Submission to the Work and Pensions Committee

Pension freedoms inquiry

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About this inquiry

The Work and Pensions Select Committee is running this inquiry to ascertain the impact that the 2015 ‘freedom and choice’ reforms have had on individual consumers.

Key points and recommendations

- It is of great concern that the Financial Conduct Authority’s Retirement Outcome Review suggests that many savers are deriving sub-optimal outcomes from their pension pots.
- Large numbers of people appear to be cashing in their savings or failing to shop around when they purchase a retirement income product, which is unlikely to be in their best interests.
- The long-term impact of freedom and choice is of the utmost importance, and there should be more focus on the impact consumer decisions are likely to have throughout their retirement. There also needs to be a proactive effort to ensure that as people get older – possibly with health conditions or declining cognitive capability - they do not end up making poor decisions or being exploited.
- Monitoring of outcomes is unsatisfactory. The data collected is insufficient to conduct a full analysis of consumer decision-making – in particular, data is not collected on a ‘per individual’ or ‘per household’ basis, which limits our understanding of the new regime.
- We fully support the Pensions Dashboard. However if it is to be a success with consumers it must be trustworthy and accessible through a truly independent source, with commercial opportunities for providers being tightly controlled.
- Pension Wise is providing a good service to users, but is experiencing low take-up rates. We support proposals to default everyone to the service on an opt-out basis.
- We are very concerned by the lack of product innovation. The industry has had ample time to start delivering solutions, and there is little evidence of any action. This is disadvantaging consumers, particularly smaller and mid-sized savers, who are forced to use the limited products that already exist.
- We note that much of the money withdrawn is simply placed in cash accounts. We would like to see the Committee considering the impact on the cash savings marketplace and its role in supporting retirement income.
- The Government and FCA need to press the industry to develop default product-pathways, which are essential to help improve outcomes for disengaged consumers.
- More emphasis needs to be put on preventing savers giving up safeguarded benefits – this issue has largely slipped under radar and needs greater prominence.
- The ban on pensions cold-calling and restrictions on transfers are a welcome first step towards tackling pension scams, but need to be legislated for as soon as possible.

Introduction

1.1 The freedom and choice reforms have changed the at-retirement (and pre-retirement) pensions landscape. Although popular, it is still early days, and while individuals who have accessed their pensions savings are for the most part happy with their decision-making, the true test of the reforms is whether they deliver over many years across retirement, not just at the outset. This will not become evident for several years.

1.2 Notwithstanding the early popularity of the reforms, there are still several deficiencies with the process, for example:

- the low numbers of consumers taking up advice and guidance;
- widespread disengagement and lack of trust in pensions leading to poor decision-making in some instances;
- the near-absence of innovation in new products,
- the lack of transparency of product charges;
- the disconnect between inertia-driven saving and at-retirement decision-making;
- consumer reliance on products like cash savings;
- the risk of fraud.

1.3 These, and others, are all significant issues that need action from the Government, the Financial Conduct Authority and other stakeholders if pension saving is truly going to serve the interests of consumers.

2. Inquiry questions

- **What are people doing with their pension pots (including defined benefit pension entitlements) and are those decisions consistent with their objectives? Is there adequate monitoring of the decisions being made?**

2.1 The research published by the Financial Conduct Authority, alongside its Retirement Outcomes Review interim report, highlights that many people are taking their tax-free lump sum early, while still working and with no firm plans to retire. The research suggests there has been a “decoupling of some of the decisions consumers make about their DC pots from their retirement planning.” This presents a problem as pensions are increasingly seen as a “windfall” instead of savings to support a decent standard of living in later life. Anything left over is simply moved into a drawdown account with an inappropriate investment allocation and ill-understood charges.

2.2 Age UK has also conducted some polling as part of our forthcoming report on women and private decumulation, focussing on couples. We have found that the majority of savers in couples budget at a household level, and view their pension predominantly as a means of paying for general living expenses, secondarily to spend on treating themselves or the household, and thirdly for savings. We will share this research with the Committee when available.

2.3 More generally, we are concerned that the process of accessing a pension is still extremely opaque and difficult to understand. The terminology used by the industry in communicating with customers is often jargon-heavy, and (where providers offer the full product suite) is still failing to encourage shopping around, in spite of years of effort to improve this. This suggests greater regulatory intervention is needed to ensure products are appropriate and competitive, alongside changes in patterns of consumer behaviour, which can also be helped towards better outcomes through a system of nudges, opt-outs and defaults.

