Consultation Response

Helping savers understand their pension choices

Department for Work and Pensions

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About this consultation

The Department for Work and Pensions is consulting on measures that could help pension savers in trust-based schemes make informed decisions about using their savings, once they come to access them from age 55. This follows the Financial Conduct Authority introducing similar rules following its Retirement Outcomes Review, including the creation of Investment Pathways which make sure savers' investments remained aligned with their desired retirement income product choice.

Key points and recommendations

- We welcome this call for evidence and support the DWP's intention to improve member outcomes in the trust-based pensions marketplace, and also believe that mirroring the Financial Conduct Authority's (FCA's) successes is a good starting point.
- Pursuing a goal of savers making 'informed choices' has potential drawbacks. While it is a well-meaning aim, it is difficult to get the regulatory regime to deliver it right, and it risks allowing firms to avoid having a responsibility to ensure customers take decisions in their personal best interests.
- Notwithstanding, pension schemes should still provide high-quality information and signpost to other sources.
- We believe that a series of pathways are the best way of making freedom and choice work for typical disengaged savers:
    1. A pathway into guidance and advice - all savers should be opted in to Pension Wise to aid retirement decision making.
    2. Investment pathways to navigate the pre-retirement years
    3. Product pathways throughout retirement to facilitate the correct decision-making in a fiendishly complex marketplace.
- The DWP should investigate whether the regulatory regime should be amended to explicitly compel trustees to help their scheme's members at retirement.
- Savers with smaller (i.e. lower value) pots are highly likely to get a worse deal from the product markets. This could mean getting a lower return on an annuity, or paying higher charges on drawdown. This requires measures to address this, for example applying a charge cap of 0.75% on drawdown products.
- Similarly, our research found that non-advised customers are highly exposed to the complexities of the marketplace. Tools should be developed to assist customers with their decision-making, particularly if they are drawing down their money into later life.
- Nest should be allowed to offer the full range of retirement income products as soon as possible. It is unfair on its members to prevent their scheme from doing so.

About Age UK

Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe and secure at home; and feel valued and able to participate.

Introduction

Age UK welcomes the intention behind this consultation, and we agree that savers in trust-based schemes need a greater level of support in the run-up to retirement. Mirroring the FCA's Investment Pathways seems to be a sensible way forward – ultimately only a miniscule number of savers will be aware whether they are in a trust or contract-based pension scheme, and people would be surprised to learn that there are different procedures and governance standards that depend on which type you are in.

We broadly agree with the Government's aim, stated in the consultation paper as:

> *"to support individuals who are saving into occupational pension schemes make informed decisions about how to use their pension savings in the way that is best for them. By informed decisions, we mean understanding the variety of options available on how to use pension savings in retirement and their associated risks."*

Enabling savers to make appropriate decisions in their best interests should be the objective of reforming this area. However, it is worth noting that 'informed decisions' does not necessarily mean that decumulation decisions are taken in a consumer's best interests. This very much depends on providing good quality information to savers and, crucially, ensuring it is coupled with an equally good understanding of retirement income products. The financial skills, confidence and awareness of savers is both (largely) outside providers' control and, with the pension freedoms too alien and complicated for the majority of savers to understand, arguably too difficult a task to improve these en masse. It may be impossible to genuinely achieve informed choice, which is why pathways or defaults will ultimately have to be relied upon. In some ways, using such terminology as 'informed decisions' or 'informed choice' is a get out of jail free card for the industry – if they meet perfunctory targets and carry out the regulator's instructions to the letter, then they will claim to be informing their customers – and they may well be – but without any way of ascertaining whether they are actually giving people the understanding, knowledge and expertise needed to take appropriate decisions.

Given the complexities of decumulation, which is widely acknowledged to be fiendishly difficult to get right, without appropriate impartial advice and guidance it is difficult to see how people can become ‘good’ consumers and take decisions that best meet their personal circumstances and needs.

