



Response to the consultation on freedom and choice in pensions

Introduction

As the UK's financial capability charity, The Money Charity welcomes the opportunity to respond to this consultation.

Our vision is for everyone to be on top of their money as a part of everyday life. So, we empower people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives.

We do this by:

- developing and delivering products and services which provide education, information and advice on money matters, in an appropriate way for young people and adults;
- working with all parts of the financial services industry to improve practice and outcomes for their consumers; and
- influencing and informing policymakers, the media, the industry and public attitudes to support our vision, purpose and delivery.

The proposals in this consultation represent a significant change to individuals' ability to access their pension wealth, and will alter the type and frequency of decisions individuals need to make. They therefore have implications for the level of financial capability and engagement needed during both the accumulation and decumulation phases. We respond to this consultation from the perspective of supporting people to stay on top of their money and to make informed decisions that are right for them.

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It is absolutely crucial to the success of these reforms that the 'guidance guarantee' offers meaningful, tailored guidance, and it is essential when setting the parameters and conditions of the guarantee not to underestimate the difficulty individuals have in taking decisions about retirement. The FCA's thematic review of annuities found that this difficulty – whether through inertia, a lack of understanding, or both – is prevalent in the current system where in most cases only one type of product is under consideration, and clearly this difficulty will be compounded by widening the scope of products available to most individuals upon retirement.

At present it is not known whether the guarantee will consist simply of providing a list of options and the 'pros' and 'cons' of each, or a more tailored approach that considers an individual's financial, family, and health situation and offers a 'steer' towards certain types of products (without straying into regulated activity). We strongly believe that the latter approach is the only one that can possibly be effective and it would be naïve and dangerous to only provide people with a list of options on retirement in the belief that consumer choice trumps all. Leaving individuals' finances in retirement at the mercy of their ability to make decisions with cursory information, or their willingness or ability to pay for regulated financial advice, would be irresponsible and would lead to significant and lasting consumer detriment.

In order to be effective, the guidance guarantee must meet the following criteria:

- It must be tailored to an individual's situation;
- It must come to some form of conclusion; and
- It must provide ongoing support throughout retirement.

We make more detailed comments below.

Comments on the proposed approach to reforming the pensions tax framework

At a high level, we support the principles behind the proposed reforms, but we also have serious reservations about some of the potential unintended consequences of reform, which we outline later in this section.

We believe that people should have more control of their finances, and by allowing greater flexibility in how the majority of retirees with Defined Contribution pension pots access their pension savings, the reforms will allow consumers to make their own decisions around pension products. By removing the effective requirement to make a one-off purchase of an annuity, consumers will be able to choose different products for different stages of their retirement and to reflect their needs and goals as these change throughout this period.

It is also clear from research conducted by the Financial Conduct Authority that the current annuity market, whereby one type of product is effectively mandated for most retirees with a Defined Contribution pension, is not functioning for consumers. Therefore there is the potential for reform to lead to better outcomes in retirement for individuals, whether by

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spurring annuity providers to innovate and offer improved rates or by widening the range of products available.

However, as well as these potential positive outcomes, there are a number of issues that the proposals raise and that are not considered in the consultation. We highlight these below, and urge government to address these points as these reforms are finalised.

Firstly, it is important to consider these reforms in the wider context of pension reform, in particular with regard to the introduction of auto-enrolment. The Financial Conduct Authority, in its thematic review of the annuities market, notes that difficulties faced by consumers in decision-making and engagement with pension funds upon retirement could be exacerbated by the introduction of automatic enrolment: “Auto-enrolment potentially reduces consumer engagement, as they no longer need to engage with or actively participate in pension-saving activities. Therefore, these consumers will be faced with choices at retirement with relatively little knowledge of the value of their pension savings.”

The combined impact of these policy directions is to present consumers with a wider range of options regarding a pot they did not engage with during the accumulation phase. While we support the principles behind both reforms – of increasing saving for retirement and providing greater choice upon and during retirement – the interplay between them needs to be recognised.

One point to note is that for most people approaching retirement, who will be auto-enrolled for only a few years, the amount accumulated will not be large. The introduction of auto-enrolment is likely to increase the number of individuals with Defined Contribution pension savings, but at least in the short term the challenge of managing the flexibility of withdrawal of pension money continuously throughout retirement could well outweigh the potential benefit. Figures from the Association of British Insurers shows that the median defined contribution pension fund used to purchase a single life annuity is around £20,000; fewer than 1 in 5 funds were worth more than £50,000, while around 5% were worth over £100,000. For most individuals currently approaching retirement with Defined Contribution pension pots, therefore, the freedoms will not apply to large amounts of pension wealth. For these individuals, if they do not choose to make the ‘one-off’ decision of purchasing an annuity with their full pension pot on retirement, the stresses inherent in providing greater freedom are likely to be high compared to the potential benefit.