2.4 The lack of shopping around for drawdown is particularly concerning – the FCA cites data from the Association of British Insurers (ABI) who say that 94% of drawdown products are bought from the customer's existing provider, while 30 per cent of drawdown plans are bought without advice.[i] This lack of wider engagement with the marketplace is linked to the language used and presentation of information, and there is lots of scope for improvement. We continue to argue that the government and FCA should look at radical solutions to improve this, such as developing blind auction sites for drawdown or implementing default product pathways. While we welcome the FCA's proposal to develop a cost metric to aid comparison, on its own this will not go far enough.

2.5 The recent trial conducted by the Behavioural Insights Team[ii] finding that a simplified statement, instead of a wake-up pack, improved engagement and use of Pension Wise is worth further consideration. However, this is only one part of the solution and should not be prioritised at the expense of other ideas. For example, pursuing this should not prevent the creation of a system of defaulting people into Pension Wise (see paragraphs 2.13 and 2.14).

2.6 There is also a lack of emphasis on the long-term implications of the pension freedoms. Consumer decisions have to be put in a long-term context, and (potential) outcomes considered across a 20, 30, 40 or even 50 year time frame. While decisions taken in the new landscape's early years are rightly being analysed in depth, other issues, such as the impact of drawdown products' investment strategies and charges on fund value across many years, need to be given equal consideration.

2.7 Large numbers of people will be required to make important financial decisions throughout later life, so more attention should be given to how people are equipped manage their pension, what happens if they experience bereavement or poor mental or physical health, and how they are treated by the financial services industry in these cases. It is important the Government and regulator take proactive steps to ensure good practice and provide the necessary help to consumers, or there will be significant future problems. It is easy to imagine scenarios where people unwittingly make poor decisions, are led down a sub-optimal path by providers, or fall prey to scammers, unless there are high standards of practice and sensible safeguards in place.

Monitoring

2.8 Monitoring of consumer decision-making is far from satisfactory. In terms of data, there are three main sources: the FCA publishes data on a per pot basis; HMRC shows the total money withdrawn from private pensions[iii]; and the Association of British Insurers produces analysis based on its members' pots.[iv] While these are each helpful in their own way and do improve understanding, none give a sufficiently detailed picture of the circumstances and nature of the choices being made by individuals and households.

2.9 We believe the FCA and the Treasury should work together to develop a comprehensive monitoring system that allows decisions to be analysed at both an individual and household level. Without this, it will be impossible to fully understand consumer decision making or the full impact of the reforms.

To what extent will pensions dashboards enable consumers to make more informed decisions about their retirement savings? What are the remaining obstacles to their creation and success and how should those obstacles be overcome?

2.10 Age UK fully supports the pensions dashboard, and we believe it could be a helpful tool for engaging people with their pension saving, especially retirement planning. However, it is not a silver bullet, and we believe claims that it will "revolutionise"[v] pension saving are overstated, particularly if the final dashboard does not include a comprehensive overview of all an individual's pensions.

2.11 The research published by the ABI in October 2017[vi] highlighted that consumers will value a dashboard, but only if it delivers full coverage and is free from commercial pressures. We agree with the ABI on two important points: that there needs to be legislation to bring reluctant providers on board; and that there should be a public-service dashboard, possibly held under the brand of the new single financial guidance body.

2.12 We would be very concerned if multiple dashboards are operated by commercial providers only. However, there is already a lack of trust in private pensions among the public, and there is no reason to think that if the (multiple) dashboards are operated by commercial providers they will stimulate anything other than continued distrust. We are concerned by reports that the dashboard will not include any information on charges or safeguarded benefits – this can only lead to poorer consumer outcomes and must be included. It is essential that people are able to make informed decisions about retirement decisions and consolidating pots, or the dashboard could perversely end up exacerbating some of the (potentially) poor decision-making that is emerging under freedom and choice.

2.13 We also believe that there is scope to aid people in their longer-term retirement planning by introducing a 'Career MOT at 50'. This builds on the Mid Life Career Reviews piloted by the Government in 2013-15, and represents an opportunity to engage people not just about their future working plans, but also by encouraging them to increase pension contributions in order to meet a desired transition to retirement. We are soon to publish a 'discussion paper' looking at different ways of bringing this to life, and would be pleased to discuss further with the Committee.[vii]

Are people taking proportionate advice and guidance and if not, why not? Are people adjusting behaviour in response to advice and guidance?

Is Pension Wise working? If not, how should it be reformed? Are there any implications for the proposed creation of a new single public financial guidance body?

