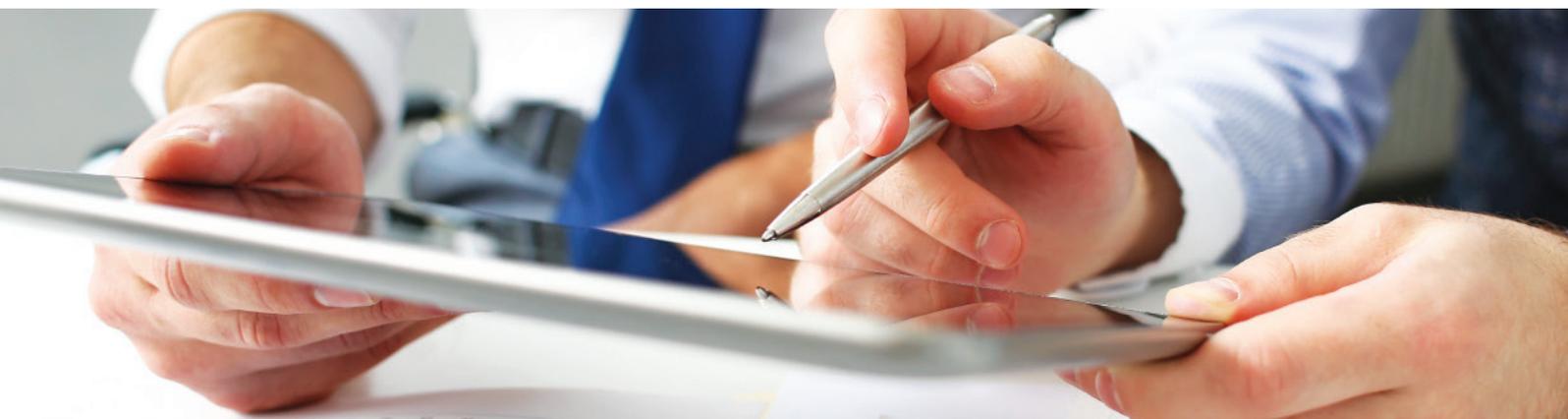


# Understanding the risk associated with Defined Benefit transfer advice

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**Any firm that provides or has historically provided financial advice in relation to the transfer of Defined Benefit (DB) pensions is exposed to the risk that this advice could, in future, be deemed unsuitable. This would necessitate an offer of compensation to the investor.**

IFAs are increasingly expected to understand the extent to which they are exposed to the risk of such compensation payments arising. This is because:

- The possibility of unsuitable advice (either arising as a one-off event, or as the result of systemic approach by the firm) is likely to be identified as a significant risk within the firm's risk management framework. As part of the risk assessment process, it will be appropriate to consider the financial exposure to future redress payments.
- The FCA is applying increased scrutiny to DB transfer advice. Being able to demonstrate an understanding of the risks associated with the provision of the advice will help firms manage their relationship with the FCA. Indeed, the FCA may request that firms quantify the liability arising in relation to potential future claims.
- When negotiating terms for professional indemnity (PI) insurance it is helpful to demonstrate an awareness of the factors that affect the risk of future claims and understand how these apply to the book under review.
- Understanding the risks associated with historic DB transfer advice enables the firm to make informed decisions in relation to acquisitions and sales.
- Understanding the risks associated with ongoing DB transfer advice enables the firm to make appropriate strategic decisions in relation to the provision of future advice and to identify steps that can be taken to manage this risk.

It is recognised that IFAs are finding it challenging to obtain PI cover for DB transfer advice and that this is having a knock on effect on the availability of advice to consumers. The complexity of defined benefit pensions means that it is difficult for insurers and brokers to understand the potential financial exposure associated with transfer advice and this is driving them away from providing cover.

Increasing awareness of the factors that affect the risk of claims is therefore a first step towards a better functioning financial advice market. As such PI insurers may also wish to develop their understanding of the risk of compensation falling due.

Broadly speaking there are three factors which drive the liability in relation to potential future compensation payments:

1. How likely is it that the case will need to be reviewed – for example, what is the risk of a complaint arising from the investor? Is there a possibility of regulatory intervention?
2. Will the advice be found to be unsuitable or have material information gaps?
3. If compensation is required, what might the compensation payment be?

It is difficult to come up with a precise method of incorporating these factors into the liability calculation. Furthermore, the liability is not static – it is affected by the evolution of the claims management industry; changes in market conditions and by regulatory change. With so many moving parts, we may ask ourselves whether attempting to accurately quantify it is a worthwhile task. For this reason, it can be tempting to put the risk of future claims to the back of our minds.

However, a more robust approach might be to educate ourselves about the variables that influence each of the factors listed above. By breaking down the risk in this way, we can make it more digestible.

Many firms will be able to identify the factors that increase the risk of a complaint being made by, for example, considering the ongoing relationship with the client. Similarly, reviewing sample cases, or assessing historic advice procedures – perhaps in conjunction with the FCA's recently released DB transfer advice assessment tool - will inform a view on the likelihood of advice being found to be suitable.

The more challenging element is therefore to assess the potential magnitude of compensation if a successful claim is made. At a high level, this is affected by: the amount of transfer value paid, investment performance on the personal pension since the transfer; and any changes to the ceding scheme benefits since the transfer. Again, each of these can be considered in greater detail - the latter, for example, could arise as a result of scheme specific developments or industry wide changes.

OAC have been calculating the compensation arising as a result of unsuitable pensions advice for over 20 years. We understand each stage of the remediation process: from receipt of the complaint to the file review and finally the calculation and communication of the redress payment. We work with a variety of experts including claims managers, PI insurers and lawyers as well as with large insurance companies and IFAs.

We combine our knowledge of the complexities of loss assessment and the redress industry with our broader experience of the current and past pensions environment. This enables us to offer our clients unique insight into their potential exposure to future claims. In this regard, we offer a range of services from generic training to a detailed analysis of a particular book and take a consultative approach to each project.

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**For more information**

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