



Treasury Committee

Oral evidence: Budget 2014, HC 1189

Tuesday 1 April 2014

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Members present: Mr Andrew Tyrie (Chair), Andrea Leadsom, Mr Andrew Love, Mr Pat McFadden, Mr Brooks Newmark, Mr David Ruffley, John Thurso

Questions 212-358

Witness[es]: **Chris Woolard**, Director of Policy, Risk and Research, Financial Conduct Authority, and **David Geale**, Head of Savings, Investments and Distribution, Financial Conduct Authority, gave evidence.

Q212 Chair: I want to begin by saying that, although it is extremely important that it be looked at carefully, we are not going to examine the question of the apparent leak or pre-briefing of part of the business plan of the FCA today. There are very important issues there that we will return to on this Committee, but not in this session.

Can I begin with you, Mr Geale? In your thematic review on annuities, the FCA found that three insurers had accounted for 97% of the market for standard annuities, which is most of them. Who were they and isn't this a serious competition failing?

David Geale: I will pass part of that question to my colleague in terms of the market study, but there are several major players in the annuities market, being obviously Legal & General, Aviva, Standard Life, Scottish Widows and others. In terms of whether there is a competition issue that is one of the things we will be looking at in the market study, which Chris may want to talk more about.

Chris Woolard: In terms of the piece of work we have now launched, the purpose of that is to look at how well that market is working for consumers and, in particular, whether there are any competition issues either around how annuities are offered into that market or how the market works more broadly.

Q213 Chair: Who were the three firms and is this a serious competition failure?

Chris Woolard: In terms of the firms, Mr Geale has just mentioned the major players in the market. In terms of whether there are serious competition failings or not, the market study is entirely intended to look into those kind of questions.

Q214 Chair: You do not think you already have a rough idea? We are doing here a thematic review, which has taken a year, and we are now going to have a year-long market review of competition. I am just wondering whether we need two years to answer this question.

Chris Woolard: There are a number of issues there that are quite complex that we clearly need to look into. There is an interplay with the wider resettling and questions around the market, which no doubt we will come on to, that were announced within the Budget. Also, we just need to bear in mind here, in terms of our ability to look at issues from a competition perspective, that is something relatively new still for us as the FCA and that is something we are developing.

Q215 Chair: You are feeling your way and that is why you need more time?

Chris Woolard: I would not say we are necessarily feeling our way, but I think a lot of the issues we are dealing with are quite complicated.

Q216 Chair: But it is because you are new to the area. That is what you have just said, isn't it?

Chris Woolard: The FCA has had the ability to look at issues from a competition perspective since April of last year. That is when we took on our new powers in relation to competition. We have obviously built capability and capacity around being able to act on those issues. That team sits within my part of the organisation.

Q217 Chair: Is it because you are new to the area that this is taking two years?

Chris Woolard: No, I do not think it is because we are new to the area. I think it is because the issues we are dealing with are quite complex.

Q218 Chair: I am just trying to clarify the point you made earlier. We should set little store in the fact that you have just arrived with this responsibility. You are up and running.

Chris Woolard: Yes, we are.

Chair: All systems go. You have what you need to do competition work?

Chris Woolard: Yes, we have, but it is still a relatively new concept.

Q219 Chair: Could I go back to Mr Geale? You mentioned a number of firms. What are the three that have 97%?

David Geale: The three that have 97%, I will have to come back to you on specifics. Off the top of my head, the major players would be the likes of Legal & General, Aviva, Scottish Widows, Partnership, Just Retirement and so on.

Q220 Chair: You found that 80% of consumers who purchase their annuity from an existing provider could get a better deal on the open market. Who is responsible for this area?

Chris Woolard: We will take the questions together. That is fine.

Q221 Chair: Mr Woolard, isn't that what anybody, even when they are shopping around, finds when they try to get a chicken leg? They very rarely get the cheapest chicken leg in the market, do they?

Chris Woolard: No, but I think there are a number of features around the annuities market that we need to be quite careful about. If you go out and shop around for a chicken leg and you find you have bought a very expensive one, then next week you have a chance to go to a different supermarket and buy a different chicken leg. Buying an annuity clearly is a one-off decision for people. It cannot be reversed or it cannot be very easily reversed.

Q222 Chair: But, logically, it is extremely unlikely that everyone is going to get the very cheapest deal in any market at any time.

Chris Woolard: Yes, that is absolutely right. Nevertheless—

Q223 Chair: So this stuff does not mean very much. It looks good, but it does not tell us much, does it?

Chris Woolard: I think it probably does.

Chair: Okay. So tell us.

Chris Woolard: At the moment, what we have found within the work that was done as part of the annuities review is that, roughly speaking, for every £1,000 of potential income you are losing about £70 worth of income by not getting that best deal. That is the four out of five people who do not shop around. Clearly, over an average life expectancy and over an average annuity, that begins to mount up to a reasonable amount of money that people are simply leaving on the table.