2.14 Pension Wise appears to have provided an effective service with 94 per cent of users reporting being very or fairly satisfied and 90 per cent helped to make an informed choice about their next steps.[viii] However this success has been tempered by low take-up rates – notwithstanding that the service is free. Over the six month period between October 2016 and March 2017, 35,701 people had a Pension Wise appointment.[ix] A total of 276,761 pension pots were accessed for the first time in this period.[x] This suggests that only about one in six people who accessed their pension had used the guidance service. While more will have used the Pension Wise website, it is difficult to ascertain the nature of the online interaction. Even so, this is a worryingly low proportion.

2.15 We believe that people should be defaulted into Pension Wise on an opt-out basis. This would mean savers would be unable to access their pension unless they either had a Pension Wise appointment, took regulated advice, or actively decided they did not want either. This would encourage more people to take guidance and at least find out their options before taking a decision – particularly those smaller and mid-level savers who are likely to have lower financial capability and who are not in a position to pay several hundred pounds for regulated financial advice.

Is there evidence of product market competition resulting in cheaper, clearer or a wider products for consumers? Are people switching from their pension provider in accessing their pots? Is an adequate annuity market being sustained?

2.16 While there appears to have been some innovation among drawdown, hybrid and blended products, this seems to have been concentrated on products aimed at savers with larger pots. Innovation aimed at lower value savers has been considerably more limited.

2.17 Providers have had three and half years since freedom and choice was announced, and two and a half since the reforms went live, and there is still relatively little evidence of any products in development. Instead, we have seen large insurers like Standard Life and Prudential pull out of the open annuity market, leaving consumers with further reduced choice. In the drawdown and hybrid spaces there is minimal development – providers have had time but have done little, often citing 'the changing nature of decumulation' – which is frankly a weak excuse – suggesting strongly that firm action is required to drive innovation and competition.

2.18 People with smaller pots (and often but not always lower incomes[xi]) do appear to want drawdown-type products. The absence of suitable products for smaller savers seems to be contributing to the high numbers cashing out in full or otherwise reducing consumer options across the marketplace. This leads to people with a pension pot that is sizeable relative to their income being given the impression that their pot is not large enough to significantly boost their retirement income.

2.19 Age UK strongly supports the idea of default product pathways to help disengaged consumers through their decision-making. Suitable defaults would simultaneously enhance the benefits and mitigate the risks of the freedom and choice reforms. The industry should be pushed to develop suitable proposals – other than the NEST blueprint, there have been no serious attempts to do so. The FCA, along with the DWP and HM Treasury, should look to build the evidence base here, rather than accept that it does not exist.

2.20 We also disagree with the DWP's decision not to allow NEST into the drawdown market. The majority of consumers who do not cash out their pot are moving into non-advised drawdown products, which makes it very important that they offer value for money. In its response to the consultation 'NEST: evolving for the future', the DWP found little evidence that there are suitable drawdown, hybrid products are available for the mass market.[xii]

2.21 Furthermore, it argued that "it will be several years before there is meaningful demand from newly automatically enrolled members."[xiii] We disagree. As noted in our response to question one, monitoring of the freedoms revolves around individual pots rather than the individuals themselves, and many savers will have more than one private pension. The data (particularly for NEST members, as NEST is a younger scheme) therefore creates a misleading picture. Furthermore, the high proportion of smaller savers cashing out is likely to be at least in part *because* of the lack of suitable, low-cost options available to people who might welcome such a choice.

2.22 We believe that intervention is necessary to stimulate product development for the mass-market. In the drawdown and hybrid spaces there is minimal development – providers have had time but have done little, often citing 'the changing nature of decumulation' – which is frankly a weak excuse – suggesting that strong action is required to drive innovation and competition. If, as FCA suggests, a new norm of cashing out is already being established, then it is vital that new alternatives are created as a matter of urgency.

Annuities

2.23 In its interim Retirement Outcomes Review, the FCA identified providers continuing to withdraw from the open annuity market as a potentially serious problem. We've seen large insurers like Standard Life and Prudential pull out of the open annuity market, leaving consumers with further reduced choice. The FCA intends to keep a watchful eye on this marketplace, but it is essential that it remains competitive and consumers can exercise their right to shop around.

2.24 We are also very concerned by the numbers of people giving up a Guaranteed Annuity Rate (GAR). While only 9 per cent of those encashing do so, it represents a higher proportion of those with smaller pots and is highly likely to leave people worse off in later life. We believe this should be considered a priority issue and urgent steps taken to prevent people losing GARs or other safeguarded benefits.

