Prestwood Group White Paper

Prestwood has always led the way in lifelong financial planning. Our founder, Paul Etheridge MBE, TD, JP, MBA, FCII, FCSI, CFP, has been a leading financial planner for over six decades. He started the Institute of Financial Planning (now the CISI) to spread best practice across the country turning a 'financial product sales' mentality into a 'professional advice and guidance' mentality. He also developed the UK's first lifelong cashflow modelling software in 1984.

Over the past four decades, the landscape for financial planning has radically changed. Today, the internationally accepted 6 steps of financial planning are now firmly embedded in the best advisory firms. However, this must be set against a number of devastating episodes of mis-selling of financial products leading to severe mistrust by consumers of the financial services industry as a whole.

There will be many complacent individuals who believe this is not their problem because they follow the rules and have significant relationships with their clients. However, the savings and pensions crisis will impact our society soon and, in turn, will affect all our pockets.

We contend that all firms providing any kind of retirement advice or marketing MUST use some form of cashflow modelling. This is a crucial step towards protecting consumers from mis-selling and giving clarity to them; reducing IFAs' PI insurance; and restoring faith in our profession.

DISCLAIMER

Acknowledgements:

We contacted over 1000 IFAs, appointed representatives, Financial Planners, and various organisations including the CISI, PFS, FCA, FOS.

This publication is available to download from www.truthsoftware.co.uk

This paper has been submitted to The Work and Pensions Select Committee inquiry into pension freedoms and also to the FCA.

Contents:

Foreword

Executive Summary

What are the Concerns?

Government Position

Financial Conduct Authority

The Stats

Advice

Products

Scams

How can our profession address these issues?

The consequences of not doing so?

ANNEX A: All Old People are the Same

Foreword

It's a well-known fact the population in the UK is getting older.

The rosy picture painted by some is that because we live longer, we have more time to enjoy ourselves.

The reality is that while one in six of the UK population is currently aged 65 and over, by 2050 one in four will be and the majority of them will be on the poverty line.

We hope to contribute to the debate about provision for our elders and halt the pensions timebomb.

Executive Summary

On the 24th April, 2014, Prestwood published a press release warning that while the Government's new approach to retirement income was like a breath of fresh air, consumers were in danger of being short-changed if their adviser did not use cash-flow modelling. We explained that pensions freedom did not mean that the rules were any less complicated or less open to mis-selling or scams. We insisted then that a visual picture of future financial situations was vital for individuals especially if they were being 'advised' to move schemes or withdraw their pension funds altogether.

More than three and a half years after our warning, the FCA has realised that there "are risks that older consumers' financial services needs are not being adequately met, resulting in exclusion, poor customer outcomes, and potential harm."

Whilst more and more networks, providers and individual advisory firms recommend cashflow modelling is used to evidence the potential sustainability of income and capital, the majority or those advising on pension issues do not.

What are the concerns?

Since April 2015, consumers aged 55 and over have been able to access their defined contribution pension savings. This 'freedom' from having to buy a poor return annuity had long been called for, but freedom often comes at a cost. Many consumers who have taken advantage of the new rules have no idea how much they expect to spend in retirement or omitted to factor in the costs of elderly assisted care.

The FCA understands that consumers are being asked to take responsibility for increasingly complex financial decisions in later life, including planning for long periods of retirement and potentially periods of ill health.

Over time, changes to government policy on taxation, state pension and social care all impact on the level of resources people will need as they enter later life. Combined with economic influences such as inflation and fluctuating house prices, such factors can make planning and decision-making particularly tricky.

The freedom to access pensions has resulted in a swathe of bad advice and mis-selling scams. The biggest concern is that a whole generation of our society will be unable to afford their cost of living, post-retirement.

Government Position

The Work and Pensions Select Committee's inquiry into pensions freedom will look for evidence as to whether there are gaps in the advice and sales arena and if consumers are changing their behaviour after getting advice.

Pension freedom rules were introduced in 2015, giving those aged 55 or over access to their retirement savings. In fact, it appears to be "reckless caution" rather than "reckless spending" that legislators and regulators want to address. Three years ago, we discussed the possible 'Lamborghini effect' that in reality, has failed to materialise.

