The Evolution of Member Options

Part two – the financial advice market

The financial advice market – what does the future hold?

A well-functioning financial advice market is key to members engaging in their choices and making quality retirement decisions.

Regardless of how active an approach you take to member options, at some point members are going to want to talk to someone they can trust about the choices they have. This is even more vital for transfer values, as members typically have to take financial advice before they can take their DB benefits as a transfer value.
But with demand for member options at an all time high, is the financial advice market fit for purpose?

In this paper we explore the financial advice market in depth, providing a recap of the changes the market has seen to date, and our predictions for how it will evolve in future. We also provide some tips for Trustees to help ensure members have the support they need to make quality retirement choices.

We'll help you understand:

1. Market dynamics and key players
2. The changing regulatory landscape
3. What the future holds
4. Simple actions you can take to provide better support to your members

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This is the second in a three-part series exploring the evolution of member options. Part one focused on supply and demand dynamics of member options, with some clear actions trustees can take to help improve member outcomes. Part three will explore the continued innovation in the insurance market and the valuable role insurers have to play in member options.

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Market dynamics

A Defined Benefit (DB) pension is likely to be one of an individual's most valuable assets – in many cases it will be worth more than the value of their property.[1]

The need for members to have quality advice around what they decide to do with this asset has therefore never been greater.

Supply and demand

The Pension Freedoms significantly increased engagement from members around their retirement choices – we've seen a 4x increase in transfer values since the Freedoms were introduced, with over £30bn being moved from DB to DC in the last year alone.[2] By the government's own admission, not enough planning went into launching the Pension Freedoms and it feels like the Financial Conduct Authority (FCA), who regulates the financial advice market, has been playing catch up ever since.

The financial advice market is currently in a delicate place. While demand for advice is at an all-time high, supply of advice is contracting quickly as the FCA is imposing higher standards and taking a tougher approach to policing the market.

Key market players

Historically, the bulk of DB transfer value advice was delivered through the retail market. There are a number of established high quality advisers operating in this market with members' best long term interests at heart. However, since the introduction of the Pension Freedoms, increasing numbers of trustees and sponsors are facilitating access to advice for their members, i.e. the 'workplace' or 'corporate' market.

We expect up to a 1/3rd of advice could now be delivered through the workplace. This is a significant proportion of the market, which just a handful of firms currently dominate. This lack of supply is making it increasingly challenging for trustees and sponsors to facilitate advice, especially for the largest schemes.

With established retail advisers looking to bring their expertise to the workplace market, we expect to see competition increase. Meanwhile, the retail market is contracting due to greater FCA scrutiny and increased costs for Professional Indemnity (PI) cover.

The table below contrasts some of the key features of the retail and workplace advice markets. There will of course be naunces for individual firms. Regardless of which market the quality advice is given through, the benefits should be the same - improved member outcomes.

Retail and workplace advice – a quick comparison

	Retail	Workplace
Customers	Members find an adviser themselves, typically through unbiased.co.uk.	Trustees and Sponsors run a due-diligence process to select an adviser who their members can use if they wish.
Advice medium	Typically delivered face to face	Typically delivered over the telephone
Charging structure	Often on a contingent basis to help make the advice affordable to members, i.e. the adviser is remunerated if the member takes a transfer value, often based on a % of the fund transferred.	Non-contingent basis. Given economies of scale, advice can be provided at a lower price point, especially for larger schemes.
Market size	c.2,500 to 3,000 firms.	Around a dozen firms.

[1]Hymans Robertson analysis 2019
[2]https://www.thepensionsregulator.gov.uk/en/about-us/freedom-of-information-(foi)/number-of-transfers-out-of-db-schemes-in-2018-19

The changing regulatory landscape

As regulatory bodies have tried to raise the bar on the standard of advice, the market has seen a flurry of regulatory change and guidance over the past 18 months.

