BARNETT WADDINGHAM

DB to DC transfers

Supporting members

Our previous article summarised the current DB to DC pension transfer landscape. It can be characterised as an area with a lot of potential demand from members over the next few years, but an increasingly limited supply of good quality financial advice.

In this article, we will look at this topic from the perspective of the defined benefit (DB) scheme members and ask:

- What are the pitfalls of an unsupported DB transfer process?
- How can sponsors and trustees provide better support to members?
- What should sponsors and trustees consider when looking to partner with a financial adviser firm?

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An unsupported transfer process

Transferring a DB pension out of a scheme is an arduous process for a member – perhaps rightly so given the significance of the decision. Many schemes take a 'compliance-first' approach to transfers and the resulting process means that only those who really want to transfer are likely to persevere.

Below we briefly draw out some pitfalls of a compliance-first approach and then consider how a transfer support process can be structured to avoid these.

1: MEMBERS RETIRE WITHOUT BEING AWARE OF ALL THEIR OPTIONS

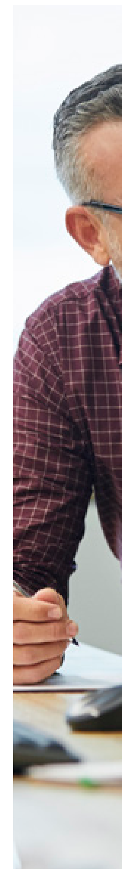
Not all schemes will pro-actively communicate all options to members, particularly transfer values. Many members will take the path of least resistance, follow the default option of drawing the pension at the normal age and maximise the amount of tax-free cash they can take. For many, this will be the best outcome. However, for some, it may represent a large opportunity missed.

> "We're committed to driving high standards and improved transfer option communications, aiding members to make informed choices in a secure environment."
>
> **PASA GUIDANCE**
> **July 2019[1]**

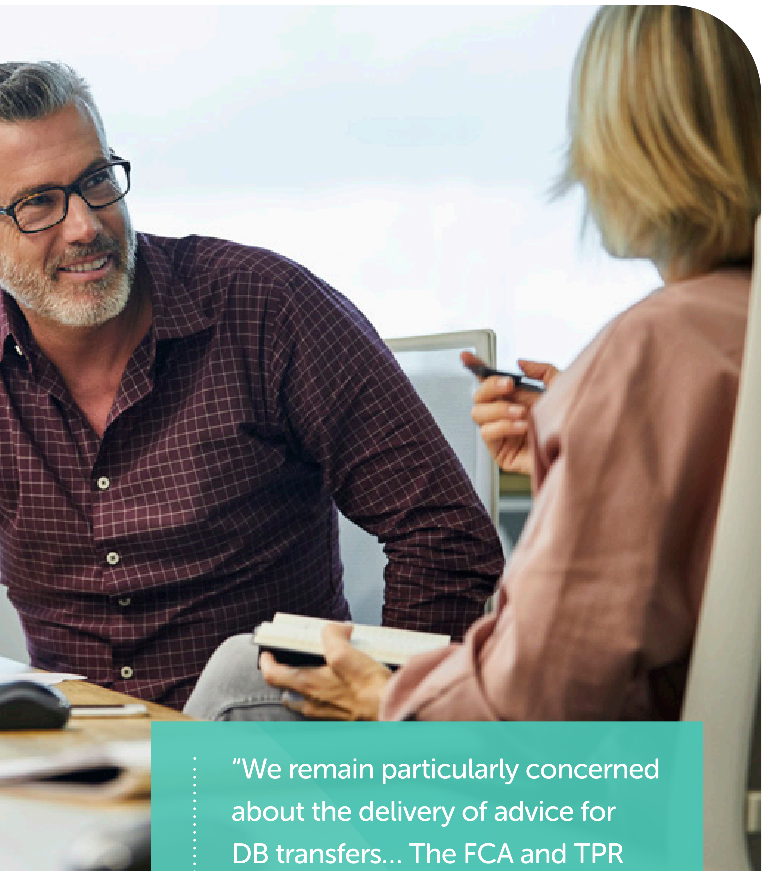
2: MEMBERS FIND IT DIFFICULT TO EXPLORE THEIR TRANSFER OPTION

Most members have a statutory entitlement to request a formal transfer quote from their scheme. To control costs, members are only entitled to one free quote a year. They need to be at least one year away from their normal retirement age – but approaching normal retirement age is precisely the time when members are most likely to be considering their options. Some schemes are more flexible in this area than others.

