LCP on point

"Mind the transfer advice gap?"

A joint paper from LCP and Aviva on the current state of the DB transfer market

September 2021

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Foreword from Aviva & LCP

Foreword from Mary Harper, Managing Director of Aviva Financial Advice

Pensions represent the biggest single source of private wealth in the UK. The supply of good advice is therefore critical to the nation's financial wellbeing. This report provides excellent insight into the health of our defined benefit transfer market today. The demand for good advice in this area is strong. Its supply, however, is increasingly challenged by rising costs and tightening regulation. When supply can't meet demand, savers suffer. Aviva thanks Sir Steve Webb and LCP for their analysis and insight. We are committed to working with them, and others, to ensure good defined benefit transfer advice is readily available for all who need it.

Foreword from Steve Webb, Partner, LCP

Exchanging the security of a Defined Benefit pension for the flexibility of a Defined Contribution pension is a major and irreversible decision. To protect consumers from getting this decision wrong, the government quite rightly requires members to take financial advice on all but the smallest transfers. But such advice needs to be affordable, readily available and of high quality. This report assesses how far that is the case, not least in light of recent regulatory changes. We were pleased to partner with Aviva to undertake a large-scale survey of the views of financial advisers who are, or have been, active in providing transfer advice in recent years. And we complemented this with seven in-depth interviews with advice firms who are regularly appointed by individual schemes to support their members. We hope that this new data on both 'high street' advisers and scheme-appointed IFAs will inform the industry and policy-makers about the state of the market for DB transfer advice and highlight areas where further action may be needed.

01 Introduction

For many years a Defined Benefit (DB) pension has been seen as the 'gold standard' of pension provision. The scheme member benefits from a pension which should last as long as they do, which insulates the member from the ups and downs of the stock market and which provides a measure of protection against inflation through retirement.

But, in the last six years, more than 200,000 people have chosen to transfer DB pension rights with a combined value of more than £80 billion into Defined Contribution arrangements[1]. Given the advantages of DB pensions and the regulatory presumption that remaining in the DB environment is likely to be in the best interests of most members, it is clearly vitally important that those considering a transfer receive high quality impartial advice before they make the irreversible and potentially life-changing decision to transfer.

The purpose of this paper is to assess the 'state of the nation' when it comes to DB pension transfers and the advice available to DB members. Specifically, the research provides the first opportunity to assess the impact of a package of regulatory changes implemented by the Financial Conduct Authority (FCA) in October 2020. Our particular focus is on the concern that members interested in transferring are finding it increasingly difficult to source affordable, high quality advice.

The report is in three main parts:

- First, we provide the latest data on the demand for DB transfers and the supply of DB transfer advice;
- Second, we report the results of a new survey of financial advisers, jointly undertaken by LCP and Aviva; more than 200 advisers, roughly evenly split between those still active in the DB transfer market and those who have recently pulled out, have given us their views on how the advice process is working and on the impact of recent regulatory changes;
- Third, we analyse an important and growing sector – the scheme-appointed IFA firms which supply transfer advice (and potentially wider advice) to members of a specific scheme, often on a free or subsidised basis; for this research we have undertaken in-depth interviews with seven major firms in this market who have also kindly provided us with quantitative data.

In a concluding section we consider the lessons of our research for government, pension schemes and the wider advice market.

[1] See, for example, FCA market data covering the period Apr 15 – Sep 18 at: Defined benefit pension transfers market data October 2018-March 2020 | FCA, and Oct 18 to Apr 20 at: Defined benefit pension transfers – market-wide data results | FCA

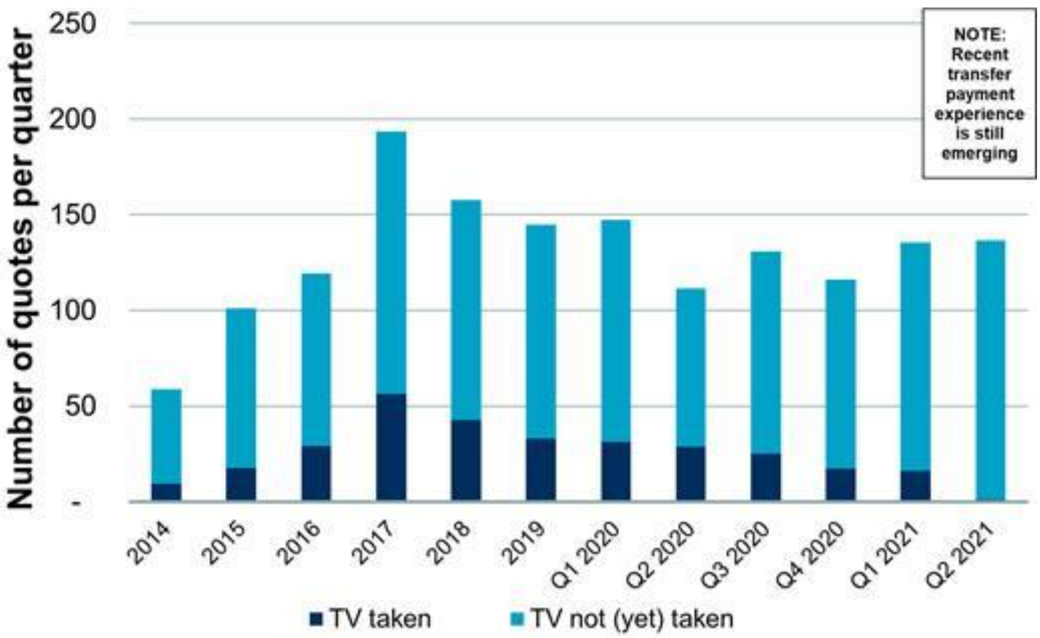
02 Market trends – demand for transfers and supply of advice

We begin by setting the scene in terms of what has been happening in recent years to the demand for DB transfer advice and to the supply of advisers in this market.

a) Demand for DB transfers

The chart below is based on data from more than 80 Defined Benefit pension schemes administered by LCP. It shows the number of deferred members who asked for a Cash Equivalent Transfer Value (CETV) quotation and, amongst these, how many subsequently went on to transfer. Figures are expressed as rates per 10,000 deferred members. As the most recent data is shown for each quarter, the annual figures have been divided by four to ensure comparability[2].

Chart: Transfer value requests obtained and transfers taken per 10,000 deferred members



As the chart shows, the period 2014-2017 saw a surge in the demand for DB transfers. This seems to have been driven initially by the introduction in April 2015 of 'pension freedoms' which provided for much greater flexibility in the use of DC pension pots. This growth was reinforced by surging transfer values (primarily reflecting ultra-low interest rates) and a relatively permissive / benign regulatory regime.

[2] For the most recent quarters, whilst we have data on how many CETV quotations were requested, it will be some months before we know with certainty how many of these eventually turned into transfers out.