The inquiry will look into what people are doing with their pension pots and whether their decisions are consistent with their objectives. It also wants to know if there is adequate monitoring of people's choices.

Scams will also be under the spotlight, and the Committee wants to hear from scam victims about their experience.

Committee chair, Frank Field, said: "In this case, it is vital that adequate support ensures people are equipped to ensure they don't make decisions they subsequently regret. I am particularly concerned that savers are more vulnerable than ever to unscrupulous scam artists. This policy must not become the freedom to liberate people of their savings."

The Committee is also concerned that consumers are taking money out of a pension where it has the potential to grow and be tax free, to re-invest in low-interest, taxable cash savings accounts.

Improving engagement and understanding of retirement saving needs to become a central aim of the Government.

Financial Conduct Authority

The FCA recently published the interim findings of their 'Retirement Outcomes Review,' looking at how the retirement income market is evolving since the pension freedoms were introduced in April 2015. The review, published in July this year, has mainly focused on consumers who do not take advice.

This follows on from the publication of their Occasional Paper, 'Ageing Population and Financial Services' and a series of alerts, aimed at warning older consumers in particular of possible scams or unauthorised pension firms.

For example, 'Find out how pension review scams work, how to avoid them and what to do if you are scammed'. 'Find out how to protect yourself from investment and pension scams, and how to check you're dealing with an authorised firm'.

So, the issue of 'advice' and whether consumers are taking it is a large part of the timebomb.

With regard to products, the FCA is looking across the pension suite but particularly at whether drawdown plans provide value for money and suitable investment choices for those taking advantage of them.

Pension unlocking or pension liberation is also on their radar as it is marketed as a way of accessing money in your pension fund before you retire. Usually, you can only take money from your pension once you are aged 55 or over, but some schemes claim to let you gain access to your money earlier by borrowing from your pension fund. Commonly known as 'pension liberation,' the FCA is concerned that early access to a pension is rarely in anyone's long-term financial interests.

It is clear that the regulator has been taking the pensions timebomb seriously for a while.

The Stats

*Savers have accessed £14.2bn

*More than a million DC pensions have been accessed under the pension freedom rules and 72 % of these pots have been accessed by the under-65s.

*Before 2015, 90 % of pension pots were used to buy annuities.

*Almost twice as many people are selecting drawdown rather than an annuity.

*Around a third of those going into drawdown have done so without taking advice.

*Before 2015, just 5 % of drawdowns were without advice. These are often known as a "zero income drawdown accounts" as they are simply being used as a means to access tax-free cash in stages, rather than engaging in the investment process.

*Today, more than half of those accessing their pensions have cashed in their pots entirely (although most are smaller pots worth less than £30,000).

*Figures from the FCA show that more than half (52 per cent) cashing in their retirement pots move the money into a current account or cash ISA.

*Only 7 per cent of people aged 55 and over and planning to retire in the next two years have used the free and impartial Pension Wise service.

Advice

The Retail Distribution Review completely changed the advice market, and advisers used the opportunity to clarify their services and charge accordingly. However, although there is a growing acceptance by some consumers of their need to pay for expert advice, it is clear that many cannot afford the fees charged by professional planners. In cases like these, there has been an opportunity for unregulated advice or guidance to move into this space and thereby lead to mis-selling.

Prestwood believes that qualified advice should become mandatory when taking pension benefits. Although this is already necessary when transferring defined benefit pensions of more than £30,000, we believe it should be mandatory for everyone using Drawdown.

Also, qualified advice should incorporate cashflow modelling so consumers can easily see in a visual format, the impact of taking their pension pot.

Prestwood conducted a survey amongst 1500 advisers and 99% said that cashflow modelling is essential for retirement planning.

The CEO of the PFS, Keith Richards, said:

"Since the introduction of pension freedoms, cashflow modelling has increasingly become an essential planning tool whilst also helping to ensure better client engagement, understanding and confidence."

Another aspect of good advice is 'knowing your client'. Prestwood does not believe pensions specialist firms who have clients introduced to them, can be said to 'know their clients'. Particularly for execution-only clients, a sense-check using cashflow modelling may cause the client to rethink.

