28 April 2021

Submitted via UK Parliament Committee's online form

Dear Sir or Madam

Evidence to Parliamentary inquiry into Protecting pension savers – five years on from the Pension Freedoms: Accessing pension savings

The Society of Pension Professionals welcomes the opportunity to respond on this matter.

Executive Summary

We believe that appropriate flexibility exists within workplace and retail pension products, but it's important to recognise that not all workplace schemes provide for the full panoply of Freedom and Choice (F&C) options. Retail products are available and successfully fill the gap where in-scheme options don't exist, however they are generally more expensive for members and often require advice to take out the product.

CDC could offer a third way between annuitisation and drawdown. Hybrid products combining annuity and drawdown could provide a guaranteed income underpin with income flexibility on top. Regulatory support is required to make these options more scalable, cost efficient and streamlined.

Most people are not receiving the guidance and advice they need to make an informed decision about how to access their pensions. Guidance is too generic while regulated advice is too expensive. Some form of personalised guidance or low cost focussed advice is needed.

The Money and Pensions Service (MaPS) should focus on equipping members with sufficient knowledge to make simple decisions or give them the confidence to take regulated advice. Such support is needed when members first access their pension and at regular points throughout the retirement/decumulation journey, especially for drawdown products or where they have multiple pots they choose to access on a staggered basis.

A significant training programme would need to needed to equip MaPS advisers with the different skills and knowledge to undertake anything which is akin to regulated advice. This would increase employment costs and time spent on each guidance event, both of which have implications for the general levy. It also creates a possible conflict/trade-off between advice and guidance and the potential loss of MaPS's impartiality.

Decumulation pathways can support generic outcomes, but they cannot tailor/flex to individuals' spending patterns, lifestyle choices, wealth or other circumstances. The issue is further complicated when a member has multiple pension pots with different pathways and different time horizons. Decumulation pathways need to be supplemented with advice and guidance and regular review to ensure they remain on track and evolve to meet individual's changing circumstances.

The process of stop/go communications and multiple risk warnings in order to place a time barrier between hasty decisions and access to benefits, but the number of complaints from members accessing F&C benefits serves as evidence that the process is perhaps too long and complex and does not serve members' interests well. Some simplification would undoubtedly improve the member experience.

The Society of Pension Professionals
Kemp House, 152 – 160 City Road, London EC1V 2NX T: 020 7353 1688
E: info@the-spp.co.uk www.the-spp.co.uk

Detailed Response

Q1: Do people have access to a range of pension options to meet their needs for later life and how might these needs change in future?

We believe that appropriate flexibility exists within workplace and retail pension products as a whole, but it is important to recognise that not all workplace schemes provide for the full panoply of Freedom and Choice (F&C) options. Defined Benefit schemes are designed for a single retirement outcome (scheme pension) and typically offer no F&C options. Therefore whilst many pension savers may be able to access F&C directly from their scheme with little difficulty, others will need to purchase an appropriate retail product.

Commercial 'go to market' schemes whose success is dependent on wide market appeal (such as Master Trusts and GPPs) generally offer all F&C options. Some GPPs may facilitate drawdown through transfer to an individual personal pension, but the transition is within the same provider and the journey relatively seamless.

Legacy commercial schemes (mainly older contract-based schemes) which are no longer marketed but instead run as a closed book have no commercial imperative to offer all F&C options. Many members of these schemes may need to transfer to a retail pension product in order to access them.

Single employer trusts may offer simple options (such as UFPLS for DC schemes), but rarely offer in-scheme drawdown. Moreover six years on from the introduction of F&C, there remain regulatory barriers and risks which impede the use of 'buddy schemes', such that the sponsor or Trustee of a single employer trust is often unwilling to promote an alternative scheme for a member wanting an option not offered by the scheme.

Retail products are available and they successfully fill the gap where in-scheme options do not exist. However, they are generally more expensive for members (i.e. they are not subject to charge caps or fiduciary 'value' oversight via a Trustee or IGC). Advice is often required to take out the product, the cost of which may be disproportionate to the pot value. Although an increasing number of such products are available on a Direct to Customer (D2C) basis, many members lack the knowledge and confidence to purchase.

Most members of DB schemes face a significant advice cost in order to transfer to a product through which they can access F&C options. For reasons such as regulatory permission, liability risk and decreasing availability of Professional Indemnity Insurance, the advice market for DB transfers is contracting and this can be expected to increase average fees. Through higher demand (for what are often no more than speculative transfer value requests), sponsors of DB schemes are likely to face increased administration costs as their members explore F&C options.