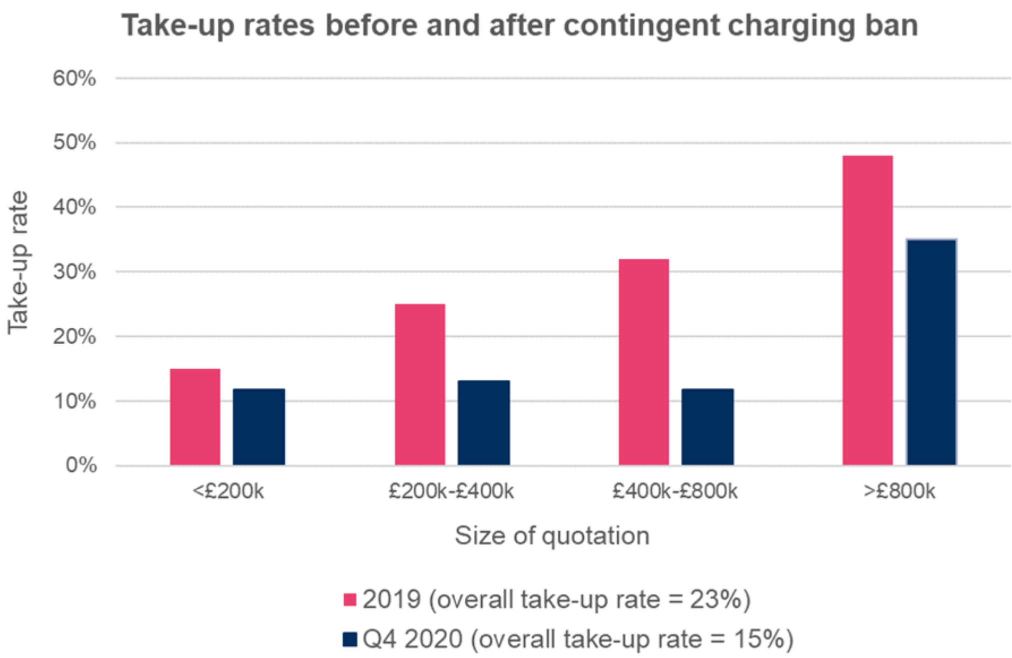
Pension freedoms remain in place, and transfer values are still at close to record levels, but the biggest change in more recent times has been in the attitude of regulators and in the costs of providing advice.

Following high profile cases such as British Steel and wider concerns around unsuitable transfer advice, the FCA has gradually tightened up on the rules around DB transfers. At the same time, Professional Indemnity (PI) insurers have become increasingly concerned about the risk of substantial claims for 'mis-selling' of historic transfer advice and have hiked premiums and restricted cover, thereby increasing the cost of advice to the end consumer. Taken together, these trends have contributed to the fall back in the volume of transfers in 2018 and 2019, albeit with activity still well above pre 'pension freedom' levels.

The first quarter of 2020 looked similar to the previous year, but we then start to see some evidence of the impact of lockdown and the Pandemic. Numbers of members asking for quotations were down, notably in Q2 and Q4, although much of that decline has been reversed in the first half of 2021.

What has not been reversed however is the decline in the proportion of people who obtain a quote who then go on to transfer, which is now at around half of its peak in 2017. Rule changes in October 2020 meant that advisers could no longer charge for transfer advice contingent on whether the transfer went ahead, and instead had to charge a fee regardless of the outcome. Although it is hard to say with certainty, this may have led some scheme members who approached a financial adviser (having already obtained a transfer value quote) to decide not to proceed with taking advice. It is also possible that FCA regulatory action may have driven out of the market some advisers who had a tendency to have above-average rates of recommendation to transfer.

Some evidence for the hypothesis that it is the ban on contingent charging which has driven the decline in take-up of transfer quotations comes from looking at the size of transfers now going ahead. The chart below shows how the take-up rate of transfers has changed since the ban went ahead, broken down by pot size.



As the chart confirms, take-up rates of transfers for the smallest pots were always relatively low, but there has been a slump in take-up of transfers across the range from £200k-£800k. Demand above this level has also fallen but by less and remains at a relatively high level.

It seems reasonable to suppose that a member faced with a potential upfront charge for transfer advice of anything from £3,000-£20,000 may not think this is good value on anything other than the largest pot sizes, especially with the risk that the outcome might be advice not to transfer.

We have also obtained new data from the FCA which sheds some light on the potential link between contingent charging and recommendations to transfer.

Earlier in 2021, the FCA published data on 1,349 firms and the percentage of clients approaching them for DB transfer advice who went on to transfer (the so-called 'conversion rate'). LCP asked for a breakdown of these figures according to whether the firm charged on a contingent basis or not. The FCA said that 335 of the firms charged on a 'hybrid' basis (part contingent, part fee) but for those who purely charged on a contingent basis (641 firms) or purely on a non-contingent basis (373 firms), the average conversion rates were:

1. Firms only used a contingent charging structure **68.25%**
2. Firms only used a non-contingent charging structure **27.97%"**

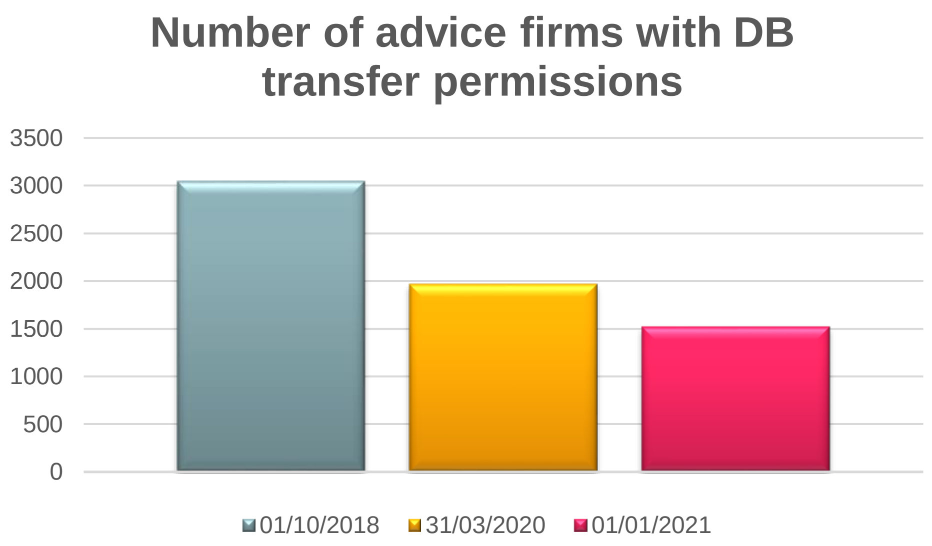
Source: FCA data supplied on request to LCP.

Whilst other factors may be at work, there is a striking difference in the extent to which advisers who charged on a contingent basis (before the ban) were recommending DB transfers. Other things being equal, it would seem that a member charged on a contingent basis for transfer advice was more than twice as likely to be recommended to transfer as a member paying a set fee for advice. It seems highly likely that the decline in the proportion of those obtaining transfer values who went on to transfer in Q4 2020 and Q1 2021 will reflect at least in part the fact that such advice would in most cases now be charged for on a non-contingent basis.

b) Supply of advisers

A crucial determinant of the viability of the DB transfer market is the supply of suitably qualified advisers willing to provide advice in this space, especially in the case of members who do not have access to an adviser appointed by their scheme.

In the first phases of pension freedoms there was, not surprisingly, a growth in the number of advisers recorded as being able to offer DB transfer advice. But the number of advisers still active in the market has since fallen back, as shown in the chart.



We discuss in more detail in this report the reasons why the number of advisers active in this market has fallen so sharply, and indeed may fall further. However, key factors include the cost of obtaining Professional Indemnity (PI) insurance for DB transfer advice and the increasing level of regulatory scrutiny around this area.

03 DB Transfer advice from 'high street' advisers – results of our survey

In this section we present the results of a new survey of financial advisers who are either currently actively involved in advising on DB transfers or who have done so within the last three years. We use the term 'high street' advisers to refer to financial advisers who scheme members may source directly, as distinct from those who have been appointed by individual pension schemes to support members of that scheme. Any given advice firm may, of course, operate in both markets.