Q224 Chair: Let us just have a look at how much is being left on the table. You have these very big figures, apparently large numbers, that again look impressive, but if you scratch them I would like you to clarify just how much weight we should set by these either. I certainly do not think we should set much store by this 80% figure. These are that pensioners lose between £115 million and £230 million over their lifetimes, but in your own work—well, why don't I ask you? How much does that work out per month or per year lost for a standard pension in absolute cash terms?

Chris Woolard: Just to come back on the £115 million to £230 million figure, that is the estimate of what is lost by people not shopping around as they approach an annuity year, so as each cohort of people buying an annuity reaches retirement.

Q225 Chair: I understand. Now we need to know what this means for the man or woman in the street. What is the answer?

Chris Woolard: In terms of the man or woman on the street, the average pension pot is somewhere around £20,000. Therefore, the average loss is £70 on £20,000. Roughly speaking, each month that is probably somewhere in the region of £100 potentially lost in total.

David Geale: I think it is also important to recognise that those are the figures for people who stay with their existing provider, rather than shopping around for a better rate. There will also be

people who could look at enhanced annuity rates and someone who may be losing more. It is about encouraging people to understand that they can shop around and they may get a better deal as a result of that more broadly, I think.

Q226 Chair: You have a table in your report that shows that the average amount of annual increase in income for the standard annuity is £67 per annum, which is £5.50 a month, let us say. Yes?

David Geale: Correct.

Q227 Chair: We are not talking about a great deal, are we? This figure here that starts off at £115 million to £230 million does not sound so drastic when we translate this into what it means for each person. We have also discovered that the suggestion that everyone is being ripped off because they are buying an annuity far more expensive than they should needs certainly a lot of care. This figure of 80% that you put out is by no means as straightforward as it looks. Would you agree with both those two conclusions that I am drawing?

David Geale: I would agree we need to take a lot of care in this market and I think that the £67 is per £1,000 worth of income. Obviously for people it does multiply up, as Chris said. Equally, that is on people who stay with their initial pension provider to take their annuity and it does not take account of the people who could do better by looking at enhanced annuities. I think, in that context, we would welcome the flexibility that the Government has brought.

Q228 Chair: My concern is that there are aspects of this review that look as if at least some of the presentation of it appears to be geared to providing headline numbers that may surprise or even shock. I am not sure that is what we need from these thematic reviews. Would you agree? What we need is the hard analysis, and that 80% figure, unless a lot of thought is given to it, is a pretty misleading number, isn't it, Mr Geale?

David Geale: I would agree we need hard analysis. I would not agree it is a misleading number. I think this was a discovery—

Q229 Chair: Everybody can tweak the two points I have just made in relation to it, can they? First, very few people are going to get the very best deal, however hard they try, and therefore it does not tell you that much on its own. What you need is a lot more information before you know whether it is telling you that the market is in some way dysfunctional or that people are being ripped off. The second thing you need to know is how much people are losing on average, and we have discovered that it is a small number. Isn't that correct?

David Geale: I would agree, as I say, that there needs to be hard analysis. I agree that what we need to do is look at the market and see what detriment people are suffering, but this was a discovery piece of work that will then flow through into a further market study piece of work that will look in more depth. What we need to do, as the figure shows, is encourage people to shop around. They may not get the best deal every time, but they can achieve a significantly better deal than they are achieving at the moment.

Q230 Chair: I am not suggesting for a moment we do not want more competition or we want to discourage people from shopping around. On the contrary, I think this whole Committee has been pressing vigorously for four solid years to get more competition work into the FCA and indeed, after a struggle, we got it into the FCA's operational objectives as a consequence of a Treasury Select Committee recommendation.

One last question on this. Inasmuch as there is excess rent being taken from the fact that, perhaps because they do not have all the available information, people are not getting the best deal, have you looked at where that excess rent goes, whether it is going to the firm or whether it is going into cross-subsidy to other products?

Chris Woolard: If I may, Mr Chairman, part of why we are doing the wider competition piece of work here is to look at what underlying dynamics are happening within this market.

Chair: Other customers may be benefiting from this, so it may not be all firm rip-off. We just need to take a look to think that through as well, it seems to me.

Q231 Andrea Leadsom: Just following up from what the Chairman was saying about chicken legs, is there not the point also that it is not simply about whether you are getting the highest amount of annuity, but it is also whether it is appropriate for you; whether you are also trying to extend the beneficiary to your spouse, for example? Can you just talk through exactly what you are doing not just to focus on the absolute level of the annuity but the appropriateness of the sale for the individual?

David Geale: First, I completely agree, it is not just about the cost. It is about the shape and it is about the type of annuity. These are all issues that we picked up in the market study. Obviously in the design of the guidance framework to go with the Government announcements, we will be looking at that as well and making sure people are given the information they need to make that right decision there, but as I say, the issue of what type of annuity people buy will be picked up as part of the market study work.

Q232 Andrea Leadsom: Why has it taken you so long to do this study, bearing in mind the market has been saying that the annuities market is dysfunctional for years? Why is it only now that you are undertaking this market review?

David Geale: As Chris said, we have only recently been given the competition powers to look at it from a competition perspective. On the thematic side, there has been a lot of commentary around whether annuities work or not and views on both sides. The thematic work has given us the conclusive evidence that the market is not working well for consumers and made the case for change.