They can be made to wait up to three months before receiving their transfer quote. When it arrives it will be daunting: lots of paper, lots of warnings about scams and lots of information to process – making it potentially difficult to see the wood from the trees. And, if the value of the member's benefits is worth £30,000 or more, they face the task of finding a financial adviser and getting financial advice before the scheme will allow the transfer to be paid. All within three months.



1 www.pasa-uk.com/wp-content/uploads/2019/11/PASA-DB-Transfers-GUIDANCE-P1-FINAL-Updated-16072019.pdf



> "We remain particularly concerned about the delivery of advice for DB transfers... The FCA and TPR will take all necessary action, both singly and jointly, to improve outcomes for members and consumers."
>
> **TPR AND FCA**
> **Joint regulatory statement, October 2018[2]**

3: MEMBERS STRUGGLE TO FIND GOOD QUALITY FINANCIAL ADVICE

If a member does want to explore the option to transfer then the final hurdle is finding good quality financial advice. The FCA's concerns in this area are well documented and our previous article highlighted reasons why this is likely to get harder in 2020 and beyond. Evidence is growing of a hardening PI market which is starting to reduce the number of adviser firms who will provide transfer advice[3].

Even if the member is able to find a good quality adviser, there is the thorny issue of charges. If contingent charges are banned, as seems likely, then upfront costs will be significant (likely around £3,000 to £5,000). Ongoing charges would also be payable if the advice is to transfer into a drawdown arrangement – which is often between 1% to 2% per annum depending on the advisory services provided and the funds that the member invests in.

> "We will also work with the FCA and the Money and Pensions Service on DB to DC transfers to ensure that they work effectively for those who want to transfer..."
>
> **TPR**
> **Corporate Plan 2019 – 2022[4]**

2 www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/fca-tpr-joint-strategy.ashx

3 www.pensionsage.com/pa/Over-30-firms-stop-offering-DB-transfer-advice.php

4 www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/corporate-plan-2019-2022.ashx

What is the industry doing to help members?

Experience over the last couple of years has pushed the industry to take action and try and find ways within the existing legislative framework, to support members more effectively.

REGULATORS:

The Financial Conduct Authority (FCA) and The Pensions Regulator (TPR) published a joint regulatory strategy in October 2018. This contained a specific objective to improve member outcomes from DB transfers. Following on from this, TPR's 2019-2022 corporate plan, published in May 2019, includes a commitment to work with the FCA in the area of DB to defined contribution (DC) transfers to "ensure they work effectively". Finally, the FCA seems poised to take decisive action this year in banning contingent charging, eliminating the incentive to recommend a transfer when it is not in a member's best interest but also further restricting the supply of advice.

INDUSTRY BODIES:

As discussed in our previous article, the Personal Finance Society published its gold standard for giving DB transfer advice, which over 1,250 adviser firms have signed up to (about 50% of the firms which have provided transfer advice since April 2015). In a similar vein, PASA (the Pensions Administration Standards Association) published a consultation in February 2020 on a new Code of Good Practice with the laudable aims of speeding up the transfer process, improving efficiency for administrators and keeping members better informed throughout a transfer process. It is too early to assess the effectiveness of these initiatives but, both show a willingness by the industry to improve standards.

BARNETT WADDINGHAM VIEW:

The industry as a whole, apart from the scammers, is still playing catch-up following the 2015 Freedom and Choice changes – most notably the FCA. It faces a difficult balance between ensuring members get good quality advice and having enough firms in the market to provide that advice. However, we support all initiatives designed to improve member outcomes. Whilst members retain a statutory right to a transfer there will always be a role for trustees, and sponsors, in helping members make an informed decision.

Providing better support to members

So what can trustees and sponsors do if they want to provide better support to members? In this section we will address the first two pitfalls identified above. In the next section we will focus on the key considerations, if thinking about partnering with a financial adviser firm.

Pitfall 1:
Members retire without being aware of all their options.

Pitfall 2:
Members find it difficult to explore their transfer option.

