

## Inside FCA Podcast: Regulating the changing pensions landscape, featuring Keith Richards, Emma Stranack and Chris McGrath

**OI:** Hello and welcome to the Inside FCA podcast. I'm Ozge Ibrahim. Today we'll be focusing on the pension sector from pensions transfers to scams, defined benefit to professional indemnity, we'll be examining the key issues from regulatory trade and consumer perspectives. The pensions landscape has undergone massive change over the last few years. There's been a significant trend away from defined benefit or final salary pensions which provide a guaranteed lifetime income. More and more people now have defined contribution pensions which means they invest money over their working life and then make a decision at retirement about what to do with it.

Until recently, most people bought annuity which provided a guaranteed lifetime income, but since the Pensions Freedoms came into force in April 2015, this is no longer necessary. This was a significant change which has driven a lot of the FCA's work on pensions over the last five years. Keith Richards, Chief Executive of the Personal Finance Society which represents 40,000 members recalls the Pensions Freedoms announcements came as a surprise.

**KR** I think the reaction from industry initially was shock given that it was a surprise announcement by the Chancellor, but of course as with the public being given greater freedom and choice to make the right decisions about your retirement plans is quite empowering. So, in many ways, the sector embraced the change. I think it's fair to say that there were degrees of concern around on intended consequences that come with greater freedoms and that's, I guess, where the sector now is more nervous about some of the issues that are starting to emerge. But generally, it's really important that we don't bypass the fact that Freedoms has led to a lot of good decisions and it has empowered people to take much greater engagement in their financial world being in retirement and we shouldn't forget that, you know, everyone's living longer which is great news but the problem is too many consumers underestimate their longevity.

So, Pension Freedoms has created a degree of very positive focus around that and the sector have engaged very positively in trying to

support the whole principles of helping people plan for their retirement.

**OI** What were some of the intended consequences you mention there?

**KR** Well, I think the biggest one is clearly defined benefit pension transfers that were chosen to be included in part of those Freedoms. So, and of course with the issue around British Steel, that continues to fuel some pretty negative perceptions that no-one should be transferred out of the DB when in fact there are good reasons why some people may transfer out of defined benefit. But of course, the starting point is generally it's not going to be in most people's best interest to give up the safeguarded benefits that that scheme provides.

That would probably be the single biggest issue which has had a number of other impacts associated with it such as a hardening PI market which is leaving a lot of advice firms now exposed because they're not being able to secure renewal.

**OI** That PI is Professional Indemnity insurance, a mandatory and essential component for advisory firms. It is an ongoing worry for the sector, according to Keith Richards.

**KR** We are seeing a slight shrink in the market now, not least because the FCA are increasingly focused on supervisory work and honing in, in particular on DB transfers. What that has done is it has hardened the PI market even further so some firms cannot now secure PI insurance going forward. I mentioned earlier that does cause us some significant worry about the impact that may have in the future but what's happened since then is a few firms have de-registered in line with the FCA's request that any firm now not giving or using their permissions to relinquish them. So, over a thousand firms still continue but about 25 have de-registered since registering directly, as a result of being impacted by the lack of PI insurance in the market.

**OI** What are some of the lessons you think the regulator can learn from that experience?

**KR** Yeah, I think the FCA was themselves put in a very awkward position given the surprise news and I think it's well known that government had chosen not to engage either regulators or the rest of the market in arriving at that. So, I guess like the rest of us, FCA have been having to catch up. The lesson I think to learn is that FCA could have been quicker at coming out with more decisive guidance around things like DB, they certainly could have reinforced the position that it was unlikely

to be in most people's best interest.

So I think that was, for me, that was one of the learning curves for the regulators, not to be too frightened about coming forward quickly in areas where it would have been a no regrets position. I mean, it would have been easier to relax back from that rather than stand back and then come in afterwards.

The other issue that's really come out of Pension Freedoms right from the beginning, of course was associated with a comment that the then pensions minister made just to demonstrate that you can't give Freedoms and then stop people from doing what they want to do. So, the infamous Lamborghini quote really came from that but what we had seen at the start was a lot of insistent clients, so where mandated advice was required for safeguarded benefits above £30,000, there were a lot of clients who didn't really want the advice, had to take it and then wanted to ignore it, and that in itself caused quite a lot of tension and some potential issues that again perhaps the FCA could have taken a much stronger stance on from the outset.