EXTRACT FROM FCA's work on DB Transfers:

Suitability of advice

"Our focus is on risks associated with specialist pension transfer firms. However, we had concerns regarding the suitability of the advice provided by the firms who we assessed, not all of whom were specialist pension transfer firms.

Since October 2015 we have reviewed a total of 88 DB transfers where the recommendation was to transfer. Out of these, we found that:

47% were suitable

17% were unsuitable

36% where it was unclear if the recommendation was suitable

We also considered the suitability of the recommended product and fund and found that:

35% were suitable

24% were unsuitable

40% were unclear

The proportion of suitable cases was much lower than we found in the wider advisory market for pensions advice, e.g. our Assessing Suitability Review found that 90% of pensions accumulation advice, and 91% of retirement income advice, was suitable.

Firms must make sure that their personal recommendations are suitable for their clients. However, many firms had designed processes and procedures which result in transfers where the suitability of advice could not be established by the firm.

This included firms:

Failing to obtain enough information about clients' needs and personal circumstances.

Failing to consider the needs of the client alongside the client's objectives when making a recommendation.

Not making an adequate assessment of the risk a client is willing and able to take in relation to their pension benefits.

In some cases, advisers had failed to make appropriate comparisons between the defined benefit scheme and the intended receiving scheme. Therefore, advice was based on incorrect or inaccurate comparisons."

Prestwood believes that had these advisers been using cashflow modelling, they would have been unable to make this mistake. They would have been able to assess the suitability of a pension transfer in the wider context of the client's whole circumstances, not just by comparing the DB scheme with a personal arrangement in isolation.

The value of a good adviser cannot be overstated. Not only should a good adviser 'know' their client they need to be able to show their client the risks associated with taking a particular action and help them understand the impact that action will have on their later lives.

If advisers do not as a community improve the way they communicate these messages of risk and action to their clients, our profession will continue to be slated and called to account. More seriously, our ageing population will not be cared for by a Government knee-deep in debt.

PRODUCTS

Annuity sales may have plummeted as a result of the pension changes, but a third of savers are still choosing to buy an annuity with their retirement pot. However, with annuity rates providing a pittance for many who have worked their whole lives, this figure is likely to decline.

As part of this discussion paper, we talked to many financial advisers about their experiences of DB transfer schemes. Many said they were resolutely disinclined to help their clients with this option, even if it was the preferred option of the client. They felt the product area was fraught with hurdles and the time and complexities involved meant it was not profitable for them. Interestingly, those advisers who used cashflow modelling with all clients felt unafraid to deal with these choppy waters as the cashflow simulation provided a product audit trail for them.

"**We always use Truth modelling software as part of our DB analysis process. We don't believe it's possible to carry out transfer work without it. In many cases, it confirms why the member should remain in the scheme."**

Bruce Bulgin

Partner - Chartered Financial Planner

Concerns about the rise and promotion of DB transfers is reaching the unions. The Trades Union Congress (TUC) warned that employees are reportedly being targeted by pension freedom liberators eager to relieve employees of their pension pots.

They too noted evidence of a large number of people wanting to take their DB transfer without advice. The TUC also said in some cases, employees with little or no investment experience were being encouraged or incentivised to transfer out of DB schemes by their employers, in a bid to relieve the company of some of its pension obligations.

'Unions are concerned that this has led some employers to highlight the potential for transfers to staff whenever possible. We would like to see the Work and Pensions Select Committee explore the potential for restrictions on the publicising of transfers (while not highlighting the many benefits of being in a scheme), particularly at times such as consultations around pensions changes.'

The TUC is also concerned that savers are increasingly dipping into their pots early. "And others are following the path of least resistance and risk buying rip-off products," TUC General Secretary Frances O'Grady said.

Advisers tell us that they cannot operate with unprofitable clients, but it is clear that 'unprofitable' clients are falling prey to unscrupulous firms. A visual plan providing a breakdown of their current expenditure and expected expenditure in retirement could help to provide a robust audit trail in this regard.

