Regulatory Policy Committee

Advising on pension transfers

Financial Conduct Authority

RPC rating: validated

The impact assessment (IA) is now fit for purpose as a result of the FCA's response to the RPC's initial review. As first submitted, the IA was not fit for purpose.

Description of proposal

The Financial Conduct Authority (FCA) has rules that govern advice to consumers on the transfer of defined benefit pensions and other safeguarded benefits providing guaranteed pension income and valuable benefits to most consumers. The FCA recognises, however, that the pensions environment has changed considerably, especially since the introduction of new pensions freedoms in 2015. These freedoms gave consumers more options, including transfers from a scheme with safeguarded benefits to one without safeguards. Additionally, more consumers are taking advantage of opportunities to transfer, and transfer values have increased to historically-high levels in a changing financial environment.

Under current law, consumers looking to transfer defined benefits worth more than £30,000 are required to seek regulated advice. The FCA has introduced new rules and guidance to provide advisers with a framework that enables them to give better advice to consumers, who can therefore make more appropriate decisions. The current assessment is concerned with the rule which came into force on 1 April 2018, that requires all advice on pension transfers to take the form of a personal recommendation specific to the consumer's circumstances. The remaining rules and guidance that will come into force later in 2018 include:

- Clarifying the role of a pension transfer specialist (PTS) when checking
- Replacing the current transfer value analysis requirement with a requirement to undertake an 'appropriate pension transfer analysis' of a client's options and a prescribed transfer value comparator indicating the value of the benefits being given up and the cost of purchasing the same income in a defined contribution environment; and
- Applying a consistent approach for pension opt-outs where there are potential safeguarded benefits.

The FCA has agreed to submit a separate assessment, covering these rules, when they come into force.

Impacts of proposal

The FCA draws on findings from its ongoing supervisory work, which indicate that 5 per cent of advice transactions have been carried out without a personal recommendation.

Costs

Combining their own data with industry data and information from providers and the Pensions Regulator, the FCA estimates that there are 80,000 to 100,000 pensions transactions a year and, therefore, that 5 per cent of these (4,000 to 5,000) transactions would be affected. The FCA then uses an independent consumer guide to the price of advice to estimate that a consumer would be charged £1,625 for a personal recommendation (compared to a non-personal recommendation). It claims that this charge would cover all additional costs except the cost of software, which the FCA intends to address in the further impact assessment.

The FCA notes that this approach overstates the cost to advisers, as it includes an element of profit. The FCA has not, however, been able to estimate this profit, as profit margins are highly sensitive data for businesses. It argues that by not correcting for profits it has taken a conservative approach to estimating the cost to business.

On this basis, the FCA estimates that the additional cost to adviser firms is between £6.5 million and £8.125 million per annum, with a best estimate of £7.312 million.

Benefits

As part of its supervisory work review of defined benefit to defined contribution transfers, the FCA found that advice on pension transfers was considered suitable in only 47 per cent of cases. The FCA's subsequent review of some members of the British Steel scheme indicated that 51 per cent of advice given was suitable. The FCA argues that pensions transfer advice given without a personal recommendation results in action that is not in the best interests of the consumer. The FCA's proposals are intended to address the harm that is caused by consumers receiving unsuitable advice which may result in lower retirement income. It estimates the annual benefits to consumers to be between £16m to £30m, based on average redress.

Quality of submission

When originally submitted the assessment was not fit for purpose, for two key reasons:

- The additional cost estimate of a personal recommendation was derived using the additional cost to consumers and not to advisers and, would, therefore, include a profit element. The FCA accepts that its calculation of cost includes profit but as this data is of a highly sensitive nature, it has used a conservative approach.

- The FCA notes in its consultation paragraph 27 CP 17/16 that the difference between the cost of personal advice includes set up and on-going costs (such as software and professional indemnity insurance) but that some respondents to its consultation felt that these costs had not been fully included in estimates. The FCA has addressed this point by stating that the impact assessment of the new rules and guidance, which come into force later this year, will include costs of software. It also states that these rules will not change its professional indemnity insurance requirements. The RPC believes that the FCA has taken a straightforward approach to calculating costs. However, the regulator should ensure that in the future it clearly addresses the concerns of consultation respondents as to whether all costs are fully reflected in the FCA estimates.

