Summary
• Members of distressed DB schemes are being targeted for 'inappropriate' transfers into DC schemes with high fees.
• Work and Pensions Select Committee chair Frank Field warns that a "major mis-selling scandal" is emerging regarding DB-DC transfers, brought upon by scammers and insufficient advice to members.
• The advice industry would be the most affected by a scandal, but the pensions industry would also face a reputational risk.
• To help mitigate this risk, trustees and sponsors could help increase awareness of member retirement options and facilitate ways in which the member can access quality guidance and advice.

Vultures circling

Are the concerns about member transfers from the British Steel Pension Scheme just the start of a wider upcoming mis-selling scandal? Laura Blows finds out

Vultures have an impressive ability to hunt out dead or dying prey from over a mile away. It's little wonder then that they have already been circling around the injured British Steel Pension Scheme (BSPS), ready to devour its vulnerable – the scheme members.

The £15 billion BSPS recently

separated from its sponsor company, Tata Steel, in order to improve the 'viability' of its UK business. The Pensions Regulator (TPR) gave its approval for a regulated apportionment arrangement to be put in place. The arrangement means members of the BSPS had the option of switching to a new scheme, the New BSPS, or moving with the old BSPS into the Pension Protection Fund (PPF) – either way it was confirmed that both unretired and retired members of the original scheme will see lower pension payments.

It took over a year before the separation of the company and scheme was officially announced in autumn 2017, with the process of transferring members into the new schemes taking yet more months.

Amidst all these turmoil, over 2,600 members have taken flight, with £1.1 billion worth of pension transfers having been carried out since March 2017.

A recent Work and Pensions Select Committee report into how the events of the BSPS transpired states that the circumstances created the "perfect conditions for vultures to take advantage".

"Given a choice between two defined benefit options worse than what they had been promised, with precious little support in making that choice, many steelworkers were drawn to the superficially attractive third option [*of a DB-DC transfer*]," committee chair Frank Field notes.

The committee heard of advice fees of typically around 2 per cent of the transfer value – sometimes with high annual charges and 'punitive' exit penalties ranging from 5-10 per cent imposed. Unregulated "parasitical introducers" were used to get as many members as possible to consider transfers. The advisers used contingent pricing, meaning they only took a fee if the transfer went ahead. This led to them pushing for transfers, often against the interests of the members, the committee says.

"While doing so, they shamelessly bamboozled those members into signing up to ongoing adviser fees and unsuitable funds characterised by high investment risk, high management charges and punitive exit fees," the committee's report adds.

While the committee is still picking over the bones of the BSPS saga, the Pensions and Lifetime Savings Association (PLSA) has warned about scammers potentially circling members in other distressed schemes in the news lately, those of Carillion.

The company's pension schemes recorded a £587 million deficit in 2017, with a number of these schemes now due to enter the PPF.

"Following the collapse of Carillion, we have already seen warning signs that scammers may be seeking to exploit DB scheme members' fears about their future," PLSA head of governance and investment Joe Dabrowski reveals.

He notes that one in six pension holders in the UK generally have been contacted by a company – other than their provider – to discuss making changes or transferring their pension.

Field has been forthright in saying that a "major mis-selling scandal" is emerging in the case of the BSPS transfers. It also seems that other pension scheme members are being lined up as prey. So are these the warning signs of a broader mis-selling crisis emerging within DB-DC transfers?

Aegon's pension director Steven Cameron thinks not. "We don't believe we are facing a mis-selling scandal regarding people transferring from DB to DC schemes to access the pension freedoms," he says.

"The pension freedoms have proven very popular, with many people seeing them as a way of transitioning into a flexible retirement. This means there's a high demand from individuals seeking advice on whether to transfer from defined benefit schemes that don't offer the freedoms. This demand has been greater because of historically high transfer values and concerns over the funding position of certain DB schemes. Transferring certainly won't be right for everyone, but it will be suitable for some."

The popularity of DB-DC transfers has been such that they have been described as the 'new norm' post-freedom and choice reforms, with an estimated 200,000 people withdrawing £1.5 billion each quarter in 2017. However, the Work and Pensions Select Committee notes research by the Financial Conduct Authority (FCA) showing that only half of DB transfer advice nationwide meets its standards – far lower than typical rates for other forms of financial advice.

It is these record numbers that is all the more concerning, should concerns about a mis-selling scandal prove correct.

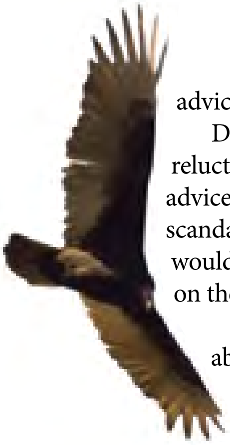
"Unfortunately, like any area of life, the financial services sector includes people who are prepared to take advantage of other people's weakness," Mercer partner and senior DB actuarial consultant Deborah Cooper states.

