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Financial advice on defined benefit transfers

The Financial Conduct Authority (FCA) remains concerned about defined benefit (DB) pension transfer advice and high-risk investments.

It has this week announced the launch of its Assessing Suitability Review 2 which focusses on the advice that consumers receive around retirement income.

At the same time the FCA has published a portfolio strategy letter to CEOs and directors of financial advice firms outlining the key risks for financial advisers and making it clear it is unhappy with current market practices.

Choosing an independent financial adviser (IFA) who is truly "independent" may not be an easy task for pension scheme members and trustees should consider appointing an IFA who members are not obliged to use.

Background

From 6 April 2015 greater freedom and choice became available to members of defined contribution (DC) pension schemes. This enables members to draw pension benefits at an accelerated rate but increases the risk of members making poor choices and being scammed. Generally, DB pension scheme members cannot take advantage of the new flexibilities and consequently the UK has seen a rise in the number of DB to DC pension transfers.

Legislation was introduced in 2015 to require anyone with DB rights of more than £30,000 who is looking to transfer to a DC pension scheme to take advice from an appropriate IFA who is authorised by the FCA. The FCA is, however, concerned about the number of members who are being advised to make such transfers and the reasons behind IFAs giving a 'yes' recommendation to transfer.

The FCA continues to assert that the starting assumption for advisers should be that a pension transfer is not likely to be suitable for all clients. However, the percentage of members being advised to transfer remains far above the level that would be expected given the risk the transferee is taking on (and which the FCA is comfortable with).

Another consultation

The FCA has this week announced that it is to launch a second review of pension and investment advice as part of its wider strategy for the financial advice sector. The review will focus on the advice that pension scheme members receive around retirement income, both in terms of making transfers and investing pension scheme assets after the transfer.

In doing so, the FCA also published the text of a portfolio strategy letter it has sent to CEOs and directors of financial advice firms summarising the action that it expects them to take.

The portfolio strategy letter

This again stresses that IFAs should always start from the position that a transfer is not in their client's best interest. The FCA sets out concerns in relation to:

- Authorised firms receiving introductions from introducers or lead generators, particularly where the introducer has inappropriate influence on how the authorised firm carries out its business;
- Authorised firms delegating regulated activities, particularly where they outsource their advice process to unauthorised entities or other authorised firms that do not have the relevant permissions, or who are not their appointed representatives;
- Principal firms having inadequate oversight of their appointed representatives;
- Authorised firms failing to undertake adequate due diligence on products and services they recommend;
- Investments containing non-standard assets, complex structures and/or high charges; and
- Financial advisers having inadequate financial resources and/or professional indemnity insurance.

Action for trustees

Whilst it is not part of the responsibility of trustees to stop members from making bad financial decisions, two recent Pensions Ombudsman cases are worth noting. The Ombudsman has ordered DB pension schemes to reinstate members who have been scammed where he concluded insufficient due diligence had been undertaken by the transferring scheme on a transfer.

One way trustees can reduce the risk of members going to the wrong IFA and/or making bad investment decisions is to appoint an IFA who members can go to, but don't have to. This should reduce the instances of transferring members receiving poor advice and stop the obvious instances of conflicts of interest which have been highlighted in several recent high-profile cases, such as British Steel. Members can be reassured that an adviser appointed by their trustee board is at least truly independent.

In August 2019 Margaret Snowdon, president of Pensions Administration Standards Association and a prominent industry figure, was quoted as saying "*Pension schemes should at least appoint an IFA, which the member is not obliged to use. But if the individual wants to, at least the option is there".* The appointment of an IFA by trustees is a way of giving members some direction when looking to get financial advice, reduces the risk of a member being the victim of a scam and the risk of the Pensions Ombudsman ordering their reinstatement in the transferring scheme.

Comment

Trustees and sponsoring employers of DB pension schemes should consider the risk they are taking by providing little or no support for members when choosing a financial adviser to advise on a DB transfer. These risks are likely to be even greater where members have a concern over employer covenant. If it is felt that this risk needs to be mitigated, trustees should consider appointing a preferred IFA.

Trustees should only work with IFAs that do not employ contingent charging and can demonstrate robust processes that support delivery of the most suitable advice in the market. Buck’s preferred IFA service can help trustees minimise the risk of their members receiving poor advice, along with helping trustees evidence to the Pensions Regulator that they take the risk of poor advice seriously.

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