HELPING MEMBERS ACCESS DB TRANSFER ADVICE – TIME FOR SCHEMES AND REGULATORS TO DO MORE?

A joint policy paper between LCP and Royal London
September 2020

EXECUTIVE SUMMARY

The last five years have seen a surge in the number of people looking to transfer their pension rights from a Defined Benefit (DB) scheme to a Defined Contribution (DC) arrangement. From the introduction of 'pension freedoms' in April 2015 up to September 2018, official figures suggest that nearly a quarter of a million people took advice on a DB to DC pension transfer. Around 170,000 transferred out with sums transferred exceeding £80 billion.

Savers enjoyed the new flexibilities and the historically high transfer values, the Treasury enjoyed the extra tax revenue, and the Financial Conduct Authority (FCA) even consulted on softening its historic presumption that a transfer out of a DB scheme was a bad idea for most people.

But as the market developed, concerns grew over the quality of some of the advice being given and the value for money being achieved by members post transfer. The FCA's small-scale data gathering suggested high levels of 'unsuitable' advice around whether or not to transfer and the destination of transferred funds. These concerns were reinforced when thousands of members of the British Steel Pension Scheme were found to have received unsuitable and often expensive advice.

As a result, FCA rules around DB transfer advice have been repeatedly tightened. Changes have included:

- requiring advisers to show in a graphical way the value 'lost' when giving up DB rights;
- the abolition of 'contingent' charging models where full fees are only paid to an adviser if a transfer goes ahead;
- the requirement to benchmark the investment vehicle used for transferred funds against a workplace pension, which would typically have relatively low charges capped at 0.75% in the default fund

At the same time, providers of Professional Indemnity (PI) cover have become increasingly concerned about the risk of providing insurance to advisers in this market. These concerns have been amplified by an increase in the maximum amount of compensation payable via the Financial Ombudsman Service to £350,000 and regulatory action by the FCA leading to hundreds of advice firms pulling out of the market. PI costs have soared and many advisers have been forced to stop advising on DB transfers.

Against that backdrop, this paper brings new evidence to bear on what the future holds for DB transfer advice.

A new survey of advisers by Royal London finds high levels of concern among advisers about the future of DB transfers. More than 4 in 10 of those who offer DB transfer advice are unsure if they will be in the market in a year's time, and most cite a mix of regulatory uncertainty, hostility to DB transfers and rising PI costs as key factors. Around one third operate a minimum transfer value below which they will not provide advice, with floors of £100,000 and £250,000 being quite common.

Analysis of the response from DB pension schemes by LCP finds trustees and employers becoming more engaged in helping members to source advice, with a range of models being adopted. LCP finds that typical member costs for scheme-supported advice can be around £1,000. These low charges can be achieved where the trustee or employer has also paid the adviser firm a one-off fixed cost to enable them to build their knowledge of the scheme and to setup efficient processes and typically the trustee or employer also pay an annual fee for maintenance. This compares to the £3,000-£4,000 envisaged by the FCA and current charge levels where a fee of up to £10,000 on a large transfer is not uncommon.

LCP and Royal London both believe that members should be able to access high quality, impartial financial advice to help with key life decisions on using retirement capital, including the possibility of a DB transfer, whether this is comes from an adviser they have sourced themselves or from an advice firm made available by the trustees or sponsor of a scheme.

As things stand, pressures on adviser firms are likely to lead to a decline in supply. Members may struggle to meet rising advice entry costs, especially where these have to be met whether or not the transfer goes ahead, and those with smaller pots face a restricted range of advisers willing to advise them. We believe that a combination of schemes doing more and regulatory action to secure the supply of high quality advice is needed if members are to achieve good outcomes.

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1. Context – the evolution of the DB transfer market

In his 2014 Budget, Chancellor George Osborne announced a major liberalisation of pension saving. Savers with a Defined Contribution (DC) pension pot would no longer be 'forced' to use that pot to buy an annuity but instead could access that pot flexibly. This flexible access could range from taking the whole pot in one go once aged 55 or over (subject to paying appropriate taxation) to managing the pot into and through retirement, drawing from it as required.

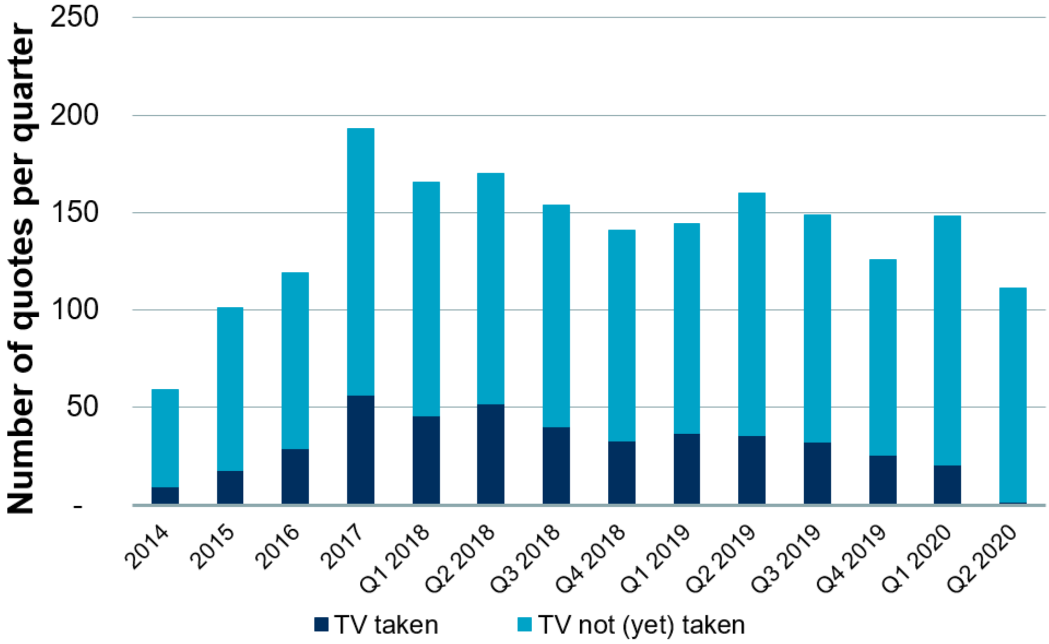
These 'pension freedoms', as they became known, were hugely popular, but only applied to DC pensions. Those with Defined Benefit (DB) pensions could still enjoy some flexibility within their own scheme, depending on the rules of the scheme, but nothing like the flexibility enjoyed by their DC counterparts.