Introduction – about our sample

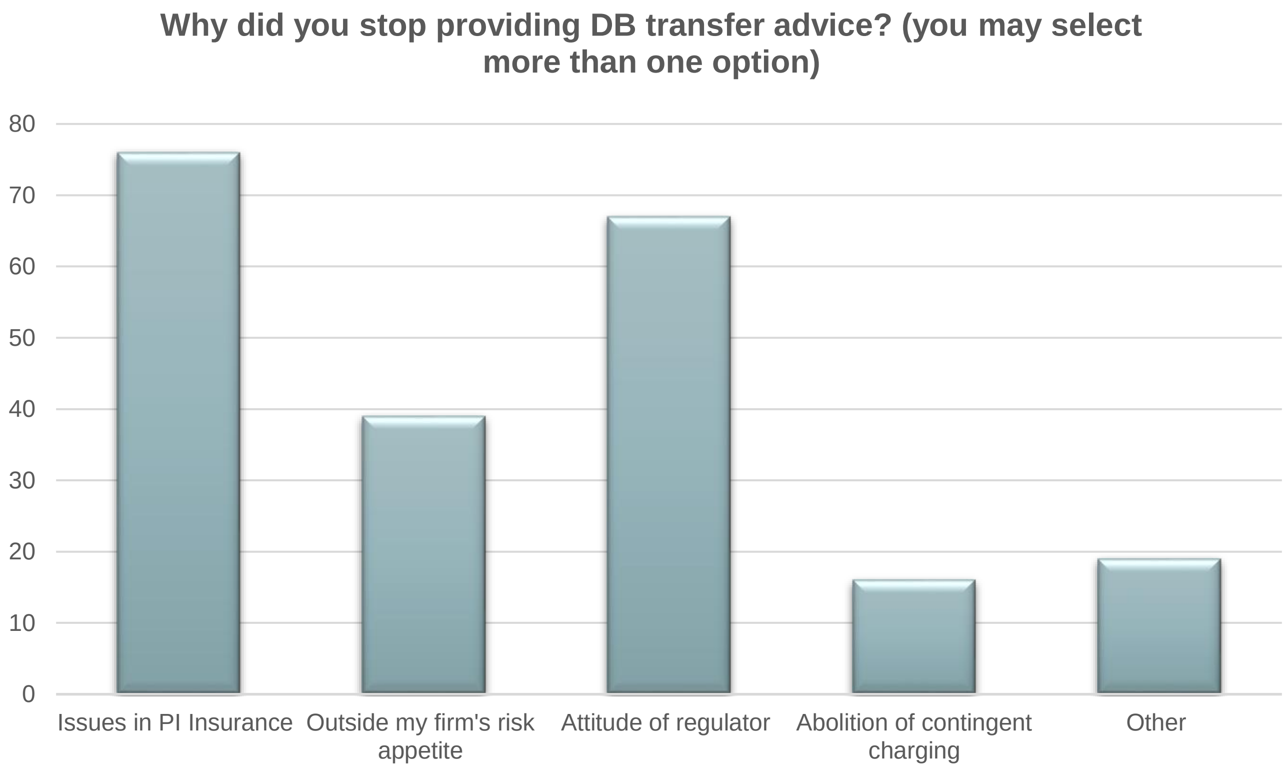
In the summer of 2021, Aviva sent an email to its database of financial advisers inviting them to complete a short online survey about the DB transfer market. Responses were sought only from those currently active in giving DB transfer advice or who had done so in the last three years. Follow-up emails and promotion on social media by Aviva and LCP led to 213 substantive replies. Just under half of these (97) were from advisers still active in the market, and the balance (116) were from those who had relatively recently ceased providing DB transfer advice. In this section we look at the replies received first to the shorter questionnaire answered by those who have left the market and then the more detailed questions answered by those who are still active.

Where relevant we compare findings with our previous survey of advisers active in the DB transfer market undertaken in 2020 in partnership with Royal London. We refer to this as the 2020 survey. More details of the results of this survey can be found at: On point paper: Helping members access DB transfer advice – time for schemes and regulators to do more? | Lane Clark & Peacock LLP (lcp.uk.com)

a) Advisers who have ceased doing DB transfer work

We began by asking the 116 advisers who had ceased doing DB transfer work when they left the market. Of those who specified a date, five said 2018, thirty one said 2019, fifty eight said 2020, and sixteen said 2021. The majority therefore have relatively recent experience of advising in this market.

We then asked why advisers had left the market, giving four suggested answers based on previous surveys, but giving advisers the opportunity to add their own reasons if not covered. Respondents were allowed to tick more than one answer. The responses were as below:



As the chart shows, issues around Professional Indemnity (PI) insurance were a key reason for advisers to leave the market. To give DB transfer advice, the FCA requires advisers to have PI cover, which protects the firm against new claims against them, almost invariably in respect of advice given in the past. In some cases, advisers will simply have been unable to obtain renewal cover or in others the cost will have been too high or the exclusions / excess too large for cover to be attractive.

The second largest factor driving advisers out of the market came under the broad heading of 'attitude of regulators'. Some advisers object to the regulatory presumption that transfers are unlikely to be in a member's interests, whilst others disagree with the FCA's judgments when historic advice files are reviewed.

A small number of respondents cited the abolition in October 2020 of the ability to charge on a 'contingent' basis, where the client only pays the full cost of transfer advice if the transfer goes ahead. Such advisers may have expected that this would discourage people from going for transfer advice (because of the risk of a large advice fee even if the advice is not to transfer) and that the reduction in volumes of business could make it unviable to continue to provide transfer advice.

Of those who wrote in an 'other' reason, the two main ones were:

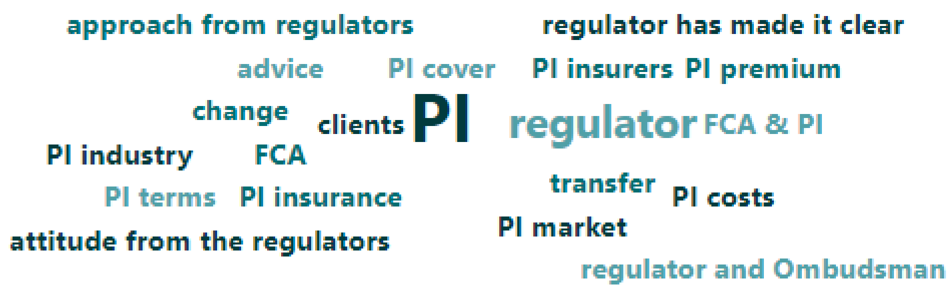
- A decision by the 'network' of which the adviser is a part to pull out; this in turn was sometimes due to PI issues;

- An issue of scale – it is not viable to have the infrastructure/training/insurance etc. required to provide DB transfer advice if those costs are only spread over a small number of cases per year;

Comparing these answers with the response to the 2020 survey, whilst PI insurance issues remains at the top of the list of reasons for leaving the market, the 2021 survey respondents were more strongly critical of the role of regulators. This is likely in part to reflect the abolition of contingent charging as well as further regulatory activity in light of the British Steel case.

For those who had left the market we asked what, if anything, would encourage them to return. The following 'word cloud' is probably the easiest way of conveying the balance of responses:

Question: Is there anything that would prompt you to re-enter the DB transfer market?



In many ways, these responses mirror the reasons for leaving, with resolving Professional Indemnity insurance issues by far the most important.