Stronger guidance

New rules were introduced in October 2018 to improve the standards of transfer value advice. One requirement is for the adviser to consider a 'transfer value comparator' (TVC). This shows a comparison of the transfer value available to the member alongside the risk-free cost of providing the guaranteed DB income. For all but the most generous of transfer value bases, the TVC will show a material shortfall in the transfer value relative to the risk-free amount.

Where members have no clear need to access their benefits, or no clear retirement plan, the new guidance makes it increasingly challenging for advisers to recommend a transfer value. This is one factor that has led to a number of financial advisers no longer advising members under age 55.

FCA review

Political pressure arising from the British Steel case sparked the FCA into action. A targeted review carried out by the FCA revealed that less than 50% of the advice given was considered suitable.

An in-depth review of the advice market is now ongoing, which we understand initially covered around 3,000 advice firms. The findings of this review came as a real surprise to the FCA, revealing that 69% of the members advised were recommended to transfer. This is a staggeringly high figure, especially against a backdrop of warnings by the FCA for advisers to start from the position that a transfer is unsuitable.

Those within the industry have questioned the credibility of this figure, especially given many firms have robust triaging processes which mean that those members would wouldn't benefit from a transfer are filtered out of the advice process before going through formal advice.

The FCA remains highly concerned that member outcomes are suffering, and that this could be linked to contingent pricing. As such, we expect to see a ban on contingent charging to apply from early next year, following its current consultation in this area.

The workplace advice market has not been immune to the FCA's scrutiny. The FCA is currently focusing its attention around the concentration of risk across the few firms advising in this space. Details remain limited, however LEBC's voluntary withdrawal from the market is undoubtably linked to this review.

Pension Gold Standards

To help drive up advice standards, a new initiative 'Pension Gold Standards' has been introduced by the Personal Finance Society. This goes beyond being purely compliant in terms of advice process – firms adhering to it should meet a higher benchmark.

It is early days for the Pension Gold Standards but it should be helpful in giving much needed increased confidence to the industry.

What does the future hold?

As market dynamics continue to shift and regulatory requirements toughen, the financial advice landscape could look quite different within the next few years.

Supply of quality advice

It is clear the FCA is worried about a mis-selling scandal brewing – it's tighter scrutiny is causing a significant number of advisers to leave the market.

It could be argued that a natural fall out of firms whose advice isn't up to scratch will ultimately help to improve member outcomes. However, there will no doubt be instances where good firms have left the market simply as a result of PI cover being too expensive, or the regulatory risks of providing DB transfer advice being viewed as too great. The FCA needs to find the right balance here – the advice market needs to serve the needs of members without being paralysed by fear.

With the FCA currently engaging with around 1,600 firms, we expect further material fallout and consolidation in the market. However, it also presents opportunity for new players to enter the market - those who can demonstrate 'best of breed' advice and use technology to deliver advice more competitively will be in high demand.

Demand for advice

If the FCA's ban on contingent charging goes ahead as we expect, this could result in a material slow down in the number of members taking financial advice. Having to meet potentially significant advice costs upfront may mean members simply stay put and sleepwalk into a DB retirement. Those impacted most could be those on modest incomes who are least able to afford to meet advice costs directly.

Advice costs (including ongoing charges)

In light of the FCA's proposal to ban contingent charging, and to introduce a lighter touch advice option for members who aren't expected to benefit from a transfer, we expect pricing models will have to change. Advice costs will be payable upfront regardless of the advice outcome.

Cross subsidies that currently exist under contingent pricing models will be removed. In the absence of contingent charging, retail advisers will be considering the right price point for advice, which we expect could be in the region of £3,000 to £5,000.

Advice costs need to considered in the context of the significant level of detailed work and analysis that is needed to deliver quality advice. Members need greater education on the benefits of advice so they are more willing to meet upfront costs.