- OI** The million-pound question in the minds of many people has been whether the reputation of pensions and pensions advisors have improved as a result of the changes. It's a complicated picture with no guarantee that hard fought advances are permanent.
- KR** Yes, reputationally, I think the sector has improved marginally. We have to accept that I mentioned earlier people trust their advisor but they don't necessarily trust advisors and I think that goes the same for most sectors. You know, the legal sector, the accounting sector are not immune from that either. Pension Freedoms did stimulate a lot of interest so we did see quite a bit more activity in accumulation rather than just people looking at how they decumulate. So, what would be really important now, given that we have got an ageing population, the concern before Pension Freedoms was that people may not have been looking around to secure the best annuity rate possible which could have a profound impact on their long-term financial wellbeing.

I think what we all have a duty to do now is help the public have more confidence. We as a professional body have a role charter and at the heart of that is about securing and justifying the public's confidence in our members. Broadly, we've done that through qualification framework and increasingly playing a role as a professional body to support the better delivery of outcomes and certainly the implementation of the right set of cultures aligned to the expectations of regulators.

Now equally regulators' overarching role is to secure and justify the public's confidence to engage in the markets that they regulate, so I think the time has come where, you know, the market has improved significantly, of course it's not perfect and as many people would say, there's always going to be ground for improvement. When you raise standards, you'll still have a top, middle and bottom. So, I think that will be ongoing and together I think in a more modern joined-up approach, we really do need to empower the public to make informed decisions even if that is not to do something, we need to give them the confidence to come to the market because it's well-regulated, because it is more professional, because people are better technically qualified and that there are much better protections in place for UK customers than perhaps anywhere else in the world.

So, you know, I really do hope that the lessons we can learn certainly from the recent past is to make sure that we don't go backwards and disempower the public and frighten them away from engaging in their own future financial wellbeing and I think that's a responsibility that certainly both the personal finance side and the FCA have jointly together.

**OI** The real key to raising the reputation of pensions might be to educate people earlier and provide better and more public resources for vulnerable consumers. This is a focus area for Keith Richards.

**KR** We're doing a lot of work on vulnerability, on the importance of recognising things like dementia, Alzheimer's, as advisors increasingly will be on that same life journey with an ageing client-base. On the other end of the scale, we introduced earlier this year a programme called "My Personal Finance Skills", it's based around a board game so it uses gamification to engage young people about to leave school to better understand the importance of budgeting, finance, avoiding financial scams because more of them now have technology at their use and they're becoming vulnerable themselves – as we know, scammers don't discriminate age-wise, it's wherever they can get some money.

So we've created this programme where so far over 700 financial planners up and down the country have been trained as education ambassadors and are going into schools. Since we've launched the programme, just over the last three months, over 7,000 young people have gone through this gamification and it's quite amusing because, for us, using a board game, you know, seems a bit old-fashioned but actually for young people it's quite retro. They're used to apps and actually the board game has really gone down well.

**OI** One area where the regulator is trying to raise standards is by banning Contingent Charging. Does he think this will lead to better advice and outcomes for consumers?

**KR** I'm not convinced it will, I'm not convinced that contingent charging is the route of bad advice, I think bad advice is bad advice. Contingent charging is simply a mechanism to be agreed with the consumer on how they wish to pay for the advice. What of course we can't deny, and we've put it in our own guidance, is that it's more important about recognising potential conflicts of interest and then demonstrating how you mitigate against that risk.

So, DB is quite unique because if the starting point is that it's unlikely to be in most consumers' best interest to transfer, then of course it is a bit of a conflict to use Contingent Charging with the assumption from the outset that a transfer will ensue. So, separating the initial fee for the research and recommendation, of whether to proceed with a transfer or not, is best separated from any dependency of ongoing assumption that a transfer would be suitable.

So, I think we're slightly cool, you know. To answer your question, I don't think it's the root of the problem, you know, if you remove Contingent Charging, someone that is intent on giving bad advice will continue to give bad advice, so I think we've all got to be more diligent in making sure that doesn't happen.

**OI** One unwanted side effect of Pension Freedoms has been the rise of pension scams. Unscrupulous operators trying to part consumers with their life savings. It can be traumatic and highly damaging and this is a priority for the FCA via its ScamSmart campaign. Head of Business and Consumer Communications, Emma Stranack, who leads the ScamSmart campaign explains why pensions are such appealing targets for scammers.

