth bearing in mind that the tax-free cash will be limited to the element of the fund that is available after the GMP has been bought in full. Quite often the resulting tax-free cash will be less than 25% of the overall fund. In these cases transferring a GMP may lead to a higher tax-free cash payment from the resulting protected rights fund and/or a higher pension – particularly if the member is single.

## 4.4 Protected rights/safeguarded rights

Protected rights derive from periods of contracting out of SERPS or S2P. Safeguarded rights arise as a result of a pension sharing order on divorce relating to a contracted out pension scheme. Historically these were both subject to different rules from other pension benefits (for example: tax-free cash was not permitted and payment was not allowed before age 60).

Almost all of these restrictions have now been removed for both protected rights (6 April 2006) and safeguarded rights (6 April 2009). However not all providers' scheme rules may be amended to reflect this position and a transfer to another provider may offer the client the extra flexibility allowed under newer legislation.

## 4.5 Death benefits

Typically any money purchase pension arrangement will pay the full fund value to the member's beneficiaries if death occurs before the member takes benefits. This is subject to any requirements imposed by contracting out legislation relating to GMP and/or protected rights – generally the requirement to provide a survivor's pension.

Some older contracts (predominantly RACs but can also include OPS) may only return contributions paid without interest or contributions with a nominal rate of interest. There is therefore the potential to improve death benefits to a full return of fund by making a transfer. However, this may not be straightforward for those in poor health. The existing scheme may have underwriting requirements which could reduce the transfer value, and there is a risk of HM Revenue & Customs attacking any subsequent death lump sum for inheritance tax.

Where death benefits under the existing contract are written under an individual trust (often the case with RACs and S32s) this may also impede a transfer, unless the new provider can accept the trust. However the rules of the receiving scheme may not allow this. GMPs carry a default survivor's entitlement built into the cost – even if the member is single. Transferring a GMP into protected rights can offer the potential for a higher single life pension to be bought for the benefit of the member.

## 4.6 Pension term assurance

Tax relief on personal contributions to pension term assurance was removed in the 2007 budget. However policies in force prior to December 2006 (March 2007 for occupational pension schemes) continue to receive tax relief as do certain 'integrated' policies combining both life cover and pension in a single contract. When considering a transfer of pension benefits, it will be important to consider any existing pension term assurance arrangements.

## 4.7 Waiver of contribution benefit

Waiver of contribution benefit (or contribution protection) is a feature that could be provided within personal pension schemes and retirement annuities prior to April 2001. It provides for pension contributions to continue in the event of sickness or incapacity which prevents the member from working. Contributions in respect of this benefit are tax relievable. In these circumstances a transfer to a new provider would cause the benefit and tax relief on contributions to be lost, although a replacement policy without tax relief may be possible.

## 4.8 Guaranteed Annuity Rates (GARs)

Many older pension contracts (typically but not exclusively RACs and S32) provide GARs within their policy terms and conditions. These were written when inflation and long-term interest rates tended to be higher and life expectancy was lower. As a result they are often significantly higher than annuity rates available on the open-market today. In some policies GARs may only apply at certain ages or on a certain specified payment basis eg single life, level, guaranteed for ten years. Others may apply over a range of ages with options eg to select a continuing spouse's entitlement contingent on the first death of the member. Any advice to transfer must take into account the value of any GARs and their importance to the client, in the context of their personal circumstances and objectives. The value of GARs today is such that it will be rare that advice will be given to transfer out of a contract that offers them.

## 4.9 Guaranteed growth rate

Some pension contracts may provide for a guaranteed growth rate or bonus rate if certain conditions are met. This must be taken into account when comparing illustrated benefits on the standard bases and considering whether to transfer benefits to another provider.

## 4.10 Investment options

The existing pension contract may offer a limited choice of investment funds. Transferring to another provider may offer a wider choice of funds and/or fund management styles. This can add demonstrable value to a client's pension portfolio, even where the funds come at a higher price than the existing choice.