Another recurring theme was a more constructive approach from regulators. One of the main concerns with regulators is a perception that measures designed to tackle 'rogue' advisors ('cowboys') end up penalising legitimate advisers, adding to their costs and regulatory burdens. There was also a feeling that a blanket presumption against transfers (as a starting point) makes it harder to recommend a transfer even when the adviser strongly believes this is in the client's interest in a particular case.

Dissatisfaction was also expressed with the role of the Financial Ombudsman Service (and the increase in FOS compensation limits) particularly when it comes to evaluating claims for poor advice. Some advisers felt that the FOS assessment process could over-ride thorough and detailed advice based purely on a relatively superficial examination of a case. Concerns about being exposed to 'claims management companies' looking to promote DB transfer complaints were mentioned in a number of cases.

Finally, those who had left the market were invited to make any general observations. Key points included:

- Considerable concern that the current situation is not good news for clients, particularly those for whom a DB transfer might still be in their interests; one adviser wrote: "I think DB advice is an important part of full financial planning. To not be able to offer this is disadvantaging all those people with DB schemes". Several said that the shrinking supply of advisers willing to provide transfer advice means costs to members are rising, which is further to the detriment of clients
- Frustration that 'good' advisers, with unblemished records and high standards cannot obtain affordable PI cover;
- The need for 'stability', both in terms of the regulatory regime (often described as 'knee jerk') and the PI regime;
- The desirability of a 'long stop' on compensation claims so that advisers would not continue to be at risk many years after the event

- Concern was expressed at the FCA actively contacting those who had transferred in the British Steel case to encourage them to complain, even if they would otherwise have been happy with the outcome;

The overwhelming message from advisers who have left the market is that a combination of rising PI costs (and a perceived unreasonable / irrational approach by PI insurers) and regulatory hostility to DB transfers makes it an unattractive market to be in. These advisers generally felt that a shrinking in supply of advice, coupled with a ban on contingent charging, would simply mean fewer people would be able to take advantage of 'pension freedoms' even if in their individual case it would clearly be beneficial for them to do so.

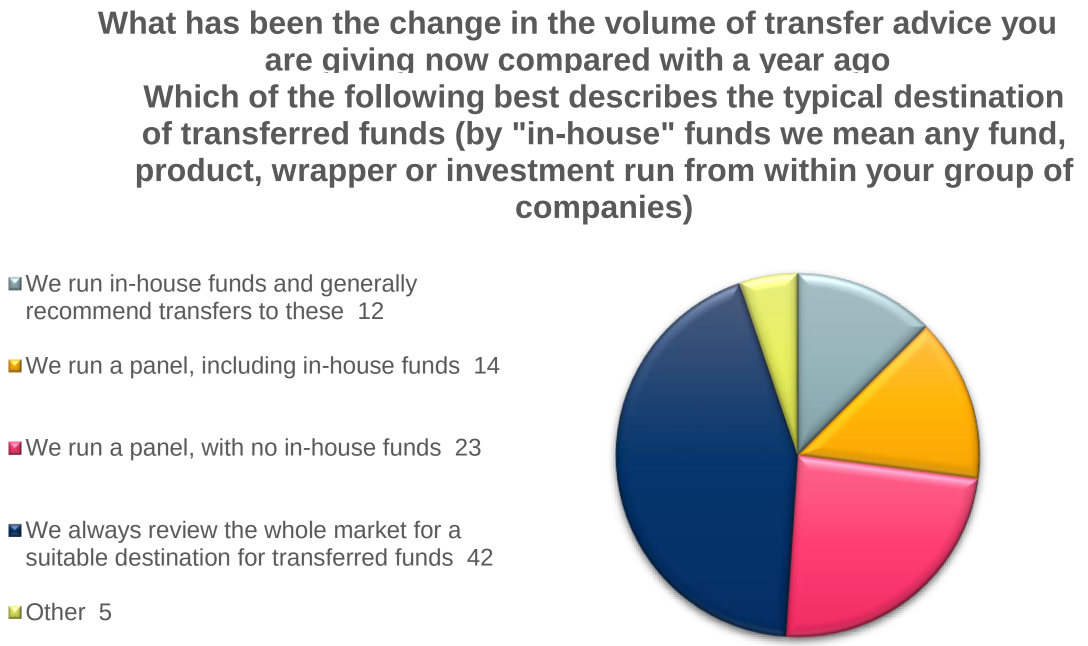
b) Advisers still active

Advisers still active in the DB transfer market range from those who provide advice in a handful of cases and only to existing customers as part of wider advice, to those who specialise in this area. The next section reports on the results of seven in-depth interviews with scheme-appointed advisers, but in this section we present the responses from nearly 100 'high street' firms to a series of questions we asked via our online survey.

i) Characteristics of sample

- Roughly half of the sample advised on no more than one DB transfer per month; at the other end of the scale, five respondents said that their firm advised on at least 100 DB transfers per year, including one which advised on around 1000;

- A majority reported that activity was down or flat on a year earlier, though about a quarter reported an increase in business (see below); it is difficult to disentangle the impact of lockdown which, as we have seen, depressed the number of scheme members seeking transfer quotes in the first place, from other changes such as the new rules which came in on 1st October 2020 and which banned contingent charging;



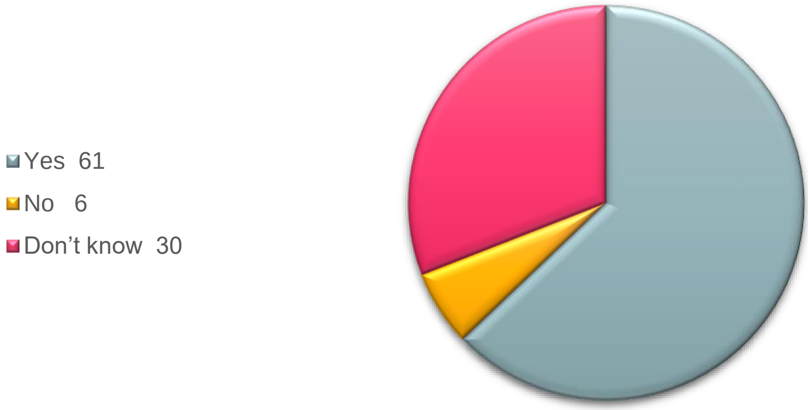
The advisers in our sample had a range of approaches to the destination of transferred funds. The split is as shown:

The most common model amongst our sample was to provide 'whole of market advice', followed by those who managed the process by running a more limited panel for transferred funds but still without any 'in-house' funds. About a quarter of our sample either transfer money largely to in-house funds or include in-house funds on their panels[3].

ii) Level of commitment to the market

Interestingly, although these advisers have remained in the market when many others have left, their continued participation is far from certain; six said that they did not expect to be active in the market in a year's time, whilst around one third were unsure (see below); given the existing problems which members are reporting in accessing advice, this suggests that there is a serious risk of further contraction in the supply of 'high street' advisers willing to advise on DB transfers;

Do you expect to still be active in the DB transfer market in a year's time?