**ES** Well I think since the Pension Freedoms were introduced, people have more access to lump sums and that gives fraudsters a way in and that's, you know, they are very good at being persuasive, providing potential lucrative opportunities for people that are tempting, they have very sophisticated websites and they draw people in to the opportunity that their investment provides. The trouble is, it often sounds too good to be true and that should be a warning sign for all consumers.

**OI** It's such an important issue that the industry is playing its part too, helping by being another set of eyes on the problem.

**KR** We have an initiative aligned to the FCA's ScamSmart programme where we have signed up a significant number of professionals around the country who spend a minimum of fifteen, they commit to spend fifteen hours per month deliberately researching to try to spot scams and then direct them straight into the FCA website. Professionals after all are much better equipped to spot when something looks too good to be true, and as we're all aware if it does look too good to be true, it almost certainly will be.

So, rather than just leaving it to the unsuspecting consumer to fall foul to scams and then reactively the FCA having to do something about it, we are encouraging the profession to play a role in trying to spot them and alert the FCA much quicker.

**OI** If scams are to be stamped out, it's essential that industry and the regulator work closely together and that consumers keep their eyes open.

**ES** So we've had really, really good partnership working with a lot of industry who use our ScamSmart materials linked to our warning signs but also provide their own advice to their customers about what to watch out for. And, you know, check who you're dealing with – I mean, they identify the FCA register, for example, where you can look up to see if the firm is legitimate and use the phone number on the register, don't use the phone number that the potential scammer has given you.

**OI** What's the FCA's approach to tackling scams?

**ES** Well, we tackle scams on a number of different fronts through our intelligence teams, of course, where we're monitoring and gathering intelligence on scams that are out there. We also have an enforcement team who looks at prosecuting and closing down boiler rooms and so on, and my team in particular looks at the ScamSmart campaign where we are advising people and warning them to watch out for the signs of scams.

**OI** What methods have you been using to reach all the different audiences that you'd like to speak to?

**ES** So the ScamSmart campaign really uses a number of different channels. We use advertising, our website, we've done advertising on radio but also through social media and quite a lot of the time we have people whose children or family friends have pointed out some of our ScamSmart information through those channels but also, we rely on the press, broadcasters, Rip Off Britain has done some excellent coverage

for us on some of the issues faced by people being scammed. So, a number of different channels, really.

**OI** Chris McGrath, Head of Investment Intermediaries & Scams at the FCA, what have been the biggest challenges for regulating pensions over the last few years?

**CM** So, I think broadly there are two there. I think firstly the government brought in Pension Freedoms in 2015 and that's given people a lot more control over their pensions, which is great. But what we've found is that there's a particular area which is quite complex around the option to transfer out of a DB pension, a defined benefit pension where it's a very complex decision and sometimes advisors aren't always giving the best advice on that, so it's one of the big challenges we're facing on defined benefit transfers.

And then the second one is probably around pension scams, so that's where some quite poor players out there in the market are purposely actually trying to get people to invest in things that basically won't make the return that they're promised or simply take their money away.

**OI** And out of those, what are the priorities over the coming twelve months?

**CM** So, I think we've still got quite a big piece of work to do on our defined benefits work so that will continue to be one of our priorities and we will continue with our ScamSmart campaigning and sort of looking at firms that are potentially involved in scams and rooting out the ones that are pretty poor players in the market, so we'll continue doing that as well. I think finally we'll be looking at all our interaction with firms and trying to spot what some of the emerging issues are and try and get ahead of those before they're causing harm to consumers out there in the market.

**OI** Chris, why is pension transfer advice a priority for the FCA?

**CM** So, the decision whether or not to transfer out of a defined benefit pension scheme is a really complex decision. With the current economic environment, we've got quite low interest rates which results in high transfer values and that's often more money than many people will see in their lifetime. So, they want to access that money but that design needs to be balanced against the loss of certainty of income which these DB pension schemes offer and that needs to be balanced quite carefully. So, very complex decision and people need advice and they

need advice that's actually personalised to them individually.

Now, some firms are doing this really well but other firms that have not managed the conflict between the fees they charged often on a contingent basis and what is the best interest of their client individually. And they've also, some of them have also not demonstrated the competency they need in terms of what they need to consider and make recommendations to their clients and that's resulted in really poor advice.