Addressing these pitfalls comes down to effective communication with members. This is an area identified by the FCA and TPR in their joint regulatory strategy for the pensions sector published in October 2018[5]. It is worth considering the regulators' views in this area.

FCA and TPR's joint regulatory strategy - driving change

One of the four key issues identified in their joint strategy is "People not being enabled to make good decisions" and addressing this is one of two new priority areas for joint action. Within this, DB transfers is a particular focus area.

More broadly than just considering members looking to transfer a DB pension, the issues they identified for all members and consumers in the pensions sector include:

- Behavioural biases, information gaps and disengagement mean only around a quarter of the population feels confident enough to choose a pension product without advice;
- Information provided is often complex and can intimidate members; and
- Take-up of high quality, free guidance from sources such as the Money and Pensions Service is lower than they would like.

They intend to take action in this area. One of the starting points is a "joint review of the consumer pension journey", originally due to be published in 2019, though it has not yet been published at time of writing. This will look at how the information pension schemes provide combined with existing guidance services helps (or hinders) consumers in making well-informed decisions.

5 www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/fca-tpr-joint-strategy.ashx

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Other workstreams include a review of the guidance given to trustees on transfers and a review of the information and support given to members – both being led by TPR. Taken together, it is clear that there is a strong desire from TPR and the FCA to raise standards in this area.

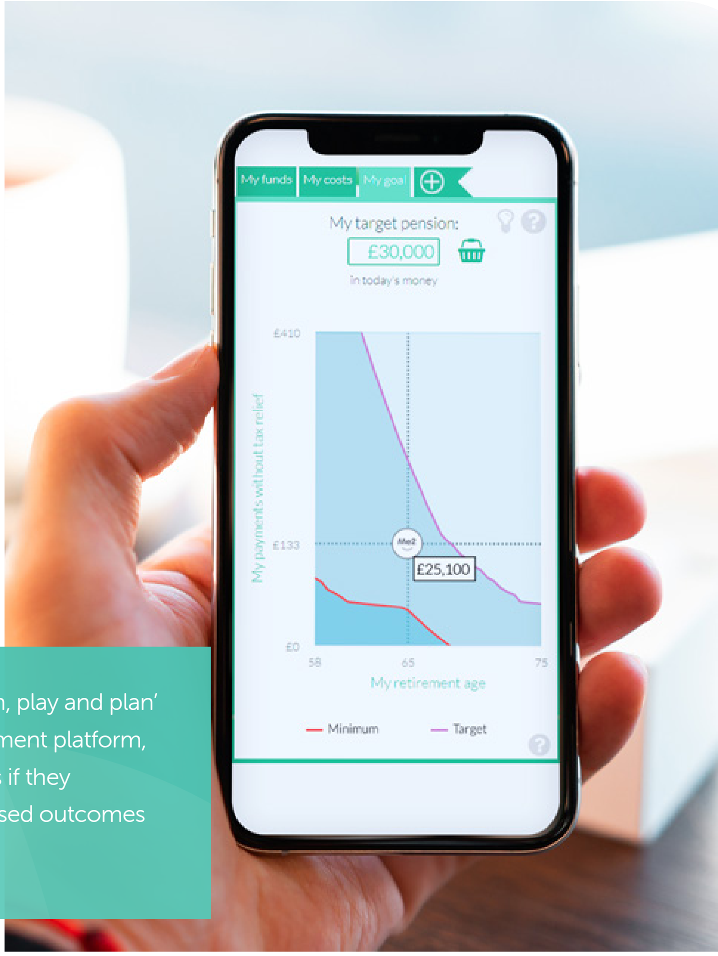
> We believe that trustees and sponsors of DB schemes have every reason to act now in order to avoid future risks.

How can you engage with members better?

So, where should you start if you want to help members on their pension journey?

An obvious starting point is the scheme's existing communications to members. Within Barnett Waddingham, we have revamped the member communications that we provide as administrator on many of our clients. This includes simpler, cleaner member packs with a short summary page of a member's options, including the member's transfer value if a client is happy to show this.

This provides a rationale for schemes and sponsors to take action well before a member is requesting a retirement pack. The table below provides some examples of ways that this can be done.



