The Money Charity Response – FCA Consultation Paper 19/25 on Pension Transfer Advice (October 2019)

The Money Charity is a financial capability charity whose vision is to empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives.[1]

We welcome the opportunity to respond to Consultation Paper 19/25 on Pension transfer advice: contingent charging and other proposed changes.

In this response, we set out our Key Points, make some overall comments on the issue then answer selected questions posed in the Consultation Paper.

[1] See box on back page.

Key Points

1. We agree with the proposed ban on contingent charging for DB transfer advice (Q2). The FCA should also consider the potential conflict of interest arising when advisers are associated with fund management firms, in which cases the incentive to give poor transfer advice may persist even in the absence of contingent charging (Q2).

2. We are not convinced by the argument for carve-outs on the grounds of "serious ill-health" or "serious financial hardship" (Q4) which seem too much like invitations to evasion.

3. We think that any carve-outs would need to be closely supervised and enforced by the FCA. (Q4)

4. We are sympathetic to the idea of 'scheme pays for advice' (Q9), though we think it has a significant moral hazard. It would need to be accompanied by a test that there is a reasonable objective expectation that taking advice would make the consumer better off in the longer term. There would need to be additional FCA supervision and enforcement to ensure this provision is not abused.

5. We think there should be mandatory independent guidance (Q10) prior to pension transfers. Government, FCA and MAPS should consider how this should be funded, with a cost sharing model analogous to Fair Share with debt advice being one possible model.

6. To help consumers compare workplace pensions with other possibilities (SIPPs, stocks and shares ISAs etc) FCA should consider encouraging the development of an online pension comparison tool (Q13).

7. Major improvements are needed in communications with consumers about fees, charges and transfer recommendations (Qs 14 & 15) and checking that consumers understand these client communications (Q17). Because of the high risk of poor outcomes for DB transfers, FCA should require firms to include a "health warning" on any DB transfer advice, analogous to the health warnings on cigarette packets (Q17).

8. The FCA's findings of large-scale inappropriate DB transfer advice and excessive adviser charges indicate that the existing regulatory framework is insufficient and/or has not been properly enforced. As far as we can see from FCA's website, none of the firms or individuals responsible for the consumer harm described in CP19/25 have been subject to FCA sanction, either fine, public censure or de-authorisation, despite breaking FCA Principles and rules as they are currently written. The FCA should:

- Apply penalties to firms and individuals that have inflicted serious harm on consumers taking DB transfer advice.

- Amend its regulatory framework by introducing a Duty of Care requiring financial service firms to avoid reasonably foreseeable consumer harm and act in the best interests of the customer.

9. In addition to enforcement action, there is a need for consumers who have received inappropriate pension transfer advice to be compensated for the results of poor advice. In our response we ask whether the FCA is taking action to ensure that consumers are compensated for the harm that has already occurred? (Q14)

Overall Comments

The findings of CP19/25 are alarming. The FCA has found that:

- There is a strong bias to recommend DB pension transfer, with a 69% conversion rate, even though the FCA believes "most consumers will be best advised not to transfer". (Page 14)
- Firms charge 2-3% of the transfer value for making a transfer, which results in charges of £7,000 to £10,500 on an average transfer value of £350,000. (Page 15)
- Many firms get consumers to sign up to ongoing advice contracts which cost a significant proportion of the monthly income value of the fund. When combined with ongoing product charges, fees can take as much as 61% of the equivalent DB monthly income of the pension being transferred (eg £730 per month out of a pension income value of £1,200 per month). (Page 26)

This level of charging is not just unfair – it is predatory. The effect will be that over the course of a typical retirement, a large part of the value of the pension pot will disappear in fees and charges, effectively converted into income for the firms concerned rather than for the consumer. At the same time, the consumer has lost the guaranteed value of the DB pension, with its longevity insurance, and taken on the investment risk of the pension investments.

To give this advice and to make these levels of charges cannot be consistent with FCA Principles and rules as they are currently written. However, we do not see from published sources, including the list of fines on the FCA website,[2] any sign that individual managers or firms have been sanctioned for mis-advising DB transfer customers.

In our view, the individuals and firms responsible should be held to account, using the FCA's powers to fine, censure and de-authorise. We call on the FCA to take this action in all cases involving severe consumer harm.

[2] https://www.fca.org.uk/news/news-stories/2019-fines

In addition, we call upon the FCA to strengthen its regulatory framework to embed consumer protection as the overarching requirement on firms. As we have argued elsewhere,[3] this can be done by amending the FCA Principles to introduce a Duty of Care to avoid reasonably foreseeable consumer harm and to act in the customer's best interests.

Answers to selected consultation questions

Q1: Do you have any comments on the intended commencement dates of our proposals or the draft Handbook text set out in Appendix 1?