To enable more people to share in 'pension freedoms', the government decided to continue to allow those with funded DB pension rights (i.e. excluding those in unfunded public sector schemes) to make a transfer into a DC arrangement where they could then exercise much greater freedom and choice. Recognising the complexity and risks around such a decision, the government put in place a mandatory requirement to take financial advice in respect of any transfer worth £30,000 or more.

The impact of these reforms on the DB transfer market was huge. Coming at a time of historically low interest rates, the transfer values available were very substantial and could easily put the value of a member's DB pension above the value of their family home.

As Figure 1 shows, the result was a surge in the volume of transfers out of DB pension schemes, with a peak of transfer activity in 2017 and early 2018.

Figure 1. Number of transfer value quotes per 10,000 members – 2014 to Q2 2020



Source: Sample of 80 DB schemes administered by LCP.

According to a recent FCA policy statement[1], between April 2015 (when the new flexibilities were introduced) and September 2018, 235,000 DB scheme members took advice about transfers on transfer values worth £80 billion in total. Of these, over 170,000 transferred out.

It seems likely that the DB transfer market may now have passed its peak, for a variety of reasons which we discuss later in this paper. But later in 2020 financial pressures on households because of the current economic crisis may lead cash-strapped over-55s to look very closely at their DB pots as a way of accessing relatively large amounts of cash relatively quickly. If we are to see a new wave of interest in DB transfers, it is especially important that those members are able to access good quality advice at a price they can afford.

[1] https://www.fca.org.uk/publication/policy/ps20-06.pdf

2. The FCA's Perspective – the evolving regulatory framework around DB transfers

The regulations around DB transfers have evolved considerably since the Chancellor's 2014 Budget announcement of 'Pension Freedoms' and their subsequent introduction in April 2015. It is possible to identify three main phases:

a) *Initial phase – getting the system up and running*

The FCA had roughly one year to come up with a framework for DB transfers in the context of the new Pension Freedoms, which were announced in March 2014. The Primary legislation covering the new framework was contained in the Pension Schemes Act of 2015 which ultimately came into force just weeks before the new freedoms went live, though the headlines have been known for some time. The rules are summarised in a DWP briefing note[2] as follows:

> *Section 48 of the Pension Schemes Act 2015 and regulations made under it require pension scheme members who have subsisting rights in respect of safeguarded benefits worth more than £30,000 under the scheme to take appropriate independent advice from an FCA authorised adviser before:*
>
> *• converting safeguarded benefits into flexible benefits (or in the case of benefits which are both safeguarded and flexible, into different flexible benefits)*
>
> *• using a transfer payment in respect of safeguarded benefits to acquire flexible benefits under another scheme*
>
> *• being paid an "uncrystallised funds pension lump sum" (UFPLS) in respect of their safeguarded benefits.*

It is easy to forget that in these early days of Pension Freedoms, the new policy was extremely popular. Thousands of members of pension schemes who may not have been especially high earners but who had long service in a DB scheme suddenly had the opportunity to convert those rights into eye-watering amounts of money which they could access far sooner and more flexibly than before.

Instead of money in DB pension funds being largely used to pay a steady income over a period of decades, some DB members were now able to access some or all of the value of those funds immediately. Beyond any tax-free lump sum, any such withdrawals were subject to income tax at the individual's highest marginal rate. As a result, income tax revenues on the value of DB pension saving would be brought forward considerably.

When the Pensions Freedoms policy was originally announced it was assumed that it would add over £3 billion to income tax revenues in the first 4 years[3]. But in March 2020 the Office for Budget Responsibility said that the actual amount raised over that period was around £5bn and that revenues from pension flexibility 'continued to surprise on the upside'.[4]

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/495377/pension-benefits-with-a-guarantee-factsheet-jan-2016.pdf
[3] See for example, p12 of this OBR document: https://obr.uk/docs/dlm_uploads/FSAP-pensions-and-savings-1.pdf
[4] See https://cdn.obr.uk/EFO_March-2020_Accessible.pdf especially pages 76 and 198

Although the regulators required advisers to start from a presumption that remaining in a DB scheme was likely to be the best thing to do, the FCA in these early years appeared neutral to the potential attractions of pension transfers in a post-Pension Freedoms environment. This was demonstrated in the FCA's June 2017 consultation document 'Advising on Pension Transfers', which contained the following paragraph:

> *"It remains our view that keeping safeguarded benefits will be in the best interests of most consumers. However, the introduction of the pension freedoms has altered the options available and for some consumers a transfer may now be suitable when it wasn't previously.* ***We therefore propose to remove the existing guidance that an adviser should start from the assumption that a transfer will be unsuitable****. This will be replaced with a statement in the Handbook that for most people retaining safeguarded benefits will likely be in their best interests and guidance that advisers should have regard to this…..An assessment of suitability should focus on whether a transaction is right for the individual and* ***should be assessed on a case by case basis from a neutral starting position****. The adviser needs to demonstrate that the transfer is in the best interests of the client"*

(Source: FCA consultation paper CP17/16 para 3.11 – our emphasis)

b) *Second phase – growing concerns over quality of advice, tighter rules*

As DB transfer advice grew in importance, FCA undertook a series of relatively small scale 'thematic' studies into the quality of advice given by 'higher risk' firms. These were referred to as 'DB1', 'DB2' and 'DB3'. The results of this research made for increasingly sobering reading.

In October 2017, the FCA published the results of its latest survey[5] (DB2) which included detailed analysis of 88 DB transfer case files where the recommendation was to transfer. They expressed concerns both about the suitability of the advice to transfer or not, and the suitability of the product into which funds were transferred.

They reported:

On the advice to transfer:

- 47% were suitable
- 17% were unsuitable
- 36% where it was unclear if the recommendation was suitable

On the suitability of the recommended product and fund:

- 35% were suitable
- 24% were unsuitable
- 40% were unclear

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

Understandably, the FCA was concerned about the low number of cases where the advice to transfer was demonstrably suitable, and also the low number where the money was being transferred into a demonstrably suitable investment vehicle.

In March 2018, the FCA issued a new policy statement on DB transfer advice[6], as well as publishing another consultation paper. The March 2018 policy statement introduced a number of changes to the advice framework. These included:

- Dropping the idea from an earlier consultation that advisers should start from a 'neutral' position about pension transfers;

- Introducing a new analytical framework for advice – the Appropriate Pension Transfer Analysis, which included a new way of comparing the value of the benefits given up with the benefits obtained in the new scheme; this was called the Transfer Value Comparator or TVC; the TVC process involved showing clients a simple bar chart comparing the capital value of the DB pension rights given up (on something close to a "risk free" basis) and the transfer value on offer; in many cases the transfer value would be shown graphically to be far smaller than the value of the benefits given up[7];

- Higher qualification requirements for transfer advisers and new rules on cases where transfer advice was subcontracted by an advice firm to a third party specialist;

By March 2018, it was already clear that the regulatory sands were shifting and that FCA was now looking to tighten up the rules around transfer advice.