More broadly, we have a strong belief in the power of a 'learn, play and plan' approach to engagement – embodied in our digital engagement platform, Me2. Members will feel empowered to make good decisions if they understand their options, have the ability to model personalised outcomes and a clear view of what they need to do to get there.

METHOD OF COMMUNICATION	WHAT DOES IT ACHIEVE?	WHAT ARE THE CHALLENGES?
“Wake-up” pack of generic guidance and information	Rather than hit members cold at retirement, start to warm them up with options they will have in the scheme and other sources of free guidance, like the Money and Pensions Service. Do this well in advance of normal retirement age.	There’s lots of sources of information out there and providing too much may overwhelm members. So content needs to be selective and targeted.
Online content via a scheme, or employer, website	More communication channels is likely to lead to more engagement. Opportunity to vary the method of communication – for example by creating short videos.	Not all schemes will have their own website or have the number of members to justify building one.
Face-to-face financial and / or retirement seminars	One of the most effective ways to engage members: face-to-face presentations from experts in the area. These can be targeted – for example by age or by ‘stage of life’, such as those planning to retire in the next two years.	Often works best when members are still employed by the same employer and geographically concentrated. Difficult to arrange when membership geographically diverse.
Tailored benefit statements	Use benefit statements to talk about options at retirement, rather than just accrued benefits in the scheme. Use the member’s own figures to bring this to life.	More costly to produce and requires automation of the relevant calculations. Need clean data.
Online modelling and budgeting tools	Allow members to play with a modelling tool that is pre-loaded with their data. Allow them to add other pension benefits and build up the full picture in one tool. Allow members to build up a budget for their retirement.	Similar to tailored benefit statements. Additionally, have practicalities of getting email addresses for deferred members.

Removing other barriers to engagement

In addition to boosting engagement, schemes and sponsors should consider what other practical barriers get in the way of members exploring their options. Human nature means that the more steps a process has, or the more difficult it seems, the more members will simply resort to the path of least resistance. In short, we believe that there are actions that all schemes and sponsors can take to remove barriers to members engaging with their options.

However the biggest barrier of them all is the requirement, since April 2015, for those members with DB benefits worth £30,000 or more to take financial advice before being allowed to take a DB to DC transfer. The next section discusses this.

PRACTICAL BARRIER	ALTERNATIVE APPROACH
Members' options, including a DB transfer, only available on request	Provide information pro-actively on a regular basis or provide access to up-to-date information online
Members have to pay for multiple transfer requests within a 12-month period	Relax policy to allow two or three quotations per year without charge. Allow members to access indicative transfer quotes online that are regularly updated (e.g. quarterly)
Long delay between request for information and receiving it	Work with administrator to see how timescales can be improved. PASA guidance[6] sets out how a maximum turnaround time of 7 working days can be achieved for standard cases
Some members have no right to a statutory transfer value (e.g. those within one year of, or over, Normal Retirement Age)	Put in place a policy to allow non-statutory transfer values to be paid

6 www.pasa-uk.com/wp-content/uploads/2019/11/PASA-DB-Transfers-GUIDANCE-P1-FINAL-Updated-16072019.pdf

Accessing the right financial adviser

Pitfall 3:
Members struggle to find good quality financial advice

2020 is likely to be seen as a turning point in the DB transfer financial advice market for the following reasons:

- Contingent charging is likely to be banned by the FCA
- PI insurance premiums are increasing, with some firms reporting 500% increases in premiums[7]
- Firms are starting to exit the market and we expect the rate of exit to accelerate substantially

What will the market look like after this and how will members be able to access financial advice?

Life after contingent charging

The FCA's cost-benefit analysis of the impact of banning contingent charging[8] gives a good insight into how they expect the market to look after their intervention.

As a result of banning contingent charging they estimate that demand from individuals for transfer advice will fall by between 56% and 66%, simply due to the fact that most will be put off paying £3,000 to £5,000 in upfront advice fees.

As a result, they expect the number of firms in the market to fall. They do not estimate how many of the c. 2,500 firms who have given DB transfer advice since April 2015 will exit the market. But they do highlight that 60% of these firms (1,454) are ones where at least 75% of their clients were advised, to transfer and that they are mainly firms giving DB advice to fewer than 50 clients each year.

In short, it is the firms that do not specialise in this advice, and are recommending far too many transfers, that the FCA is targeting and expects to exit the market after its intervention.

