FCA Acknowledges Widespread Adviser Failings in Pension Transfer Business

FORUM CHAMBERS

1 Quality Court
Chancery Lane
London
WC2A 1HR

As a consequence of the pension freedoms introduced in April 2015 consumers have increased choice in how to access their pension savings. Previously pension savings could be used only to provide an income on retirement, through purchasing an annuity or by drawdown. Now pension savings can be accessed to provide an income or cash or both. But in order to be able to draw cash, a defined or safeguarded benefits (DB) scheme must first be transferred to a defined contributions (DC) personal pension scheme.

Add to this menu of new options the historically high levels of transfer values in DB schemes, and the recent increase of transfers from DB schemes to DC personal pensions is unsurprising.

The question of whether or not to transfer or convert safeguarded benefits is a topic of some complexity, and it engages one of the FCA's most important objectives (enshrined in s.3B of the Financial Services and Markets Act (FSMA)): the general principle that consumers should take responsibility for their decisions. The regulatory regime in the FCA's Handbook, in particular the COBS 9 and 19.1 rules, is focused on that objective, and the twin outcomes of protecting consumers and empowering them to make decisions because, self-evidently, consumers require meaningful advice and guidance if they are to be empowered to decide what is best for them.

There are industry experts (such as Nathan Long, a senior pensions analyst at Hargreaves Lansdown) who consider the starting point for anyone with a defined benefit pension should be to assume that it is best left as it is. That starting point is echoed in the guidance to the current COBS rules that the adviser should start from the assumption that a transfer from a DB scheme to a DC scheme would be unsuitable. In addition, the technical and complex nature of the issues arising on pension transfers is recognised and underlined by the rule that advice on pension transfers, pension conversions or pension opt-outs must be given or checked by a pension transfer specialist.

With these safeguards in place, what could possibly go wrong? Well, quite lot, it seems. Since 2015 the FCA has felt it necessary to issue several warnings and alerts to advisers that the regulatory system in relation to pension transfers is not working as it should. Its particular concern has been to highlight poor advice to clients transferring out of defined

020 3735 8070

www.forumchambers.com

clerks@forumchambers.com

benefits or safeguarded benefits pension schemes (typically final salary schemes) into defined contribution personal pension schemes allowing flexible access.

In June 2017 the FCA issued a consultation paper (CP17/16) entitled "Advising on Pension Transfers". The declared purpose of that consultation is to bring the COBS rules into line with the new pension freedoms environment and equip advisers with a framework which will better enable them to give the right advice, so that consumers, in turn, will be empowered to make better informed decisions. Responses to the consultation were invited by 21 September 2017, and a Policy Statement is to be issued by the FCA in February 2018.

But before the consultation process could run its course, the FCA felt compelled, on 3 October 2017, to intervene again and issue a further update to its previous warnings on DB transfers. The tone of frustration is palpable. In the light of evidence that it has seen, the FCA has concluded that some firms have not taken its earlier warnings and alerts on board. The matters highlighted in the 3 October 2017 update are, indeed, quite remarkable, identifying widespread practices in the conduct of pension transfers business that result in poor process and poor advice and, therefore, poor outcomes for consumers:

1. In relation to process, the FCA identified widespread poor communication and information sharing between the introducing firm and the specialist transfer firm (tasked with carrying out the mandatory check of the transfer recommendation). This resulted in unsuitable advice where the specialist firm had insufficient information about the client's objectives, needs and personal circumstances. While it is not necessary that the specialist pension transfer firm duplicate advice or make recommendations when the introducer has already provided the regulated advice on investments, the FCA does, not unreasonably, expect that both the introducing firm and the specialist firm share information on the destination of the funds. The FCA has seen cases where the specialist firm (when checking the advice) had not made a recommendation for a receiving scheme because the introducing adviser intended to make that recommendation only after the transfer had been concluded. That meant, however, that the consumer would not be able to make a fully informed decision about the overall merit of the transfer before it was made. This kind of failing, the FCA observed, went hand in hand with a significant growth in DB transfer business transacted by firms who lacked the necessary specialist and compliance resources to manage that business in accordance with the regulatory regime.