## 4.11 Contractual retirement date/Early exit penalties

This might apply where a client is currently over aged 55 and there is a market value adjustment or exit penalty on transfer from the existing scheme which could be avoided if the client transfers in order to draw retirement benefits immediately. The driver for the decision is the wish to avoid the penalty rather than the need for benefits, although where the receiving scheme offers income drawdown, it should be possible to access the tax free cash and leave the remaining fund invested.

Depending on how flexible the receiving scheme is, it may be possible to make further pension contributions from earned income. Alternatively, further contributions could be made to a separate plan. In both cases, these contributions would attract tax relief, and could be offset by the pension benefits realised by the transfer.

## 4.12 Other contractual features/options

The availability or otherwise of some contractual options with a pension arrangement may be a factor in deciding whether to transfer. These may include features such as automatic 'lifestyling' of the investment portfolio, unsecured/alternatively secured pension (income drawdown) or self-investment. Unless these are needed immediately, such features should not, in themselves, constitute a justification to transfer benefits, although they may support another reason for transferring. In contrast, where a feature is required immediately, then it may be the principal justification for transferring. An example of this would be an OPS that does not offer income drawdown, where the client needs to transfer benefits to access this option.

## 4.13 Demutualisation or orphaned assets windfall

Where the existing pension fund is invested in a with-profits fund, consideration should be given to the potential for a demutualisation windfall or a distribution among remaining policyholders of orphaned assets. Entitlement to such windfalls may be lost if benefits are transferred out.

## 4.14 Divorce earmarking order

A pension arrangement may carry an earmarking order as a result of previous divorce proceedings. The ex-spouse will have to be told about the transfer and, in some cases their agreement may be required before it can proceed (although this cannot normally be withheld without good reason).

## 4.15 Administrative duties (A-Day/Pensions Act 2004)

OPs carry certain reporting requirements to HM Revenue & Customs and the Pensions Regulator as a result of A-Day and the Pensions Act 2004. These fall directly upon the scheme administrator – often the sponsoring employer/ company directors. As A-Day effectively created a single regime for all registered pension schemes, transferring benefits from an OPS into a PP need not have an adverse impact on members' benefits but may enable the administrator's duties to be passed to the provider.

## 4.16 Refund of contributions

If a member has completed less than two years service as a member of an OPS, then in some circumstances they may be able to take a refund of contributions, with or without interest. This would be an alternative to a transfer value or a deferred entitlement in the scheme.

The member will receive an amount equal to their own contributions, with or without interest, less deductions for tax and any amount required to restore state scheme benefits.

The employer's contributions will be returned to the employer (after deductions) and will not be available to the member.

#### 4.17 Loans/borrowing

Some OPS may have loans outstanding to the sponsoring employer. Both OPS and PP may also have outstanding borrowing. (Please note: this applies mainly to self-invested schemes such as SIPPs and SSAS.) In both cases the loans may have to be repaid before any transfer can take place.

#### 4.18 Consolidation of funds

Normally a transfer would only be recommended if it can be demonstrated that there is likely to be a financial advantage in doing so for each individual transaction. However, in some cases this could be over-ridden where a client has a number of contracts with different providers and has the specific objective of looking to consolidate their holdings, perhaps for ease of administration. Where combining funds can demonstrate an overall cost saving, or opens up access to options such as income drawdown that would otherwise be denied due to minimum contractual requirements, then consolidation may be a valid reason to transfer.

#### 4.19 Transfer to current employer's pension scheme

The option of transferring benefits to a client's current employer's scheme should be considered as this may offer lower costs/charges due perhaps to employer negotiated discounts and/or economies of scale. Perhaps the employer offers a defined benefit (final salary) pension scheme that will accept a transfer to purchase guaranteed benefits. Guarantees of any description are becoming rarer so this could be a valuable alternative. On the other hand, there may be valid reasons why transfer to an employer's scheme is not appropriate, despite the potential for cost savings or guarantees. However the adviser will need to record that the option has been explored and discounted, and the reasons behind the decision, before other solutions are considered.

