



## AIFA member Factsheets

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### Pension Term Assurance

#### Introduction

This factsheet is designed to inform members about the opportunities and risks associated with arranging pension term assurance (PTA) which have arisen as a result of the pension simplification changes.

AIFA members will already be considering PTA as a possible option when considering a client's life assurance needs. The changes brought about by pensions simplification mean that the potential market for PTA is now much wider: PTA can now be arranged separately, with no requirement to also be contributing to a pension arrangement.

As a stand alone product, PTA fits the definition of a pure-protection contract and can be sold under ICOB rules, as well as COB rules, provided the IFA firm also holds the insurance mediation permission. Firms can elect to arrange PTA under ICOB rules or COB rules, but need to clearly document which regime they are operating within.

This factsheet provides information on the ICOB rule requirements for PTA, which differ from COB rules. An important distinction to note is that there is no comparable definition of 'independent' under ICOB, but the rules require advisers operating on a 'whole of market' basis to undertake 'fair analysis' of the market.

**Any firm operating on the basis of 'fair analysis' for term assurance contracts falling under ICOB should read this factsheet to ensure that they are aware of the impact that these changes will have on compliance with the FSA guidance in ICOB on fair analysis.**

#### Issues relating to PTA

Although the tax relief available to PTA brings benefits to clients, there are some important points to note about the effect PTA may have on existing pension arrangements, in particular the potential impact on the lifetime allowance and any enhanced protection:

### **Key points to note:**

- The gross cost of PTA is generally higher than the cost of ordinary term assurance.
- Waiver of premium and critical illness cover are not permitted in a PTA contract (although these are sometimes made available as a stand-alone contract with no tax relief on the premiums).
- Not all providers allow PTA to be written on a joint life basis.
- The taxation benefits available on PTA could change in the future.
- In the event that a client's circumstances change (for instance the lifetime limit is breached or near to breaching) contracts without a replacement option could need to be terminated, (leaving a client in declining health with potentially higher premiums or unable to insure themselves) or the lifetime limit could be breached incurring a tax charge of 55% on the excess.
- Clients' individual circumstances may change in a way that impacts the suitability of PTA.

### **Specific risks associated with the sale of PTA**

There are specific risks associated with the sale of PTA compared with ordinary term assurance:

- The lump sum death benefit under PTA counts towards the overall 'lifetime allowance'. The lifetime allowance restricts the amount of benefits which can be paid free of tax from pension arrangements. If the limit is exceeded the benefits payable beyond the limit are taxed at effectively 55%.
- Tax relief on combined annual pension contributions (inc PTA premiums) will be limited to the higher of 100% of earnings or £215,000. Non-earners can contribute a maximum of £3,600 per annum. Breaching this limit will affect the level of tax relief granted.
- Contributing to PTA could invalidate any 'enhanced protection' put in place for pension arrangements.
- Clients could mistakenly think that PTA will provide them with a pension.
- Cancellation and replacement of existing term assurance benefits will require careful consideration before proceeding.

It is essential therefore that those firms/advisers who are not active in the pensions market ensure that they familiarise themselves with the pension simplification changes, as relevant to PTA.

### **Electing to use ICOB rules**

Where an IFA also holds the relevant permission to carry out non-investment insurance mediation, the firm can elect to apply ICOB rules to PTA business rather than COB rules. This election must be made in writing and retained on file **indefinitely** for future reference.

The election can be made either on a case-by-case basis, in which case the firm must record the election on each client's file, or at a firm or adviser level, where a record should be held centrally confirming the date on which the election began, and, where applicable, ceased.

Firms considering making such an election must place appropriate systems and controls in place to ensure that advisers are aware of how to deal with cases under the ICOB rules. This may include additional training and increased monitoring.

**Many members may elect to advise and arrange PTA under COB rules. The next section focuses on ICOB rules and how they differ from COB.**

## **ICOB rules**

### ***Scope of service***

Under ICOB rules, firms must describe their scope of service in the IDD as one of the following:

1. A range of insurers ('fair analysis' of the market)
2. Limited number of insurance undertakings
3. Single insurance undertaking

ICOB 4.2.11 (R) provides further information on the scope of 'fair analysis':

*'An insurance intermediary cannot hold itself out as giving information or advice to customers on non-investment insurance contracts on the basis of a fair analysis of the market in accordance with ICOB 4.2.8 R(6)(a) unless:*

- (1) it has considered a sufficiently large number of non-investment insurance contracts available in the relevant sector or sectors of the market; and*
- (2) the consideration in (1) is based on criteria which reflect adequate knowledge of non-investment insurance contracts in the relevant sector or sectors of the market.'*

There is no further definition of fair analysis in the FSA handbook, however ICOB 4.2.12 (G) provides the following supplementary guidance:

