

# Consumer Focus Board

Paper 4.1

**Title:** Supercomplaints – Trail commission on pensions update

**Purpose:** For decision

**Date of meeting:** 4 November 2010

**Responsible officer:** Prashant Vaze

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**Attachments:** Annex 1: Main findings of Ignition House report on pension charges  
Annex 2: Other ideas for supercomplaints

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## 1 Overview

- 1.1 As we set out in our paper to the Board in February, we have been investigating the trail commission paid to IFAs by pension providers.
- 1.2 We have met with OFT, FSA and spoken to the industry to hear their views about the problems we discovered in this market. OFT were interested in the matter and suggested we use our own powers to research the subject further, working with the FSA, as FSA's retail distribution review is the most obvious platform for making any rule changes (this comes into effect end 2012). OFT is not sure a supercomplaint will work. We have not entirely ruled this out yet and are now seeking more information which will help us define the detriment and solutions more clearly and decide whether or not a supercomplaint is the right route. Both FSA and OFT suggested there might be problems finding a suitable remedy. If there are substantial payments to advisors but no standard contractual form FSA there will be legal challenges in imposing a single rule change on IFAs that some will feel overrides their proprietary rights to trail commission, We are undertaking more work to collect evidence on a feasible remedy to either submit a 'fully cooked' super-complaint or lobby the FSA ourselves. We hope to collect the evidence over the next six weeks.
- 1.3 We are also investigating other possible markets which we see evidence of consumer detriment. These include the charges for building works affecting leaseholders in private and public housing. We have also written around the organisation to develop a pipeline of other supercomplaints.

## 2 Action for the Board

The Board is asked to:

- 2.1 NOTE our approach on the draft supercomplaint on trail commission, with a view to issuing this either as a supercomplaint or as a high profile campaign in winter (see Annex 1 for a skeleton of the report).
- 2.2 NOTE the other supercomplaint projects being considered (see Annex 2).

### **3 The key issues**

- 3.1 At the January 2010 meeting, the Board emphasised its desire to see Consumer Focus make a supercomplaint soon and to submit further supercomplaints on a fairly regular basis. This is in line with the supercomplaints strategy agreed at the January 2009 Board meeting.
- 3.2 In February we commissioned Ignition House to undertake a desk-study on the impact of fees on personal and stakeholder pension funds.
- 3.3 The report identifies two consumer detriments. Firstly, IFAs receive trail / renewal commission, of around 0.5%/yr of the value of the fund, from the pension provider irrespective of whether the customer is receiving any service. The purpose of this trail commission is disputed. It could be a deferred charge for advice, or it could be to pay for on-going services to the client such as reviewing their pension needs and issuing paperwork. We understand the contracts between the pension provider and adviser are unclear on this and in any case vary.
- 3.4 The Ignition House report says “As a ball park estimate, Ignition House believes that around 80-85% of personal pension policyholders are paying trail to IFAs and yet do not have any contact with an IFA. We estimate that some £800m is being paid in trail commissions by these customers”. Secondly, the structure of charges for older pension funds make it is expensive for customers to switch. Barriers to exit e.g. market value adjustments and exit charges/loss of terminal bonuses. It may therefore not be cost-effective for the customer to transfer their savings to more suitable products, especially if they need to again seek (and pay for) advice to select an alternate product.
- 3.5 We are NOT *addressing* the issue of high exit charges on pension products in our investigation. Most customers will need professional advice about whether they are better off exiting their pension and the costs of the advice and set-up may outweigh the savings from reduced annual management charge / commission to the adviser. Further, much of the high cost of the initial product might have due to high initial charges, which would now be difficult to now recoup.
- 3.6 If the evidence supports our theory we would argue that trail commission would only be paid to the IFA if he or she continues to provide on-going services to the customer. Simply mailing an annual statement to the client would not count. If the IFA does not provide such services on-going payment of trail commission should cease and the charge should be retained in the pension wrapper.
- 3.7 We have also consulted staff internally to hear suggestions for other consumer matters they would like us to consider in Fair markets as possible supercomplaints. The most promising are included in Annex 2 along with information on the leaseholder charges.