#### 4.20 Closed life office

A life office that is closed to new business may not have the incentive to offer leading fund management services, customer service or product innovation. Instead in-house funds may 'de-risk' with a view to managing liabilities and client expectations and clients may expect to receive a basic level of service and product design. Where a pension is held with a 'closed office', this may not be suitable for the client over the medium to long-term and a transfer may offer the potential for better investment returns and service. For more information, please refer to the Technical zone on the Scottish Widows adviser website.



## Step 5: Product charge review

Product charges are a consideration for both existing and new business. You will need to consider the range of charges; are they easy to explain to your client or too complex? Are they reasonable? Do they cover the cost of your advice, and do they treat the customer fairly?

For existing business, you'll need to assess the current charging structure and compare it to alternative products available today. The question of whether it is right for clients to transfer existing plans into cheaper modern products was discussed by the FSA in Occasional Paper 18 in 2002. This paper, whilst not part of the FSA's policy or proposals, outlined key charging considerations that need to be reviewed to determine if it's in the client's best interest to transfer. The paper also raised some valid reasons why a transfer may not be appropriate, even where a cheaper product is available elsewhere, such as guarantees or product features not available on new plans.

These product suitability considerations were addressed in the previous step of this process. Whilst this paper is nearly seven years old, the issues and considerations still remain as valid today as when the paper was first published. A copy of OP18 can be obtained from your usual contact, or is available from the FSA website at <http://www.fsa.gov.uk/pubs/occpapers/OP18.pdf>.

### Process to assess product charge suitability

#### 5.1 Initial assessment of charges

**Refer to Key Features documents and illustrations, paying particular attention to the reduction in yield (RIY) and transfer value figures. Also refer to fund charge information and with profits guides.**

Consider obtaining alternative illustrations:

- from alternative providers
- and/or using different charging designs (charges which are paid up front, or in the early years, can result in improved maturity values over mid to long terms)
- third party illustration portals can provide comparison quotes against multiple providers and products in one go
- ask the existing provider for existing business illustrations, and full details of the any exit penalties or Market Value Reductions.

#### 5.2 Detailed product charge analysis

Where the initial charge assessment indicates that the client may well benefit from a charges perspective, more detailed analysis should be carried out. An effective way of carrying out this analysis is by using third party software that has been designed specifically for the purpose of comparing product charges, and can be used both for new business and existing business.

Below is a generic checklist of charge analysis considerations which are supported by third party software systems. For support on using these systems, please talk to your Scottish Widows Account Manager.

Is the software configured to show your own business terms with the provider?

**For with-profit investments:**

- Analyse independent fund ratings, and financial strength of the provider.
- What is the provider's bonus rate track record?
- Analyse asset mix of fund – does it still meet client's requirements, does the AMC represent good value for that asset mix?

### Product projections:

- Compare charges on a like for like basis; either remove all remuneration costs to demonstrate value of base product price, or compare products using a defined commission rate (as not all products defer to the same basis).
- Compare against whole of market or just chosen providers. The software will be able to rank products by maturity value.
- Compare against stakeholder to help demonstrate RU64 compliance (how a non-stakeholder plan can be at least as suitable as, or favourable to, a stakeholder).
- Consider the different charging shapes available – compare the RIY of plans that take charges in the early years versus those that spread cost throughout plan term.
- Ensure investment allocation is on a like for like basis (as not all products defer to the same basis).

### Product transfer analysis:

- Input details of the current plan (including transfer value), and compare projected values against new plans.
- Ensure investment allocation is on a like for like basis (as not all products defer to the same basis).
- Remove commission bias from analysis.
- Consider consolidation of existing plans into one new plan – this may reduce charges in the new plan (by way of increased bonuses or large fund discounts).

Third party software may also contain provider or product information that can help you write your suitability report for your client.

## 5.3 Additional support for charge reviews

Appendix 1 of this guide reviews the impact that charges have on a product, and show how this is shown in illustrations. Appendix 2 contains a glossary of charges and related terms that may appear in products or material you are reviewing.