Alongside the new policy statement, the FCA published a further consultation paper[8] which, for the first time, started to raise concerns about the 'contingent charging' remuneration model whereby a fee for advice was only payable if a transfer went ahead. Some concern had been expressed as to whether this led to a bias among advisers to recommend transfers. At this stage the FCA was not proposing any rule change but was simply seeking views.

However, having sought views in March 2018, the FCA backed off taking the matter further at that stage. This was due to the lack of demonstrable evidence. In its October 2018 statement, the FCA was still taking a relatively balanced view on contingent charging and wrote:

[6] https://www.fca.org.uk/publication/policy/ps18-06.pdf
[7] A detailed analysis of the TV approach can be found in an earlier joint paper between Royal London and LCP: https://www.royallondon.com/siteassets/site-docs/media-centre/policy-papers/fcas-transfervaluecomparatorslcproyallondonoct18.pdf
[8] https://www.fca.org.uk/publication/consultation/cp18-07.pdf

> *"The responses also confirm our initial thoughts that any causal link between contingent charging and suitability is difficult to prove. Charging models are only one of the potential drivers of unsuitability, and they need to be considered amongst other factors. Our work in this area will take into account the responses and suggestions as we look at whether intervention is necessary. If we consider that changes are appropriate we will consult further on any new proposals in the first half of 2019".*

Source: https://www.fca.org.uk/publication/policy/ps18-20.pdf p27

c) *Third phase – British Steel and further tightening of the rules*

Although DB transfers remained very popular, there was growing concern that some DB scheme members could be taken advantage of by unscrupulous advisers and introducers.

This concern was evident most clearly in the case of the British Steel Pension Scheme, as part of a wider restructuring of the pension scheme, where steel workers with relatively large DB rights were presented in late 2017 with a time-limited choice to remain in their existing scheme (which was expected to enter the Pension Protection Fund) or to transfer to a new British Steel DB scheme. Members separately had the option under general pension regulations to ask for a transfer quote and to consider a transfer out to a DC arrangement. Unregulated introducers and others travelled to steel towns and sought to persuade steel workers of the attractions of transferring out, often in breach of the prevailing regulations. The British Steel case attracted national press attention in 2018 and high profile scrutiny of regulators by, among others, the Work and Pensions Select Committee, then chaired by Frank Field.

A report on the British Steel case was prepared for the Pensions Regulator by Caroline Rookes[9], which was published in January 2019. Subsequently, in June 2020, having reviewed the advice given to British Steel members, the FCA[10] said:

"the FCA intends to write directly to all c.7,700 former members of BSPS for whom contact details are available, who transferred out. This will help them revisit the advice they received, and to complain if they have concerns"

Following the Rookes review, and in the light of the FCA's own research[11], the FCA issued yet another consultation paper in July 2019[12] which marked a significant toughening of their stance.

The paper reported new estimates that the total consumer harm from unsuitable DB transfer advice could lie in the range £1.6bn - £2bn per annum (or an eye watering £20bn overall[13]) and proposed a number of measures to tighten up the advice process.

Proposed changes included:

- The abolition of contingent charging for transfer advice, with very limited carve-outs;

[9] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/rookes-review-british-steel-pension-scheme-members.ashx
[10] https://www.fca.org.uk/news/press-releases/fca-sets-out-next-steps-improve-defined-benefit-pension-transfer-market
[11] https://www.fca.org.uk/news/statements/fca-updates-work-financial-advice-given-members-british-steel-pension-scheme
[12] https://www.fca.org.uk/publication/consultation/cp19-25.pdf
[13] https://www.fca.org.uk/publication/corporate/sector-views-2020.pdf

- A new form of 'abridged' advice designed to allow advisers to recommend against a transfer without going through the full advice process;

- A requirement on advisers to benchmark the proposed investment vehicle for the transferred funds against a workplace pension.

All of these proposals from July 2019 were carried forward, largely unamended, into the final policy statement published in June 2020.

The FCA also reported in June 2020 that out of 3,000 advice firms from which it had gathered data, it had provided detailed feedback to over 1,600 and of these over 700 had now given up their permissions to advise on transfers. The FCA reported that it was undertaking 30 enforcement investigations into potential breaches of its rules. It also produced a document[14] for consumers to help them identify if the advice they received might have been unsuitable, and what steps to take in order to complain. This document asked consumers to think about whether the balance of advice they received was right or gave too much emphasis to very prevalent motivations for transferring such as an enhanced tax free lump sum, improved death benefits or avoiding ending up in the Pension Protection Fund. There is a real chance that claims management companies could use this document with consumers to prompt widespread and potentially very expensive compensation claims.

Summary

There can be no doubt that the regulation of DB transfers has evolved considerably since the introduction of Pension Freedoms in April 2015. There was clearly a 'honeymoon phase', when the regulator saw its job largely as providing a neutral environment in which DB scheme members could enjoy their new options. As concerns about the quality of advice grew, FCA research on the quality of advice remained noticeably small scale, and as late as the summer of 2017 the FCA was prepared to talk about advisers being 'neutral' as to whether or not someone should give up their DB rights. Only as the British Steel case became headline news and political pressure increased did regulators start to toughen the rules. Even so, the FCA initially held the line on not banning contingent charging for more than two years after it first floated the idea.

But what is clear is that latest approach is very different. Regulatory action has led hundreds of DB transfer advisers to leave the market, Professional Indemnity insurers have hiked premiums and, as we see in the next section, growing numbers of individual advice firms are debating whether it is viable to continue advising on DB transfers.

[14] See: https://www.fca.org.uk/consumers/defined-benefit-pension-transfers/advice-checker

3. The adviser perspective

For some advisers, the surge in DB transfer activity has been a huge commercial opportunity. Typical advised transfer values of around £400,000 have produced potential for substantial revenue streams both from initial transfer advice and ongoing advice and investment management charges. But the FCA's work shows that the quality of advice has varied considerably. At one end of the spectrum are those who have provided high quality advice at good value, and have clearly put the client's interests first. At the other end, including those where regulatory enforcement action is being undertaken, are those who have 'rubber-stamped' unsuitable transfers and are providing poor value post transfer.