In response to a follow-up question asking for reasons why they might leave the market, reasons given largely matched those given by advisers who had already left the market. Comments included:

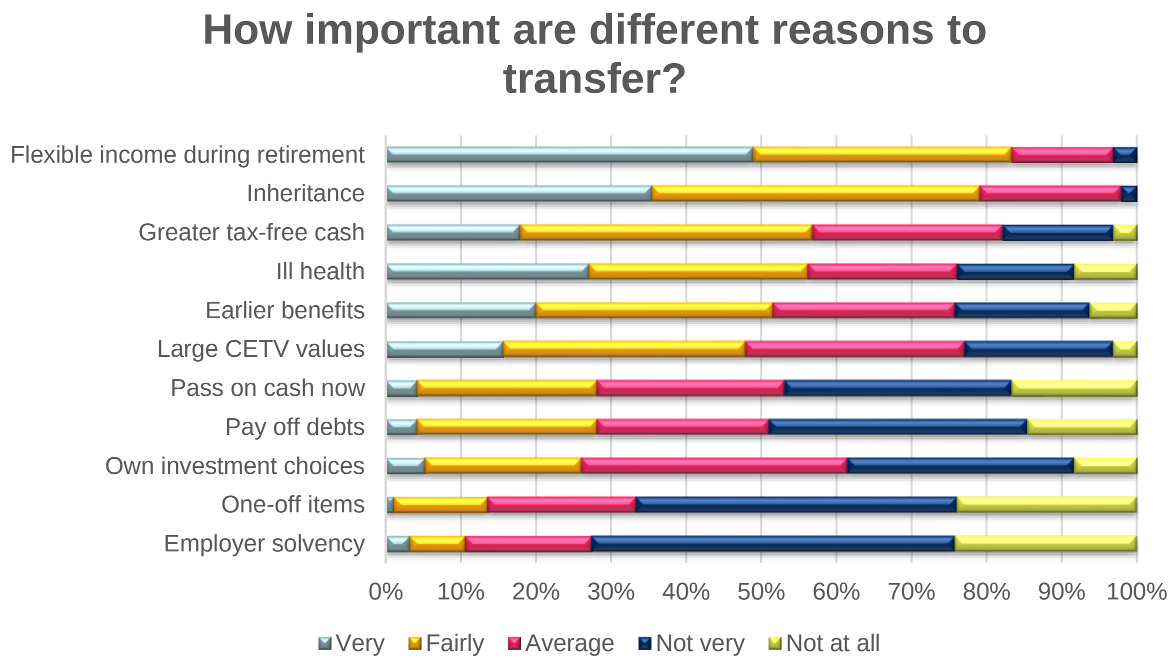
- "hostile and changing regulatory environment" / "because the FCA doesn't like it" (similar comments about the approach from regulator came from several respondents)
- "getting PI is not guaranteed, even though we have never had a complaint" (similar comments about PI were also made by many respondents)
- "clients put off by non contingent charging"
- "only viable if we have the volumes because of fixed costs"
- "FOS hard to predict"

It is absolutely clear that many advisers have left the market already and others may follow, primarily because of the rising cost of advice (and of obtaining PI cover) and a feeling of regulatory 'hostility' and unpredictability.

iii) Why do clients want to transfer?

We gave respondents eleven different reasons why people may wish to do a DB transfer and asked them to say how important each was to clients, on a scale running from 'very important' to 'not at all important'. The results are summarised in the chart.

[3] Our survey email was sent to a large number of advisers on Aviva's adviser database. This database is, of course, unlikely to be exhaustive and may under-represent advisers who exclusively provide access to in-house funds.



The different answers have been ranked so that those with the highest number of advisers saying the factor was either 'very' or 'fairly' important to clients are at the top.

The biggest driver for DB transfers is a desire for 'flexibility', and in particular the ability to reshape income in retirement when it is in a DC arrangement[4]. This is closely followed by the inheritance advantages of a DC pension compared with rights in a DB scheme. This may be particularly important in cases where someone is in relatively poor health or does not have a spouse or partner who would get a survivor's pension from the DB scheme. More than three quarters of advisers said that each of these two factors were 'very' or 'fairly' important to clients.

Next comes the potential to secure more tax-free cash out of transferred funds than would be available from the DB scheme, and the advantages of DC rights for those in poor health. The other factor rated as important to clients by more than half of advisers was the ability to take benefits earlier in a DC arrangement, although many DB schemes will offer an early retirement option.

At the other end of the scale, concerns about the solvency of the sponsoring employer were rarely seen as being a particular driver (presumably partly because of the reassurance provided by the Pension Protection Fund) and DB transfers were rarely undertaken to fund a one-off purchase. Perhaps more surprisingly, the 'DIY investor' wanting to control their pension wealth and make their own investment choices was only important according to around 1 in 4 advisers.

The eleven items were chosen to mirror the factors included in a 2017 survey[5] which we undertook of advisers in partnership with Royal London. Areas of consistency between 2017 and 2021 were:

- The most important driver for transfers across both surveys was 'flexible income in retirement';
- Inheritance considerations and potential access to greater tax free cash were both in the top four on each occasion;
- Paying for one-off items and worries about employer solvency remained minor factors in both surveys;

However, there were some notable changes over the four year period:

[4] In a recent paper 'Live and let PIE', we highlighted the fact that considerable flexibility may already be available within a DB scheme – see: On point paper: Live and let PIE?– making the most of the flexibilities within your Defined Benefit pension scheme | Lane Clark & Peacock LLP (lcp.uk.com)
[5] See: helping-db-members-make-better-retirement-choices.pdf (royallondon.com)

- Record CETV values were a big driver in 2017, being the second most important consideration, but this factor comes sixth in our latest survey; it may be that people have become used to 'high' CETV quotes, and also that some of those most motivated by this factor have already transferred out;

- Ill health seems to have become a more important factor (up from 8th to 4th); we can only speculate but it is possible that the recent Pandemic has led more people to consider what would happen to their pension wealth in the event of their death and that they have concluded that a DC pension would be a better option;

iv) Recent regulatory changes – abolition of contingent charging

Since October 1st 2020, advisers are no longer able to vary the charge for transfer advice depending on whether or not the transfer goes ahead, subject to tightly defined exceptions[6]. In most cases this means that clients could find themselves paying for advice even if the advice is not to transfer and they do not transfer. The FCA originally estimated that non-contingent advice could be expected to cost £3,000-£4,000, but, as we see below, in practice actual costs can be much more than this.

With regard to our sample, <u>nearly two thirds previously charged on a contingent basis</u> before the ban was implemented, so this change could be expected to have had a big impact on their business model. When asked what had happened as a result, key themes were:

- Many said that the volume of transfer advice had dropped as a result of the need to charge up-front fees, though about 1 in 4 said the change had had no effect; comments by those who had seen an impact included:
    - "some enquirers walk away when hearing about advice fees"
    - "dropped to almost zero"
    - "numbers dropped initially but now back up to previous levels"
    - "Reduced demand offset by other firms pulling out"

- Those with smaller pots were more likely to be put off and find it harder to source advice, as charges are often a higher proportion of transfer value when pot sizes are small; one firm said they had now imposed a £200k minimum pot size and others were considering increasing existing floors on pot size;

- Most advisers said that, contrary to expectations, there had not been an increase in 'insistent' clients. (This question was asked as there had been concerns that clients might insist on transferring even against advice in order to recoup upfront advice costs, now that contingent charging had been banned)

- Some had adjusted their process to embed (lower cost) 'abridged' advice as part of the process, avoiding the need for unsuitable cases to proceed to (higher cost) full advice; others said their existing triage process already 'weeded out' unsuitable cases, so the abridged advice rule change made little difference; we discuss the role of 'abridged' advice more fully below.
- We asked our sample to tell us how much they now charged for DB transfer advice following the abolition of 'contingent charging'. Replies revealed a wide range of charging structures:
- Roughly 1 in 5 charged a straight percentage of the CETV value, in some cases with an overall cap; the percentage charge mostly ranged from 1% to 3%; in some cases the %

[6] Advisers were however allowed a three month 'grace period' to continue to charge on a contingent basis if the advice process had started before 1st October.

charge was higher on the first slice and then lower on further slices; some respondents to our survey had a pure 'fixed fee' model, with charges quoted ranging from £3,000 to £10,000, though Aviva report that their research has found fees up to £20,000;

- Many had a 'hybrid model', for example charging a fixed fee of £3,000-£4,000 plus 1% of the CETV;

- In some cases, any charge for abridged advice (see later) would be knocked off the final charge for full advice as much of the work needed for full advice had already been done if someone took abridged advice.