Q233 Andrea Leadsom: But the market has known that for years and, forgive me, but I do not think you can hide behind the FCA only just being given powers. Previously you were part of the FSA. An awful lot of your employees at the FCA were in fact employees of the FSA. As far as the Treasury Committee is concerned, we can take it as a given that you have always had the responsibility for looking at the proper order of the markets. Perhaps not under this hat or employment contract, but many of the individuals who work for the FCA

previously had competition responsibilities at the FSA. It is not good enough to say you have only just been given competition powers. I will ask you again. Have you considered doing a market review before now and why did you only start one just recently?

Chris Woolard: So we are absolutely clear on this, in terms of the FSA, it did not have competition powers.

Q234 Andrea Leadsom: So you could not have carried out a review?

Chris Woolard: It could not have carried out a competition study.

Q235 Andrea Leadsom: You are saying you could not have carried out a competition study of the annuities market under the FSA, just to be clear on that?

Chris Woolard: Yes. As the Chairman was indicating, one of the new powers of the FCA—

Q236 Andrea Leadsom: No, but could you just be clear? You could not, if you had wanted to, as an employee of the FSA have carried out a review of the annuities market? That would not have been within your remit to investigate. Is that correct?

Chris Woolard: Speaking personally—

Andrea Leadsom: No, speaking for the FSA.

Chris Woolard: If I can just answer your question. Speaking personally, I joined to be part of the FCA. I am a relative newcomer to this field. My understanding is previously the legal position in terms of competition issues was that they sat purely with the Office of Fair Trading during the days of the FSA. Subsequently, as a result of the change in legislation, we were given competition powers in order to pursue them. If I can just come back, though, and perhaps give you a slightly more helpful answer.

Q237 Andrea Leadsom: I think an important point is whether you have only recently been able to carry out such a review, because it has certainly been very commonly held in the market that the annuities market was dysfunctional and, at worst, a complete rip-off for many years. Perhaps you could investigate and let us know whether in fact this is the first opportunity since the FCA was given competition powers, under strong pressure from this Committee, for the British regulators to look into this market. I think that is an important point. Otherwise, I think the regulators in the UK have fallen down on the job in the past to have not been able to look into something so clearly dysfunctional before now.

Going on to the recent announcements in the budget, pensions reform is going to fundamentally change the market. Are you now looking at postponing, delaying or changing your market study?

Chris Woolard: In terms of the market study, we wrote to a number of the firms already involved in it on budget day and then subsequently on 26 March. What we have made clear to them is the review is still ongoing. We believe that it is perhaps in many ways even more important that we conduct this piece of work, but what we have done is we have modified a number of the

questions we might ask, in particular where they have effectively been overtaken by events in the budget. In particular, we are paying far more attention and far more focus to the operation of the market in future, taking account of some of these changes that are proposed, in terms of how we do that work.

Q238 Andrea Leadsom: There is a journalist report, "Other leading chief executives pointed to the FCA's recent demands for large amounts of information for its annuities review sent out 10 days ago, with a four-week deadline, and questioned whether running two consultations at once makes sense for the industry". You are out there with large requests for information to run alongside your previous remit and all of that is all very recent anyway. Is there not some merit in reviewing exactly what you are trying to now look at? Are you looking at the future prospects for the industry or its past performance or what are you looking at?

Chris Woolard: We need to look at a number of issues in terms of how competition is operating in the market at this moment in time, so we have a baseline.

Q239 Andrea Leadsom: Yes, but that has just changed, hasn't it?

Chris Woolard: Yes, so we have a baseline. We are focusing more of the study towards the future. We wrote to the firms involved on 26 March. We have taken a number of the information requests that we had previously placed off the table. We have reduced the amount of information we are asking from firms at this stage.

Q240 Andrea Leadsom: Net or just from the previous study?

Chris Woolard: In the current live investigation in terms of the market, the competition piece of work we are doing, we have reduced the amount of information we are asking for at this point in time.

Q241 Chair: Just to be clear, everyone around this table and I think anyone who has looked at the annuities market ever has concluded that there are elements of dysfunctionality about it. No one has been arguing that it is a perfectly functioning market. It seems to me, in the thematic review you have had an open goal for demonstrating that. The concern in one way or another that has been expressed so far is that your presentation of that dysfunctionality does seem to have taken us very little further forward. We do not seem to know much more than we did before you wrote it and we are now going to have to wait another year for the competition work to be done. That is the concern being expressed. Before I pass on the questioning to Andy Love, is there anything else you want to say with respect to that point?

Chris Woolard: I understand some of that frustration, Mr Chairman. Just in terms of the timeline that was being asked by Mrs Leadsom, this piece of thematic work that was done is about pinning down, from a regulatory perspective, what the facts of the matter appear to be and that has been done. In September, when we announced our first competition programme, one of the things we said we would do once that discovery work was complete is we were likely to turn our attention in the competition study to the annuities market. We said that in September. The work completed in February and we immediately said we would go into the competition work.