As we saw in the last section, a combination of factors led to advisers exiting the market. Professional Indemnity insurers have withdrawn cover or hiked premiums, making it harder for advisers to stay in the market or to provide affordable transfer advice. Regulators have also considerably tightened the rules around transfer advice – changes which have already led to more than 700 firms leaving the market.

In order to better understand how the DB transfer advice market is likely to evolve, Royal London has undertaken a specially commissioned survey of more than 750 advisers, of whom more than two thirds have given DB transfer advice in the last three years. In this chapter we describe what advisers had to say about why they are in or out of the market and what the future holds.

a) *The advisers surveyed and their involvement in the DB transfer market*

Royal London received responses from 762 people working for advice firms. More than nine in ten were client-facing advisers or other senior staff such as compliance directors or managers.

Table 1 shows the proportion who had given DB transfer advice in the last 3 years.

Table 1. Have you advised on transferring Defined Benefit pensions in the last three years?

			Response Percent	Response Total
1	Yes		71%	543
2	No		29%	219
			TOTAL	762

The importance of DB transfer work to the overall business varied very considerably, as shown in Table 2. While the most common answer was that DB transfer work accounts for less than 10% of the firm's business, in around a quarter of cases it accounts for more than 30% of overall income.

Table 2. Roughly what proportion of your firm's business income arises from pensions transfer business?

			Response Percent	Response Total
1	None		12%	92
2	Less than 10%		32%	241
3	10% to 19%		19%	142
4	20% to 29%		14%	103
5	30% to 39%		7%	57
6	40% to 49%		6%	48
7	50% or more		10%	79
			answered	762

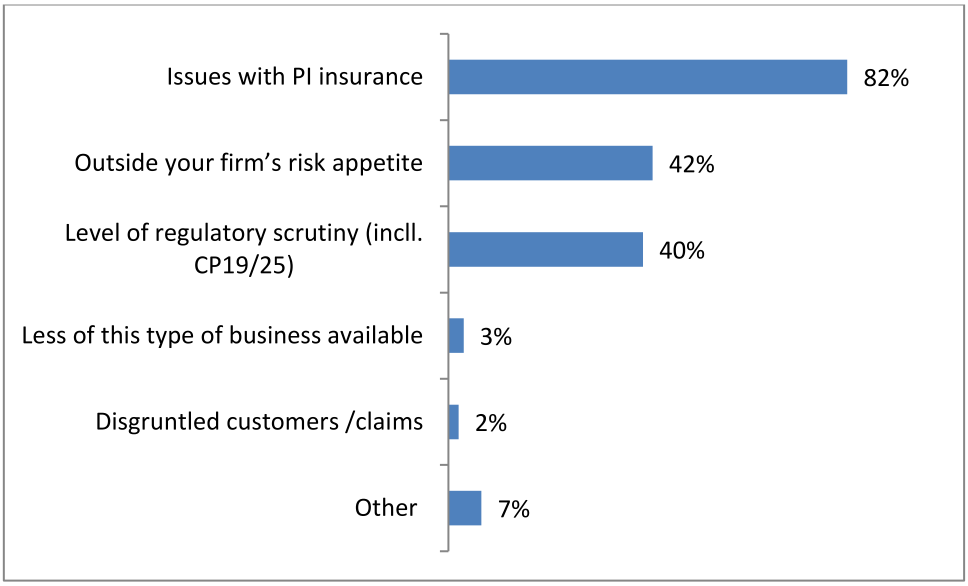
b)

Reasons for leaving the DB transfer market / What would draw you back

Royal London asked advisers who had left the DB transfer market what had caused them to leave, and those who were not in the market what would bring them back. The results are summarised in this section.

Just over a third of those who had given transfer advice in the past 3 years were no longer active in the market. Their reasons for pulling out are shown in the graph below. Respondents were allowed to identify more than one factor if applicable.

Chart: Why did you stop doing DB transfers (multiple answers allowed)?



As the chart shows, by far the single biggest factor driving advisers out of the DB transfer market has been the rising cost and diminished availability of Professional Indemnity (PI) insurance. A second key factor was simply that it was regarded as 'too risky' for the firm, followed by a range of concerns about regulatory change.

On PI cover, the following comments were made by advisers who had pulled out of the market:

- *"PI Insurance went up 165% this year! And we have a voluntary £25k excess…. We have always turned away speculative inquiries no matter how big the transfer value. We are professional have an incredibly robust process and are confident in our advice process. In fact 2 of my DB transfer files were checked by the FCA as part of the supervisory review and deemed suitable advice".*
- *"Our experience of PI and DB transfers has not been good even though to date we have zero complaints of any kind we were still tarred with the same brush"*
- *"Ceasing DB transfer work was a condition of obtaining PI cover. The decision to cease doing this work has been forced upon me by my PI insurer, not due to the risk posed by my firm … but because the insurer does not know which direction the FCA is going on this issue, and fears a wholesale review".*
- *"PI increased 500% and told to STOP doing DB transfers as we were a small firm and further DB transfers would put our firm into a higher risk category for PI purposes. However, they are v happy with the DB work done to July 2019".*

A small majority of those who had left the market said that they would consider re-entering, and were asked an open-ended question about what would draw them back in. The replies in many ways mirrored the reasons for leaving in the first place, and again focused on PI and regulatory issues. Comments included:

- *"If we knew how PI Insurers would react to this business".*
- *"PII cover availability and a softening of FCA stance that almost always not in best interests of clients".*

- *"Less harsh view from the regulator, which could lead to lower PI costs".*
- *"Certainty that the FCA will look at all circumstances surrounding the recommendation and that retrospective legislation will not change the validity of the original recommendation".*
- *"Once review from FCA complete and clear guidance issued"*

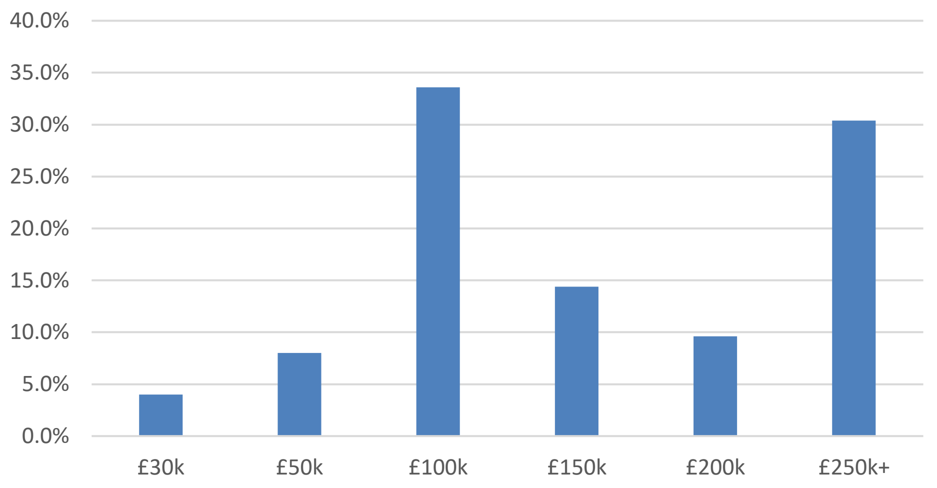
A common theme from these and other replies is the need for regulatory certainty. As set out in the previous section, the rules around DB transfers have been changing on a regular basis over the last 5 years, and many advice firms now consider it simply too risky to offer DB transfer advice until the regulatory environment has stabilised.

