Summary
• The Financial Conduct Authority (FCA) consulted on banning advisers' contingent charging for transfers in early 2018, but found that it was not the main driver for poor customer outcomes.
• The Work and Pensions Committee's own inquiry closed on 31 January, and will present its findings to the FCA imminently.
• The issue splits opinion across the pensions industry, with some leading figures calling for an outright ban, while others are not so sure.
• The stakes have been raised after the FCA said almost 5,000 pension transfers were completed by firms who were later told to exit the market, following issues with their advice.

Finding a way through

As the Work and Pensions Committee prepares to send its findings from its inquiry into advisers' contingent charging for transfers to the FCA, Theo Andrew takes a look at the responses, possible solutions and why finding a way out of this challenge continues to be a maze for the regulator

Navigating through the complexities of the pensions industry is hard enough at the best of times. It can be easy to get lost, hit a dead end or drift off path, as one looks to understand the myriad issues facing the sector.

There isn't much that divides opinion more than that of cost and pricing models in the industry, except for perhaps tax issues, which why it is imperative that the regulators, who in the quest of making it a fair market for all, will do all they can to avoid running the risk of making a wrong turn.

For the Financial Conduct Authority (FCA), one of these meandering issues seems to be contingent charging, where advisers only receive their fee once the member goes through with a pensions transfer. There is a risk that this may encourage advisers to deliver bad advice, to suggest a transfer even when not in the member's best interest, in order to receive their fee. Therefore, there is a danger that without proper action, the regulator could find itself slightly lost on this problem.

Following a 2018 review, the FCA did strengthen the rules around advisers, introducing specific qualifications for providing advice on transfers from October 2020, while reiterating its stance that defined benefit transfers are an 'unsuitable' starting point for consumers.

At the same time, and following the events of the British Steel Pension Scheme (BSPS) scandal, in March 2018 the FCA launched its own consultation into this pricing model, but ultimately found that this was not the main driver of poor customer outcomes.

Data from the Financial Services Compensation Scheme (FSCS) revealed recently that Compensation payouts to members who have been wrongly advised to transfer out of DB schemes have doubled to £40m in two years.

Now, the Work and Pensions Committee, whose chair Frank Field is looking to tackle the "scourge of contingent changing", has picked up the buck, and along with the regulator, is looking to gather evidence on what can be done to navigate its complexities.

In early February, the committee said it will be sending a letter on its findings to the FCA "in the next few weeks", however, many in the industry have been very vocal on what they think the possible solution could be.

Possible solutions

One possible remedy, put forward by Royal London, which has perhaps received most attention, is that where the cost of advice is debited from the members rights under the defined benefit scheme.

For example, if a member received a cash equivalent transfer of £200,000, and where the cost of providing the advice was £4,000, if the transfer went ahead, the member would receive £196,000. If it did not, the member would receive 2 per cent less in DB rights when they retired, which is "unlikely to make a material difference", explains the firm.

Commenting on the proposal, Royal London director of policy, Steve Webb, says: "This could remove the need for clients to find cash up front to pay for advice and might enable more advisers to offer a viable fixed-fee option when charging for advice."

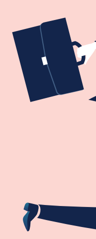
However, Hargreaves Lansdown senior pensions analyst, Nathan Long, believes there are a number of questions the system would raise.

"On the face of it looks quite good because you get rid of the bias of contingent, but what is not quite so clear is the cost of providing income is actually quite penal," he says.

"If you had the choice of whether paying from money you had in your bank account, or paying with money from your scheme, almost certainly you should be paying from your bank account."

There is however precedent for such a system through the 'scheme pays' mechanism, which DB schemes use for 'pension tax charges or in the case of pension sharing on divorce', according to Royal London.

In order for the change to be made, a small amendment would be required



in order to allow trustees to make the deductions, beyond what is already allowed for 'scheme pays'.

But Pinsent Masons partner, Stephen Scholefield, believes this too is not as simple as it may seem.

"Schemes in reality do something very similar for the scheme pays, where they pay the annual allowance charge from their benefits. While that is true, the big difference is it is not applied very often in practice," he says.

"It seems like an expensive way to solve the problem and it is not really a problem for pension schemes, it's more a problem around how financial advice is regulated and made affordable. Passing admin costs onto pension schemes seems a bit harsh."