Q242 Andrea Leadsom: Yes, just one last question. Now that the pension reforms have been announced, that is going to fundamentally transform the market. Is it not absolutely essential therefore that the FCA pulls their finger out and gives people enough information to be able to choose whether they continue to want to buy an annuity or whether they want to do something else with their pensions? Is it not, therefore, even more pressing, bearing in mind the very long length of time it has taken to get as far as we have, which is not very far at all, that you now do something quick that enables people to form their own view on the reforms and whether they should just avoid the annuities market altogether or stick with it on the basis of some kind of assurance of fairness?

Chris Woolard: I think there are two points in there. One is the speed of the competition work that we do, which we will absolutely do as fast as we can. The second is what happens to people in the current climate where the Treasury obviously has most of these reforms out for consultation. They have not formally changed the rules for the landscape. They have the consultation in place. We do have some basic advice on our website for consumers. We are also directing people towards a mixture of the Money Advice Service and indeed to talk to their own provider at this moment in time if they have pension choices that are immediately in front of them, but clearly none of us are in a position to be absolutely concrete until the Treasury completes its consultation.

Q243 Mr Love: Sticking to the pension reforms, does increasing choice increase the prospect of consumer detriment, Mr Woolard?

Chris Woolard: In theory, whenever you have complex choices that can be made, there is clearly the prospect of consumer detriment arising, depending on how those choices are presented. However, in broad terms, I think the fact that there are now more choices potentially on the table for consumers at the point at which they either decide to purchase an annuity or do something different, we would be welcoming those changes.

Q244 Mr Love: It has been reported that the Treasury are reluctant to give details of its modelling on the pension reforms. Have they shared this modelling with you?

Chris Woolard: No.

Q245 Mr Love: Is that a reasonable thing for them to do? Considering the impact that this reform might have, as you have already indicated, in terms of possible consumer detriment, should they be giving you sight of their assumptions and their modelling?

Chris Woolard: In terms of the market study that we are going to do, we will obviously reach our own conclusions around what we think the likely impact on the market will be and how we think about those questions in the future. I think, more broadly, our role in this around the budget process has been the Treasury asking us to take forward the piece of work that is around having guided conversations for people getting to the point of making a decision at retirement. We have not directly asked them for their model and, as I say, nor have they shared it with us.

Q246 Mr Love: Barclays has estimated that the annuity market will shrink by two-thirds. Legal & General suggest it will be 75%. RBC Capital suggests the

slump will be 90%. Do the reforms mean effectively the end of the annuity market as we know it?

Chris Woolard: I think there are two things to say on that. The first is that I suspect we will see a range of innovative responses from the industry. I think already they are talking about whether there are different products that might blend annuities with income release or those kinds of questions coming on to the market. I do not think the market is dead in that respect. Also, if you look at the experience of other countries, despite predictions there of markets sometimes disappearing on the back of certain changes, I think the case has often been that that is not what has happened. Switzerland is a very different regulatory environment. We ought to be careful about stretching the analogy too far, but if you look at Switzerland, they have gone through a very similar deregulation and still 80% of people who are retiring choose to buy an annuity there. I think we have to be very careful about predictions of doom.

David Geale: I think it is also very important to recognise that an annuity will still be the right product for many people who are looking for a guaranteed income. The flexibility will help some, particularly people who have small pots, for example, or people who would otherwise use drawdown, but an annuity is still the right product for some.

Q247 Mr Love: Moody's have suggested that annuities account for as much as half of insurers' profitability in the UK. I want to ask you about the impact that that is likely to have and whether they will continue to be attracted by auto-enrolment savings and other savings. Is this going to have the wider impact that the life insurers will not be as interested in this area as they have been while the annuity market is as buoyant as it currently is?

Chris Woolard: Clearly those are commercial decisions that the different insurers are going to have to make. These are still very significant markets and there is very significant business to be done in them. Whether that is done by the insurance firms as straight annuities, as we have known them, or whether they choose to launch some other kinds of products, my own expectation would be they would still want to be active in that space but clearly it is a commercial decision for them.

David Geale: I think the flipside of that question is that with auto-enrolment we expect there will be more funds invested. Therefore, there will be more funds for insurance companies to invest on behalf of their clients, whether that be through annuities or other products.

Q248 Mr Love: You do not think it will have as dramatic an impact as some are suggesting?

David Geale: Clearly it will have an impact, but this is an innovative industry and we would expect to see, as Chris said, different types of products available and, as I say, annuities will be the right product for many people.

Q249 Mr Love: Can I turn to the impact on annuities themselves? If there are fewer annuities sold, then risk-pooling does not work as effectively as it would have done in the past and so there will be poorer rates and poorer expectations from annuity providers. Do you think that is likely to happen?

Chris Woolard: That is certainly one argument that we have seen put forward in the press, particularly by a number of the annuities firms. I think if you just track back a second to the piece of discovery work that was done thematically, one of the things that comes from that is that

where people shop around and where they are prepared to perhaps get more specialist products for their type of risk, for example the so-called impaired life annuities where people have particular health problems, they can result in better rates for individuals. I also think there is a piece of analysis here that is missing that which says that, if you have an industry and it comes under competition from a range of other products, necessarily the result of that is some kind of zero-sum game where it gets worse for the consumer. In my general experience, when you have more competition you tend to get better results for consumers.