By the same token, consumer engagement, while a good thing and to be encouraged, is not going to drive the behaviour change needed to deliver optimal retirement outcomes. To over-emphasise engagement will be to the detriment of typical consumers, and we believe that the implementation of different pathways is critical to underpin good financial outcomes.

Age UK envisages three different ‘pathway’ systems, each working together to help people navigate the process of accessing their pension, while helping them understand their choices and provide them with appropriate options:

1. A guidance and advice pathway – where people are automatically enrolled into Pension Wise, either at age 50 or alternatively closer to the time they first access their savings. This will help people understand their options.
2. Once savers have decided how they want to access their pensions in future, they are placed on an investment pathway to maximise returns against their desired outcome.
3. When the money is accessed, people’s income should be smoothed to meet their requirements, using product pathways that are designed by providers (who are well placed to understand their customers’ needs) in conjunction with the regulators.

All of these would be designed as opt-out solutions, so consumers who wish to make a positive choice for different options can do so. We believe a system of opt-outs is the correct choice architecture because it is in keeping with the policy intention behind the pension freedoms, while providing a strong steer to (the majority of) consumers who are unfamiliar with retirement income products and who would benefit from extra support and guidance.

Consultation questions

Question 1a: Do you feel that the information you receive from your pension scheme is enough for you to make informed decisions about using your pension savings, and if not, what do you think would have helped?

Question 1b: Do you feel that this information is clear and concise, and if not, how could it be improved?

Age UK supports simpler annual statements as we are confident it will help savers engage with their pension. However, we continue to argue that these should include an accurate representation of fees and charges incurred – no other product would be sold to a consumer without giving them a clear understanding of what they are paying, and although the pensions market is atypical we believe that excluding this crucial information constitutes unfair treatment.

Question 2: As an occupational pension saver, do you expect your pension scheme to offer you guidance and support on the options available to you when accessing your pension, and if you do, what do you think that should look like?

Question 3: Thinking about other potential sources of information and support, aside from your scheme, who do you see providing these and what do you expect from them?

While pension schemes have a clear role to play in offering support and signposting to appropriate information, we believe the role of the schemes themselves should be limited. Although it is tempting to think that because there is an advice gap and because the schemes have some knowledge of the customer and their own retirement income products then it is logical they should fill this gap, this is an erroneous idea. It is not possible for schemes to be impartial or benevolent providers of guidance or advice. They are ultimately governed by their commercial interests and, given the difficulties of encouraging consumers to shop around are well known even under perfect market conditions, allowing firms to conduct this activity would kill any nascent competition.

This is not to say that schemes should not provide information to their members, and signpost towards appropriate advice and guidance – this is important and schemes have a key role to play in engaging with and informing their customers, but it is unlikely to make a meaningful difference to savers' retirement outcomes. There are many good firms and good people within the industry, but ultimately they are constrained by their commercial interests.

However, it is likely that the fiduciary duty does ameliorate the situation within the trust-based pensions environment (as the new Consumer Duty may do in the contract based world). Trustees do at least have a legal obligation to act in their members' best interests, even if this does not mean being able to provide independent advice, and potentially have the scope to go further than contract-based schemes may do. We believe there is a gap at point-of-accessing a pension, in that many trustees do little or nothing to help their members, often due to a lack of knowledge and skills and because they are afraid of straying into financial advice territory. If necessary, the regulatory regime should be amended to ensure trustees are explicitly obliged to provide their members with help and support to aid the transition.

Clearly annuity providers are regulated by the FCA, and in theory the Consumer Duty could improve consumer outcomes. However this will be difficult to evidence, and we recommend that the FCA sets out clearly how it intends to apply the Duty to the retirement income marketplace – although on the surface this may not fall under the auspices of this call for evidence, given that many trust-based savers will purchase annuities it is very relevant to ensuring good outcomes. The DWP and TPR need to ensure that they are working closely with the FCA to address this issue.