Another potential solution, put forward by financial advice firm LEBC, is to make it compulsory for providers to offer £500 of tax-free allowance for advice.

This is a view echoed by the Pensions and Lifetime Savings Association (PLSA), who, while "broadly in favour of a ban", welcome the additional work being done to understand the causes of unsuitable advice.

"While we recognise concerns that a ban could make it harder for those with smaller transfer values to access advice, technological advancements may mean low-cost, automated advice might be possible in the future," says PLSA policy lead, Craig Rimmer.

"We also believe this risk could be mitigated through further guidance from the new Single Financial Guidance Body (SFGB) and by revisiting the pensions advice allowance to help create more affordable financial advice options."

The FCA introduced the allowance in 2017, however, many believe it is not communicated effectively enough for people to take advantage of it.

"We now want to see a re-visit to both the pensions advice allowance and the employer-arranged advice allowance, as they are currently not being made widely available and looking to properly re-introduce/launch them to give savers greater access to regulated financial advice," Rimmer adds.

Another solution brought forward in the inquiry was the more prominent use of triage services, which, the PLSA says, could be offered through the SFGB to "allow the consumers to work through whether they should be starting the transfer process or not", which could potentially save consumers money.

The Pensions Advisory Service (TPAS) is another big proponent of this solution, believing that it can explain "processes and contingencies to a degree an adviser is unable in an initial conversation".

Writing to the inquiry, TPAS argues: "Triage could address these points by providing a neutral, comprehensive and intuitive breakdown of the factors that one should consider with respect to a defined benefit transfer.

"It could

be structured such that it offers certain fundamental content as standard."

The complexities of the issue means that any slight amendments in the regulation around the charge could have both positive and adverse consequences for customers, as many have pointed out.

Unintended consequences

Following the launch of WPC inquiry, a number of industry commentators warned the MPs looking into the charge of the "unintended consequences" a ban could cause, such as exacerbating the advice gap, as well as the disruption it could cause advisers.

TPAS highlights the issue that an outright ban could restrict the public's access to financial advice, while the PLSA agrees – particularly for those with small to medium transfer values.

According to TPAS, a majority of firms charge between 2.5-4 per cent of the cash equivalent transfer value.

Personal Investment Management and Financial Advice Association (PIMFA) senior policy adviser, Simon Harrington, agrees: "Removing contingent charging without a viable way for individuals to access advice will ultimately turn people away from an absolutely indispensable part of the retirement planning process."

However, it is also argued that a ban could unfairly affect the advice market.

Hymans Robertson head of member option, Ryan Markham, says: "Banning contingent charging could be highly disruptive for advisers and is unlikely to be straightforward to implement given the broader link to charging structures for managing investments and providing ongoing financial advice."

Further to this, there is the distinct lack of proof that removing the charge, or that any possible alternative solutions to the charge will improve the quality of advice for consumers.

Show me the evidence

For many in the industry however, there is just simply not enough evidence to suggest that contingent charging leads to bad advice.

Data from the regulator, shared with the *Financial Times* in January, found that almost 5,000 pension transfers were completed by 19 companies who were later told to leave the market after issues were found with their advice. Here though, there was little evidence that the charge was the cause.

Long believes that more evidence is needed before any decisions are made.

"Until the FCA has finalised its opinion on whether contingent charges are doing detriment, then I think we are not quite there yet in terms of alternatives," he says.

"I suppose it comes down to what you think – I think the general view should be, you shouldn't transfer one of these pension schemes, unless there is a real strong reason your pension doesn't suit what you want it to do in retirement, and that is more important than any of the messages on contingent charging."

Rimmer agrees: "To help safeguard against poor practice, we also want to see the right data collected annually by the FCA and The Pensions Regulator to understand any detrimental impact affecting savers stemming from DB to DC transfers."

This is certainly the position of PIMFA, which concluded: "We are not necessarily against a ban on contingent charging. However, without a viable alternative to replace it, we cannot support a ban at this current time."

Whether or not the Work and Pensions Committee comes up with sufficient evidence to ban contingent charging altogether, or at the very least offer a viable solution, it is clearly an issue that continues to split the industry.

If an outright ban is not achieved, it could be an issue that continues to prove a puzzle for the regulator.

Written by Theo Andrew