We agree that the proposals should come into force as soon as possible and the schedule on page 7 of CP19/25 seems reasonable.

Q2: Do you agree that a ban on contingent charging is likely to be an effective in reducing the numbers of consumers receiving unsuitable advice? If not, how would you suggest we effectively reduce the numbers of consumers receiving unsuitable advice? Do you think we should address the conflict of interest issues differently?

We agree with the ban on contingent charging, which we think may reduce the number of consumers receiving unsuitable advice.

However, we think the practices described in CP19/25 show there is a deeper problem. As we say in our overall comments, the misguidance that has taken place in many cases of DB transfer advice must have been in breach of existing FCA rules on treating customers fairly. The fact that firms have gone ahead and given bad advice despite TCF[4] shows that TCF in its current form is not sufficient to prevent consumer harm. In our view, two further things need to happen:

- Sanctions need to be imposed against managers and other individuals who have been responsible for giving incorrect advice.
- The FCA Principles should be amended to introduce a formal Duty of Care to avoid reasonably foreseeable consumer harm and to act in the best interests of customers.

The DB advice fiasco is the latest in a series of cases in which the financial services sector has been found to be inflicting harm on large groups of consumers. The FCA has been proceeding sequentially to deal with these situations and we welcome this as far as it goes, but it should by now be clear that there is a deeper problem. The culture of the financial services industry has not shifted to place consumer value at its heart; rather, the

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[3] In our response to the Duty of Care consultation.
[4] The requirement to Treat Customers Fairly: https://www.fca.org.uk/firms/fair-treatment-customers

industry continues create products and services that inflict harm, either deliberately or incidentally. If this is to stop, both regulation and enforcement need to change.

We have made this point to HM Treasury in our response to HMT's Financial Services Future Regulatory Framework Review, a copy of which can be viewed on our website.[5]

There is an additional conflict of interest the FCA should consider: where advisers or adviser firms are associated with fund management firms. In these cases, even without contingent charging, an incentive may persist to give inappropriate transfer advice, with firms expecting to earn back the cost of advice through other charges, such as platform and fund management charges.

Q4: Do you agree with the scope of the proposed carve-out [from non-contingent charging] and our proposals for monitoring its use? If not, how would you change it?

For the following reasons, we are not convinced by the arguments made in CP19/25[6] in favour of carve-outs from non-contingent charging for advisers of people with serious ill-health or experiencing serious financial hardship:

- "Life expectancy less than 75" is hard to certify with authority and potentially means a lifespan of 20 years beyond the qualifying age for the pension freedoms, which is long enough for a person to need the security of a DB pension.
- There may also be survivor rights to DB pensions which could be liquidated by a pension transfer, affecting spouses for decades after the transfer.
- "Serious financial hardship" is an even more elastic concept than "serious ill health" and may turn into a demand by creditors for people in financial difficulty to liquidate their DB pensions in order to pay their debts. For example, we could see firms implementing the FCA's persistent credit card debt rules try to avoid forbearance by telling customers they need to liquidate their DB pensions. This would be highly undesirable.
- Liquidating a DB pension in cases of severe financial hardship would involve shifting the hardship from the present to a time in the future when a person might need their DB pension to avoid living below the poverty line.
- Both the "serious illness" and "serious financial hardship" provisions are invitations to evasion, and we expect the advice industry to be creative in using these provisions to maintain contingent charging.

If the FCA decides to go ahead with these carve-outs it would need to substantially intensify its supervision and enforcement work, including being prepared to sanction

[5] https://themoneycharity.org.uk/work/policy/consultation-responses/
[6] Pages 17-18.

individuals who break the rules, to deter others from attempting to do the same. We do not see this yet in the FCA's enforcement processes.

Q9: What are your views on the potential for 'scheme pays', changes to the pension advice allowance and partial transfers to improve the quality of advice or address conflicts of interest adequately, or both?

Because of the advice gap, we are sympathetic to the idea of enabling consumers to use scheme funds to access pensions advice, including transfer advice. However, there is considerable moral hazard in this approach, as the findings of CP19/25 have shown. Any such access should be subject to a test that there is a reasonable objective expectation[7] that taking advice will make the consumer better off in the longer term, ie that reinvestment of pension investments would produce a return to the consumer greater than the cost of the advice. If FCA were to introduce this provision, it would need to step up its supervision and enforcement to make sure the provision provides genuine benefits to consumers.

Regarding the proposal for partial transfers of DB pensions, we are not sure how a clear line would be drawn between "essential" and "discretionary" income. For most small and medium DB pensions there is unlikely to be a margin above "essential" income. The concept may apply to some large DB pensions, but we think would be challenging to implement. Again, it would require additional FCA supervision and enforcement to make sure it is not misused.

Q10: Given the timeframes that apply to guaranteed transfer values, what are your views on the need to provide guidance to members considering a pension transfer? Should guidance be mandatory and, if so, who should deliver it?