Pension Wise

For consumers to take the most appropriate decisions, guidance and advice needs to be provided independently. Pension Wise is well placed to do this, which is why we continue to believe that more people need to speak to Pension Wise prior to accessing their pot, and that people should be defaulted in on an opt-out basis. For example, between October 2020-March 2021 only 10.5% of pots being fully withdrawn had visited Pension Wise.[i] This is far from 'the norm' that's been suggested by the Pensions Minister and the Work and Pensions Committee, and we believe it should be significantly higher.

The 'stronger nudge' trials run by the Money and Pensions Service, were a small step in the right direction, but overall made only a small difference. In spite of the DWP claiming the measures "significantly increased" take up, in fact the report states that for each of the two interventions piloted, around 8 per cent more people than in the control group subsequently had a Pension Wise appointment.[ii] This means that even with the 'stronger nudge' solution implemented a significant majority would still be accessing their pension without any support.

Pension Wise has been shown to be a valuable service, receiving high approval ratings from users and helping a majority change their mind about their best course of action.

The proposal to create a automatic pathway into Pension Wise has support from the Work and Pensions Committee, and it is surprising the DWP has not pursued this more actively – with the 'stronger nudge' results from its trials achieving insufficient behaviour change it is extremely disappointing that we will now seemingly need to wait for it to fail in practice before a more meaningful solution can be implemented.

Question 6a: What information do members need in the run up to retirement such as from age 40-50?

With standard communications and simpler statements taken as a given, we believe that by age 50 everyone should have been offered (and ideally received) a mid-life MOT. We are encouraged by the DWP's recent announcement on this, however we believe the option of a face-to-face intervention will be preferable. The MOT (which ideally will be rebranded, as the name appears off-putting for many people) should include pensions, and represents an opportunity for some more intensive engagement and alerting people to their options for accessing their pension savings. We will follow its progress closely.

Question 6b: What information do members need from age 50?

As per our answer to Questions 2 and 3, we believe that Pension Wise usage should become 'the norm' and agree with the Select Committee's suggested target of 60%.[iii]

The Pension Wise appointment should be taken as close to age 50 as possible, with scope for a second appointment at point of access. This will help people understand their options prior to taking a decision – it is believed that many people may have already decided what they will do before taking guidance and are less open to changing their mind.

Pension schemes should be in regular contact and can help engage their customers.

Question 8a: What income options or products, if any, does your scheme currently offer members when accessing their pension savings?

Question 8b: Do these options or products differ depending on pot size?

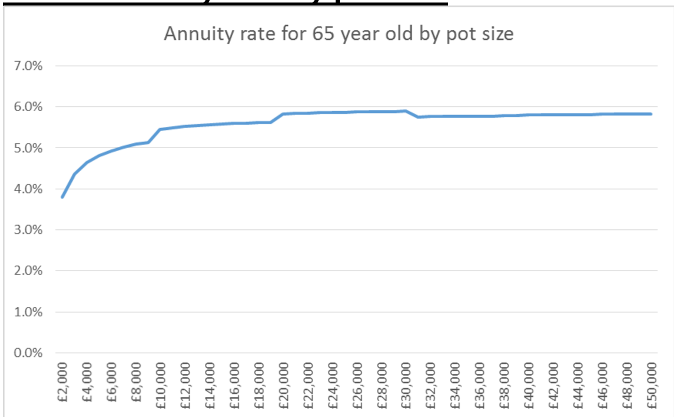
People with different pot sizes can expect access to different products, as well as different levels of financial advice/guidance, when using their pension savings. As is to be expected, those with smaller pots will get less product choice and are likely to pay higher fees. In addition, while higher value pot holders may be able to find and afford an IFA, people without substantial savings are unlikely to be able to afford

Annuities
For example, previous research commissioned by Age UK following the announcement of the freedom and choice reforms, shows that am individual buying an annuity with a small pot will get a lower rate of return. Even if the individual concerned has a number of small pots with a higher total value, if they fail to shop around and buy several annuities with each pot's provider, this will also harm their retirement income.

