Supporting good member decision making

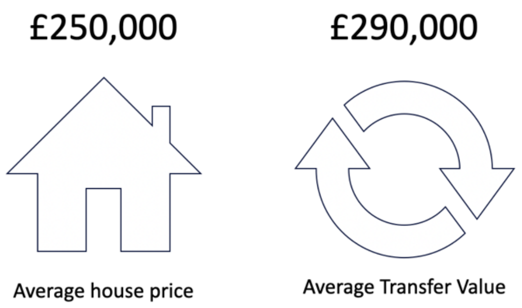
SPENCE

Why bother?

Why should trustees bother to help pension scheme members with their choices, beyond any legal requirements?

Well, there are a few points worth considering:

- Most people find the subject of pensions, especially defined benefits (DB), difficult to understand.
- The average reading age in UK is 12.
- 49% of the UK population have the numeracy skills of an 11 year old.
- For some members, their pension can represent a big chunk of their personal wealth.
- Financial advice is increasingly unaffordable for the average scheme member.
- The average DB transfer value is now larger than the average UK house price.



All in all, this represents a toxic blend that can make pensions simply too complicated for many people to engage with. Use of pensions industry jargon in member communications (accrual, commutation rates, etc.) only serves to turn off consumers even more.

Complex choices

More recently, pension scams have come up the agenda for trustees concerned to protect their members, whether through guidance or advice.

In a DB context, there are often complex choices presented to members:

Take a transfer to another pension plan

While advice must be taken where the value of the benefits is larger than £30,000, this is a very complex area and helping members to understand their different options before the advice stage can be very helpful.

Give up future pension increases for a higher starting income at retirement

Usually called Pension Increase Exchange (PIE), at face value this can look attractive, but it may not represent the best lifetime value. Consumers tend to place a higher value on more money now, at the expense of the longer term. In the jargon, it's called temporal discounting.

Bridging pensions

A similar set of considerations to PIE. At face value a simple choice – take a higher pension before State Pension Age (SPA), which then reduces once SPA kicks in.

Give up pension for a tax-free lump sum at retirement

It's the default for most members, but whilst the tax-free element is beneficial, is the "exchange rate" good value for money? From a DC perspective, it's a different set of considerations, in fact more than DB, as members also need to think about where their fund is invested, and how to draw income.

Different for DC

From a defined contribution (DC) perspective, there's a whole different set of considerations; in fact, more than for DB schemes. Members also need to think about where their fund is invested, and how to draw income.

Investment

Go for the default or select their own funds? How to make an informed decision on risk and return?

How much to pay in?

Generally, this is not an issue for DB members, who have the added benefit of certainty on what their pension will be, unlike DC savers.

How to draw an income

Annuity and / or drawdown. If using drawdown, how much will be needed and at what intervals? This is an area where advice is critical, but largely absent, as Financial Advisers have increasingly moved to serve high net worth members.

What the Regulator allows

The Pensions Regulator (TPR) is very clear that trustees can support member decision making, but within prescribed limits.

This has been codified in two recent TPR and Financial Conduct Authority (FCA) consultations – see link for more detailed information:

- Guidance for employers and trustees on providing support with financial matters without needing to be subject to FCA regulation (Guide for employers and trustees on providing support with financial matters without needing to be subject to FCA regulation (thepensionsregulator.gov.uk))

- FG21/3 Advising on pension transfers (FG21/3: Advising on pension transfers | FCA)

The guidance spans the generalities of what's acceptable for DC and DB in terms of advice. There is a particular focus, however, on guidance around DB to DC transfers.

✓ Provide general information and support as long as there is no commercial benefit to the Trustees or Employer.

✗ Promote a solution, product, or set of options. That tips into advice and is a regulated activity.

So, what gets the thumbs up and what doesn't? Well in general terms support, guidance and provision of information is fine.

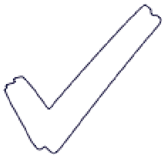
When it comes to DB pensions, and matters relating to transferring, TPR and FCA have worked together to provide consistent guidance to schemes and the Independent Financial Advisers that support the DB to DC transfer advice process.

