HYMANS ROBERTSON

Sixty second summary

FCA action on DB transfers

The Financial Conduct Authority (FCA) has decided to proceed with a ban on 'contingent charging' for advice on transfers from defined benefit (DB) to defined contribution (DC) pension schemes.[1] The prohibition is one of several measures intended to improve the suitability of financial advice about such transfers. Most of the changes will come into effect on 1 October 2020.

Advice audit

The FCA has also published the results of its investigations into the quality of the DB transfer advice that scheme members have received since the DC 'Freedom and Choice' reforms were introduced in in 2015. It found evidence of improvements in advice suitability over time, but says that the proportion of advice recipients who are advised to transfer is still '*unacceptably high*', and that there were still too many cases in which advice was unsuitable.

Contingent charging

Contingent charging is a practice whereby scheme members pay a fee to the financial adviser only if a transfer goes ahead. The FCA has agreed that it creates a clear conflict of interest for advisers. The ban will be accompanied by anti-avoidance measures to prevent firms gaining competitive advantage by cross-subsidizing transfer advice using investment or implementation charges, for example offering low upfront advice costs but charging significantly more for implementing the advice where the recommendation is to transfer.

There will be exceptions to the ban for those who are otherwise unable to pay for advice. There will be two such 'carve-outs': one that applies when, for medical reasons, a DB scheme member can reasonably expect to die before reaching age 75; and the other when early access to pension funds could help alleviate '*serious financial difficulty*', evidenced by, for example, missed bills and credit-card payments. However, the charges paid by people in those circumstances should not exceed the charges for advice paid for on a non-contingent basis.

Abridged advice

To mitigate the effects of the ban on access to advice, financial advisers will be allowed to offer their clients a less-costly form of 'abridged advice'. However, the new advice process comes with the limitation that it cannot result in a recommendation to transfer: the adviser must either counsel against a transfer or say that full advice is necessary to reach a conclusion.

Improving advice quality

The FCA's latest package of measures contains other changes that are intended to raise the quality of DB-to-DC transfer advice:

- Pension transfer specialists will have to undertake at least 15 hours' continuing professional development (on top of their other CPD commitments) every year.
- Advisers will have to present their clients with tailored information about the charges that they would pay from the outset.
- During the advice process, the adviser must log evidence of the client's understanding of the risks involved in transferring out of their DB scheme.

[1] For an overview of the package of measures, please go to <www.fca.org.uk/news/press-releases/fca-sets-out-next-steps-improve-defined-benefit-pension-transfer-market>. The changes to the advice rules are detailed in *Policy Statement PS20/6: Pension transfer advice: feedback on CP19/25 and our final rules and guidance* <www.fca.org.uk/publications/policy-statements/ps20-6-pension-transfer-advice-feedback-cp-19-25-final-rules>.

- If the transferring client has a workplace DC scheme to which he or she could transfer the DB rights, the adviser will have to explain why any other proposed destination for the transferred funds is more suitable than that workplace scheme. This requirement is intended to confront the incentive for advisers to recommend complex, costly products for which they stand to receive high, ongoing advice fees.
- Advisers will have to give one-page summaries at the start of their transfer suitability reports, detailing all expected charges, the advisers' recommendations, risks and information about any ongoing services.

The FCA is also consulting on guidance intended to help advisers identify weaknesses in their existing processes.[2]

Support for transferring (and transferred) members

The FCA has created a new web-page for DB scheme members who are considering transfers.[3] It restates the Authority's belief that it is in most members' interests to keep their defined benefits, and outlines the characteristics of those for whom transfers are least and most likely to be appropriate. The main factor is the level of reliance on the income from the DB scheme (transfers being most likely to be beneficial for those with other sources of income).

A new 'advice checker' resource is intended to help members identify historically poor advice—and educate them on how to complain about it.[4]

The ban on contingent charging has polarized the industry, especially given that the FCA's ongoing market review has failed to find compelling evidence that poor advice outcomes are correlated with contingent charging models. However, the FCA is hoping that, by removing this conflict of interest, overall advice standards and outcomes will improve. Only time will tell if this objective is achieved.

The ban on contingent charging should help provide a much-needed increase in confidence and transparency to the market and, importantly, to consumers. That can only be a good thing. However, it remains to be seen how members most in need of advice, but not meeting the FCA's strict criteria for use of contingent charging, will be able to pay material upfront costs once the ban is in force. Abridged advice may be helpful but it is highly uncertain what appetite advisers will have to offer it and at what price. Where members do pay for advice upfront, they may be more determined to go ahead with the transfer, regardless of the adviser's recommendation, and even when it is not in their best interests. Education and communication on the value of quality advice, regardless of the outcome, will be key.

The ban on contingent charging is likely to lead to even greater numbers of advisory firms leaving the market and the supply of advice reducing further. Unfortunately, the effects of COVID-19 are likely to be far-reaching and lasting on jobs, finances, sponsor covenants and health, and over the coming months and years we expect that the need for quality DB transfer advice will only increase.

We remain strong advocates of trustees and sponsors facilitating quality financial advice for their members. A ban on contingent charging coupled with an increase in demand makes the business case here even more compelling. By facilitating financial advice, trustees and sponsors can ensure that members have access to a high-quality service which is priced transparently and delivered affordably through economies of scale. This approach can ultimately help deliver better member outcomes for all. Please speak to your usual Hymans Robertson consultant to find out how we can help.

[2] <www.fca.org.uk/publications/guidance-consultations/gc20-1-advising-pension-transfers>.
[3] <www.fca.org.uk/consumers/pension-transfer-defined-benefit>.
[4] <www.fca.org.uk/consumers/defined-benefit-pension-transfers/advice-checker>.

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