2. When it came to the issue of suitability of advice, the FCA noted worrying and prevalent failures to meet core COBS requirements. Out of 88 DB pension transfer files reviewed by the FCA (where the recommendation was to transfer):

   47% were suitable

   17% were unsuitable

   36% were unclear as to whether the recommendation was suitable

   That means a staggering <u>53% of recommendations did not meet FCA's suitability criteria</u>.

   Advice outcomes were no better when it came to the suitability of the recommended product or fund in the receiving scheme. Of the files reviewed by the FCA:-

   35% cases were suitable

   24% cases were unsuitable

   In 40% of cases it was unclear whether the recommended product was suitable for the client

   That means <u>64% of reviewed cases did not meet the FCA's suitability criteria</u> in relation to the product or scheme to which the funds were being transferred.

The FCA commented that while the regulatory regime required that firms ensured the suitability of its *personal recommendations* (advice), many had designed processes and procedures which resulted in transfers where the suitability of advice could not be established by the firm. This was a systemic failing, and was likely to be replicated on most of the pension transfers business transacted by such firms.

The shortcomings specifically highlighted by the FCA concerned such basic core areas of adviser obligations in COBS 9 as failing to obtain sufficient information about the client's needs and personal circumstances, failing to consider needs alongside objectives when making the recommendation and failing to make an adequate assessment of the risk a client was willing and able to take in relation to pension benefits.

The 3 October 2017 update was widely reported in the media with commentators concentrating on the FCA's findings that one in five recommendations in relation to transfers out of DB schemes (often final salary pension schemes) was unsuitable which would leave savers worse off, and that, in many cases, the funds being moved from DB schemes represented nearly all of the consumer's cash wealth and was typically larger than the value of the consumer's home. The Daily Telegraph commented that the data showed that people were increasing using the pension freedoms to swap a guaranteed long-term income provided by a final salary pension for flexible pensions effectively giving them a cash machine.

That exercise of choice is fair enough, of course, and was expressly contemplated by the pension freedom reforms. Provided always that the consumer is empowered to make an informed choice which presupposes the availability of suitable advice based on a thorough fact find, appropriate explanations concerning the assumption of volatility, market and other risks when giving up previously guaranteed benefits and a fair analysis of the true value of the benefits under the ceding scheme when compared to those obtainable in the open market for the unlocked transfer value.

The changes proposed to existing regime in COBS 9 and 19.1 by the FCA in its June 2017 consultation are aimed at honing such advice partly in a discretionary and partly in a mandatory format. These proposals will be explained in a further short article due on the Forum website shortly.

In the meantime, the manifold and systemic past failings identified by the FCA in its recent alerts and the update of 3 October 2017 will amount to rule breaches in COBS 9 likely to give rise to a statutory cause of action for compensation under s.138D of FSMA. The alternative route to redress is a complaint to the Financial Services Ombudsman (FOS), although currently the FOS cannot compel payment of compensation above the cap of £150,000.

Where as a result of an unsuitable *personal recommendation* a consumer has transferred out of a DB or safeguarded benefits pension scheme, his loss (or fair compensation if the complaint is advanced before the FOS) should be calculated by comparing the notional transfer value of the previous DB pension first with the actual transfer value of the receiving scheme and then with the estimated current replacement cost of the benefits under the DB scheme. That is because the consumer should be restored (so far as possible) to the pension income position that would have pertained, had he not transferred out of the DB scheme. The total award should be a sum that would buy the client an income equivalent in the open market and restore to him equivalent income benefits to those that he enjoyed under the DB scheme. Where this is achieved in part by cancelling the new DC personal pension scheme, the consumer will also be entitled to an award covering any resulting charges and any penalties.

If you think you have lost out as a result of unsuitable pension transfer advice, we are able to advise you on your claim and on the best route to compensation.

Contact clerks@forumchambers.com for assistance.

Susanne Muth
Forum Chambers

smuth@forumchambers.com

November 2017