✓ Provide transfer values on request

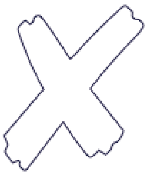
✗ Provide unsolicited TVs without "context".

It's common practice for many DB schemes to issue transfer values (TVs) on benefit statements, or at the point of retirement, without the member requesting them. This is fine as long as the member is provided with support and context around the TV.

For example, TPR suggests that helping members to understand their life expectancy could give some context to the size of the TV. Without this and other support, there's a concern that many members may seek to transfer. Of course, it's not down to the member to take the decision where the TV is larger than £30,000. That will be down to the adviser to recommend, but the member could burn money on advice fees simply to be told to stay put!



Provide factual information for comparative purposes where a member might be considering a transfer. For example where a member has reached the scheme minimum retirement age you could show what an immediate annuity could provide.



Provide “modellers” that make assumptions about the future. That’s comparisons between DB & DC where future investment returns and inflation assumptions are used.

TPR has also made it very clear where they see the boundary between guidance and advice in the context of DB to DC transfers.

In summary, factual information is allowable based on the client’s age. So, for a member who is below age 55, it is fine to talk in general terms about how they might take a cash lump sum from a personal pension. It would not be allowable, however, to roll forward the TV at an assumed growth rate to age 55, and show 25%.

From age 55, however, it is allowable to provide such side-by-side comparisons. For example, you can compare the scheme pension at 55 with what the member could buy with an annuity at 55 on a similar basis. You still can’t roll forward the TV unless this is part of an advice process.

When guidance isn't enough

Whether it's DB or DC, many members would benefit from a recommendation of what's best for them. Unfortunately, the mass advice market is poorly served. Due to increasing costs and a move away from commission, many financial advice firms have gone "up market".

For DC savers, there are a number of specialist firms who can provide affordable fixed fee advice around retirement options.

The nature of these firms is that they are appointed by the scheme and generally charge a set-up fee and annual retainer to support the membership. This isn't unreasonable as they need to train their advisers in the detail of the scheme and set up dedicated phone lines.

For DB to DC transfers, "high street" firms have largely left the market, as a result of pressure from the FCA, which has rightly been concerned about poor practice in this market, and rising PI costs.

This is a real problem for members who want to explore their options, exacerbated by the removal of something called contingent advice. Under that model, the member was only charged if the recommendation was to proceed. What could go wrong with that!

Whilst inherently biased, it did at least allow members to access advice without being on the hook for large fees.

Specialist advice

The best way to support members who want to explore a transfer is for the scheme to appoint a specialist adviser. There are currently around six firms specialising in this market who can deliver fully regulated fixed fee advice for around £1,000. They are subject to substantial FCA scrutiny and have robust scale processes.

If the scheme is running an exercise by promoting TVs to members for a limited period, something called the "Code of practice on incentive exercises" (Incentive exercises | The Pensions Regulator) kicks in, which describes best practice requirements. Even in a business as usual setting, where the TV and advice is freely available to all, the code is still adhered to by the specialist firms.

Abridged Advice

A recent development is 'Abridged Advice', designed to fill the gap left by contingent charging. It's still full advice but tends to be cheaper than the traditional model. That's because it's effectively a stage one process with only two possible outcomes.

1. Stay in the scheme
2. Proceed to the next advice stage

As many members will be best served by staying in the scheme this is a cost effective way to deliver advice, with a further fee for the stage 2 process. In addition, there is no requirement for an adviser to consider the TV in terms of its strength, or indeed where it might be invested. That happens in stage 2.

That means that illustrative TVs are fine for abridged advice. These can represent a significant cost saving.

Conclusion

There's never been a greater need to protect and support members around their pension choices, whether this is in relation to a transfer or for a DC member wanting to draw income.

The Pensions Regulator is clear on what is permissible in terms of guidance and information. For those needing advice, there is a strong professional specialist advice market that can help members make the most of their benefits.

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