In the context of pensions freedom, this exploitation could range from providing poor quality advice, such as advising a risk-averse person to invest in risky assets, or advice given that is in the adviser's own, rather than the individual's, interest, she explains.

By removing the need to annuitise, pension freedoms made pension savings far more accessible, widening the range products they could be invested in, Cooper adds. "However, most people with pension savings do not have a deep understanding of how financial markets operate, or how financial products can be structured."

Advice

The counterpart to this is good, quality advice. However, "taking the individual's particular circumstances into account is not cheap and, unfortunately, people's lack of financial understanding extends to not understanding the value of good




advice", Cooper says.

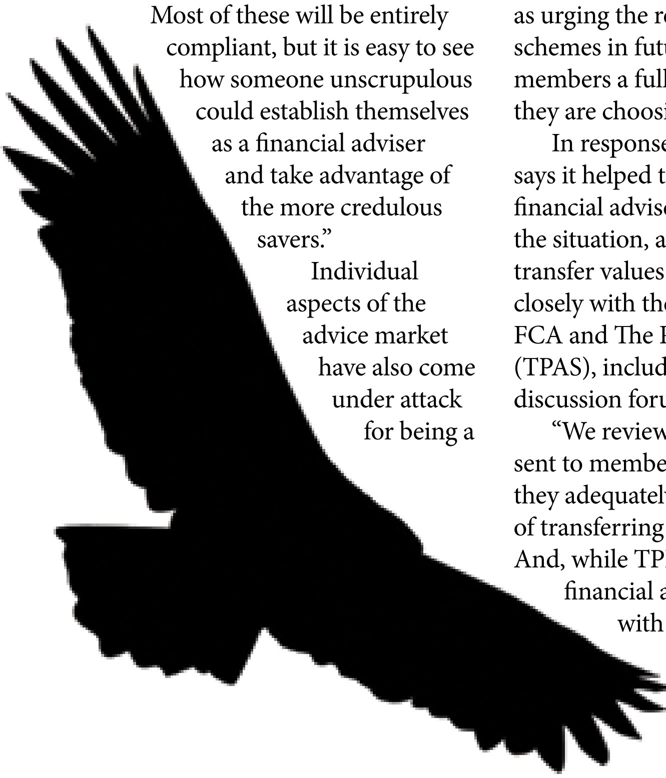
Despite individuals' general reluctance to obtain,and pay for, advice, if a transfer mis-selling scandal was to emerge, advisers would still see themselves first on the firing line.

Advisers are worried about this.

Momentum Pensions' September 2017 research found that 63 per cent of advisers state their biggest concern about DB business to be the risk of future liabilities from advice that is contested. Forty-eight per cent of advisers worry that customers do not understand the investment risks of moving DB into DC, with a similar percentage (47 per cent) of advisers seeing a rise in insistent DB pension transfer clients over the past year.

Large financial advice firms are conscious of their reputation, which makes it easy for the FCA to engage with them, Cooper says.

"However, there is a very large tail of small or lone traders where making these connections will be far harder. Most of these will be entirely compliant, but it is easy to see how someone unscrupulous could establish themselves as a financial adviser and take advantage of the more credulous savers."



Individual aspects of the advice market have also come under attack for being a conduit for poor advice and even potentially scams.

Field says that he struggles to fathom why contingent fees have ever been considered as an acceptable basis for providing impartial advice. The committee has even told the FCA to ban contingent charging, which it claims is a "key driver of poor advice". "Genuine independence is not compatible with a charging model that only rewards advisers for recommending a particular course of action," the committee states.

Regulators

However, it is not just advisers experiencing the committee's wrath. The two pensions regulating bodies, TPR and the FCA were both criticised by the committee for not adequately protecting members from poor advice.

In the case of the BSPS, the committee claims that a member communication plan sanctioned by TPR "proved woefully inadequate".

As a result, the committee has called on TPR to conduct a review to listen to BSPS members and learn how the members were let down, as well as urging the regulator to ensure all schemes in future are equipped to give members a full picture of the options they are choosing between.

In response, a TPR spokesperson says it helped tackle unscrupulous financial advisers who were exploiting the situation, and the current high transfer values available, by working closely with the scheme trustees, the FCA and The Pensions Advisory Service (TPAS), including particpating in a discussion forum with scheme members.