Q250 Mr Love: Can I turn to flexible drawdown? Currently the average drawdown candidate has £160,000 worth of assets. The median pot size currently is around £20,000. Will the industry have an appetite for these smaller pots that are likely to come on the market as a result of the pension changes?

Chris Woolard: David might want to say a little more about that in a moment, but we will obviously have to see. The fact that, potentially, there is some more flexibility here and there may be a range of other products that people might want to bring to the market would suggest that at least there is a chance. I do not know if you want to add to that.

David Geale: No, I agree. I think it is a bit too early to tell. As you say, there are a number of moving parts here, including the fact that under the proposals people will be able to take the money. I think it is too early to tell, but there is the potential certainly for product innovation given the restriction of moving towards an annuity.

Q251 Mr Love: One final question. They are talking a lot about platforms as being advantaged by this. Who is likely to come into this market that will make it more effective?

David Geale: A number of the existing players, obviously. The platforms, as we saw, where some of the insurance companies suffered in the share price and some of the platforms benefited. I think that there is scope for the platforms to do more here. There is clearly scope across the whole of the industry, given the flexibility that people will have in how they take the money and how they invest it. I think there are potential winners all around obviously to go with the risks.

Q252 Mr Ruffley: One of the consequences of the pension liberalisation is that there might be a flight of money into the buy-to-let market. The FCA does not regulate that. Don't you think you should?

Chris Woolard: Both as the FCA and previously the FSA, we have made a number of comments on the record about the fact that we think there are significant risks potentially with buy-to-let market. In particular, we think there are some risks posed by what we might describe as so-called amateur investors. In other words, people who maybe take on one property or two properties as a sort of amateur landlord, but at the moment I think the boundaries are pretty clear from a regulatory perspective that we do not cover it.

Q253 Mr Ruffley: But you must be concerned, as a regulator. I fully understand you cannot arrogate those powers to yourself, I am not suggesting that, but there is a policy problem emerging in the eyes of a lot of commentators. What is to be done, rather than to say, "Well, it is not regulated"? There is a problem emerging. What action needs to be taken to regulate this buy-to-let market, which, in all probability, will be burgeoning in

the coming years as a direct consequence of the pension liberalisation announced in the budget?

Chris Woolard: We flag those kind of risks on a regular basis. We would want consumers thinking about entering this market to think very carefully about those kinds of investments. At the moment, though, the advice around them, and indeed the individual decision to invest in those kinds of properties, is unregulated. Our ability to pursue the issue is pretty limited, to be honest.

Q254 Mr Ruffley: What is your understanding as to why you were not given the powers to regulate this market? Give a bit of the history, just so we understand.

Chris Woolard: In terms of the broad history of this, there are a number of issues, not just this, around the regulatory boundary that is set in what is called the Regulatory Activities Order. This is something that the Treasury publish, which basically sets out the boundary by which we regulate. There is a general policy stance that says that business transactions, pure and simple, are not largely covered by us and that falls within that category is my understanding of the history.

Q255 Mr Ruffley: Do you view the potential flight of money into the buy-to-let market a potential source of instability in the financial system?

Chris Woolard: One of the things we covered in our risk outlook that we published yesterday was, more broadly, a question about whether, if you have a strong level of investment into the wider property market, there are issues there if people are over-extending into that space. Clearly, for someone who is taking a pot in cash under potentially these reforms, one of the questions you think about, whatever they are investing in, whether it is property as buy-to-let or whatever it might be, is what the overall balance of risk is they are taking. Clearly, in any product, someone who says, "Great, I am going to take all of my pot and I am going to put it all into one thing", is running an awful lot of risk and, if you had a significant amount of money to invest in those circumstances, we would want them to consider taking independent advice.

Q256 Mr Ruffley: On the question of interest-only mortgages and shortfalls in straightforward interest-only mortgages, it has been speculated that some mortgage lenders could force consumers with shortfalls on their interest-only mortgage to use their pension pot to clear any shortfall. Do you see that as a problem at all or is that something that is perfectly acceptable?

Chris Woolard: I am not quite sure of the basis on which someone could insist that you use your pension pot for that purpose, but I think, on the broader question of interest-only mortgages, this is one of the early pieces of action that we have taken. We got the providers to act early and responsibly in terms of contacting those consumers who are going to have a shortfall so that they can address it over a period of many years rather than as an instant problem. Personally, I do not think that relying on a pension pay-out to cover an interest-only shortfall is a particularly sensible course of action for anyone.

Q257 Mr McFadden: I would like to ask you about this issue of advice and guidance for people in these circumstances. The Chancellor said in his budget speech, "We are going to introduce a new guarantee, enforced by law, that everyone who retires on these defined contribution schemes will be offered free, impartial, face-to-face advice on how to get the most from the choices they will now have", but then the pensions document released on the same day as the

budget, which is called *Freedom and Choice in Pensions*, says there will be “a new duty that, from April 2015, pension providers and trust-based schemes must offer to each of their defined contribution customers a ‘guidance guarantee’ at the point of retirement”. In paragraph 411 it also talks about “a new guarantee that all individuals will be offered guidance”. Can I first of all ask you, are advice and guidance the same things and if they are not, what is the difference?