For members, finding their own financial adviser will be a lot harder and seem a lot more expensive. The FCA estimates that about 20% of members who will be put off getting advice are cases where a transfer would have been suitable. Conversely, the remaining 80% of members who will be put off getting advice are ones where the FCA estimates a transfer would have been unsuitable anyway –and, in the FCA's eyes, these are the main beneficiaries of the FCA's intervention into this market. However, for many of these members financial advice would have looked at all of a member's retirement options, including when and how best to take their benefits from their DB scheme.

So where do trustees and sponsors fit into all of this?

7 www.professionaladviser.com/news/3083376/pi-insurance-hikes-continuing-stop-pension-transfer-advice

8 See Annex 3 of CP19/25 www.fca.org.uk/publication/consultation/cp19-25.pdf

Partnering with a financial adviser

Our view is that trustees and sponsors are uniquely placed to help members bridge this gap. They can do this by partnering with one of the handful of 'specialist' financial adviser firms – meaning those firms that operate in the 'bulk' DB to DC transfer market. We are aware of about ten firms that could credibly claim some expertise in this area. This is a tiny fraction of the c. 2,500 firms which have operated in this market since April 2015.

Some of these firms advise thousands of members each year on DB transfers and have robust processes in place to ensure suitable advice outcomes. They face regular FCA scrutiny, though are by no means immune from the pressures of the market, as LEBC's abrupt exit from the market in 2019 showed.

> When considering partnering with such a firm it is important to carry out due diligence to understand the experience, capacity, financial resilience, member journey and advice outcomes of the firm.

There are differences between the firms and trustees and sponsors will have their own priorities about what is most important to them. We regularly carry out due diligence in these areas for our clients.

A well-structured due diligence process will leave trustees and sponsors in a much more informed position about how the market works and what the pitfalls are.

The most experienced firms have a strong pipeline of projects and need to schedule resource carefully; there is a limited supply of financial advisers with the expertise needed to give DB transfer advice. So trustees and sponsors need to allow sufficient lead time to get a financial adviser in place.

Tesco: a case study in the public domain

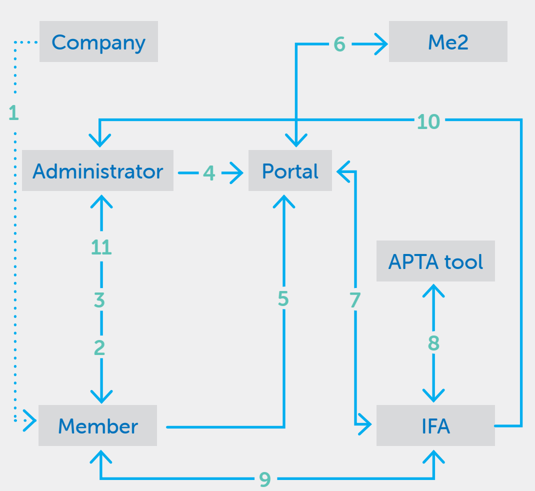
The most recent public example was Tesco. The Tesco Pension Scheme announced that it will partner with two "carefully selected" financial adviser firms in 2020 to provide financial advice. Its pension scheme has 350,000 members. The financial adviser firms will be overseen by a third firm who will be responsible for reporting back to the Trustees on the ongoing suitability of the two firms – a new development in this market. Whilst clearly possessing the size and scale to justify a large upfront investment in setting this up, like most developments in the pensions industry where large schemes go smaller schemes tend to follow. As such we expect to see more examples of this in 2020 and beyond.

An integrated approach

Once a financial adviser firm has been appointed, time and money needs to be invested in getting them set up. The most involved part of this is setting up the 'APTA' (Appropriate Pension Transfer Analysis). It involves preparing a detailed summary of scheme benefit structure and member data to allow the financial adviser to set up the necessary financial analysis they will need to carry out.

Alongside this, trustees and sponsors will also need to consider how the various parts of the process integrate together. Data will need to be exchanged between the member, IFA, administrator and APTA provider and the quicker this can be done the better the process for members.