This isn't all about the costs of the financial advice itself. Once a member has taken a transfer value and moved into drawdown, they will be paying various costs in relation to investment charges, platform costs and ongoing advice. Potential conflicts of interest therefore still exist for all advisers, which we expect the FCA will address next. This may lead to charge caps, or more likely to a clear £ and pence pricing model, particularly for ongoing advice costs. Ongoing charges can materially erode member's pension pots, so greater clarity and transparency of pricing structures would help protect member outcomes. However, ongoing advice is key to members managing their income well over their retirement - it is vital for improving member outcomes. Again, a sensible balance needs to be struck here.

Advice recommendations

Against a backdrop of the FCA's industry-wide review and stronger guidance around transfer value advice, it is clear they are keen to see a material reduction in the level of transfer values leaving DB. The FCA scrutiny and increase in PI cover could see more advisers moving to a 'safety first' advice approach. Where members do not agree with the advice recommendation, the regulatory landscape may make it increasingly challenging for an adviser to transact that business on the member's behalf. Transfers out could therefore slow.

However, DB schemes are generally maturing with more schemes having lower risk investment strategies. The lower risk a scheme's investment strategy is, the more generous the transfer terms. Maturing DB may therefore help counter or offset some of this slowdown in advice recommendations.

Better supporting your members: actions for trustees

Financial advice is complex, but crucial for members. Without it, at best members risk sleepwalking into a DB retirement. At worst they risk getting picked off by scammers and losing the bedrock of their retirement income. There are three key areas Trustees can provide more support:

1 Engage your members with their options

Trustees have a duty to help educate members on their choices so that informed decisions can be made. The sooner Trustees start engaging with members on their retirement choices, the more time members have to build their understanding and feel comfortable engaging with a financial adviser. With the growing importance of member engagement, 75% of trustees have already, or plan to, enhance their communication and engagement strategy.

2 Provide good choice to members

This isn't just about transfer values. Trustees should give members a full range of options on terms that are fair to both the member and the scheme. An option that could really offer the best of both worlds is partial transfers, which prevent an 'all or nothing' decision for members. We expect partial transfers to continue to grow in popularity, especially as schemes tackle GMP equalisation and conversion and some of the administration complexities reduce.

3 Support members in accessing quality advice

There are various approaches to helping members access quality financial advice:

– Providing members with a guide on appointing a financial adviser. This can help educate members on what good practice would look like and importantly how to spot and avoid a scam. There are lots of high quality advisers operating in the retail market and members need more support to help them access this.

– Facilitating access to wholesale financial advice. We remain strong advocates of this approach and we're pleased to see 45% of trustees have already, or plan to, take this route.

There are several benefits:

- Members fully engage in their choices, with a clear route to trusted advice if they want it;
- Reduced risk of scams and of members being picked off by unscrupulous advisers; and
- Materially lower advice costs per member due to economies of scale

Trustees and sponsors may be concerned around the risks of something going wrong and members coming back to blame them. This can be mitigated through formal ongoing monitoring of the adviser, including member engagement and take up rates. Regardless, in our view, the risks of doing nothing and leaving members to fend for themselves is far greater.

– Facilitating access to, and paying for, wholesale financial advice.
Even where advice is made available to members, having to meet the advice costs themselves is often a barrier to members actually taking the advice. As such, over a quarter of trustees now contribute towards the cost of financial advice for their members, or plan to within the coming months.

Value should not be assessed on the number of members transferring away, but in improving overall member outcomes. We shouldn't forget that a member who has taken financial advice and received a recommendation to stay in the DB scheme can have peace of mind for the rest of their life that they've made a good choice.

% of trustees who have already, or plan to, take action to support their members:

75%
are enhancing their communication & engagement strategy

45%
are facilitating access to financial advice for their members

Over a quarter
contribute towards the cost of financial advice for their members

The financial advice market is changing with the aim of improving standards and confidence across the industry. Now more than ever, it is clear members need the support of trustees and sponsors to navigate this complex area and ensure their outcomes are protected.

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