The FCA's assessment is that the measure imposes a cost on financial advisers equivalent to that of providing a personal recommendation in all cases where they would formerly have given a general recommendation. Although the FCA acknowledges that this cost – and an additional incremental profit - will ultimately be paid by consumers through higher prices, this is not reflected in the equivalent annual net direct cost to business figure.. This could be regarded as being in line with the better regulation treatment of 'pass-through', whereby the benefit to business of recovering regulatory costs through higher prices is considered to have an indirect impact, although there is a complication here in that consumers are possibly receiving services of greater value.

It would seem more appropriate to view this measure as effectively banning the production of pensions transfer advice without a personal recommendation, rather than necessarily imposing the higher costs of producing pensions transfer advice with a personal recommendation. The direct impact on business would then be the lost profit from no longer being able to sell pensions transfer advice without a personal recommendation. This cost appears to be referred to in the consultation paper, which states: "*For some firms, however, their business model may be based on only providing advice that is not a personal recommendation. These firms need to either change their business model or exit the market*." (paragraph 24, page 33) – although in this case there might be gains to other businesses that do provide personal recommendations.

In its response to the RPC's initial review, the FCA indicated that it is unable to identify the profit element from the selling of pensions transfer advice (or the different profit levels from general or personal profit recommendations) and, therefore, has no basis for adjusting its estimates. It does not, therefore, seem possible for the FCA to make an estimate of lost profit along the lines of the approach indicated above. On this basis, the RPC is prepared to accept the FCA's estimate in this case, noting that its estimates are "…likely to overestimate the cost of compliance…" and are derived from a "…most conservative approach…" (footnote 5, page 2). The RPC strongly encourages the FCA to review its method of estimating the impacts of this type of measure, with a view to producing cost figures that are "most likely" rather than upper estimates, and the RPC would expect to see that the comments in this opinion have been considered in future relevant business impact target assessments.

The FCA has confirmed that automated advice which can provide a personal recommendation based on a full assessment of the consumer's circumstances can be compliant with this rule. The consultation, policy statement and assessment would have benefitted from explicit consideration and clarification of this position.

The FCA states that this rule has been proposed to address the harm that is caused to consumers from receiving unsuitable advice. However, the FCA notes in its consultation document that, "*there is very little information available on advice where there is not a personal recommendation*"-paragraph 41 CP17-16. Furthermore, the Pensions Freedoms[1] enquiry suggests that advice may not lead to better outcomes. The RPC would expect to see a fuller consideration of the evidence relating to perceived benefits of measures and their effect on the full spectrum of consumers in future business impact target assessments.

The FCA's impact assessment briefly touches on the wider benefits expected from applying this rule in the IA and explores them thoroughly and helpfully in the linked consultation documents. A slightly, fuller summary of this material in the IA would have improved it greatly. Similarly, the IA should include a clearer explanation of how the initial consultation has informed the policy and consider any circumstances in

[1] https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/917/917.pdf

which a personal recommendation is not cost-effective or believed by consumers to be necessary. There is a brief discussion of the point in the linked policy statement, which could, for example, helpfully be summarised in the IA.

The regulator does not discuss its plans to review or evaluate the rule or commit to a review; the IA could usefully have included a brief summary of the FCA's plans for appropriate and proportionate post implementation review of the rule.

Overall, the RPC believes that the regulator has taken a proportionate approach in this case and is able to validate the assessment.

Departmental assessment

Classification	Qualifying regulatory provision IN
Equivalent annual net direct cost to business (EANDCB)	£6.8 million
Business net present value	-£58.7 million

RPC assessment

Classification	Qualifying regulatory provision IN
EANDCB – RPC validated[2]	£6.8 million
Business impact target score[1]	34.1 million
RPC rating (of initial submission)	Not fit for purpose

Regulatory Policy Committee

[2] For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.