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Defined benefit pension schemes transfer market review

The Financial Conduct Authority (FCA) has published its review into the defined benefit (DB) transfer market some five years on from the introduction of pension freedoms.

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The FCA is concerned that far too many people have been advised to transfer from DB pension schemes when such a transfer was not in their best interest and has also highlighted the levels of fees charged by financial advisers for DB transfer work.

It has concluded that the risk to scheme members from unsuitable advice remains unacceptably high. Accordingly, in order to make the pension transfer market more sustainable in the longer term, steps are being taken to reduce cases of poor advice, and the high redress and insurance costs that this leads to.

This includes a ban on most contingency charging, where scheme members only pay for advice when a transfer or pension conversion actually takes place.

The FCA has also published a consultation on advising on pension transfers. This gives examples on what the FCA sees as suitable and unsuitable advice. The consultation closes on 4 September 2020.

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Background

The introduction of pension freedoms in 2015 gave members of defined contribution (DC) pension schemes more flexibility over how and when they could access their pension savings. However, since then significant numbers of members with DB pension savings have transferred to DC schemes, so they can also make use of this flexibility.

FCA data shows that around 235,000 members took DB transfer advice from nearly 2,500 advisory firms between April 2015 and September 2018, on transfer values worth over £80bn in total. Over 170,000 of them then transferred, including over 9,500 who transferred despite advice to the contrary.

An FCA investigation into DB to DC transfers based on information supplied to it in late 2018 looked at 85 financial adviser firms responsible for 43% of DB transfers in this same period. As a result, files were obtained from 55 advisers. 17% of these cases, which recommended the member transferred their DB pension, were found to be unsuitable and a further 36% had material information gaps.

Banning contingency charges

To remove the conflict of interest that arises where an adviser is only paid when a transfer goes ahead, a ban on contingency charging is to be introduced from 1 October 2020 - except in limited circumstances.

Transitional arrangements will allow contingency charging where clients have agreed these terms before 1 October 2020, work has begun on giving advice before that date, and a personal recommendation is provided before 1 January 2021 (i.e. within three months of the ban being implemented).

Cost of transfer advice

The FCA was concerned that pension scheme members who transferred their benefits were paying excessive charges under the contingency fee system. Those going ahead with transfers were often paying a fee close to £10,000. Banning contingency charges should mean that members pay the same fee whatever the advice. This is expected to substantially lower the costs for those that proceed with transfers and ensure they do not subsidise those who decide otherwise. It will of course increase the cost of advice for those who do not proceed.

Exceptions

The FCA has identified a small number of vulnerable scheme members who may benefit from a pension transfer, but who cannot afford to pay for the advice. These fall into two categories:

- Members with a specific illness or condition that causes a materially shortened life expectancy. (Evidence will be required from a registered medical practitioner that they have a medical condition which means their life expectancy is likely to be lower than age 75.)
- Members facing severe financial hardship; for example, losing their home because they are unable to make mortgage or rental payments. (Evidence of such financial hardship will need to be provided.)

In these two limited circumstances, the financial adviser may continue to charge on a contingency basis.

Workplace pensions

To address “ongoing conflicts”, advisers are also required to consider an available workplace pension as a receiving scheme for a transfer. Where the advice is not to go to an available workplace pension, advisers must demonstrate why the proposed alternative option is more suitable. The FCA considers that transfers to workplace pensions are likely to reduce the need for, and costs of, ongoing advice.

Abridged advice

From 15 June 2020, advisers will also now be allowed to (but are not required to) provide an abridged advice process which will help pension scheme members access initial advice at a more affordable cost. This must include a full fact-find and risk assessment.

The abridged process can only result in:

- a recommendation not to transfer; or
- a statement that it is unclear whether a member would benefit from a pension transfer without giving full advice (in which case the adviser must check whether or not the member wants to continue to full advice, and if they understand the associated costs).

Other issues in the review

The review contains a number of other recommendations around disclosure of charges and additional Continuing Professional Development requirements for pension transfer specialists involved in advising on DB transfers.

Comment

It is disappointing that it has taken five years since the introduction of pension freedoms and a number of high-profile cases for the FCA to reach this point. Whether this is the final word on the ongoing saga of DB transfers, and whether at some stage in the future there will be an outright ban on DB to DC transfers, remains to be seen. The FCA has always remained of the view that advisers should start from the point that a transfer is not in the interests of a member, but it still feels members are being advised to transfer in too many cases.

We have already seen a large reduction in the number of advisers in the DB transfer market and this trend is likely to continue. Whether the cost of transfer advice will fall as the FCA intends, or be driven up by a lack of supply, remains to be seen. The requirement for advisers to charge a potentially substantial fee up front for giving advice that could well be not to transfer could, in itself, reduce the number of transfers in the future. This is compounded by such higher charges needing to be met from member savings where a transfer does not proceed.

Abridged advice could solve this problem, filtering out those members for whom a transfer is not in their interests given their circumstances. However, it seems most of the work necessary for the full advice process needs to be carried out in order to provide the abridged advice service. Therefore, in making it affordable to members, financial advisers are going to struggle to avoid cross-subsidisation between those that proceed to transfer and those that do not.

If members are put off by the new resulting charging structures, both bulk transfer and “preferred adviser” projects may become more attractive if DB trustees and/or DB scheme sponsors feel members are not considering an option that could be in their best interests.

Whilst we expect those advisers we deal with to be largely unaffected; we are following up with them individually to understand any impact on the services they can provide to our clients in the bulk and preferred adviser spaces.

Trustees who have appointed a preferred adviser, or are in the process of doing so, should consider whether this new guidance impacts on those agreements and how to communicate any changes to scheme members.

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