As a financial capability charity, we believe there is a need for enhanced financial education and pensions advice beginning at school and continuing through working life and into retirement. We have submitted on this to the Money and Pensions Service.[8] One of the opportunities is to use pension auto-enrolment to establish a system of automatic pensions advice within the workplace, part of which would involve informing people about the values of DC and DB pensions, the associated rights and risks, the pension freedoms and particular hazards (such as inappropriate transfer) to look out for. Pensions are

[7] i.e. an expectation justified by objective facts, not simply an expectation in the mind of the consumer or adviser. Most small pension pots will have difficulty passing this test, because of the scale of adviser charges. But there may be some medium and larger-sized pension pots where the test could truthfully be passed. We agree with the FCA's assessment that, generally, people should not switch out of DB pensions.

[8] The Money Charity Response to the MAPS Listening Document, June 2019. Available at: https://themoneycharity.org.uk/work/policy/consultation-responses/

complex and it is easy even for relatively well-informed people to make mistakes in considering their future pension provision.

In the case of pension transfers, the risks are so severe that a requirement for independent unbiased advice is justified. MAPS will need to play a key role in this and, if more resources are needed, Government should respond accordingly. One possibility would be a cost sharing model (analogous to Fair Share with debt advice) whereby the firms benefiting from transferred pensions share the cost of advice, with adviser charges being regulated by MAPS to ensure value for money.

The UK has made policy choices over decades to have a complex and multi-faceted pension system with wide disparities in outcomes for individuals. As a society we could have decided to have a simpler pension system with more certain outcomes, as some jurisdictions elsewhere in the world have chosen to do. As a country we made a different choice and need to respond to the consequences, which include making sure that people can get the advice they need, especially in the post-pension freedom environment.

Q 12: Do you agree that our proposed abridged advice service will enable firms to provide a low-cost alternative to full advice for those consumers that need it? If not, how would you suggest we amend it?

The proposals on pages 24-25 of CP19/25 seem to make sense as a way for firms to provide relatively cheap advice not to transfer DB pensions. As with other aspects of the FCA's proposals, these will need effective enforcement to make sure they are used in the way the FCA intends, rather than, for example, as a bridge to full advice and an unsuitable DB transfer.

Because we have not been convinced by the argument for financial and health carve-outs (Q4) we would not see abridged advice being used to support such carve-outs in the way suggested in paragraph 3.65.

Q13: Do you agree that requiring firms to demonstrate that an alternative scheme is more suitable than a WPS is the most effective way to reduce the numbers of consumers being transferred into schemes that do not meet their needs and limit unnecessary charges paid? If not, how would you suggest we address this issue more effectively?

We agree that a workplace pension scheme (WPS), if available, should be the first option to be considered as the destination for transferred funds. However, the complexity of the comparison between the WPS and the adviser's proposed scheme is likely to challenge all but the most financially literate pension customers. Any such provision will need to be coupled with enhanced FCA supervision and sanctions for wrongdoing. Requiring advisers to create a document comparing offers will help provide an audit trail, but

success will depend on them fearing the consequences of being caught and sanctioned for giving inappropriate advice.

Missing from the market at present is an online pension comparison tool, ie a tool consumers could use to compare an existing WPS with other options such as a SIPP or stocks and shares ISA. FCA could consider encouraging the development of such a tool.

Q14: Do you agree with our proposals for requiring the disclosure of charges in engagement letters? If not, please indicate what alternatives should be considered.

Again, we find the FCA's finding under this heading alarming: 61.7% of files were non-compliant on disclosures and communications with clients.[9] To the best of our knowledge no advisers have been sanctioned for these failings.

We agree that charges should be disclosed in full in advance and in a standard form the ordinary consumer can understand, and covering the advice options set out in paragraph 5.5 of CP19/25. Regarding any difference between first-year charges and subsequent year charges (final bullet point of paragraph 5.5), we think a provision should be added requiring that subsequent year charges are given equal prominence with first-year charges and are explained in similarly accessible language.

Such communications should be required to pass a suitable consumer comprehension test, to make sure they are appropriate for and understood by the target consumer population.

A further question arises at this point: given the FCA's findings of inappropriate DB pension transfer advice (Q2), non-compliant disclosures (Q14) and non-compliant suitability reports (Q15) what action is the FCA taking to ensure that consumers are compensated for the poor advice they have received and losses incurred? Presumably the FCA is initiating a process to remedy the harm that has already occurred?

Q15: Do you agree with our proposals to introduce a one-page summary at the front of a suitability report? If not, please indicate what alternatives should be considered to improve disclosures to consumers.

Once more, the FCA findings under this heading reveal multiple rule breaches:[10]

- Only 29.2% of client communications compliant.
- Unclear recommendations.
- Benefits over-emphasised; risks downplayed.
- Charges not presented clearly.