But it is important to recognise that these stresses and concerns will also exist for all individuals with new pension freedoms, including those with large pots. There are a number of points to consider here.

Firstly, by removing the single decision point provided by the previous effective requirement to buy an annuity, the proposed reforms are likely to increase the length of time individuals will need to engage with their pension pot and therefore the length of time that the management of their finances could cause them worry. This is particularly likely to be the case for individuals with large pension pots who would not have met the Minimum Income Requirement for flexible drawdown under the previous rules but now have a sizable amount

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of money to manage – in almost all cases this will be the largest amount of money they have ever had access to at any one time.

Additionally, as the proposals raise the possibility of individuals making decisions about their pension wealth well into old age, consideration needs to be given to the difficulties of making decisions later in retirement if an individual's mental capabilities decline. This is especially pertinent given increased life expectancies, which is likely to increase the number of people in the UK with dementia or similar conditions, and will lead to greater numbers of people struggling to make important decisions about their finances.

An increase in the number of people who are unable to make decisions also likely to lead to more individuals holding power of attorney, and the implications for them of the proposals should also not be discounted. An attorney may now be responsible for making decisions over a relative's remaining pension pot, which would previously have been taken care of had an annuity been purchased, which is a considerable additional stress at what is likely to be a difficult time in any case.

The proposed single point of free guidance will not resolve these important issues. We believe that a more extensive entitlement to guidance would go some way towards reducing the dangers that we have noted. In our response to question 8 below we suggest that this could take the form of an entitlement to multiple free guidance sessions, which could be taken by an individual – or a nominated family member – from 12 months before the individual reaches the minimum pension age.

A further risk is that, if individuals are able to access their full pension pot, they could access it for the wrong reasons. While we recognise that government's position is that this is an integral part of allowing increased responsibility for the use of pension wealth to be transferred to the individual, this is not only about an individual potentially overspending their pension wealth at an early stage of retirement. There is a risk, for example, that if individuals can access their whole pension wealth from age 55, they will be put under pressure by debtors to access this wealth to pay down outstanding debts. For some individuals this will be a good decision, but for others it may not; this could significantly reduce their pension pot and thus their retirement income, undermining government's intention of increasing people's retirement savings.

Finally, while we support the principle behind the proposals, it should be recognised that these reforms represent a fundamental overhaul of the tax treatment of withdrawals from pension funds that could have great impacts on individuals' saving behaviours and retirement planning. This sets a precedent for further significant reform, and reduces certainty for individuals that the same or a similar set of tax rules for pensions will be in place when they retire, which in turn complicates decisions around saving even more. The impact of this is likely to be particularly felt by younger workers where the date of their retirement is further in the future, and we would make the point that certainty around the tax treatment of pension savings is likely to bring its own benefits.

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While at this point we have not developed detailed proposals to resolve these issues, a commitment to tailored, meaningful, ongoing guidance is a critical part of any solution. If this is not provided we believe there is a high risk that the reforms, while well-intentioned, will inadvertently lead to considerable detriment to individuals and their families.

We have responded to specific questions below.

1) Should a statutory override be put in place to ensure that pension scheme rules do not prevent individuals from taking advantage of increased flexibility?

We do not see a justification for allowing some pension schemes to prevent individuals from taking advantage of increased flexibility, and therefore we would support a statutory override. If such an override is not created, there is a risk that individuals could be locked in to making particular decisions upon retirement that may not be right for them, negating the positive intention of the reforms.

2) How could the government design the new system such that it enables innovation in the retirement income market?

The Money Charity has no view on this.

3) Do you agree that the age at which private pension wealth can be accessed should rise alongside the State Pension age?

We believe it would be appropriate for the age at which private pension wealth can be accessed to rise alongside the State Pension age. Although this means individuals would have to work longer before being able to access their pension pots, in line with the principle behind raising the State Pension age this seems reasonable given increasing life expectancies.

This would also prevent an increased risk of individuals spending large amounts of their pots in a short period of time. If the gap between the minimum pension age and the State Pension age were to increase, so too would the length of time that an individual could access – and potentially spend – their private pension before they were eligible for the safeguard of the State Pension.

4) Should the change in the minimum pension age be applied to all pension schemes which qualify for tax relief?

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On the grounds that simplicity and consistency are valuable principles in any tax system, we believe that any change in the minimum pension age should be applied to all pension schemes which qualify for tax relief.

5) Should the minimum pension age be increased further, for example so that it is five years below State Pension age?