Your Account Manager can also provide you with support on product reviews, including:

- material on product specific review opportunities
- support on using third party software for pension reviews
- a printable checklist, as shown in this guide, which you can use as a tool to assist you with your client reviews and retain on file as part of your compliance record.



## Step 6: Investment review

Whether it's new business, or a potential transfer case, there are two key areas when reviewing investments: how do you best meet your client's needs within their attitude to risk, and how do you ensure that their portfolio continues to meet their needs?

### 6.1 Determining your client's attitude to risk and investment portfolio

Understanding your client's attitude to risk is a hugely challenging task. While personal judgement and experience play a key role, it's difficult to document how you've assessed the client.

#### 6.1.1 Risk Profiling

By using a psychometric risk profiling tool as part of your processes you can augment your experience and prove a robust and unbiased process for determining your client's attitude to risk.

#### 6.1.2 Stochastic modelling

While a risk profiling tool can prove objective assessment of attitude to risk, this still needs to be converted into an investment portfolio taking into consideration:

- Term – for example, a fund suitable for a client who is more than ten years from retirement may not be suitable for a client within 5 years of taking benefits;
- Investment objectives – what is your client actually looking to achieve?
- Required returns to meet your client's investment objectives;
- What level of income they need if they are already in, or are transferring to a drawdown arrangement
- Their existing investment knowledge and experience.

How do you prove that you've taken into account the nature and overall risk level of the investments recommended? A stochastic modelling tool can help you to build an asset allocation for your client taking all of this into consideration.

A modelling tool can also provide an illustration of your client's potential returns based on their current asset allocation and the allocation based on their current attitude to risk.

#### 6.1.3 Clear client reporting

When selecting a modelling tool to use, it's worth ensuring that it will provide outputs that you can use not only to evidence the review process that was undertaken, but also to disclose to the client their attitude to risk, your proposed investment strategy, the difference in returns from their original and potential asset allocations and the likelihood of achieving these returns.

Scottish Widows offer a Portfolio Architect tool that can help you to establish attitude to risk and to construct client portfolios. If you'd like more information on Portfolio Architect and how it could support your business processes, your usual Scottish Widows contact will be able to help.

As the FSA's thematic review on the 'Quality of advice on pension switching' in December 2008 identified, these tools shouldn't be used as a definitive solution for all clients. It's worth considering whether you need a process to allow you to adapt from the norm if individual client circumstances merit more flexibility.

### 6.2 Ongoing investment advice

If you're looking at using an asset allocation approach, or if your client will be taking advantage of the full flexibility offered by self-investment, then there is going to be a need for ongoing investment advice.

You'll need to be able to confirm that the investments continue to meet your client's attitude to risk, and that the portfolio is rebalanced regularly to remain in line with this and your client's expectations.

Ask yourself, does your client understand the need for ongoing investment advice whether this is annual, biannual or more frequent? How does this align to your value/service proposition? How will your clients be expected to pay to cover this ongoing commitment?

## Appendix 1: Illustrations

Key features illustrations must include appropriate charges information. This normally includes illustrative figures of the benefits available at the client's selected retirement age, the 'total paid in to date', 'total actual deductions to date', 'effect of deductions to date', 'transfer value of your plan' and 'reduction in yield' information.

### Actual deductions to date

This is the total sum of all charges taken ignoring any effect of inflation or growth on those charges.

### Effect of deductions to date

This is higher than the actual deductions to date because it takes into account the growth that would have been achievable on the element of the fund that has been taken out as charges.

### Transfer value

This can be lower than the actual fund value at any point because it takes into account the surrender penalties applied, if any.

### Reduction in yield

The reduction in yield illustrates the impact of the various charges that the policy will or may bear, including the cost of commission and the provider's expenses. It is calculated by firstly obtaining the projected fund value using the intended contribution(s), the intermediate projected growth rate for the product, plan term and charges.

Secondly we calculate the growth rate required to match the projected fund value using the same contribution(s) and plan term but no charges. The RIY is the intermediate growth rate minus the nil charges growth rate.

