

# The benefit of hindsight

## Summary

- Increased regulation, growing insurance costs and ongoing member demand has seen industry experts warn of a potential ‘capacity crunch’ in the DB to DC transfer advice market.
- The quality of advice has also been questioned, following recent FCA research.
- Facilitating DB to DC transfer advice for members can carry risks, but can also ensure members receive high-quality advice.
- Broader legislative or regulatory change could prompt improvements, although industry framework has begun to step into this role with the recent Pasa guidance.

## ► Sophie Smith looks at how trustees can protect both members, and themselves, throughout the DB to DC transfer process

The introduction of pension freedoms in 2015 saw members gain more freedom and power over their pension, but as the saying goes, with great power, comes great responsibility. And whilst members are of course required to source financial advice before making a transfer over £30,000, recent research from the Financial Conduct Authority (FCA) has brought the quality of this advice into question. Meanwhile continued demand, increasing regulation and growing insurance costs have seen a dwindling number of firms offering the service.

### A shrinking market?

A recent FCA report found that as much as 76 per cent of firms with DB transfer advice permission could be giving harmful advice, with 69 per cent of members who asked for guidance being advised to transfer.

In addition to this, the last three

months of 2019 saw 30 firms withdraw their DB to DC transfer advice offering altogether, due to growing professional indemnity (PI) insurance costs. Opdu executive director, Martin Kellaway, agrees that costs have risen, but adds that this has been driven by an increase in claims, in turn driven by regulatory activity and increasing legislative burden.

This increased regulatory influence has also had a direct impact on the advice market, with Aegon pensions director, Steven Cameron, warning that while many of the proposals in the FCA's latest consultation on DB transfer advice should be welcomed, they could also have an inadvertent impact on the accessibility of advice.

“There is a risk that some proposals, when added to an already stringent regulatory regime, coupled with a difficult PI market, could lead to a sharp shrinkage in the supply of advice. This is a critically important market where

people need expert advice. Without it, individuals can't explore their statutory entitlement to transfer,” he adds.

With customer demand showing no signs of slowing, an increasing number of industry experts have echoed this warning of a potential capacity crunch. The Personal Finance Society, for example, recently revealed further evidence that firms are having to turn away members in need of the government-mandated advice due to PI costing and regulatory concerns.

Historically a paternalistic industry, many schemes are concerned that members may be hit most by a potential capacity crunch, but there is also a defensive side to be considered. “Given the recent well-publicised issues of members obtaining financial advice in the first place, let alone good quality advice, trustees should consider doing more than the legal minimum,” states





Pinsent Masons legal director, Michael Jones.

He adds that whilst trustees must comply with members' statutory right to transfer, they must also honour their duty to act in the best financial interest of beneficiaries and are therefore faced with a conflict between trust law and statutory duty.

Indeed, issues around the British Steel Pension Scheme have revealed the media attention and reputational risk that can hit a scheme, and as Pasa president Margaret Snowden highlights, it is not only reputational damage at risk, but financial penalties too. So, the question for trustees, as to what exactly they can do to protect both members and themselves, remains.

#### How much action?

Whilst one suggestion may be to remove the statutory right to a transfer altogether,

Law Debenture managing director, Michael Chatterton notes that this could put even more of a burden on trustees, who would then have to consider every transfer request on an individual basis, likely leading to more complaints from both members who are refused a transfer, and those who later regret the decision.

"When pension freedoms first came in," Chatterton adds, "a number of trustee boards were reluctant to provide transfer values to members automatically as they feared that members would see the large amount of 'cash' available to them and not understand the benefits in the scheme that they were giving up." However, this just makes the role of member communications that much more important.

"Engaging and educating members so that they understand how their defined benefit pension actually work will both help them to make sensible decisions

between their transfer value and the benefits in the scheme and will help to protect them against scams," Chatterton explains. Communications can also play a crucial role from a legal perspective and should be considered "an integral risk-management tool for trustees", adds Jones.

"If trustees are faced with a member challenge, they need to show they have explained the financial risks of transferring out of the scheme," he clarifies, "the risk of pension scams and that transfer is unlikely to be in members' best financial interests. It is also prudent for trustees to monitor and record transfer activity to safeguard against the risk of pension scams".