We would support a further increase in the age at which pension wealth can be accessed, although we do not have a view on the level relative to the State Pension age at which this should be set. Reducing the gap between the minimum pension age and the State Pension age further reduces the risk of individuals unwisely depleting their pension pots in the first years of retirement, leaving them in financial difficulty until they reach the State Pension age. The freedoms that would be granted by these reforms need to be balanced with protection for consumers, and increasing the minimum pension age further would seem to be an appropriate mechanism through which to achieve this.

Comments on the proposed approach to supporting consumers in making retirement choices.

We welcome the recognition that the proposed reforms will increase the need for support for consumers, and believe that the ‘guidance guarantee’, if implemented correctly, represents a positive step towards supporting individuals in making retirement choices.

However, the proposal in the consultation document of a one-off, free-to-consumer guidance session will not sufficiently support consumers in these decisions. Greater choice in retirement requires greater planning in the accumulation phase, and also requires engagement beyond the State Pension age. We would greatly welcome action from Government, including funding and support for the generic advice sector, to address this.

Whatever the shape of the eventual guarantee, it is important that people know what advice they are entitled to, and the limits of that advice. Where those limits are set will also have a great bearing on the effectiveness of the reforms. A guidance guarantee that consists of a list of options with risks and potential benefits would be redundant and ineffective, as it would replicate information that is already available and would not help individuals to decide what, given their situation, is the best path for them. However much information an individual has, taking decisions about how best to use a pension pot is an extremely complex and difficult decision, and this must be recognised in the guarantee by a commitment to not only improving individuals’ understanding of their options but also by more actively supporting them in taking a decision.

We also believe that there should be some form of a ‘default recommendation’, which would provide individuals with a recommendation appropriate to most people. Much has been

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made of the FCA's finding that eight of ten people who buy an annuity from their existing pension provider could have benefited from switching – the default option was to purchase an annuity from the current provider. Under the proposals put forward in this consultation, the default option for an individual who does not greatly engage with their finances on retirement would be to draw down their pension as they see fit until the fund was exhausted. While some individuals might choose to do this, it is unlikely that this would be the best option for most – by providing an alternative default recommendation the risk of negative outcomes stemming from inertia is mitigated, and this presents an opportunity to improve on the current system. We recommend that government works with consumer groups and industry to develop this default recommendation.

6) Is the prescription of standards enough to ensure the impartiality of guidance delivered by the pension provider? Should pension providers be required to outsource delivery of independent guidance to a trusted third party?

We strongly believe that pension providers should not be permitted to offer the guidance, given the clear risk of a conflict of interest leading to potential consumer detriment and the prevalence of recent mis-selling scandals across the financial services industry. As the FCA's recent research into the implementation of the disclosure elements by advisory firms has shown, the prescription of standards also does not guarantee these standards will be followed.

The potential detriment to consumers of being poorly advised on such a significant decision is great, and for those who do continue to purchase a single product with their entire pension pot, this detriment will continue throughout the rest of their lives.

This could be overcome in part by a powerful programme of monitoring and enforcement, but any effective programme would be expensive and time-consuming, and any action would undoubtedly come too late for some consumers. Therefore the most appropriate response to this risk is to require pension providers to outsource delivery of independent guidance to a trusted third party.

As part of this, it is vital for sufficient funding to be provided to develop a more vibrant and diverse generic advice sector in England. At present the generic advice sector is highly concentrated and limited in its potential reach – allocating the seed funding to this sector would both improve and widen the guidance that could be available. The Money Advice Service could play a valuable role in the oversight of this provision, and in bringing together industry and advice bodies to find a way to implement this guarantee in a challenging timescale.

Given the limited seed funding available for capacity-building, we are also concerned about how realistic the ambition of offering face-to-face guidance is, particularly by the planned implementation date of April 2015. We suggest that it would be more practical – and ultimately of greater overall benefit – for the requirement for the

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guidance to be available through a particular channel be removed. Face-to-face guidance is expensive, and as we note throughout this response, for this guidance to be meaningful in the context of the wider proposals it must be ongoing. Therefore it is difficult to see how this could be afforded, and recommend that telephone or online – which will be suitable for the majority of individuals – are the primary channels for this guidance.

7) Should there be any difference between the requirements to offer guidance placed on contract-based and trust-based pension schemes?

We see no reason for any difference between the requirements to offer guidance placed on contract-based and trust-based pension schemes.

8) What more can be done to ensure that guidance is available at key decision points during retirement?

Guidance is essential to the success of these reforms. We are pleased that there appears to be recognition in this question that guidance is needed during retirement, not just at the point of retirement, but are concerned that there does not appear to be any provision for it in the current proposals other than around the point of retirement.

This is a particularly important point given trends around individuals of State Pension age in employment. The latest official figures show that 10.3% of people aged over 65 are economically active, and this proportion is rising. This raises the possibility of a new generation of partially-retired pensioners, who might take advantage of the proposed freedoms to supplement some income from employment with a smaller amount withdrawn from their pension fund.