In the Financial Ombudsman Services' annual review, investment and pension complaints for the year 2016/17 make disappointing reading:

*personal pension plans make up 13 %

*small self-administered schemes (SSASs) and self-invested personal pensions (SIPPs) form 11%, up 34% on the previous year

*52% of investment and pension complaints were about sales and advice

*the uphold rate for the top five most complained-about products: self-invested personal pensions (SIPPs) 64%; personal pensions 39%

Prestwood asked the Ombudsman how many of these upheld complaints involved firms using cashflow modelling. However, although the FOS clearly sees a rise of complaints in this area it does not drill down to the processes used. It is our expectation that none of the firms where complaints were upheld, used a lifetime cashflow model to determine the suitability of the advice.

Prestwood also asked the FCA for their view and we are still waiting.

Scams

One of the most significant unintended consequences of pension reforms was opening the door to pension fraudsters. Although the FCA has worked to highlight the issue to consumers plus force many scam firms out of business, they stand accused of failing to protect savers from scammers.

In January the FCA published a warning to SIPP providers which said scammers are 'becoming increasingly sophisticated' and the 'third generation' of scams are using DFMs to hide the nature of the underlying investment.

The regulator has asked SIPP providers to reveal how many non-standard assets they hold and how these assets arrived with them. This includes looking at discretionary fund managers (DFMs) and the advisers who recommend investments to pension savers. A non-standard asset is one which cannot be accurately valued and readily realised within 30 days. Such assets, or non-standard investments (NSIs), tend to pose a high risk of loss to investors, and some NSIs have been connected to scammers.

Deregulation has led to even more devious ways for profit to be made at the point of distribution, product design, cost of charges and underlying investments.

The Financial Services Compensation Scheme (FSCS) is also considering the whole process of delivery to consumers.

"We are considering what we do regarding the amount of attention we pay to the intermediary sector, for example, how much we pay to the sales of unregulated products and things like that, so we are looking at where to target our resources on a supervisory front."

How can our Profession address these issues?

Pensions freedoms have brought a much-needed flexibility for consumers but alongside that, as we have discussed, there have been many examples of mis-selling; a lack of reinvestment; squandering of funds; a rise in consumer complaints; and a rise in compensation.

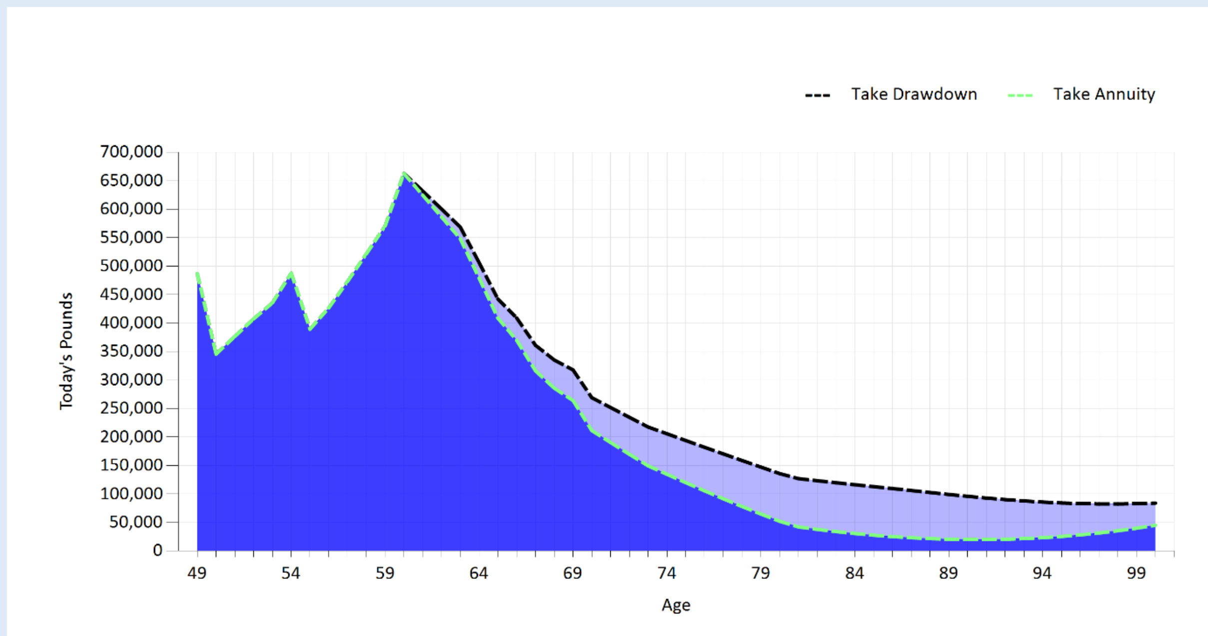
Many readers will assume that this does not affect them either because they do not operate in this arena or because they assume that they give best advice to their clients, it has no bearing on them.