[9] CP19/25, page 29.
[10] CP19/25, page 30.

- Ongoing pension advice frequently misrepresented as a mandatory feature of the pension transfer package.
- Recommendations to invest in schemes where the charges are higher than future investment returns.

We agree with the proposal to introduce a one-page summary, but we note that while the FCA Behavioural Economics and Design Unit is reported to have reviewed the layout of the examples in Appendix 1,[11] CP19/25 does not say that the one-page summary has actually been tested with consumers. It is known from previous FCA work (eg the testing of overdraft explanations) that it is challenging to produce financial comparisons that the majority of consumers understand. It is easy for professionals working in the field to make over-optimistic assumptions, based on our greater familiarity with the jargon.

Looking at the Annex 1 examples, there are several terms which may cause problems for consumer understanding:

- "Defined contribution pension".
- "Advice charges"
- "Product charges" (what is a product?)
- Use of negative numbers.
- What does "variable" mean in relation to future pension income?
- Equating the terms "current value of my pension income" with "current scheme income" in the percentage calculation.
- The percentage calculation.

Also, advice and product charges are shown only for the first year, so it would be easy to show "0" values by deferring charges. As with the proposed engagement letter (Q14), subsequent year charges need to be covered too.

Against this, a transferring consumer is being offered a transfer sum of, say, £300,000 which, given hyperbolic discounting and the usual behavioural biases may be hard to resist, even if faced with substantial charges.

We agree with the idea of the one-page summary, which we think would help provide an audit trail, but we think further design work on the communications is needed, involving actual consumer testing.

Further, looking again at the examples, which we understand to be based on FCA's file reviews, there must be a point where the regulator says that a certain level of charging is unacceptable for the fund values in question.

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[11] CP19/25, page 31.

Taking Example A in Annex 1,[12] which shows monthly advice charges of £250 plus monthly product charges of £438 on a pension scheme that is generating only £833 per month. This is not just unfair, but predatory pricing.

We suggest that in addition to the Duty of Care we urged in answer to Question 2, the FCA introduce a principle that charges must be reasonable in relation to the value of a given investment and that where an adviser is found to apply charges that are clearly excessive by any normal standard of fairness, they should be de-authorised.

Q16: Do you agree with our proposal to require that suitability reports are always provided before a transaction is undertaken?

Yes.

Q17: Do you agree with our approach to checking that the client has a reasonable understanding of the risks of proceeding? If not, what alternative approaches might achieve the same outcome?

We broadly agree with the proposals set out in paragraphs 5.21 to 5.24 (page 33) of CP19/25, i.e. that firms should gather and keep evidence that the client understands the risks of proceeding with a pension transfer. However, in our experience, discussions of pensions and investments tend quickly to move into areas that ordinary consumers find hard to understand, due to jargon and the complexity of markets and products. It will be easy for the message to be lost in static.

For this reason, we think that firms should be required to give a health warning on DB transfers (similar to health warnings on cigarette packets) along the lines of “The UK’s financial regulator, the FCA, warns that in most cases DB transfers are inadvisable, due to the risks and costs the consumer is taking on and the loss of guaranteed lifetime pension rights.” If the adviser makes a recommendation to transfer, they should describe why the case in question is an exception and be able to prove that the consumer understands the reasons for this and the risks and costs they are taking on.

Q18: Do you agree with our proposals to introduce CPD requirements for PTSs? If not, what other approaches could be used to help PTSs maintain knowledge?

Whether CPD is effective depends entirely on the content and philosophy of the CPD. We suggest that the FCA specifies that this additional CPD includes the requirements for treating customers fairly, fair pricing of financial services and avoidance of consumer harm.

[12] CP19/25, page 48.

Q22: Do you agree with our proposed changes to the pension transfer definition?

From the explanation given in CP19/25, we do not understand the argument for removing pension schemes with flexible benefits from the transfer definition. From the evidence in CP19/25, when transferring a pension with flexible benefits there appears to be a significant risk of excessive fees and charges being applied, as well as a risk that the recommended investments may be less suitable for the consumer (but more remunerative for the adviser). For this reason, we think such transfers should be covered by the requirements for suitability reports, consumer understanding and any new rules (such as a fair pricing rule) that the FCA might decide to introduce.

(end)

The Money Charity is the UK's financial capability charity providing education, information, advice and guidance to all.

We believe that everyone achieves financial wellbeing by managing money well. We empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.

We do this by developing and delivering products and services which provide education, information and advice on money matters for those in the workplace, in our communities, and in education, as well as through influencing and supporting others to promote financial capability and financial wellbeing through consultancy, policy, research and media work.

We have a 'can-do' attitude, finding solutions to meet the needs of our clients, partners, funders and stakeholders.

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