The fundamental issue is around the availability of affordable PI cover which requires a stable and certain regulatory playing field. The continual changes to the regulatory landscape suggest the FCA have not really got to the heart of the issue which is a fit and proper permission systems for advisers operating in this field. Clearly the current system fails on this front.

c) *Managing cost-effectiveness*

With advisers facing increasing costs in their businesses, in particular from the rising cost of PI cover, advising on smaller transfer amounts is becoming less attractive to them. Also some PI insurers are restricting the numbers of DB transfers an adviser can carry out over a period. The abolition of 'contingent' charging will also make advice costs look high to consumers with small pots. One third of the advisers in the sample said that they applied a minimum transfer value on which they would advise. Of those with a minimum value, Figure 2 shows typical minimum sizes.

Figure 2. Minimum transfer values for advice



Although only 1 in 3 advisers applies a minimum transfer value, for those that do, the most common minimum levels are £100,000 or £250,000 plus. The latter category includes some advisers who set a floor of half a million pounds or more.

Anyone with a transfer value of £30,000 or more is required by law to take impartial advice, but it is clear from Figure 2 that members with relatively modest transfer values are likely to be find a significant chunk of the adviser market unavailable to them.

d) Future plans

In an earlier section we looked at the reasons why some advisers who had left the market might consider coming back. Many said that changes to the cost and availability of PI cover and a softer stance from the FCA would be needed for them to consider re-entering the market. Arguably, neither of these is likely in the short term.

But among those still in the market, there was significant uncertainty about whether they would continue, as shown in Table 3.

Table 3. Do you expect to still be working in the DB transfer market in 12 months' time?

			Response Percent	Response Total
1	Yes		58%	203
2	No		8%	27
3	Don't know		34%	121
			answered	351

Perhaps the most striking result from Table 3 is that roughly a third of those who are currently active in the DB market do not know if they will still be doing DB transfer advice in a year's time. At the time that the survey was undertaken, the FCA was yet to publish its final rules on DB transfer advice, and this has now confirmed the abolition of 'contingent charging' – a charging model used by many advisers. It seems likely that this could tip a significant number of the undecideds into leaving the market.

e) Engagement with pension schemes

Until relatively recently, much DB transfer advice was sourced by individual scheme members either using their own financial adviser or seeking out an adviser specifically to advise on a DB transfer. But in recent years there has been a growing trend for pension schemes to get more involved in helping members to access advice.

Out of our sample, 29 respondents said that they had been appointed by a scheme to advise members seeking to transfer. In most cases this was by a handful of schemes, but a small number of respondents reported working with dozens of schemes to provide advice to members.

In terms of who took the lead in appointing an adviser, Table 5 shows that there is a mix between employer appointments and trustee appointments, but that both models are used. (Those who answered 'other' said that it varied from scheme to scheme, and another said that it depended if it was for one-off advice around a transfer exercise or for ongoing advice).

Table 4. When you are appointed as the adviser for members looking to transfer, do you more commonly get appointed by the employer or the trustees?

			Response Percent	Response Total
1	Employer		72%	21
2	Trustees		21%	6
3	Either / both:		7%	2
			answered	29

Respondents were also asked about the size of the schemes they had worked with, and Table 5 summarises the responses:

Table 5. When you are appointed as the adviser for members looking to transfer, how many members does the typical scheme have?

			Response Percent	Response Total
1	Up to 249		83%	24
2	250 – 499		3%	1
3	500 – 999		0.00%	0
4	1000 plus		14%	4
			answered	29

The large majority of schemes appointing financial adviser firms to help members were at the smaller end of the scale, with most having less than 250 members. This suggests that the idea of schemes working with advisers is clearly not limited just to the largest and best-resourced schemes. However, it must also be noted that this question was answered by a relatively small number of respondents.

In the next section we look at the scheme perspective on DB transfers and supporting members in receiving advice.

4. The scheme perspective

The adviser survey in the previous section points to the potential for a significant reduction in the supply of advice in this market, and the danger that the current framework may not be able to meet the demand of consumers. In this section of the paper we explore other options for advice provision, focusing on the employer and / or scheme trustees. The survey also showed very few firms have been engaged at scheme level, although a few have been on multiple occasions. So scheme sponsored advice may have a significant role to play alongside member sourced advice to help alleviate capacity issues resulting from advisers ceasing to operate in this market. In some instances, it may be the preferred option.

For understandable reasons, pension fund trustees have historically generally been wary of engaging too much with financial advice around DB transfers. Most see their primary role as helping to secure the DB benefits payable to scheme members. If members wish to consider a transfer out of the scheme, the trustees need to meet their duties to provide a transfer value quotation, check that appropriate advice has been taken, and to process any application, but are not obliged to seek any further involvement. One obvious reason for anxiety is the fear of legal action if a scheme is seen to have promoted transfers out, especially any which subsequently go wrong, or pointed members to an adviser whose advice falls short of the required standard.

However, it has become increasingly apparent that 'doing nothing' is not necessarily a no risk option.

The British Steel case probably provides the clearest example of where the Trustee provided information and helplines in connection with the restructuring of the pension scheme but did not anticipate the unprecedented interest and volume of activity created by the Pensions Freedoms.

The FCA[15] found that, based upon sample cases, fewer than 1 in 4 British Steel members received demonstrably suitable advice and this provided a catalyst for the industry on whether to go further.

The Pension Regulator also instituted a review into the British Steel case, led by Caroline Rookes, and the report[16] made a number of recommendations of relevance to this issue.