"We reviewed communications sent to members and were satisfied they adequately warned of the dangers of transferring out of a DB scheme. And, while TPR does not regulate financial advice, we wrote jointly with the FCA and TPAS to members to flag potential risks. We note the committee's recommendations and are continuing to work more closely with the FCA to protect pension savers," the spokesperson says.

The FCA that has also received fierce criticism from the committee. "Whose side are they on?", Field questions, referencing the FCA's proposal to abandon the adviser presumption against transferring out of "gold-plated, stable, indexed pension schemes". As part of its report, the committee suggests the FCA do not bring in these proposals, as it "looks reckless" in light of the BSPS case.

"From its intervention in this [*BSPS*] affair it seems clear that the FCA's actions still effectively protect these businesses' ability to make money out of pension funds, rather than protecting pension savers. They must take care they are not sleepwalking into yet another huge mis-selling scandal," Field states.

The FCA "fundamentally disagrees" with this statement, highlighting its joint TPR BSPS-dedicated helpline, its joint TPAS and TPR letter to around 12,000 BSPS members seeking a transfer quote, and a separate letter to BSPS members who have already transferred out about the complaints process should they have any queries with the transfer and advice.

In a January 2018 letter to the Work and Pensions Select Committee, the FCA says its initial investigation found some advice firms had 'industrialised' their DB transfer business so that they were no longer focused on their clients' individual circumstances and needs.

Furthermore, the FCA will be "collecting data from all firms who hold the pension transfer permission with the intention of assessing practices across the entire market to build a national picture".

According to Momentum Pensions' research, 48 per cent of advisers are concerned about the disconnect between the FCA and The Pensions Regulator on best practice regarding DB transfers.

"Recent issues demonstrate there is

not enough regulation, although the FCA is addressing the issue," Momentum Pensions group chairman Mark Gaywood says.

He recommends more focus and regulation on the qualifications of those providing transfer advice, and increased regulation of the underlying investments, with clearer guidelines on what is and is not acceptable, as well as what level of fees and incentives can be charged.

In contrast, both Cooper and Willis Towers Watson head of liability management Stewart Patterson, believe there is already enough regulation.

"There is already enough regulation, although a lot is in the form of guidance rather than rules," Cooper says. "The balance between rules and guidance should perhaps be re-considered."

However, the more important question, according to Cooper, is how regulation can be enforced in a way that "results in good behaviour across the board, rather than retrospective penalty". Extra regulation or controls likely results in higher costs though, she adds, "which could make it harder for some people to access financial advice, which might not be viewed as a desirable outcome".

Having advisers' recommendations peer reviewed could be a way around this, Cooper suggests.

Industry criticism

So far the responsibility of avoiding a mis-selling scandal seems to fall to the advice sector, not the pensions industry itself. However, if a "systematic problem" (to quote Cooper) is identified, the pensions industry would still find itself, rightly or wrongly, sharing the blame.

Some criticism will be directed at trustees who permitted the transfers to be paid, although, to all intents and purposes, their hands are tied, as the individual has the legal right to insist on a transfer, even if the trustees think a scam is occurring, Cooper says.

As pension saving is managed independently of the employer – either through trustees or an insurance company – individual employers may remain unscathed should a transfer crisis occur.

"However, we believe there have been pension scam cases where groups of employees working for a single employer have been targeted. In these cases, the employer might have an interest in supporting its pension provider in educating its employees about the risks they face," Cooper says.

She also recommends that where possible, an employer appoints a financial adviser for members contemplating transferring out of their DB scheme – the employer would also access small tax savings when providing employees with access to financial advice.

The greatest impact of a transfers mis-selling scandal for the pensions industry would be the reputational blow it would receive.

"Ultimately, any pensions mis-selling scandal damages the reputation of the whole industry and puts a question mark over the trust placed by individuals on any information put in front of them about pensions," Patterson says.

"That's a bad outcome for everyone, as it decreases the likelihood of individuals engaging in active decision making about their retirement income, which can only mean a decrease in the likelihood that the decisions they make are right for their particular circumstances."

Actions

So what can the pensions industry actually do to minimise this risk?

For Patterson, the more DB schemes adopt good practices, the better protection there will be for members to guard against poor outcomes, which could trigger a future scandal.

"Good practices centre around schemes ensuring members are aware of their options – both the pros and the cons of taking benefits as a DB pension or as more flexible retirement income via a transfer," he says.

He also recommends those managing DB schemes to direct individuals to a firm of financial advisers that has been through a robust selection process, and ideally make this advice available at no cost to the individual member.

It may be impossible to completely tame the vultures circling around DB-DC transfers, but with concerted effort, it is possible to prevent too many of them from picking off savers.

Written by Laura Blows