While this data is admittedly quite old and obviously the marketplace has moved on considerably (we do not have any similar more up to date information), it is likely that this situation continues – all the underlying variables that led to this outcome are still true.

We have included the chart below to illustrate the point (rather than to provide accurate up-to-date information). It shows the annuity rate offered by one major provider at different pot sizes (summer 2014 prices) – annuity rates are lower for those consumers with pension pots of less than £20,000 and take a further significant lurch downwards for those with less than £10,000.

Chart: Annuity rate by pot size



Single Life Annuity, Purchased at age 65 in good health, lives in SE13

The modelling found that an example consumer, with £29,000 spread across four pots, would generate an income of £1,500 per year if they pursued four separate annuities, compared to £1,700 per year if they combined them into one pot.[iv]

Drawdown
There is also an imbalance in the marketplace, with smaller potholders being less likely to understand fees and charges, creating a greater opportunity for providers to sell them more expensive retirement income products. According to the FCA's Retirement Outcomes Review, savers with smaller pots are less likely to be aware of the fees charged by drawdown providers. Only 36% of pot holders with between £10,000 and £29,999 knew exactly what the fees were, compared to 63% with over £100,000.[v]

Advice

Age UK’s policy report ‘Fixing the Freedoms’, published in 2019, found clear evidence that lower value savers were unable to access advice and crucially the support that IFA’s can offer to their clients. While advised customers were helped or given access to tools to enable them to assess their expenditure and rate of drawing down their fund, non-advised customers had no such help and were left entirely to their own devices. This included not just help with accessing pensions, but also crucially during the retirement years when advisers can help people manage their money and draw down at an affordable rate, in some cases providing tools to help their clients achieve this. These type of tools are not available to non-advised customers.[vi]

Question 10: If you have already introduced income options or products such as investment pathways, have you received any feedback from members, or conducted research to assess their effectiveness? If so, what conclusions did you reach?

Although we note it is still very early days for investment pathways, the anecdotal feedback received by Age UK is that they are working quite well, not least because they are dissuading savers from being overly invested in cash. Being over-exposed to cash with the current high inflation rates would be devastating for people’s longer-term retirement prospects, and while we remain concerned that many people are still in this position, they should protect more people’s real savings value over time.

Question 11: Should Nest be able to deliver the full range of income solutions for members unwilling or unable to access decumulation options without support?

Age UK has long supported calls for Nest to be able to deliver the full range of retirement income solutions for its more than 10 million members. Failure to allow this will put many of these savers in a difficult position, where their pension scheme cannot deliver the products they want while allowing to access their tax free lump sum, which will force them on to the open market. This is putting people at the mercy of a marketplace where products aren’t designed to meet their needs, and in the worst cases exposing them to scams. As a public-backed scheme, Nest would be well placed to deliver product solutions to meet the needs of lower-value savers, especially given its detailed learnings from the last decade of supporting auto enrolment.

While its Guided Retirement Fund is a positive development, utilising the UFPLUS arrangements does not give its members the full range of choices they need. Allowing

Nest to deliver a full product range is essential in order to avoid detrimental outcomes for its members, many of whom are likely to cash out their whole pot in order to secure the tax free cash, and it is a simple matter of fairness that so many savers should be able to receive this support.

Pushing through this reform is a no-brainer and we urge the DWP to do so as soon as possible.

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[i] FCA Retirement income market data, 2020-21

[ii] https://moneyandpensionsservice.org.uk/wp-content/uploads/2020/07/maps-stronger-nudge-evaluation-report-july-2020.pdf

[iii] https://committees.parliament.uk/publications/8514/documents/86189/default/

[iv] Age UK (2014) Dashboards and Jam jars https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/money-matters/rb_dec14_dashboards_and_jam_jars_pension_pots_and_retirement_income.pdf

[v] FCA (2018), Retirement Outcomes Review final report

[vivi] https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/33a.-fixing-the-freedoms---age-uk-discussion-paper-june-2019.pdf