*'If an insurance intermediary holds itself out as giving information or advice to customers on certain types of non-investment insurance contracts on the basis of a fair analysis of the market (or any sector of that market), the selection of insurance undertakings the insurance intermediary considers for this purpose will need to be sufficiently large to enable the insurance intermediary to satisfy the requirement in ICOB 4.2.11 R. One way in which this requirement may be satisfied is by the insurance intermediary using 'panels' of insurance undertakings which are sufficient to enable the insurance*

*intermediary to give advice or information on a fair analysis basis and which are reviewed on a regular basis. An insurance intermediary which provides a service based on a fair analysis of the market (or from a sector of the market) should ensure that its analysis of the market and the available non-investment insurance contracts is kept adequately up-to-date. For example, an insurance intermediary would need to update its selection of non-investment insurance contracts if it became aware that a non-investment insurance contract had generally become available offering an improved product feature, or a better premium, when compared with the non-investment insurance contracts currently in the insurance intermediary's selection. The frequency with which the selection of contracts needs to be updated will depend on the extent to which new contracts are made available on the market.'*

### ***Fair analysis and PTA***

Although there have been no changes to the definition of 'fair analysis', the FSA's view is that in order to sell term assurance on a 'fair analysis of the market', PTA will need to be considered alongside ordinary term assurance. The current net cost of PTA premiums is likely to mean they offer more competitive net premiums than ordinary term assurance. It is therefore likely that firms could not offer 'fair analysis' without providing access to PTA.

**All firms who elect to offer PTA under ICOB rules and who work on the basis of 'fair analysis' for term assurance should therefore review their disclosure documents for compliance purposes in light of the above.**

### ***Suitability***

The ICOB suitability rules include the requirement for the intermediary to consider the relevance of any limitations of the contract. In the context of PTA, this will include the effect of PTA on the lifetime allowance and any enhanced protection for the client's pension arrangements as applicable. Limitations of PTA could also include the inability to add waiver of premium and/or critical illness benefits, inability to have the contract written on a joint life basis, and the competitiveness of the premiums should tax reliefs change in the future, etc.

### ***Existing pension arrangements and the lifetime limit***

As with all other non-investment insurance contracts, ICOB requires that all relevant information is sought from the client by the intermediary in order to identify the client's requirements. In the context of PTA, this will include all existing pension arrangements (including lump sum payments due from registered death in service schemes) in order that a headroom check can be carried out against the lifetime limit and annual allowance for pension arrangements.

Where a client is not able to provide sufficient information on their existing pension arrangements to carry out a headroom check, a decision must be

made as to whether the suitability of the recommendation for PTA could be significantly affected by these arrangements. Where there is the potential for this, the intermediary has two options:

- i) Wait for the information to become available, then assess the suitability of PTA in the light of that information, before making a recommendation.
- ii) Make a recommendation for PTA, and make clear to the client that the recommendation may not be suitable because it does not take into account full details of their existing pension arrangements. **It is strongly recommended that firms using this option issue the warning in writing to the client and retain a copy on file in case of future complaints. It may also be considered prudent to record why the pension information was not available at the time of the recommendation.**

## Trusts

With ordinary term assurance, advisers should always consider writing the policy under trust to remove the benefit from the estate for IHT purposes and to allow speedier payment of the benefits to elected beneficiaries upon a claim. In the case of mortgage related cover, there is arguably less need as the policy is simply covering a loan.

In the case of PTA policies, PTA is generally written under a discretionary trust which gives the scheme administrator the discretion as to where the proceeds are payable. Although a nomination form can be completed by the client at outset, there is no certainty that the administrator will pay the benefits in accordance with the nomination form. It is essential that clients are made aware of this, and of their responsibilities to ensure that nomination forms are kept up to date.

## Demands & Needs Statements

Where advice is provided the demands and needs statement can provide the client with a useful summary of the advice given. Also, this document may be the only record of the reasons for the recommendation. It is in the interests of both the client and the intermediary firm to ensure that an adequate explanation for the recommendation is evidenced on file. In the past, demands and needs statements have been subject to criticism from the regulator for their lack of depth and personalisation to the client. The specific risks of PTA mean that a robust demands and needs statement, more along the lines of a suitability letter, will be essential in defending potential complaints.

ICOB 4.4.1R requires firms to provide a statement to the client before conclusion of the contract that sets out:

*a) the customer's demands and needs*

In the context of PTA, this should include:

- the reason for the need for life cover.
- details of whether other life insurance is in place (including employer benefits),
- confirmation of pension arrangements (or confirmation that information was not available on existing pension arrangements).
- confirmation of any additional features requested or required by the client, for instance, waiver of premium or critical illness.
- confirmation of the client's current income tax position (e.g. basic or high rate taxpayer).