In theory, these very large variations in charges would suggest that clients could benefit considerably if they were to shop around. However, the shortage of supply of advisers willing to provide this type of advice at all may mean that the scope for shopping around may be limited, whilst some advisers will in any case only provide DB transfer advice to existing clients.

v) Recent regulatory changes – 'abridged advice'

As part of a package of reforms which banned contingent charging, the FCA set out a formal framework for offering 'abridged advice'. Many advisers already operated a variety of 'triage' processes ranging from getting clients to watch generic videos to an initial informal conversation based on a high-level fact-find. Under the new regime, advisers can offer a light-touch initial 'abridged' advice session, for which they can charge, and which can help to weed out those for whom a transfer would clearly not be suitable without them needing to meet the costs of full advice.

In our sample slightly more than two thirds said that they now offer 'abridged advice' though, as noted earlier, many already had some form of 'triage' process. However, when we asked for more detail on how the 'abridged' advice process was working, the replies revealed a huge variation in the extent to which abridged advice was central to the process.

Key points were:

- The proportion of clients going via abridged advice ranged from zero to 100%; in other words, some advisers are willing to use the process but have not found it appropriate yet, but others put *everyone* through abridged advice first;

- Examples of comments from those who were making limited use of abridged advice include:
    - "We only use abridged advice for clients we do not know well";
    - "The customer will probably either be disappointed if the outcome is not to transfer, or slightly annoyed at the waste of time if the outcome is unclear and a move to full advice suggested"

- Where advisers charge for abridged advice, they deduct the cost from the full advice fee if full advice is taken. Our survey suggests that costs for abridged advice can range from £500 to £2000, with typical charges in the range £750-£1000; in a minority of cases, abridged advice is offered for free to avoid charging for a recommendation not to transfer.

We asked how well abridged advice was working and there was a very wide range of responses. Out of 65 responses, around a quarter were clearly positive about the process. Of those who were critical or had concerns, key points included:

- Where abridged advice is voluntary, take-up can be low and clients don't always understand how it works;
- The cost to the adviser of giving abridged advice is often not covered by the amount they feel able to charge;

- It can be 'neither one thing nor the other' – after generic information, clients who want to proceed then want full advice;
- If there is a prior triage phase then abridged advice may not add much because those that get to this stage are seldom a 'clear no';

We did however find that around 1 in 3 advisers had decided not to offer abridged advice. Reasons given included:

- Not seen to offer value for money to client
- Triage already does this job
- The work involved often not covered by the charge which can be levied; one respondent estimated that 75% of the cost of full advice is needed for abridged advice;
- Risk that regulators may regulate in 'hindsight' and find advisers have failed even at the 'abridged' advice stage
- Advice should be holistic, not just 'transfer advice', so this doesn't work with abridged advice purely on the transfer;

vi) Recent regulatory changes – benchmarking against a workplace pension

Initial regulatory concerns around DB transfer advice focused on whether or not the advice to transfer was suitable in and of itself. But more recently there has been a focus on where the transferred funds will end up. In some cases, there may be members who could be better off with a transfer, but not if the destination involves high ongoing charges or poor investment returns. In response to this the FCA now requires advisers to 'benchmark' a proposed transfer destination against transferring to a (charge-capped) workplace pension and, if that is not the chosen destination, to justify why not.

We asked advisers what impact this change had had on the advice which they gave, and around two thirds said it had made no difference at all. But around one in seven said it had led them to look more actively for lower cost funds or, in a small minority of cases, to recommend a transfer to a workplace pension. Additional comments included:

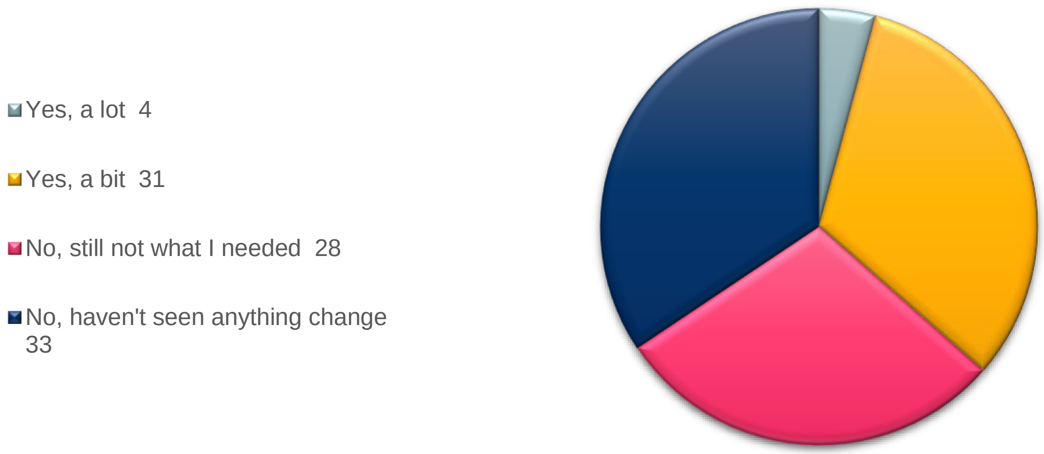
- A concern that 'cheapest may not always be best'
- Potential challenge with ongoing monitoring if funds are transferred to a workplace scheme
- Not really relevant to 'at retirement' clients
- Workplace pension may not offer range of investments or level of control which may be desirable

vii) Information provided to advisers

The rights which a client has in their DB scheme(s) can be highly complex with different 'tranches' built up over different periods of service, subject to different rules on revaluation and indexation and so forth. A common complaint of advisers is the difficulty in obtaining comprehensive information from schemes about member benefits. In response there have been various initiatives designed to standardise the information supplied by schemes, so we asked advisers how far these had helped. The replies are shown below:

Around 1 in 3 advisers said that these changes had improved matters 'a bit', but a similar number said they had not noticed any change at all, and a similar number said that they were still not getting what they need. It seems that there is still much to be done in terms of ensuring that advisers have all the information that they need about DB member benefits.

There have been several initiatives to encourage DB schemes to provide information to advisers in a template or more standardised form. Have these changes improved the information you get on scheme benefits?



viii) General Observations

At the end of our survey we gave advisers still active in the market chance to 'let off steam' with any general observations they wished to make about the DB transfer market. Not surprisingly, these comments echoed many of the answers to the specific questions that we have covered above, but key themes were:

- Supply of transfer advice will continue to contract; could end up with 'specialist' DB transfer advisers dominating, who may not look at 'holistic' picture and/or with fewer independent advisers remaining in the market;
- The increasing risk that people will simply not be able to obtain advice and that those for whom a transfer would be the right outcome will miss out;
- It is increasingly becoming a market for the wealthier client only;
- The need for stability in the regulatory position to give confidence to advisors and PI insurers that the 'goalposts will not be moved' after advice has been given;
- The balance between the rewards of staying in the market and the risks is tilting in the wrong direction
- Transfer advice should be focused on at / approaching retirement

04 Scheme-appointed IFAs

We now present the results of in-depth research into an important and growing section of the market for advice on DB transfers, namely scheme-appointed IFAs. This may be an initiative of the trustees or of the sponsoring employer or a joint initiative, but the idea is to provide members with access to a reputable advice firm which will provide impartial advice on DB transfers and often other wider matters.