For Snowden though, it is the introduction of industry frameworks and best practice that will see improvements in processes, and subsequently limit member complaints. "Eighty per cent of transfers should be completed without delay following Pasa guidance on process and the transfer template," she emphasises.

"This will stop confusion about member benefits under the scheme and reduce complaints about delays. The other 20 per cent need a bit more attention and, as well as keeping members informed, we should follow the Pension Scams Industry Group *Code of Good Practice in Combating Pension Scams* on due diligence".

However, with the risk of a potential capacity crunch in the adviser space, some schemes and trustees have taken further steps to source, or even fund, member advice services. Whilst Chatterton notes that there may be a reluctance for trustees to be seen recommending a particular independent financial adviser due to the risk of future member complaints, he emphasises that "if trustees have carried out a due diligence exercise on an IFA firm, then they will have the reassurance that members will have access to good quality advice".

In fact, recent research from Hymans



Robertson found that 34 per cent of schemes had taken steps to facilitate reputable financial advice, whilst 11 per cent were also contributing to costs. Chatterton notes that while some or all of the costs of the advice may commonly be borne by the sponsor, trustees are increasingly looking to consider whether advice can be funded from scheme assets. However, he warns that there are various issues for trustees to consider before taking such action.

“First,” he says, “it would be necessary to review the scheme rules to determine whether such payments are possible under the rules. Second, there may be a need to take legal advice on whether such payments come within HMRC’s authorised payment regime”.

He added that it is also important to consider the scheme funding position alongside these factors.

Jones echoes this, highlighting that by operating an advice facility, trustees and employers can be assured that members will receive good quality advice, adding that the balance of risks is in favour of action, rather than inaction.

He explains however, that trustees must have a robust process behind any selections and must also take care to inform members of their freedom to choose another adviser. The establishment of a panel of financial advisers is one such option that some

schemes are already acting on.

Furthermore, he states that from a risk management perspective, many trustees and employers take the view that the upfront ‘known’ costs associated with such a service are preferable to the unknown risk of defending claims for maladministration from members.

Equally, the emergence of new types of advice might also hold opportunity for trustees and schemes, such as the FCA’s proposal to introduce abridged advice. Cameron describes proposals such as this as “the next best thing to being able to offer a triage service under guidance”.

“However,” he clarified, “requiring full fact find and pension transfer specialist involvement limits cost savings. We see potential to further shorten the process, asking a few upfront questions to uncover ‘killer facts’ that can quickly rule out transferring”.

#### **A solution within the problem?**

Indeed, whilst the increasing regulation and legislative burden has caused issues for some firms, it may also play a crucial part in the solution, as many in the industry feel held back by legislative constraints. Snowden for example, emphasises the need for the regulator to be clearer about the ‘advice trap’.

“It is absurd that trustees and administrators feel unable to help members in case they are deemed to

have given financial advice,” Snowden argues, “this is a risk for schemes and results in members being left to their own devices, which in turn leaves them feeling negative about their encounters with their schemes.”

“We need to lighten up and allow help to be given, especially where good regulated advice is harder to come by. I have said for years that we have an army of skilled administrators perfectly capable of guiding members and filling the gap for a substantial portion of the population. We also see schemes selecting an adviser to offer guidance to members”.

However, under current legislation, Jones again highlights the role of guidance and member communications. He stresses that not only is there no requirement to review the advice, or check that it is reflective of a member’s personal circumstances, but that requiring this level of information or involvement could itself be a risk to trustees as they should be careful of recommending a course of action. However, he also adds that trustees should provide clear, detailed information to assist members, emphasising that they are not limited by legislation as to the level of guidance and support they can provide.

“Ultimately, trustees’ responsibility lies in flagging the risk to members, carrying out reasonable and appropriate due diligence, requesting and checking that the member has taken independent financial advice. So, as long as trustees have carried out the necessary due diligence steps, they would adequately protect themselves from complaint,” Jones concludes.

Whilst larger legislative or regulatory changes may one day see shifts for better or worse, trustees must use the tools at their disposal now to protect both themselves, and members, until such changes are made.

➤ **Written by Sophie Smith**