As far as how member needs may change in the future, it is generally accepted that many members will need to convert flexible income to guaranteed income in later life to provide funding certainty for care home fees or to protect them against poor decision making if and when their faculties deteriorate. Even assuming that pot values are sufficient to purchase an annuity of the necessary magnitude, we believe there to be some uncertainty over the durability of today's annuity market to withstand the triple threats of mortality improvements, selection against the insurer and a reducing mortality pool. No market has yet emerged for deferred annuity products and given the uncertainty just noted, it seems unlikely that a competitive market will evolve. A mid-way path between drawdown and annuity (such as CDC or hybrid products – see Q2 below) may need to evolve to meet this need.

Q2 Are there other pension options, not currently available in the UK, which would better meet people's needs in later life?

In a workplace environment, CDC is not yet well-evolved in the UK but could offer the necessary third way between annuitisation and drawdown. It is evident that scale is a pre-requisite for CDC success and regulatory efforts could be focussed on encouraging that scale through pooling opportunities.

Hybrid products or product combinations combining annuity and drawdown could provide a guaranteed income underpin with income flexibility on top. Such structures can be facilitated through retail products available today, but ideally they should be facilitated through a single product. These products often carry higher charges than workplace schemes and often require an advised process.

Such hybridisation can currently be facilitated through:

- For DC schemes, a partial transfer to an annuity provider and using either an in-scheme drawdown facility or transfer to another drawdown provider, and
- For DB scheme using a reduced scheme pension and either in-scheme drawdown or partial

transfer to a drawdown product.

It will be immediately apparent that it would be a more complex and expensive option in a DB environment since there would need to be a process of obtaining a transfer value (and calculating an appropriately reduced income level with the residual amount) and regulated advice. Such disadvantages may however be offset against potential benefits to the DB sponsor.

Q3. Are there barriers to providing other pension options which meet a need and are not currently available in the UK?

The barriers to CDC (scale) and hybrid solutions (partial transfers) require regulatory support to make them more scalable, cost efficient, streamlined and for DB schemes in particular, less risky for sponsors and trustees.

The Finance Act restricts what is allowed as an authorised payment. This restricts innovation around drawdown and annuity and a review of authorised payments may be necessary to overcome this potential impediment.

Q4. Are people receiving the guidance and advice they need to make informed decisions about how they access their pensions?

As a rule of thumb:

1. Guidance from MaPS is necessarily generic, rarely focussed on scheme-specific or personal circumstances.
2. Regulated advice is often too expensive and is generally focussed on the initial retirement event rather than on life events throughout retirement (e.g. health changes, residential changes, dependant's death etc). The advice model in the UK is not economically viable for the majority of workplace retirees due to the low average pot sizes. Encouraging consolidation, especially on a non-advised basis, could alleviate the pot size/advice cost viability issue).
3. Some form of personalised guidance or low cost focussed advice is needed to help people make informed decisions without the expense of regulated advice concluding with personal recommendations.
4. Some members are unable to afford or obtain the advice they need (e.g. to give up safeguarded benefits), thereby restricting their options to an annuity.
5. Education from scheme providers/sponsors is a significant challenge. Even the more knowledgeable members tend to lack the confidence to transact without being told to do something.

Q5. What role should the Money and Pensions Service have in supporting people accessing their pensions for the first time, including through pension dashboards?

MaPS advisers are not currently charged with responsibility for advising on scheme specific options or consolidation opportunities. Nor do they have the regulatory authority to engage in Know Your Customer activities sufficient to guide members towards or away from a particular product option.

MaPS should therefore focus on equipping members with sufficient knowledge to make simple decisions or to give them confidence to get to the next step in the process (i.e. taking regulated financial advice). Members can then engage in more productive, time and cost efficient conversations with specialist advisers. Such advisers could work closely with MaPS to develop simple, focussed retirement advice propositions to support members who have received MaPS guidance, therefore understand the basics and now need restricted, product specific advice.

As noted above, support is often needed not just at the time members first access their pension savings, but also at regular points throughout the retirement/decumulation journey. This is especially so where members use a drawdown facility which could stretch over several decades, or where they have multiple pots which they choose to access on a staggered basis. It is our understanding MaPS does not provide guidance on crystallised benefits, but it does nevertheless have a role to play in helping members understand why and when they should review their income strategy.

Dashboard cannot support tailored retirement planning in its initial incarnation since it will lack the scheme coverage, data items (e.g. scheme options/charges/investment options etc) and functionality/transactional capability necessary for ongoing advice and support. It has the potential to be a much more supportive solution, but that outcome seems many years away with the current rate of progress. For the same reasons as above, the initial phase of dashboard is unlikely to help MaPS improve its service greatly.

Q6. Should the Money and Pensions Service offer enhanced guidance or limited advice for people making decisions about their pensions?

Enhanced guidance is not defined but assuming it is akin to limited advice, it is likely that MaPS advisers would need to go through a significant training programme to equip them with the different skills and knowledge to undertake anything which is akin to regulated advice where KYC is front and centre of the advice process. Next in importance to KYC is market and product knowledge including the scheme(s) the client has at the time of advice, requiring an understanding of how, when, why and where to refresh that knowledge. This implies a regular refresher programme of training.