Commenting on the role of trustees in cases such as this which involved restructuring or other major changes, Caroline Rookes recommended:

- *TPR should consider changing the basis of guidance to trustees. Instead of guiding them to the minimum necessary to comply with the regulations, guidance should be aimed at creating what good looks like* (p6)
- *Trustees should be expected via TPR codes and guidance to provide appropriate support to members who are considering a cash transfer. The guide might build on the industry code of practice for incentive exercises (p7)*

[15] https://www.fca.org.uk/news/press-releases/fca-sets-out-next-steps-improve-defined-benefit-pension-transfer-market
[16] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/rookes-review-british-steel-pension-scheme-members.ashx

This is an interesting nudge both to regulators and trustees that minimal compliance with regulations does not necessarily guarantee good outcomes for members. The Incentive Exercise Code of Good Practice, first published in 2012 and now owned by the Pensions Regulator, points to the good practice of trustees considering whether the provision of access to good quality advice would be helpful to members who are being given a choice about their benefits (including those retiring in the normal way, and thinking about their own retirement options).

On member communications, the Rookes report said:

- *TPR should consider with the DWP as its sponsoring department whether the duties for trustees of DB schemes should more explicitly cover a duty to communicate effectively with members* (p7).

And on the specific issue of DB transfers, the report said:

- *Trustees should be expected via TPR codes and guidance to provide appropriate support to members who are considering a cash transfer. The guide might build on the industry code of practice for incentive exercises* (p7).

While this is clearly not a call for trustees to provide access to and/or pay for financial advice for any member considering a transfer, it does suggest that trustees need to be considering if they are providing 'appropriate support' to members.

This does, of course, raise the important question of what 'appropriate support' might constitute, and this is likely to depend on the specific case.

But there are several reasons why 'appropriate support' could involve greater involvement by the scheme in helping members to access affordable, high quality advice. These include:

- **The increasing challenges of finding an adviser –** with the adviser market fast shrinking, members will find it increasingly difficult to find an adviser who is willing to advise them on a DB transfer.

- **The overall cost of advice** – with rising PI costs, DB transfer advice is at risk of becoming unaffordable to some members, including some for whom a transfer might be suitable, and in many cases for whom advice on retirement options in the DB scheme would be advisable;

- **The changes to advice charging structures** – with the imminent abolition of contingent charging, most members will now have to meet the full advice cost upfront, regardless of whether the transfer goes ahead; for those on more modest means this may be prohibitive, while others may insist on transferring – even against advice – in order to recoup the cost of the initial advice; in our view this will put more members at risk of making sub-optimal retirement decisions unless advice costs are minimised by employer or trustee subsidies.

- **The position of members with smaller pots –** the mandatory advice requirement applies to those with a transfer value of £30,000 or more; as we have seen, a significant minority of advisers will not consider advice on pots of less than £100,000;

also, with FCA talking of a typical advice cost of £3,000-£4,000 this could take a huge chunk out of the total value of a member's pension.

Finally, the Rookes report also says;

- *TPR should explore if there is a way to allow trustees or trade unions to identify a panel of financial advice firms that members can select from* (p7)

This recommendation acknowledges that there can be some nervousness on the part of trustees to get involved in signposting particular advice firms, but implies that there are advantages to members if a way can be found to do this.

In the rest of this section, we consider:

- A range of possible responses from trustees and employers relating to the way they can interact with the financial advisory market
- Consideration of some of the pros / cons of appointing a financial adviser to support members of schemes and other employees
- Two case studies of how pension schemes have appointed financial advisers to support their members

What can schemes do?

One way a scheme could offer 'appropriate support' to members would be by helping them find a financial adviser firm. This could be something as simple as helping them to identify an advice firm which is FCA-registered, has advisers who have the necessary transfer advice qualifications or perhaps has signed up to the DB transfer 'gold standard' set out by the Personal Finance Society.

Another way could be for schemes to point to the Money and Pensions Service website. However, it can still be highly challenging to find an adviser using that route. In practice, we suspect many members end up searching online for an adviser, or using a personal contact. Both approaches risk landing on a less than expert adviser, who will have to familiarise themselves with the detail of their pension scheme.

Some schemes go further than this and identify one or a small number of advice firms who members can use if they wish. This would not preclude the member from using an existing adviser if they have one, but for most members the adviser made available by the scheme is likely to be an attractive option. By having a small number of advice firms handling the bulk of the scheme's transfer advice, there will also be cost savings for adviser and scheme alike, not least as the adviser gets to know the particular features of the scheme's benefits and processes in detail.

Going further, the scheme could subsidise the costs of this advice. The trustees could, for example, pay the set-up costs of the advice firm in putting in place processes to advise members and then could pay the firm a retainer. This could reduce the unit cost of advice very considerably, making it more affordable to all members and especially those with smaller transfer values. A subsidised advice offering could cost a member much less than the £3,000-£4,000 indicated by the FCA.

In some cases, trustees or employers then go further and subsidise or fully pay the advice cost for the member.

Some schemes have gone yet further, identifying a panel of advice firms for members to use, subsidising the cost of advice, and then appointing a further tier of oversight to monitor the financial adviser firms on the panel, to seek to ensure that members not only receive good service around transfer but also after transfer.

A wide variety of industry surveys suggest that perhaps as many as 20% of schemes[17] have taken the step of making a named advice firm (or panel) available to members in the ways outlined above in recent years.

In all cases, responsibility for the content of the advice remains with the FCA-registered adviser, but the intervention of the scheme may help to ensure that more members are able to access affordable and high quality advice. Each of these options involves a different level of support from the scheme, in terms of time and money, and also comes with a different level of risk.[18]

Pros and cons of trustees or employers appointing an adviser firm to assist members

In summary we see the key pros of appointing an adviser firm as follows:

- A significant advantage can be efficiency of costs, which can be particularly helpful for members, and more so following the ban on contingent charging; overall efficiency of costs is particularly beneficial the larger the scheme
- Easier accessibility and lower costs make it more likely that more members will seek quality financial advice on all their options, including normal scheme pension options, and thereby take better financial decisions; it can also be expected to reduce the risks of members being targeted by unscrupulous advisers or scammers
- Having already undertaken detailed due diligence on the scheme, and spent time accurately setting up the technical calculations required by the FCA in advance (ie the Transfer Value Comparator), the financial adviser will be more easily able to provide accurate and timely advice and consider all the options available to a member
- Where a scheme has a lot of options (eg including pension increase exchange, bridging options, or partial transfers), this can be attractive to members but potentially confusing – a scheme appointed adviser can provide the support needed for members to make the best use of these options
- Trustees and employers may feel they can more effectively assess and monitor the quality of the advice being given and thereby improve the experience of members and reduce reputation risk