A picture paints a thousand words.

But it does. Not only does it mean that everyone's PI insurance will increase as a result of the redress awarded, but it also has implications for our profession as consumers' confidence in us as professionals, declines.

Three years ago, we warned this would happen, and it has.

We said one way to prevent bad advice or mis-selling would be to make cashflow modelling mandatory.



THE CONSEQUENCES OF NOT DOING SO

It is vital the Government, regulators and the profession – both product providers and advisers - continue to work together to raise the level of engagement with consumers. Pension freedoms are welcome but we must do more to root out the fraudsters and engage better with consumers. Part of that engagement must be a mandatory use of cashflow modelling to make the consequences clear to consumers and to provide the perfect audit trail.

Failure to do so will result in a societal mess in our near future.

ANNEX A

The recent publication by the Government Office for Science makes interesting reading and is a good reminder that the over-55s are not one homogenous group.

ALL OLD PEOPLE ARE THE SAME

Experian mapped the nine segments below according to wealth and age. With an increased emphasis on self-reliance and provision, it is useful to understand the considerable diversity of needs and circumstances across all age brackets.

Established Investors: older families who enjoy an excellent financial position. They have achieved professional success and have higher than average incomes or asset holdings. Their considerable holdings are carefully managed, and they value expert insight into the latest investment options.

Career Experience: this group is in the second half of their working life. They often rely on a single salary and are working towards paying off their mortgage while building their savings. They may respond to relevant product offers via email and often read online newsletters.

Mutual Resources: older families whose incomes don't provide for many extras. However, their financial position is enhanced by the support of extended family members (eg young adults still living at home) or the wider community (through the community support of a family business).

Small-scale Savers: older employees who have worked solidly for many years but not saved significant amounts. They own their home, which provides some certainty in the years ahead. They may be interested in no-frills offers that provide good value.

Respectable Reserves: older homeowners in their pre-retirement and early retirement years. They have a reasonable level of assets saved and with careful planning can look to a positive future. They appreciate traditional communications that contain sound financial advice.

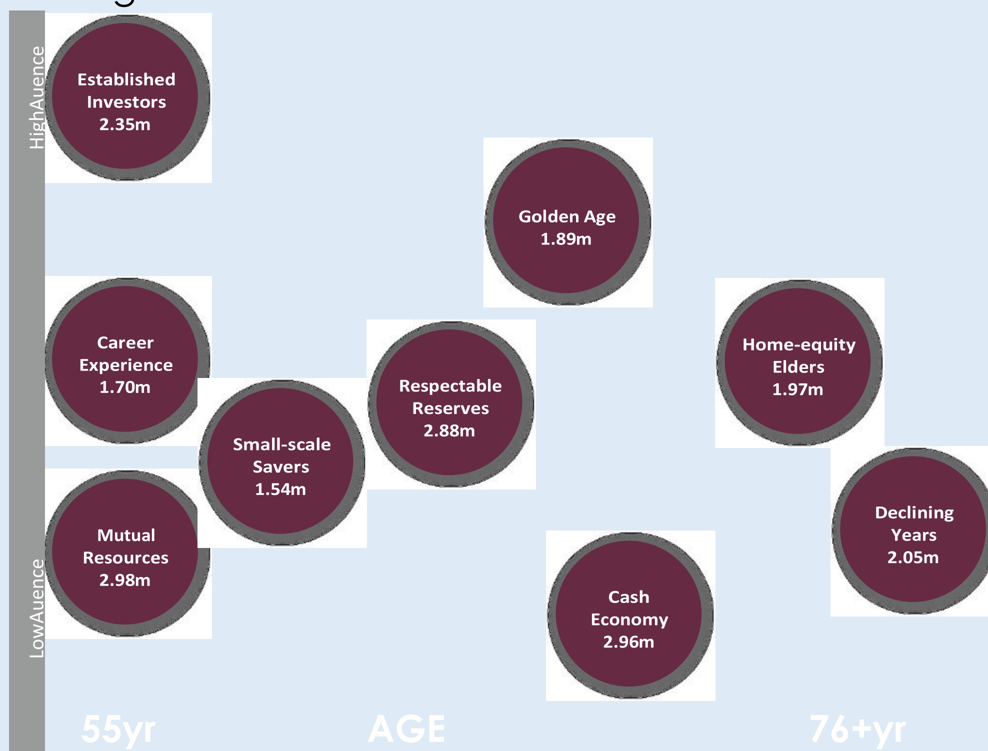
Golden Age: retired people who are able to make the most of the opportunities that life after work can bring. They have generous pension income to enjoy, and manage their considerable assets with care. They are likely to read editorials and newsletters that give investment advice and address retirement issues.