Notwithstanding these difficulties, such an upskilling programme could fill the current void between guidance and full regulated advice, providing free personalised guidance, tailored to their circumstances.

Such an evolution would be expected to increase employment costs and the time spent on each guidance event, both of which have implications for the general levy. Providers and scheme sponsors will – with some justification – resist levy increases to fund these activities. There would also be a possible conflict/trade-off between expensive full advice (with Financial Ombudsman Service and FSCS protection) and free, bespoke guidance that has no similar level of protection.

The transition from MaPS' current remit of providing free and impartial advice towards a guidance model has both cost and liability risk attached and also a potential loss of impartiality, especially when guiding clients towards a particular product solution.

Q7. Can the success of auto-enrolment in helping people save into pensions be replicated for people in retirement through investment pathways?

We believe that the circumstances of accumulation and decumulation are fundamentally different and therefore the simple answer to this question is 'not easily'.

Accumulation has two simple truisms (ignoring black-swan, LTA and AA/MPAA issues). Firstly, PAYE economic activity equals pension accumulation. Secondly, bigger is always better. Decumulation pathways can support generic outcomes (DD, cash, annuitisation or combination), but they cannot tailor/flex to individuals' spending patterns, lifestyle choices, wealth or other circumstances. There is no decumulation truism which is analogous to accumulation's 'bigger is always better' axiom.

Schemes operate in isolation of one another. A member with three DC pensions may simultaneously have three different pathways (cash, drawdown and annuity). Differences in Scheme Pension Age could mean that a member may have multiple DC pots each with different pathways and different time horizons.

Consolidation can be made more complex by pathways. For example, if a member's final workplace pension is targeting a cash outcome, but the member has a variety of other pots he wishes to transfer in for drawdown purposes, he will then need to self-select different investment funds to align the investment strategy to support drawdown. It is vanishingly rare that a deferred member will be permitted to consolidate pots into a previous employer's scheme, even if that one is targeting drawdown.

As noted in earlier answers, decumulation pathways need to be supplemented with advice and guidance and regular review to ensure they remain on track and evolve to meet individual's changing circumstances.

Q8. Including costs, what information do consumers need about different retirement products to make an informed choice?

General information is required around the different retirement products available, what they are and the types of customer and situation for which they are designed and suitable. This would include income flexibility including ad hoc withdrawals, minimums and maximums, any guarantees and options on death.

Other items, and we acknowledge that this is not an exhaustive list, include:
Charges including initial, ongoing and exit charges, financial protection available, the regulatory status of the product provider, tools which analyse charges and decumulation rate (and patterns) to predict savings-longevity, investment options, purposes and costs and increasingly importantly, information on the ESG objectives and credentials of different investment solutions.

Q9. Are pension schemes communicating options effectively to members and are there material differences between trust-based and contract-based pension schemes?

Despite industry and regulatory aspirations and initiatives, the simple and disappointing answer is that there are still good and bad examples of communicating options.

Generally speaking, there are no significant differences between commercial Master Trust and contract-based schemes. Master Trust schemes have tended to lean quite heavily on contract-based regulations which have led to a process of stop/go communications and multiple risk warnings in order to place a time barrier between hasty decisions and access to benefits. The barriers serve this purpose well, but the number of complaints from members accessing F&C benefits serves as evidence that the process is perhaps too long and complex and does not serve members' interests well. The process of interruption, rather than immediate execution, is understandable and right, but some simplification would undoubtedly improve the member experience.

In single employer trusts, the communications will vary according to the types of F&C options offered. As noted elsewhere, where no or limited F&C options are offered, Trustee and employer concerns about financial promotion rules, whether explaining in-scheme options or options to transfer to another 'safe harbour' scheme in order to access wider F&C options, are an inhibitor to effective communication.

Inconsistent terminology and jargon are still prevalent. This could be remedied through regulation. There are also some are lengthy, unengaging communications which would benefit from simplification.

Q10. Can the issues around small pension pots be solved through behavioural changes by savers?

Consolidation undoubtedly has the potential to change member behaviour. Attention and pot size are intrinsically linked. Consolidation is therefore key to any potential solution, but addressing the loss of certain tax protections (e.g. protected pension ages) on individual transfer is essential. Transferring has regulatory implications that are perhaps outdated in a pure DC to DC transfer situation where the information needs are relatively straightforward.

The other behavioural change that would help solve the issues around small pots is a simple one - save more. An opportunity to address this was perhaps missed when the Government didn't implement the recommendations of the 2017 AE Review that would have seen greater contributions. That change would have significantly and rapidly increased pot sizes. Whilst the problem of small pots in the context of meaningfully supporting a retirement income may not be resolved, the issue of micro pots would quickly be resolved.

Yours Faithfully

Fred Emden
Chief Executive, SPP

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