[17] https://www.wealthatwork.co.uk/corporate/2019/05/14/overcoming-the-risks-at-retirement-survey-2019/
[18] A more detailed discussion of the spectrum of support which schemes could offer is included in a joint paper by Royal London and Eversheds Sutherland which can be found at: https://www.royallondon.com/siteassets/site-docs/media-centre/policy-papers/royal-london-policy-paper-25-with-eversheds-sutherland---what-shall-we-tell-them.pdf

- Real administration savings can be made as the financial adviser becomes familiar with the scheme – the largest of schemes can set up streamlined processes to share data and complete retirement and transfer paperwork for members

In summary we see the key cons of appointing an adviser firm as follows:

- Trustees and employers will need to pay the set-up costs of the financial adviser firm and other ongoing non-advice costs for the duration of the appointment in order for the firm to provide advice efficiently and for the per member costs to be reduced
- There is a reputation risk associated with the appointment of a firm to assist members and employees – what if the firm provides a poor service or is caught up in a mis-selling scandal, or suddenly withdraws from the market?
- Having put in place the financial adviser firm, there is a monitoring responsibility (and associated costs) on the trustees and/or employer to ensure the adviser continues to provide a good service

We also note that there are tax and legal issues to consider when appointing a financial adviser, and these differ depending on whether the appointment is being made by the scheme or the employer.

Case Studies

LCP has supported a number of schemes of different sizes who have been looking to help members considering their retirement options including a DB transfer. The following case studies give an idea of what might be involved:

Case study – Church of England

Background:

The Church of England Pensions Board provide retirement services for people who work or minister for the Church of England. They assist over 40,000 people across almost 700 employers, and manage funds of c£3bn.

After considering the balance of risks in the fast changing world of pension transfers, the Board decided to revamp their retirement communications and select a financial adviser to help their members make better retirement decisions. Whilst they recognised there are risks with this approach, they felt that as a trustee the risks of doing nothing had increased significantly, given the confusing external messages and many options that many of their members are faced with as they come up to retirement.

Solution:

The Board selected a financial adviser firm to offer assistance to non-retired members of their 3 different pension schemes, covering a range of different benefit structures.

Members can call the firm via a dedicated helpline for an initial discussion with advisors who are familiar with the Board's schemes to help them understand their options and whether they want to take up financial advice. The initial discussion is free but the firm will then charge members a competitive fixed fee for advice to cover both their Church of England pensions and any other pensions they may hold.

The service is phone and email based. Members can continue to choose their own financial adviser, however the service the firm offers is at a significant discount to typical market rates including their standard rates.

"We recognised that as members approach retirement they face a wide range of choices and quality financial advice is often needed, which can be difficult to find and expensive. We therefore decided to provide members with the option of easy access to a specialist financial adviser firm charging competitive fees and who is familiar with our pension schemes. After taking advice from LCP and carrying out a selection process we chose to partner with a particular firm".

Peter Dickinson – Pensions Manager - Church of England Pensions Board

Case study – National Grid UK Pension Scheme

Background:

The National Grid UK Pension Scheme is a UK defined benefit (DB) pension scheme, responsible for around £20 billion of assets under management. It has around 13,000 non-retired members, mostly from the organisation's gas transmission and distribution businesses, and is closed to new members.

The Trustees were concerned about both the volume of transfers and the quality of financial advice received by their members, especially with the FCA reporting that, across the market as a whole, only 50% of advice sampled was deemed suitable. They also shared industry concerns about pension scams, about many IFAs' contingent fee arrangements and about other conflicts of interest arising from transfers into in-house advised funds. It became clear that the status quo was leading to increased risks for their members. Further, some current employees were choosing to opt-out of the pension scheme in order to become entitled to a transfer value, which was a significant concern to both the trustees and the sponsoring employers. The in-house administrator was also burdened, dealing with increased transfer related work and queries from members and IFAs.

Solution:

The Trustees and the sponsoring employers agreed that action was needed to provide a better end-to-end service for members aimed specifically at creating better member outcomes. In response, the Trustee developed a fully integrated on-line real time modeller for members, and appointed an adviser to provide advice to members in the run up to retirement.

Financial advice on the retirement options available in the Scheme (including the options available following a transfer) was made accessible to all UK-based non-retired members. The Trustees generally subsidise the advice costs once but only for members age 54 or over i.e. for those nearing potential retirement age. This was to provide members who may be considering their retirement with the full range of options available to them and to enable members to make a fully informed decision. The provision of advice is generally conducted over the phone. Other members can access the advice but have to meet the pre-agreed fees. After a detailed selection process the Trustees appointed a particular firm and their service is regularly reviewed.

The Trustees also increased the flexibility for some members within the Scheme and introduced steps to reduce the risk of employees opting-out years from retirement in order to transfer.

Over the first 12 months since the service has been provided c500 members have taken up financial advice.

"With the fast changing regulatory requirements for IFAs, and concerns having been expressed by the FCA about advice quality, we wanted to ensure our members have access to good quality advice on one of the most important financial decisions they will ever make - how best to use their National Grid pension. We were therefore delighted to work with LCP and our in-house administration team to provide members approaching retirement age with

an end-to-end service combining a personalised online modeller and paid-for financial advice from an independent advisory firm, aimed specifically at helping members make the best decision for them."

Mark Harris, National Grid Pension Trustee Executive

5. The role of Professional Indemnity (PI) insurance

Another key issue affecting the DB transfer market in recent years is that of Professional Indemnity (PI) Insurance. In recent years the perceived risks of DB transfers have caused PI costs to spiral, this is in part fuelled by the large number of DB transfers that have taken place as well as the rise in the Financial Ombudsman Service compensation limits to £350,000 (from the previous £150,000). In addition, increased FCA regulation and scrutiny of DB transfers is making PI insurers more nervous.

The increased cost of doing business has resulted in some PI insurers either withdrawing from the market or else imposing restrictions on the types of business advisers can write. This in turn has resulted in hugely increased costs for advisers – even those who have never received a complaint in this area –while others cannot access cover at all. This has led to advisers either leaving the DB transfer market or limiting access to advice to those with higher pension values.

The resulting situation means that those seeking DB transfer advice are finding it increasingly hard to access. This reduction in advice capacity and concerns about affordability suggest the PI market is broken and that something fundamental needs to change if it is to run effectively.

Tackling these concerns is vital in retaining advisers in the market and encouraging others to enter or re-enter the market. Advice will become more readily available, affordable and will assist scheme members in making key decisions about their retirement income. We also believe that controlling costs will help to reduce the number of insistent clients - particularly those that receive advice not to transfer but feel they must proceed in part or totally to pay for the advice received (as contingent charging is now banned).