### **4 Reactions from FSA, OFT and industry**

- 4.1 We wrote and met with FSA's Retail Distribution Review (RDR) team to discuss this issue. This team is overhauling advisor remuneration. The RDR will stop payments of trail commission to the advisor for all new products from 2012, though customers can still elect to pay for advice as deductions from their contributions over time (so-called “customer agreed remuneration”) – this would only collect an agreed sum of money and then stop. FSA did not agree with either about the scale of the trail commission

problem nor about the purpose of trail commission. FSA considers trail commission to be deferred payment for advice. We think its position is illogical for a number of reasons and we dispute this. Earlier this year they suggested some modest reforms in trail commission through RDR but appear to have backed down under pressure from IFAs. FSA is currently consulting on a minor change to trail commission in the event of a customer transferring from one advisor to another.

- 4.2 OFT have sympathy for our arguments. This is not an area they have expertise in, and they suggested they could find themselves replicating and agreeing with our analysis and then simply asking FSA to implement reforms through RDR. The same avenues were available to us. They were not convinced a super-complaint was the best route and suggested work with FSA or arrange a high profile campaign instead.
- 4.3 We have spoken to the two trade associations ABI and AIFA, and one pension provider on an anonymous basis. We believe that there might be some support from the industry to bring old pension products into line with new products. But there is likely to be a difference of views within the industry.

## **5 On-going work by Consumer Focus**

- 5.1 We have commissioned an omnibus survey to find out about savers' awareness on how their advisor was remunerated.
- 5.2 We have issued section 24 letters to 15 pension providers (covering over 90 per cent of the personal pension market) and 30 IFA firms covering around 30 per cent of the advisor market. We wish to have visibility of the contracts between advisors and pension providers and the levels of commission being paid / received by the industry. Our understanding is that trail commission can be 15% of the revenue of IFAs and the value of this stream of revenue is a major source of 'value' of the business and is taken into account when retiring IFAs sell their business.
- 5.3 We are investigating two legal precedents to offer a possible legal remedy to FSA.
- 5.4 We are writing up these data sources with view to producing a report setting out our complaint. The skeleton is attached at Annex 1

## **6 Risks and mitigations**

- 6.1 **Inexperience in pensions:** Pensions is a complex and evolving area of policy in which we have little experience. We are planning to focus the investigation on a narrow area of trail commission rather than the underlying performance of the pension themselves. We have approached The Pension Advisory Service and they have shared their intelligence about the market.
- 6.2 **Data quality** The information on the contact IFAs have with their clients is imperfect and likely to be disputed by the industry. Our Omnibus survey of pension customers seeks to improve this data. We have issued section 24 notices to improve the data.
- 6.3 **Unintended consequences:** there is a risk that IFAs use trail commissions to cross-subsidise the provision of information to poorer, unremunerative clients and withdrawal of this income stream will mean they have to hard charge for advice. The Omnibus survey will reveal how much contact IFAs have with different income groups.

6.4 **No feasible remedy:** There is the risk that investigation will succeed in demonstrating detriment & IFAs failing to honour their legal (or implied) duties to provide on-going services, but we might fail to demonstrate any legal scope for remedying it to consumers' benefit, will further reduce confidence in IFAs. This would suggest being open about the remedy we put forward at this stage.

6.5 **Appropriate next steps:** Given the much consumer ignorance about how much commission is taken in various guises and a complete lack of transparency – might therefore be better to do this as a campaign rather than supercomplaint.

## 7 **Proposal**

7.1 The Board is asked to NOTE that we are:

Preparing a report on trail commission paid to pension providers. We will ask the Board to decide whether it be issued as a supercomplaint or a campaign.

## 8 **Resources**

8.1 This work is being led by the Fair markets team, with the support of financial services, and data team and overseen by the Deputy Chief Executive. We have commissioned an Omnibus survey of less than £10k.