Chris Woolard: Advice, with a capital A, and guidance are absolutely not the same thing in terms of how we approach the rulebook for the industry. Advice, in terms of regulated advice, carries with it a series of guarantees and protections that are provided around it. Very much the responsibility rests with the consumer and the risks around making a decision rest with the consumer in a guidance situation. In terms of the Treasury’s announcement in the budget and the work that we are doing, we are very clear the space we are trying to deal with is as set out in that document; in other words, guidance. How do you provide somebody with that—

Q258 Mr McFadden: This point is very important, because you have said there is a material difference from a regulatory point of view between advice and guidance.

Chris Woolard: Yes, there is.

Q259 Mr McFadden: Advice is regulated, controlled; guidance less so, with the balance of the decision being on the part of the consumer. Have I summarised that correctly?

Chris Woolard: That is correct, yes.

Q260 Mr McFadden: When the Chancellor said people will be offered free, impartial, face-to-face advice, is it your view that that was a mistake; that he misspoke; that that is not what the document promises?

Chris Woolard: You obviously have to ask the Chancellor that question directly in terms of what was in his mind at the time, but I think the word “advice”, with a lower case a, is used very commonly in financial services. If you get a receipt from your bank when you pay some money in, they will often give you something back over the counter that says, “This is an advice note”. It just says, “You have paid in £100”. It is clearly not advice in the sense of regulated advice, and I think that term is used quite commonly by people. To be absolutely clear, though, the thing we are working on and the thing the Treasury proposed to us in terms of the role we were asked to take on in relation to the budget documents is about guidance and we are clear on that.

Q261 Mr McFadden: Just clarify again for us, please, from your point of view as the regulator, where does this leave the consumer if the legal guarantee that Parliament is going to legislate for is for guidance and not advice, despite what the Chancellor said in his budget speech?

Chris Woolard: I think you have to say, “Where are consumers today and where will they be in the future?” Consumers today are receiving a range of conversations that fall under the category of what we describe as guidance, quite often from their existing pension provider, and we know that four out of five people still choose to go with that existing pension provider for their decision around annuity. If we can get this space right in terms of what we are being asked to do in the budget document, improve that conversation in terms of the guidance that people receive at that

point, and make it genuinely more impartial in terms of the way people approach that decision genuinely,

I think there is a possibility of some improvement compared with the situation that we have today. What that will not be and what will still be the case for many people, I suspect, is that it is then appropriate for them to go on and get their own independent Advice, with a capital A, that is regulated advice. We will take essentially what is a good basic step in improving people's ability to make a decision about their retirement income. What we are not being asked to do at this moment in time is put full independent financial advice in for everybody.

Q262 Mr McFadden: Do you understand that, from a consumer's point of view, the difference between these two things is pretty confusing, especially when you are saying that this has a material impact on what is regulated and what is not; in other words it affects their rights?

Chris Woolard: Yes, and one of the challenges for us in building this work is we want to make sure it is absolutely crystal clear to people, when they are having that guidance conversation that is being provided for, that they understand that it is guidance and what their rights are and are not at that point, and also if they want to get into the space of having full regulated protection they have to go down the Advice, with a capital A, route.

Q263 Mr McFadden: Let me pursue this thing from the point of view of the individual customer. The *Sunday Times* reported that the free guidance offered to retirees will not be regulated and that there will be no right to complain to the Financial Ombudsman Service, yet the Chancellor has said the guidance will be enforced by law. This seems to be confusing, again. What are the rights of a consumer here if, after this guidance, they buy a product and they feel dissatisfaction with that product and it does not do what it said on the tin? This is not unknown. We have had plenty of instances like this with endowment mortgages, PPI and so on. If they can't go to the Financial Ombudsman under the scheme that Parliament is about to legislate for, what use is this guidance to them?

David Geale: Perhaps I can start by saying that I think there are several questions that we need to work through with the guidance, starting with what is it and what does it cover, moving on to who provides it, how does it work with the interaction where, for example, people have different pots; if you have two or three pots, do you receive that guidance guarantee once, twice, three times and so on? There are a number of things we need to do to work that through. It is also important to say that we are not starting with a blank sheet of paper. The Committee will be aware, from Mr Wheatley's comments in a previous visit, that we are carrying out some work on the boundary between execution and full advice, where we think there is quite a lot that can be done, including things like guided self-help. We are already carrying out some consumer research into what consumers want and what consumers need by way of guidance and help, but also—

Q264 Mr McFadden: I am interested in their rights. What does enforced by law mean if they can't go to the Ombudsman?

David Geale: I will come back to that in a second, but perhaps if I can just add that the other thing we are looking at is what people understand through the different processes that they go through, whether they have had advice or not had advice. I think that is important to feed in.