**OI** So, what is the plan to raise standards of advice?

**CM** Across the investment market, about 90% or over 90% of advice is suitable, generally, but in the DB world, in the defined benefits world, over the last couple of years we've done some work and we've found that probably that suitability rate drops to about 50% in this specific area and that's just simply not good enough. So, transfer rates are too high, we start from a position as a regulator where it's best not to transfer out of a defined benefit scheme unless there are specific individual circumstances that make that so, but yet we're still seeing many firms where the majority, if not all of the people they advise, they advise them to transfer out of these precious DB schemes.

So, look, to address this, we've got a really comprehensive approach to determine the good from the poorer firms. Firstly, we're individually assessing the ninety most impactful firms that are operating in this space which involves us visiting the firm, understanding their approach and their processes around defined benefits advice and making judgements on whether they are giving good advice or not and taking action on them. Secondly, we've written to 1,600 of the less impactful firms so those less involved in the market but still active in this market, and we've used the data we collected on DB transfers last year to outline specific concerns that we have on each individual firm in that letter and we've asked all those firms to provide a response to us and depending on the adequacy of the response, we'll follow up on that.

**OI** And is it supervision work rule changes such as the proposed ban on Contingent Charging or a mixture of both which will lead to improvement in the quality of advice?



**CM** Well, it's really a mixture of both. So, you know, we need to be out there supervising firms that aren't doing things as they should be and finding those things and take action on those firms to help improve what consumers are getting in the market. But we also use that supervisory experience to formulate what our policy response should be if there's a more widespread issue in the market. And the most obvious example of that most recently is our work over the last couple of years on DB transfers showed that Contingent Charging was a particular issue, so we are proposing a change in policy on Contingent Charging.

**OI** And why are we banning Contingent Charging?

**CM** So, contingent charging is where advisors only receive a fee if the person actually transfers out of the DB scheme. So, by banning it, we're removing that financial incentive from advisors to offer that sort of advice and so there's more chance that an advisor will simply give that person the advice based on their individual circumstances rather than the fee they might receive or not.

**OI** And what will happen when we find examples of bad practice?

**CM** So, where we see significant bad practice in firms, we'll stop those firms and we've stopped 24 of the 63 firms we've assessed so far this year, so that's quite a high proportion of them. Where those firms can fix the problems we've identified, we will consider allowing them to resume DB transferred business but only once they have satisfied us that they've made the appropriate fixes to the problems that we've identified. Where firms can't fix the problems, or show a lack of willingness to fix the problems, they will exit the market and we've seen a number of firms doing that already.

Now, where we see serious misconduct in firms when we go out and visit firms and we actually see serious misconduct, we will take enforcement action which can result in fines and in banning people from operating in the financial services industry. And if we believe consumers have lost out from poor advice, we will make sure firms take appropriate steps to put those customers right. Consumers can also complain to the Financial Ombudsman Service if they believe they've received poor advice.

**OI** What issues are you finding with PI insurance?

**CM** So, given the problems we've been uncovering in the DB market over the last couple of years, providers of PI insurance have actually been tightening their requirements in terms of providing it. When we've been doing our supervisory work, we've been checking firms' policies and we're finding firms don't always understand the rules here or the specifics of their policy and what might be excluded from it which means they're offering advice potentially in areas that aren't covered by their PI policy and they should not be doing that. So where firms do not have adequate PI coverage, we're taking action to stop them from offering advice that isn't covered.

And more broadly, we're considering what we need to do around the PI issue as firms are finding it harder to get coverage, given the poor levels of suitability that we've found in the past in this market.

**OI** And what will happen if firms are not able to reach the required standards you talk about?

**CM** So, we'll take action to stop firms that aren't reaching the standards, it's not right that consumers are not getting the sort of advice they need to make these quite complex decisions. We're relying on professional financial advisors to give this sort of advice and they need to make sure they're offering a good quality of that standard so we will stop firms who are not actually making that standard.

**OI** Chris McGrath, FCA's Head of Investment Intermediaries & Scams bringing our podcast to a close there. I've also been speaking with Head of Business & Consumer Communications, Emma Stranack, and Chief Executive of the Personal Finance Society, Keith Richards. That's all we have time for in today's podcast – join us again soon for the next *Inside FCA* Podcast.