What needs to happen?

We need a stable environment if PI insurers are to feel comfortable enough to return to the market and provide cover at an appropriate price. To achieve this we believe a strong regulatory steer is vital and we need a debate on how to get to a position where PI insurers are able to provide cover that supports a thriving adviser market that allows prospective clients (including those with smaller transfer values to receive advice).

There are several options that could be considered including:

- Whether there is an alternative method of providing cover. For instance, looking at whether the cover should insure liabilities for business written from the commencement of the cover rather than claims received from the commencement of the cover. By restricting it to claims for business written subsequent to the cover being issued, we would give insurers more certainty which should encourage more insurers to operate in the market and push down prices. Advisers would still need insurance for business written before this change to the basis of cover.

- Do we need a tighter regulatory regime for advisers operating in the DB transfer market? We need to look at how unscrupulous advisers are dealt with and whether punishments need to be toughened up for those who break the rules. This could include increased use of bans and restrictions in trade.

- Many of the issues affecting the DB transfer market are related to SIPPs and unregulated investments. Should the FCA look at whether advisers should only advise on regulated investments from now on?

6. Partial transfers

In the vast majority of cases people undertaking a DB transfer will transfer their entire pension value across to a new vehicle. This puts the individual at substantial risk if they make a poor decision, especially where the member has long service in a single scheme and is transferring out all their non-state pension rights into a DC arrangement.

Compared to an "all or nothing" approach, partial transfers of DB benefits - taking out some of the value of the pension as a transfer to a DC pot while leaving some DB rights behind – offer flexibility to members, which can result in better pension outcomes for individuals. It can also reduce risk for trustees, employers and financial advisers. This is a solution Royal London and LCP previously explored in a joint paper, *Partial transfers of DB benefits: the best of both worlds?*

As in the initial paper we call on all pension schemes to proactively consider whether they should introduce partial transfers as an option for members. Respondents[19] to the FCA's July 2019 consultation also suggested that partial transfers should be more widely encouraged across the market as they could give consumers more choice. Allowing partial transfers from schemes is outside the FCA's remit but they passed on this feedback appropriately. We also call on government and regulators to encourage schemes to offer the option of a partial transfer, although we do not think it should be mandated as the option is unlikely to be viable for certain schemes particularly smaller ones.

When considering whether to advise a client to make a DB transfer, an adviser will look at the base level of guaranteed income the client could access. This could include state pensions, other DB rights, annuity income etc. For someone with only a state pension and a single large DB pension, a full DB transfer will reduce their secure income to a very low level. This might mean that the adviser recommends against a transfer. The FCA's recent consultation[20] provides some helpful guidance to advisers around advice on partial transfers and sets out that it is good practice to ask if a partial transfer could be considered even when not apparently on offer.

If a partial transfer was on offer, the member might be able to secure a guaranteed acceptable income via a combination of state pension and (partial) DB scheme benefits, with the balance transferred to a DC arrangement for added flexibility. This could significantly de-risk the whole process from the point of view of the member, the scheme and the adviser:

- The member benefits from a flexible income and assets from the DC transfer, including the possibility of funding an income gap during early retirement (eg until their state pension commences), and much more flexible provision for dependants. Even if their DC investments don't perform well they still have a regular income from their DB scheme to rely on.

- For the adviser, the fact that the client will always have a secure DB pension income is likely to reduce the number of dissatisfied clients. The adviser also benefits by helping the member plan a suitable outcome, balancing risk and flexibility, without needing to consider the purchase of expensive annuities.

[19] https://www.fca.org.uk/publication/policy/ps20-06.pdf
[20] https://www.fca.org.uk/publication/guidance-consultation/gc20-01.pdf

- For the scheme, partial transfers will reduce overall liabilities in a way which minimises any risk of challenge from (ex) members who might otherwise blame the scheme if things go wrong post-transfer.

- For the employer, current and former employees are likely to welcome the new flexibility without them being exposed to the risks associated with a full transfer; PPF levy bills and the cost of de-risking are also likely to be reduced as the scale of scheme liabilities falls as a result of partial transfers.

7. Conclusions

There is no doubt that the last five years have seen an explosion of interest in transfers out of DB pensions and many people will have benefited from the opportunity to transfer. However, after initial enthusiasm from regulators and government, concerns have grown about the number of people who have received unsuitable advice, either over whether to transfer at all or over where their money should end up. Rules have been tightened, costs have risen and the supply of DB transfer advice has declined.

This paper shows that the DB transfer market is at a crucial juncture. There is a real risk of more advisers being driven out of the market and of scheme members finding it harder to source affordable, high quality advice, especially where the value of their transfer is relatively modest.

Both Royal London and LCP want to see a thriving market for high quality DB transfer advice. We would support measures to improve member outcomes such as increasing the supply of financial advisers and also encourage schemes to provide more support to members in obtaining advice. Boosting the number of schemes offering partial transfers would also contribute to better member outcomes.

The message from advisers surveyed for this paper is clear. They are looking for regulatory certainty and a solution to the issue of apparently ever-increasing costs for Professional Indemnity Insurance. It is hard to escape the conclusion that the current market for PI cover is broken and new models need to be explored.

The prevailing practice is that scheme members transfer their DB fund across to a DC pension in its entirety, a move which may put people at unnecessary risk. Increased access to partial transfers would reduce this risk and significantly improve member outcomes.

We have also seen that schemes may have an increasing role to play. This could be at the initiative of trustees or employers or both and the right answer may vary from scheme to scheme. But in a world of pension freedoms where DB transfers may be the right answer for some members, doing nothing increasingly seems to be a risky option.

Contact us

We would welcome feedback on the contents of this report which can be sent to Steve Webb, Partner, LCP at Steve.Webb@lcp.uk.com and Justin Corliss, Senior Pensions Intermediary Development and Technical Manager, Royal London at Justin.Corliss@royallondon.com

About Royal London:

Royal London is the largest mutual life insurance, pensions and investment company in the UK, with assets under management of £139 billion, 8.6 million policies in force and 4,348 employees. Figures quoted are as at 30 June 2020.

At Royal London, we're proud to champion the value of impartial advice. We believe it plays a crucial role in connecting people with the products that are right for them – and is key to delivering better outcomes and experiences for our customers. At the same time, it helps to build trust in our products and services.

Royal London works alongside advisers not in competition with them. That's why we've made some key commitments to the intermediary market. You'll find more detail on our commitment to advisers at http://adviser.royallondon.com/campaigns/our-commitments/

About LCP:

At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy and financial wellbeing