*b) whether the intermediary has personally recommended that contract and, if so,*

*c) explains the reasons for that recommendation.*

In the context of PTA recommendations, c) should include:

- the reason for selecting PTA instead of ordinary term assurance.
- the reason for selecting decreasing or level term assurance, and additional options such as indexation, waiver of premium and conversion options where applicable.
- why PTA is recommended in addition to, or instead of, any current life cover arrangements in place.
- either:
  - confirmation that a headroom check has been undertaken against the lifetime limit, and the results of this.
  - confirmation that this could not be carried out due to insufficient information from the client on existing pension arrangements. In this case, the warning should make it clear that the recommendation may not be suitable because it does not take into account the full details of the client's existing pension arrangements, and that the lifetime limit may be breached by taking out PTA.
- a warning that PTA arrangements must be reviewed whenever changes are made to pension arrangements, changes are made to the premiums, or in any case on a regular basis to ensure that the lifetime limit is not breached.
- the consequences of breaching the lifetime allowance limit.
- details of any other specific reasons for the recommendation for PTA or the provider (e.g. medical history).

Where the contract recommended does not meet all of the client's demands and needs, the statement of demands and needs should confirm this and specify which demands or needs the contract does not meet.

Demand and needs statements should address the limitations of PTA, including:

- that contributions to PTA may affect pension arrangements both now and in the future.
- that tax reliefs currently available may not always apply.
- where there is no replacement option on the PTA policy, the consequences of this (e.g. should tax reliefs change).
- that any increase in the sum assured in the future could lead to a breach of the lifetime limit.

### **Cancelled and replaced policies**

Where an existing policy is to be altered, cancelled or replaced as a result of the recommendation, the demands and needs statement should clearly evidence the reasons for this, along with a warning not to cancel or alter existing cover until the new PTA contract is in place. As with any recommendation to cancel, alter or replace existing arrangements, consideration must be given to any decline in health since the existing arrangements were put in place, and a comparison of the relevant terms, conditions, and definitions offered by the recommended and current contracts. In particular, firms should always check any existing trust arrangements. The demands and needs statement should clearly evidence these considerations.

### **T&C considerations**

Although there are no changes to the T&C section of the FSA handbook, members considering providing access to PTA must also consider whether any additional training is required. Compliance staff also need to be aware of the option to conduct business under COB or ICOB and ensure they have the necessary knowledge of ICOB rules and the firm's own compliance procedures for cases written under ICOB.

### **Compliance monitoring arrangements**

Firms will need to consider whether additional monitoring of PTA cases is necessary whether arranged under COB or ICOB rules.

### **PII arrangements**

Before considering the sale of PTA, members should first ensure they have adequate professional indemnity insurance in place to cover this activity. Some PII providers may also place additional requirements on firms active in this market, such as the requirement for PTA advisers (and/or their

supervisors) to hold the full FPC certificate (or equivalent), and for the firm to carry out additional monitoring on PTA cases.

### **AIFA's view**

It is possible that members will want to elect to conduct PTA business under ICOB rules, rather than COB. This may be for example, where an adviser is primarily operating in the mortgage or protection market. In this case, firms must remember to keep a record of the election (as described above in 'electing to use ICOB rules').

Those who are happy to advise under COB rules should note the following key differences between ICOB and COB:

- Advisers need to be qualified and authorised to provide investment advice
- The status disclosure rules operate differently to COB (e.g. 'independent' rather than 'fair analysis')
- COB rules require a suitability letter to be issued
- COB rules require commission disclosure to take place

Where enhanced protection has been put in place on behalf of clients, continuing or starting contributions to PTA will invalidate the protection. There could be situations where clients may consider purchasing term assurance from another source, (e.g. where the IFA does not offer mortgage advice). It may be prudent to inform any client who could be affected, of the risks of invalidating protection.

### **PTA Checklist**

- Set out procedures for electing the regime under which PTA will be conducted (COB or ICOB rules).
- Check PI arrangements.
- Update T&C Plan for staff who are to be involved in PTA sales – make sure you address how you will provide the additional knowledge required to carry out PTA sales, and how advisers will maintain this knowledge and keep it up to date.
- Review initial disclosure documents to ensure they are compliant, particularly in relation to the scope of service you will offer (e.g. fair analysis etc).
- Review fact finding documents to ensure existing pension and protection arrangements are adequately recorded.

- Ensure that demands and needs statements or suitability letters adequately cover PTA issues.
- Review compliance monitoring arrangements to ensure appropriate controls are in place to mitigate the risks of PTA sales.

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### **About this AIFA and this Factsheet**

This factsheet is intended to provide members with information on pension term assurance following the introduction of pension simplification changes on 6<sup>th</sup> April 2006.

It is AIFA's role to lobby policy makers and regulators to ensure light touch and proportionate regulation. As part of our remit we endeavour to bring insightful and plain English information to the market. This factsheet has been prepared in that spirit. Firms are advised to seek professional advice rather than rely on comments contained in this brief text.

*Prepared on our understanding as at June 2006*

For more information on AIFA, contact the address below.

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