There are various models for scheme appointments, such as whether the scheme appoints a single firm or a panel, whether the scheme subsidises the cost of advice in whole or in part, whether members have unlimited access to advice or can only access it on a one-off basis etc., and the 'right' model will vary according to the nature of the scheme and its members.

For the purposes of this research, we undertook seven in-depth interviews with IFA firms who have multiple scheme appointments and who described their experiences and their views on how the market is evolving. They also provided quantitative data on the scale of their work in this sector.

a) Market covered by the seven firms

The seven firms who took part in the research all have multiple appointments to DB pension schemes to provide advice to members. The firms vary in the extent of their involvement in the market, with the smallest working across around 10 schemes, and the largest working with more than 50. Our focus was on firms who provide 'business as usual' advice to members, though many of these firms also provide advice in support of one-off 'exercises' such as the offer of a Pension Increase Exchange.

Together, these firms provided DB transfer advice in the year to March 2021 to nearly 10,000 members across more than 200 DB pension schemes, though one noted that volumes were substantially down in that year because of the Pandemic. Whilst we do not yet have industry-wide figures on market volumes in 2020/21, as a broad estimate these firms probably advised roughly 1 in 4 of all members who took DB transfer advice last year.[7] All seven of the firms said that demand from schemes was increasing, both for 'business as usual' appointments and for advice support for 'liability management' one-off exercises.

Because of the costs associated with setting up a structure of this sort, it will tend to be larger schemes who appoint advisers (though not exclusively), and the appointments were a mixture of those made by trustees and those led by the pension scheme sponsor.

b) Key themes of qualitative research

We asked these seven firms about how they work with the different DB schemes they are involved with, what sort of conversations they are currently having with clients, what impact recent

[7] FCA data suggests roughly 62,000 members took DB transfer advice in 2019/20, and data from the schemes administered by LCP suggests that this number is likely to have fallen significantly during Lockdown. On that basis we assume that 10,000 members probably represents about a quarter of all DB transfer advice provided.

regulatory change has had, and for any wider observations. The key themes from the interviews are summarised below:

- **Theme 1: No single model of working with a scheme**

There is clearly very considerable variation in how appointed advisers work with schemes, and the exact arrangements are tailored both to the specific features of the scheme and, to some measure, the extent to which the scheme is willing to subsidise some or all of the costs of the advice.

Key variables included:

- Whether (and how much) members are charged for advice – in general, as a minimum a scheme would cover the one-off cost of setting up a relationship with an adviser, bringing the adviser up to speed with the details of the scheme, putting in place dedicated communications channels etc.; this subsidy alone allows advisers to charge less per member for transfer advice than their 'high street' counterparts; however, beyond this, there was great variation in how members were charged. Permutations included:

    - Advice entirely free to the member;
    - Advice costs partially subsidised, but some member contribution;
    - 'Abridged' advice offered for free but members pay if they go on to full advice;
    - Members pay full marginal cost of advice

  The majority of the firms interviewed said that more than 80% of schemes fully subsidised the cost of advice but some felt that the balance was shifting towards expecting a member contribution. In some cases, they felt that schemes were increasingly appointing IFAs as a 'hygiene factor' or a defence against future regulatory challenge, but wanted to do so at minimum cost, leaving members to pay the full marginal cost of advice.

  One firm did point out to us that a sponsor who is unwilling to pay to subsidise advice costs may be making a 'false economy'. There is clear evidence that take-up of advice is much lower where members are paying the full marginal cost, and as a result, transfer volumes are expected to be lower. Where a sponsor reduces the cost of advice they may see more transfer activity and, because of the 'prudent' way in which CETVs are calculated this may improve the funding position of the scheme by far more than the cost of subsidising advice.

- Ongoing 'due diligence' of appointed firms – as well as satisfying themselves that the appointed IFA(s) are up to standard at the time of appointment, schemes are increasingly expected to do ongoing due diligence; in practice this can vary considerably; examples included:

    - Requesting routine Management Information on use of the service
    - Monitoring the financial robustness of the advice firm
    - Requiring advice firms to have robust quality checks, including employing their own independent file checking
    - Contracting directly with a third party to oversee the advice process and ensure that proper processes are followed;

- The scope of the advice offer: Whether advice is 'at retirement' only or available more generally, whether it is purely 'transfer advice' or covers broader financial advice etc.;

- How advice firms approach 'insistent' clients: although there is a legal requirement to take advice on transfers over £30k, this requirement is satisfied even if the advice is *not* to transfer; in principle a member can still transfer on an 'insistent' basis in such circumstances; in practice however, most of the firms sampled said they would not handle such cases; instead most offered a 'review' / appeal process for those who felt that the advice not to transfer was incorrect and in some cases this would identify new information or issues which could result in the advice being changed.

- How advice firms meet the requirement to hold PI insurance: in the previous section we noted that many 'high street' advice firms had left the market or were considering doing so because of issues around the cost and availability of PI insurance; scheme-appointed IFAs are also required to have PI cover, but few seemed to have had major difficulties in this space; some had come up with structures which (in effect) allowed them to self-insure, some had very little 'back book' to worry PI insurers, whilst others simply worked very closely with their PI insurer to offer reassurance; it is fair to say that PI insurers may have more confidence in a large advice firm with appointments across dozens of DB pension schemes, as the level of scrutiny of the quality of advice is likely to be greater than for a 'high street' advice firm undertaking a few cases per year.

Theme 2: Impact of recent regulatory change

Just as 'high street' advice firms have had to deal with changes such as the ban on contingent charging, the introduction of abridged advice and the requirement to benchmark against a workplace pension, so scheme-appointed IFAs have had to make adjustments. One key difference is that few, if any, of these firms historically charged on a contingent basis, so the direct impact of that change has been limited. Key observations from the seven firms on major recent changes are:

- There was general (though not universal) scepticism about the value of a Workplace Pension Scheme (WPS) as a benchmark: several of the firms said that they would seldom transfer to a WPS; a number said that the potential cost advantage of a WPS was not a significant factor because, as large advice firms, they could negotiate bulk discounts on fees for transferred funds[8]; several pointed out that for those considering a transfer 'at retirement' there might be no readily available WPS; others were concerned that the WPS offering might be unsuitable because of limited investment options or because of the challenge of providing ongoing advice and scrutiny where investment decisions (such as the mix of the default fund) was not under the control of the adviser; post-retirement ('decumulation') options were also seen as being limited in workplace pensions, with one adviser concerned about charging once for a transfer to a WPS and then charging again for advising on moving the money into a more suitable decumulation vehicle only a year or two later;

- On 'abridged advice', attitudes varied considerably, though most were not especially positive – several of the firms surveyed already had elaborate 'triage' processes and felt that these already achieved much that could be achieved through abridged advice; some however felt that they had to offer it because of demand from trustees; a few firms felt that the concept of 'abridged advice' was unhelpful because it related purely to the decision around whether or not to transfer, whereas they wanted to provide holistic advice; but some thought it could have advantages such as allowing indicative advice to be given based on a recent transfer value without starting the 'clock running' for advice on a new CETV quote;

- Abolition of contingent charging in wider market had knock-on effects: even though these firms did not generally charge on a contingent basis in the first place, the fact that high street advice

[8] This may be an area where the new regulatory requirement has a different impact between a small IFA who may not have the same commercial leverage and where a WPS may have a big cost advantage and a large scheme-appointed IFA who may be able to negotiate better terms on transferred funds.

firms were now prevented from doing so had had an impact on them; on the one hand, the subsidised cost of using a scheme appointed adviser now made them more attractive relative to high street advisers charging full cost as an up-front fee; however, some schemes felt that their competitors were responding to the new charging regime by moving 'up market' and cherry-picking larger transfer values to advise on; this observation is consistent with the results of our other survey where more advisers said they were now imposing minimum pot size limits for advice;

- **Theme 3: Scheme-appointed IFAs give *different* advice**

One of the most striking results of our research is that members who are advised by a scheme-appointed IFA are much less likely to be advised to transfer than those who source their own financial adviser.