Coming back to your original question about suitability, the guidance would not be leading people into a specific product if it is not to be regulated. It would be about what are the options available, what are the implications of those options and so on. The liability that would be there would be if the firm or whoever is providing that guidance has misled somebody, but it would not be about the decision that is made. The consumer would take responsibility for the decision. The guidance provider, whoever that may be, would take responsibility for the guidance that we would design.

Mr McFadden: I think we are going to have to come back to this. Do I have time to ask a question about costs, Chairman?

Chair: If we can have a quick question and a quick reply, if you can do it.

Q265 Mr McFadden: Have you made an estimate of the costs of providing this guidance to every customer? Will the £20 million that the Chancellor said the Government will make available cover the costs?

David Geale: No, we have not made an estimate of the costs yet until such time as we have figured out what the guidance should be, who will provide it, how and when. I think those will drive what the costs are. The £20 million is effectively seed money to start the process.

Q266 John Thurso: Just following up on that, how well do you think consumers understand and can calculate the longevity risk; in other words the fact that they might live longer than they are providing for? To what extent will the guidance be able to give them help in that?

David Geale: In answer to the first question, I think not very well. It is something very difficult and it is a very difficult question to even ask yourself: how long am I going to live? It is an answer that people perhaps underestimate, particularly when you build in the interaction of things like long-term care. Even if we make a reasonable assumption of how long we might live, we may not allow for the fact that we may need care provided over that period. I think the purpose of the guidance would be to put those questions in people's minds. As I say, it can't decide the product for them but what it can do is tell people the implications of various decisions, "If you choose to take the money and you run out of money then effectively that is a decision for you and, equally, the implications of things like people on average live for X years and so on from your age", and put those thoughts, where it is factual, in people's minds.

Q267 John Thurso: To finish on that, it is quite clear from the questions you have just answered that there is a potential regulatory nightmare between Advice with a capital A, advice with a small a, Guidance now with a capital G, guidance with a little g, and the consumer ending up utterly bemused by it all. The FCA will be central to putting that into something that is comprehensible, both to consumers and to providers. Have you considered the scale of that challenge and what plans will you be making to meet it?

Chris Woolard: Yes, we have. We have been on this particular issue for some months. As David was saying, within our rulebook full-blown regulated advice is pretty well understood by both firms and consumers when they go and get it. It feels like a very formal process. Similarly, so-called execution only, where you decide to do something completely yourself, is pretty well understood by people. The piece in the middle is often quite murky for the firms themselves sometimes but definitely for consumers. We have had a piece of work in train to try to deal with

that situation across the board. I think this particular piece of work around annuities brings it very sharply into focus.

Q268 John Thurso: It does seem that we are drifting towards lifetime saving schemes rather than specific retirement schemes. Pensions are becoming more and more flexible and ISAs are growing larger and becoming more flexible. Do you think that ISAs, pensions and so forth are becoming fairly interchangeable?

David Geale: I think people have always been able to look at different methods of saving for their retirement and pensions should not be seen as exclusively that route. Is it becoming more so? Yes, I think that is right, with greater flexibility. There is also the hope that people may save more over that period, be that through ISAs, pensions or other routes.

Chair: That is scratching the surface of a huge and very important question for long-term savings in the UK, which I am sure this Committee will return to on many occasions. We are somewhat pressed for time today. It is not a reflection of our interest in your evidence that we are going to close in less than an hour, but we have a lot to get through. Thank you very much indeed for coming to give evidence this morning and I expect we will be wanting to hear more from the FCA on this in due course.

Examination of Witnesses

Witnesses: **Dr Ros Altmann**, Pensions Policy, Investment Banking, Savings and Retirement Expert, and **Jane Vass**, Head of Public Policy, Age UK, gave evidence.

Q269 Chair: To put it mildly, Dr Altmann, you have been a campaigner in this area and there appears now, finally, to have been some melting of the iceberg partly as a result of your efforts, I think. It is fair to say that this Committee, most people, in fact just about everyone, is agreed and has been agreed for some time that the annuities market is dysfunctional and that there are many causes of that. Not all of them necessarily are dark and murky but there are just causes and, as a consequence, there is consumer detriment. I think we are agreed on that too. What did this thematic review add that we did not already know?

Dr Altmann: I certainly welcome the fact that, for the first time ever, the regulator looked into all the crevices, I believe, of the annuities market, but I must confess that for people who have looked at the market, studied it and understood it in detail for a long time, it certainly did not reveal anything new. There is plenty more that could have been uncovered or investigated that I hope will still be so as the regulator gets to grips with what I believe is one of the most significant regulatory failures that we have seen in the financial system.

Chair: A lot of people round this table are sympathetic to that conclusion, as I am sure you already know.

Dr Altmann: I am grateful for that.

Q270 Chair: What we are concerned about is that a year goes by and we are not getting enough action. Is there anything that you would like to add to the conclusion that, I hope not in too leading a way, between us Dr Altmann and I are drawing on this?

Jane Vass: I think our concern has been well noted around the lower value end of the market, where we have been calling for liberalisation for some time. It has been a concentrated area. Rates have not been as good and we have been calling for a wider review of the whole decumulation area.

Q271 Chair: Have we moved forward much as a result of the publication of this thematic review?