The ability to automate and integrate these data flows is something that we see the larger IFA firms looking to put in place. Aside from cost advantages, this means that data can flow between the parties securely and that members can go through the advice process at whatever speed they want. The diagram below illustrates the flows



1. OPTIONAL: Company makes offer to member
2. Member requests early retirement or transfer value quote
3. Administrator sends pack to member
4. Administrator sends locked data to Portal
5. Member accesses Portal and agrees to release data to Me2
6. Data unlocked on Me2 and member self-triages
7. Member contacts IFA for advice via the portal
8. IFA uses APTA tool to advise member
9. Member receives personal recommendation and makes decision
10. IFA informs the Administrator
11. Normal administration processing of selected benefit option

Barnett Waddingham's market-leading APTA service – what is it and why is it needed?

In October 2018, the FCA introduced a requirement for financial advisers to carry out an APTA for every member being advised on a DB transfer. This essentially provides a mathematical comparison of the benefits being given up in the DB scheme and the benefits acquired in a DC scheme (i.e. the transfer value). Undertaking an APTA requires knowing what benefits the member is entitled to in the DB scheme.

This is difficult because all DB schemes are different and DB benefits are complicated. Barnett Waddingham recognised a demand for this amongst financial adviser firms in 2016 and, since then, has been an outsourced APTA provider for some of the largest financial adviser firms in the market.

Benefits for members

Partnering with a financial adviser firm is not risk-free – the risk of reputational, and possibly financial, blowback on the scheme or sponsor is a live one that will, ultimately, put some schemes off. But, for those schemes who see that the advantages outweigh the risks, what does this all look like from the member's perspective?

Well, the advantages can be huge. Taken together with a well-structured communication strategy and slick administration processes, having a financial adviser firm 'blessed' by the trustees or sponsor can make all the difference for the member:

- **Member is able to consider all options**: A financial adviser firm doing the right thing will advise most members to stay in the DB scheme, and often highlight just how valuable it is. They will also go through all options the member has in the DB scheme, such as early retirement and commutation, and allow the member to optimise these.

- **Reduced cost of advice**: The upfront work on the APTA (paid for by the sponsor or trustees) allows the financial adviser firm to charge far lower per member advice fees, typically between £750 to £1,500 per member. This is much lower than the £3,000 to £5,000 expected cost on an individual basis. Moreover, if a business case can be made for the scheme or sponsor to pay the advice costs, rather than the member, then it will result in much greater take-up rates.

- **Suitable advice**: Finally, and most importantly, trustees and sponsors can get comfort in knowing they have taken all possible steps to ensure that members get advice that is suitable for their personal circumstances, without conflicts of interests distorting the outcomes. In this market there can be no guarantees that this will be the case for every single member. However, in our view, such a process will lead to far better outcomes overall than leaving members to try and navigate through this themselves.

The Receiving Scheme

The support given has focussed thus far on the advice process to be delivered. Part of the advice to be given will involve the selection of an appropriate DC pension plan into which the transfer value will be paid and from which retirement benefits can be provided in due course.

To date, many transfers have been recommended to relatively high-charging individual pension arrangements. FCA proposals will require the adviser to consider first any workplace savings scheme available to the member which will have a range of investment opportunities, but with a default option capped at a maximum charge of 0.75% p.a.

98% of employers use a DC scheme for auto-enrolment purposes and in line with guidance from the Pensions Regulator and/or the FCA, the sponsor and, where relevant, trustees will have undertaken a significant amount of due diligence in establishing a workplace plan. On an ongoing basis the trustee body or an independent governance committee will also have responsibility for ongoing oversight.

The member will typically have access to a broad range of tools and educational material to help both in the period up to retirement, but also at retirement, when greater support is required to ensure informed decisions can be taken as to how to use the DC benefits.

Workplace plans will offer a carefully considered default investment approach pre-retirement, along with a number of other suitably designed investment approaches. A self-select range of funds will also be available for the member, which the IFA can consider on behalf of the member.

Workplace plans are now extending these options into the retirement space and members will be able to move from accumulation into decumulation in a seamless, integrated manner. The institutional terms will be retained, rather than needing to transfer to a retail product and, later this year, it will be possible to find suitable post retirement investment pathways in such plans as part of the design evolution of the DC products.

A more detailed consideration of the investment requirements for those moving from DB to DC forms part of the third paper in our DB to DC series.

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Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact Liam Mayne via the following:

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