## Appendix 2: Charges glossary

### Accumulation units charge

An 'accumulation units charge' applies to the fund consisting of units bought by subsequent contributions up to the previous year's levels and all increments after the initial period is over. This tends to be much lower than the 'Initial units charge'.

### Active member discounts

These normally operate as charge reductions for scheme members who are either actively contributing to their pension over a sustained period of time, or who have funds above set levels.

### Allocation percentage/charge

This dictates how much of each contribution will be invested. The figure may be higher or lower than 100% depending on which other types of charge are included and whether the contribution is a one-off amount or will be repeated on a regular basis. Typically a lower percentage would apply to shorter-term arrangements reflecting the shorter time in which associated costs could be recouped.

### Annual management charge (AMC)

This is calculated as a percentage of funds under management. This can be explicitly charged by the encashment of investments, or can be implicit in the prices of those investments, or both. Some legacy products will have this split into an 'Initial' (also known as 'Capital') units charge and an 'Accumulation' units charge. For further detail refer to the entry in the glossary.

### Bid/offer spread

This is the difference between the price at which units in investment funds are sold to customers (the 'Offer' price) and the price at which they are repurchased when benefits are claimed or switched (the 'Bid' price).

### Contribution charge

Calculated either as a cash amount or as a percentage of every contribution.

### Initial units charge

'Initial' (also known as 'Capital') units will be bought by contributions at outset and later increments for a specified initial period. The 'Initial units charge' applied to the fund consisting of 'Initial' units is much higher.

### Monthly contribution charge

This is sometimes referred to as a monthly administration charge or policy fee. This can be increased in line with an index each year at the provider's discretion, or can be fixed. In some cases a lower charge can apply if the member is not contributing to their pension.

### Market value adjustments (MVA) or market value reductions (MVR)

MVAs or MVRs are not strictly speaking charges, but a deduction which may be made from money which is taken out of a with-profits fund, on surrender or early encashment, to protect the interests of the remaining investors when market conditions are depressed. They are normally applied when the value of the 'guaranteed' benefits bought by members' contributions, together with reversionary bonuses that have been added over time, exceeds the market value of the underlying investments over the holding period. MVAs/MVRs reduce the payout to bring it into line with the actual profits made by the fund over that period.

## OP18

This refers to Occasional Paper 18, issued in 2002 by the Financial Services Authority (FSA). It coincided with the introduction of stakeholder pensions. These were much cheaper than many of the personal pensions that were sold in the past and included a Government-set charge cap. This meant that it was potentially advantageous for some clients to switch to a stakeholder pension.

The research for this paper identified that there were about two million people who may benefit from switching. The paper is split into five sections with the first being the executive summary. Section 2 explains from a theoretical perspective, why switching is likely to be important and also why consumers may not want to switch. Section 3 provides an analysis of factors to be considered in the decision on switching. Section 4 uses examples to illustrate the potential gains from switching. Section 5 summarises the results of the analysis.

## RU64

This refers to Regulatory Update 64, issued by the Personal Investment Authority (PIA) in 1999. This Update set out factors for advisers to consider when advising on personal pensions ahead of the introduction of price-capped stakeholder pensions. These factors have since been adopted as rule requirements (COBS 19.2.2 R) by the PIA's successor, the FSA.

In summary, when recommending a personal pension, advisers must explain in their client suitability report why the pension is considered at least as suitable as a stakeholder pension.

## Surrender charges

These are very common on legacy products but we have seen a gradual removal from new plans. The main driver for this was the introduction of stakeholder pensions in 2001. The providers' intention behind levying these charges is usually to recoup costs already incurred, which would otherwise have been recovered over the remaining term of the contract.

## Switching charges

These charges are normally levied on members who switch the investments within their plan more than an allotted number of times per year.



While this guide aims to assist advisers in undertaking pension reviews, it should not be viewed as comprehensive or relied upon when advising clients or making investment decisions.

This information is based on Scottish Widows understanding of current legislation, and FSA and HM Revenue & Customs rules (as at August 2009), all of which are subject to change in the future.



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