There are two related points here. The first is the question of, if there is only a single session of free guidance available, when should this be delivered if the notion of ‘at retirement’ is becoming increasingly less fixed? Offering someone guidance at age 65 if they intend to continue working for another 10 years before taking their personal pension is likely to have a limited impact on the quality of decision that they then make.

The second issue further highlights the need for ongoing support throughout retirement, not simply a single session of guidance. More and more individuals will be ‘semi-retiring’ and working part-time, or engaging with the labour market to varying degrees at various points after 65 before finally ‘retiring’.

Such individuals would benefit from advice throughout retirement at various points, such as when they first begin to access their pension pot, as their working schedule decreases, and when they stop earning and are entirely reliant on their pension for income. With a single point of guidance, however, when an individual comes to retire

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finally would have ‘used up’ that guidance; there would be then be no entitlement to guidance at the point when it is arguably most important. It is not realistic to expect individuals to know at, for example, State Pension age, how their employment – and ability to work – might change throughout their later life, especially as the proposed reforms in this document remove a potential disincentive for pensioners to work (i.e. that previously most pensioners would have a guaranteed income from their annuity and then the State Pension).

From the consultation document, we are also concerned that the difficulty people have in making financial decisions has been underplayed, while the capacity for the provision of meaningful and valuable guidance has been overstated. Paragraph 3.26, for example, appears to suggest that a correlation between age and displaying a ‘savings orientation’ is a marker of financial capability. It is important to recognise that while taking the decision to save more money might be associated with financial capability, it is not necessarily indicative of improved decision-making when it comes to choosing how to access that accumulated wealth. This is particularly true for older generations who might be expected to save more for at least two reasons that are distinct from financial capability. Firstly, they are likely to be later in their careers and therefore have higher disposable incomes, so saving is simply more achievable. Secondly as retirement approaches, retirement planning is likely to be a more pressing concern. It would a mistake to confuse these two drivers of pension saving behaviour with financial capability.

As we note above, the reforms raise the possibility of individuals making multiple, shorter-term decisions throughout their retirement, rather than a single decision to purchase an annuity that will provide them with an income for the rest of their life. This makes guidance increasingly important, but also makes the current – and proposed – model of a single point of guidance shortly before retirement outdated. An entitlement to, for example, four free guidance sessions per person, which could then be used at any point from 12 months before they reach the minimum pension age, would provide a starting point of basic support for individuals on their options for using their pension pot wisely. This advice would need to be tailored to the person’s age, and for their capabilities at that time, with the option for the advice to be given to a nominated family member in cases where a power of attorney exists.

Guidance *before* retirement could also make a significant impact on the size of pension pots and individuals’ decisions during retirement. There is no shortage of tools and calculators developed by pension providers highlighting the benefits of regular saving from an early age, but these tools require individuals to actively engage with them. It is widely recognised that individuals experience inertia around saving and retirement planning – and this inertia was a key driver behind the auto-enrolment policy – so there may be a need for a heavier policy ‘nudge’. The introduction of auto-enrolment offers a very attractive point at which to provide a degree of guidance around the importance of pension saving prior to retirement, and

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harnessing this opportunity could improve engagement and encourage individuals to think about their pension at an earlier point.

As responsibility for the management of personal finances is increasingly transferred from the state to the individual – as seen in other policies such as Universal Credit – there is a corresponding need for ongoing, properly resourced support around financial management. In relation to pensions specifically, the proposed reforms heighten the need for early engagement as individuals will have a wider range of options to understand – if they do not engage until, for example, a year before retirement, this is a large amount of information to absorb, understand, and apply to their situation in a short space of time, which may be too late.

As we state in our response to question 6), supporting the generic advice sector is essential for the intention of the reforms to be realised. Without provision of free advice, individuals face the prospect of either returning repeatedly to IFAs at various stages of their retirement, or taking out long-term products to avoid these multiple decisions, or their attendant costs (rather than because these products represent their best option), which runs counter to the intention of these proposals. Individuals would still be able to access regulated, more specific, paid-for advice should they wish to do so, but the potential perverse incentives we identify here would be reduced.

9) Should the government continue to allow private sector defined benefit to defined contribution transfers and if so, in which circumstances?

It appears to go against the general thrust of the reforms to permit pension freedoms to some individuals and not others, on the basis of the type of their pension. We do, however, acknowledge that there will be wider ramifications of continuing to allow private sector defined benefit to defined contribution transfers.

10) How should the government assess the risks associated with allowing private sector defined benefit schemes to transfer to defined contribution under the proposed tax system?

We do not have any comment to make on this.

Comments on any potential impact of the government's proposals on investment and financial markets

We do not have any comment to make on this.

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