Are the Government and Financial Conduct Authority taking adequate steps to prevent scamming and mis-selling?

2.25 No. While the commitment to ban pensions cold calling and place restrictions on suspect transfers are welcome, it is only a first step. We are also disappointed that its implementation has been delayed – we do not see any reason for the Government to drag its heels over this.

2.26 There is a fine line between a pensions scam and investment scams of other types. The categorisation of scams should be examined to ensure that all those relating to pensions – whether before or after the victim has accessed their pot – are being collated appropriately. 5 million over 65s (43 per cent) believe they have been targeted by scammers of one type of another[xiv] – even if not related directly to pension saving, it may well be linked to money saved and accessed through pension products.

Are the freedom and choice reforms part of a coherent retirement saving strategy? To what extent is it complimentary to or undermined by other policies?

2.27 If there is a central retirement savings strategy it is unclear. There appear to be competing political, financial industry, employer, and consumer pressures that have moulded the current situation, without any one taking overall precedence.

2.28 Nevertheless, we fully accept that the ‘freedom and choice’ reforms are a sensible, pragmatic development for many savers who would not find it in their interest to convert their savings into an annuity, and on balance support the reforms. We are, however, concerned that this major policy change took place without proper consideration of the implications. This does not mean only how consumers and providers are likely to behave, but also wider issues for example, the interaction with bankruptcy law, divorce law and the rules around deprivation of assets in relation to social care. And while some surviving partners may benefit from being able to inherit remaining unannuitised savings, others will not if all savings are spent too quickly. This is particularly important as there are now no inherited rights for surviving partners under the new State Pension.

2.29 There is also a tension between pension saving, which through auto enrolment is driven by inertia, and the freedom and choice reforms, which relies on unprecedented levels of engagement throughout retirement.

2.30 There are some clear deficiencies in Government policy, not least the lack of action on default pathways, scams and promoting product innovation. This inaction represents a lack of strategic direction, which sorely needs remedying.

2.31 With over half of pots (52 per cent) being fully encashed, and much of that money being moved into savings accounts, the Government also needs to investigate the interest rates offered in cash savings accounts by banks – people are likely to be significantly losing out if they leave their money here instead of a pension. We suggest that the Committee might like to consider the impact on the cash savings marketplace and its role in supporting retirement income.

2.32 Other products such as the Lifetime ISA, which is marketed as a retirement savings product, do not seem to be appropriate for this purpose and are driven largely by short-term needs. We believe it is inappropriate to bundle together saving for retirement and a first home, and are concerned that younger cohorts would be left significantly worse off in the long-term if LISAs became the dominant form of saving.

2.33 Given the success of auto-enrolment, we recommend the Government prioritises bedding this in and improving options at retirement, with an unrelenting focus on the consumer. As people gain acceptance of the need for saving for their retirement – as evidenced by the low opt-out rates among younger savers – improving confidence in pensions should be the priority rather than further tinkering with the long-term savings landscape.

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[i] Financial Conduct Authority (2017), Retirement Outcomes Review interim report
[ii] http://www.behaviouralinsights.co.uk/wp-content/uploads/2017/10/Pension-wise-trials.pdf
[iii] www.gov.uk – "HMRC statistics cover 'flexible payments', which means partial or full withdrawal of the pension pot, taking money from a flexible drawdown account, or buying a flexible annuity"
[iv] https://www.abi.org.uk/news/news-articles/2016/08/abi-pension-freedom-statistics-factsheet-april-2015-april-2016/
[v] http://www.thisismoney.co.uk/money/pensions/article-4364904/Pension-dashboard-showing-savings-2019.html
[vi] https://www.abi.org.uk/news/news-articles/2017/10/lets-put-pension-info-at-everyones-fingertips/
[vii] The paper is due out on 27 October 2017.
[viii] Department for Work and Pensions / Government Social Research (2017), Pension Wise service evaluation, full year findings on customer experiences and outcomes of using the Pension Wise service.
[ix] Face-to-face and telephone appointments combined, data from 'Pension Wise usage: transactions by channel' available at https://www.gov.uk/performance/pension-wise/appointments-delivered-by-channel
[x] FCA (Sep 2017), Data Bulletin 10 underlying data

[xi] See Pensions Policy Institute (2014), How complex are the decisions that pension savers need to make at retirement?
[xii] DWP response to its consultation - NEST: evolving for the future, March 2017
[xiii] DWP response to its consultation - NEST: evolving for the future, March 2017
[xiv] TNS Research Express polling for Age UK, June/ July 2017 – sample of 1,367 people aged 65+ in GB