Cash Economy: mature households struggling to get by on minimal incomes (less than £15,000). They have few accounts and often prefer to use cash for payment. Television advertisements and discount offers through the door are more likely to gain a response.

Home-equity Elders: seniors living stable retired lives, with modest incomes matched to modest spending. They own their home outright, which provides them with security and, if necessary, an asset. They aren't easily influenced but might respond to printed advertisements in newspapers or in the post.

Declining Years: pensioners who have low incomes and few savings. They have established a budget and know what they can afford and when; a routine that mostly allows them to buy the things they need and to pay bills. They are receptive to traditional advertising and look for familiar brands at low prices.

Consumer segments mapped by affluence (level of total wealth) and age



Source: Experian 2017 Experian's Financial Strategy Segments tool was built in 2016 using a wide range of data including demographics, lifestyle, social, economic, behavioural, product consumption, service and channel preferences. Reproduced with permission of Experian Ltd.

As the segmentation table above shows, there tend to be large differences between the different segments identified in the research.

As has always been the case, those with the most income and assets are also likely to be in the best health with larger amounts of savings than those with lower incomes. Post Retail Distribution Review (RDR), this is also the segment that advisers target and who are not unwilling to pay fees.

Research undertaken by Age UK indicates that almost two million older people currently live in poverty.

A further 1.2 million live just above the poverty line. A significant number of older consumers seem to have limited savings, pension funds, or disposable income. This has an impact on quality of later life and reduces their ability to cope with financial shocks.

Anecdotal evidence points to this segment being particularly induced to dispose of small pension pots (under £30,000) to alleviate immediate situations. More worryingly, people tend to underestimate their longevity and have an overly optimistic view of their needs in later life.

GLOSSARY

Prestwood Group press release: http://www.truthsoftware.co.uk/ethical-advisers-cashflow-modelling/

Political challenges relating to an aging population: Key issues for the 2015 Parliament (2015): http://parliament.uk/business/ publications/research/key-issues-parliament-2015/social-change/ageing-population/

Future of an Ageing Population, Government Office for Science (2016) p 6. https://gov.uk/government/uploads/system/uploads/ attachment_data/file/535187/gs-16-10-future-of-an-ageing-population.pdf

Retirement income market study: Final report – confirmed findings and remedies, March 2015, p 38. Retrieved from https://fca.org.uk/publication/market-studies/ms14-03-3.pdf

https://www.fca.org.uk/publications/market-studies/retirement-outcomes-review

https://www.fca.org.uk/scamsmart/pension-review-scams

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/654281/Pensions_Flexibility_Oct_2017.pdf

https://www.fca.org.uk/news/news-stories/our-work-defined-benefit-pension-transfers

http://www.financial-ombudsman.org/publications/annual-review-2017/pdf/Datamoredepth-AR2016-17.pdf

www.ageuk.org.uk/latest-press/rise-in-poverty-response/

Retirement income market study: Final report – confirmed findings and remedies, March 2015, p 38. Retrieved from https://fca.org.uk/publication/market-studies/ms14-03-3.pdf

https://fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf, paragraph 3.16

www.truthsoftware.co.uk