To be more precise, across the seven firms surveyed, it would be typical for only 20-25% of members who approached the firm to be recommended to transfer[9]. By contrast, the latest FCA market data for the period October 2018 to March 2020 suggested that, across the market as a whole, around 57% of those who 'received advice' were recommended to transfer.

We need to be slightly careful about definitions here, as our survey includes the fact that several of the firms in our sample had extensive 'triage' processes which helped to 'weed out' obviously unsuitable cases. By contrast the FCA figures are including in their sample only those who get as far as 'receiving advice'. Nonetheless, it seems pretty clear that scheme-appointed firms are much less likely to recommend a transfer[10].

Whilst we cannot be certain of the reasons for these apparently large differences, we would make a few observations:

- Prior to the ban on contingent charging, the majority of 'high street' IFAs advised on this basis, and the FCA data cited above entirely pre-dates the change in charging rules; it is possible therefore that any bias arising from contingent charging has now been removed and the gap between 'high street' advice and scheme-appointed IFA advice may be smaller in future;

- Advice firms appointed by schemes are almost invariably 'independent' in the sense that any recommendations on transferred funds will be across the market; high street advice firms may well be 'restricted', such as those which wholly or largely recommend use of their own in-house funds for transferred investments; if 'contingent charging' for advice was thought to lead to potential biases towards recommending a transfer, having the potential for post-transfer revenue via use of in-house funds could presumably still represent a possible reason why a high street adviser is more likely to recommend a transfer than a scheme-appointed IFA;
- Almost by definition, scheme-appointed IFAs are subject to a high level of scrutiny and oversight; they are generally appointed following a competitive process, are subject to ongoing due diligence and have to maintain a reputation in the marketplace in order to retain and attract appointments; they are therefore likely to be particularly wary of making inappropriate recommendations to transfer which could lead to complaints and/or demands for compensation.

[9] Firms were keen to point out that these were average figures and that transfer recommendation rates tended to vary considerably according to the nature of the scheme and its membership.
[10] Anecdotally, this seems consistent with examples where external advisers have been accused of 'factory-gating' and touting for business partly on the basis that there's no point using the scheme-appointed advice firm as they are unlikely to recommend a transfer.

- ## Theme 4: Consumer behaviour and market trends

As part of our qualitative research, we asked in more detail about the current state of the transfer market and any recent market trends. Some key points were:

- More 'partial' transfers – transferring partial DB pension rights can allow a member to secure a guaranteed minimum income from state benefits and retained DB pension whilst enjoying the flexibility of a transferred pot; the firms we interviewed said that growing numbers of scheme were now offering or considering offering such an option;

- Use of annuities on transferred funds – it is tempting to assume that a DB transfer is all about 'flexibility' and that transferred funds will therefore generally be held in some sort of flexible DC pension arrangement; however, several firms told us that annuities are an important part of the use for transferred funds; this could be:

    - As a way of funding early retirement, perhaps through buying a fixed term annuity to cover the period between the transfer and state pension age;
    - As a way of securing core guaranteed income, especially where a partial transfer from the DB pension is not available;
    - For those in ill health, who may be able to secure a particularly attractive annuity rate compared with their expected benefits if they remained in the DB scheme;

- Desire to support the next generation – whilst there has always been a 'bequest motive' around DB transfers, one firm told us that they see more parents who are aware that their children may specifically have relatively poor *pension* provision; a DB transfer was seen as a way of potentially boosting the next generation's pension provision with any unspent balances available to them at death;

05 Discussion and Conclusions

The DB transfer market has undergone huge change in the six years since Pension Freedoms were introduced. The legal requirement to obtain advice on transfers over £30,000 was designed to ensure that members give proper weight to the guarantees which they were considering giving up. But this regulatory model is based on the assumption that high quality, impartial and affordable advice is readily available.

This paper has shown that this assumption – which may always have been open to challenge - may no longer be safe.

In particular, the supply of 'high street' advisers willing and able to provide advice on DB transfers has halved in just three years, and our survey suggests that this contraction is set to go further. At the same time, the cost of advice has risen (notably because of rising PI insurance costs) and members are expected to fund that advice up front now that 'contingent charging' has been abolished. As a result, fewer members are seeking transfer values from their scheme and fewer still are going ahead with transfers, except amongst those with the largest pots.

'High street' advisers will continue to be the primary source of help for many who are considering a DB transfer. There is much high-quality advice provided on the high street, professionally serving the needs of thousands each year. However, the rising costs of PI insurance and the tightening of regulation means the supply of this expert advice is at risk. Many DB pension clients could be isolated. This would be in the interests of no one.

A partial solution to this 'transfer advice gap' is for schemes to appoint their own advisers for members to use. At the very least this can allow members to access more affordable advice. The initial and ongoing due diligence undertaken by the scheme should also provide reassurance as to the quality of advice which is being provided. This is not to say – of course – that there are not plenty of high quality 'high street' advisers still left in the market. But the member has very little way of separating those advisers from others still active in the market whose standards may still leave something to be desired.

The scheme-appointed market is continuing to grow and this will in part help to reduce the advice gap. But there is no doubt that more needs to be done to revive the wider advice market in this space. The high street advisers who responded to our survey were clear that two things would need to change for them to return to (or even remain in) the market. PI insurance would need to become more affordable and predictable, and the approach of regulators would need to be less hostile. There is no obvious sign that either of these conditions is likely to be met in the near future.

As a result, it seems increasingly likely that pressure will grow on schemes to do more to step into the breach. We have noted that there are many different models of working with an advice firm to support members and that the cost to schemes or sponsors can be controlled in a number of different ways[11]. The fact that growing numbers of schemes are taking this approach should also

[11] There are also new models being brought forward where a scheme can point members towards a brokerage service which shares details with selected IFAs on a case-by-case basis.

help to reduce nervousness among some trustees that getting involved in this area is an unnecessarily risky thing to do.

As we have argued elsewhere, it is increasingly apparent that trustees who do *not* act to help members to source suitable advice about a potential pension transfer are also taking a risk. Given the difficulties for members in sourcing their own affordable and dependable advice, especially where they do not have an existing relationship with a financial adviser, members may increasingly turn to their scheme for help. Where schemes do not act and members end up with poor outcomes, members may increasingly ask questions of schemes and employers as to why more help was not provided, particularly in the context of the imminent new anti-scam regulations expected from DWP, which will put a greater onus on the trustees of schemes and may have a further significant impact on this market.

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