## 9 **Next steps**

9.1 The analysis work we have commissioned (section 24s and Omnibus survey) will be completed by December. We will then know whether there is evidence that significant numbers of advisors are not fulfilling their contractual duties. These data need to be shared with ABI and FSA (both have expressed an interest in meeting to discuss these results) to see if there is scope to finding workable solutions. We should be in a good position to conclude our work when these discussions finish.

9.2 Board to discuss this paper at November now and the subsequent work done between now and December will inform whether it returns to the Board in December for a recommendation for supercomplaint or campaign. We will discuss the document with 1 – 2 board members with suitable experience.

## Annex 1: Main findings of the Ignition House report on pension charges

- There are around 10 old-style (written before the *stakeholder pension* policy was introduced which shifted the whole market to lower fees) private personal pension plans in force.
- These personal pensions have an on-going charges of >1% annual management charge (AMC to the fund manager) and also high up front charges. Many also have loyalty bonuses, exit charges or market values adjustments which increase the costs of transferring out of these products.
- Part of the AMC is used to pay on-going trail commission (roughly 0.5% pa) to IFAs that sold personal pensions to clients by the pension provider, on average around £150 per pension per year so that it now amounts to over £1 billion a year
- Most policyholders don't understand trail commission and many are unaware that they are paying it
- The industry says that trail commission is important in encouraging long-term relationships between IFAs and clients
- But £900m a year is being paid to IFAs with whom consumers have no contact – 80-85% of policyholders are affected
- Under the FSA Retail Distribution Review there will be new rules (about disclosure and transparency of charges) and the FSA will forbid the practice of payments by the pension provider to the IFA but these do not apply to policies put in place before 2012, and it does not look as though they will be applied retrospectively

## **Annex 2: Other ideas for supercomplaints**

Below are three of issues that staff raised as possible supercomplaints. We are currently reviewing the list and will come back with suggestions how we take forward the ideas.

### Leasehold charges

Leaseholders face a range of problems in dealing with their social or local authority freeholders not encountered by their private sector counterparts.

The most pressing concerns are that;

- Leaseholders in properties owned by RSL or local authorities are powerless to do anything about badly managed and overly expensive contracts for work on their properties. We have information that suggests that such high costs are quite common.
- RSL and local authority freeholders are not obliged to go through the same consultation process as their private sector counterparts before undertaking work on their properties or letting large “framework contracts” to manage the entire estate. The features missing are
  - The duty to advise leaseholders of work being planned where the cost is greater than £250 as a one off or £100 a year.
  - The requirement to consider responses to these proposals including suggestions of alternatives.
- Such leaseholders are charged very high administration charges for councils to organise work.

Some of these problems could be overcome by changes in practice by local authority / RSL but in the long run it would make sense for tenants to have the same rights regardless of who owns their property.

### Airline and their pricing policies – drip pricing

The advertised prices of airline tickets is often different to the charge customers actually incur once ‘almost mandatory’ add on-costs are included e.g. credit card handling fee, boarding card print-off fee.

Our investigation plan would gauge the extent of the problem: assess the types of almost mandatory extra costs, review practices across different airlines, carry out an exercise sampling the difference between the headline price and the final basket price of a few different companies.

The desired outcome of the problem is agree new list of allowed costs that should be displayed in the headline price.

### Credit rating agencies

Credit ratings about consumers given by credit rating agencies like Experian can materially effect people's access to mortgages and rented accommodation. During the course of our current account switching work we discovered there was the perception that credit rating agencies used the frequency of switching current accounts counts and searches for new mortgages as a negative scoring criteria when scoring customers. We are concerned if this is so since it deters consumers from switching which we regard as an important discipline for the market.

We are considering doing some work to establish what criteria are used to assign scores for people and whether any deter consumer switching or any other activities undertaken by empowered consumers.

Fuel oil costs: high price (or other problems with service) in off-gas grid areas for fuel oil