Jane Vass: I think the pensions reforms announced in the budget have been a game changer.

Chair: That is another question. I am asking about this thematic review.

Jane Vass: I think it has been useful for us to have the figures, but there is still loads more to be done.

Q272 Mr Ruffley: Could I turn to you, Dr Altmann, on the question of annuities not being fit for purpose for many; people stumbling blindly into buying an annuity that may not be suitable for them? What sort of person would you currently recommend an annuity to in general terms? Post this liberalisation, who might an annuity be suitable for? Who might want to continue to buy an annuity?

Dr Altmann: I think a number of people will continue to want to buy an annuity but not necessarily with all their pension fund and not necessarily at a relatively young age. I consider people in their 60s now to be relatively young. I would liken those who might want to buy to people who buy a house and want to insure against certain risks. The annuity will cover against one risk. It is like buying a house and insuring against fire. The annuity will cover you against the risk of living a very long time, but there are many other risks in retirement that people face that certainly a standard annuity will not cover you for. It is like having fire insurance but then you get flooded or burgled and you do not have any cover. The standard annuity will not cover you against inflation or for a partner.

This was one of the problems. The annuity market has been regulated as if annuities are a no-risk product suitable for everybody and that simply is not the case. The suitability issue will vary from person to person. There are people with severe health issues perhaps, who seriously do not know how long they are going to live, for whom an individually underwritten annuity would be suitable. The problem we had with this market was that most people ended up in one standard product where there were no obligations for suitability checks at all, not even a basic question about your health before selling you an annuity that assumed you had a normal life expectancy.

I think the idea of an annuity that gives you some certainty over an income stream would make sense from a later age for people who genuinely are concerned about financial planning in their final years, perhaps investment-linked annuities or perhaps individually underwritten annuities. There are different types. Inflation-linked annuities have become so expensive that they probably are not a very sensible option for most people because index-linked gilts have become so expensive and there are no other assets that insurance companies can use to back those particular products.

We are moving from what was the wild west of the pension system to one where people hopefully will have a fair chance of understanding the full range of options. Currently, many of the options one might like to see developed do not yet exist in this country and I am sure will now be developed, and the market hopefully will free up to work better for customers. Until now we had an asymmetry of information between the customer and the provider such that the customer ended up being almost sleep-walked into buying an annuity rather than knowing what they might want to do when and what was best for them.

Q273 Mr Ruffley: It does not necessarily follow from this pension liberalisation that the market will behave in the way you hope it will, developing more appropriate products and so on. It does not logically follow.

Dr Altmann: It will only follow when companies realise that there is a market or will be a market for products that have not yet existed. I do not know how long that will take but I certainly know that there are companies now working on ways of developing a kind of pension income type product. Drawdown and flexible drawdown, as they currently exist, are very expensive. The fees associated with those have resulted in them being unsuitable for small pension funds and very costly for any size pension fund, partly because of the restrictions that were on them and partly because of the way the market worked there was not a lot of competition anyway.

There does not seem to me to be much reason why there can't be products that simply roll on from the pension accumulation phase into the later phase. The pension accumulation phase would be the pension growth product where all income is reinvested and rolling into the pension income products where income is paid, out but not in the way that an annuity is where there is a fixed income that you have given all your pension fund away for. It is one where you retain control of your capital. Therefore, if you do die quickly or if your health is impaired in some way or indeed if you need money for social care, your pot is still there rather than having gone.

Q274 Mr Ruffley: Paul Johnson of the IFS has said that assuming a market exists for annuities, for instance in the way you have described, that annuities continue but in a new form and modified form, they might be even more expensive for those who still want to buy them. What is your view of the future cost of annuities? It is difficult to say but what does your nose tell you?

Dr Altmann: Firstly, it is important to make the point that I would expect the market for annuities to transfer significantly away from individual annuities to bulk annuities written for time benefit pension schemes who will want to be buying out. That is where I see the future of the annuity market and there is potentially big volume in that area. From a corporate perspective, it makes sense to offload the risk.

From the pricing perspective of annuities, certainly all the analysis that I have done, which I believe has been shared with the Committee, suggests that certainly the average annuity and the annuity that most people would have been buying that they had been rolled into from their existing pension provider now represents such poor value it is difficult to imagine the value worsening. The estimates that I have made, assuming that the insurance company might earn 3% or 3.5% return on the pension fund that you give them over the course of the period that you live, would require the purchaser to live well into their 90s before they got any more than their own fund back. The mortality cross-subsidy element has dwindled significantly. Partly that is a function of QE and the exceptional period of low interest rates. One assumes that itself will not be a perpetual state and that at some point, as everybody else is assuming if you look at all the

economic forecasts, interest rates are going to rise. It is difficult to see a case for standard annuities to become more expensive, so I would not be concerned that they do.

I also think that the individual purchase of annuities will be significantly reduced, not least because of the poor value and the timing. One would not necessarily want to commit all your pension fund to one product when the environment has made it exceptionally expensive in historic terms and when you do not feel you have to buy one. In the past, to get your hands on your tax-free cash you were obliged to secure an income within six months, which meant that if you wanted to take a penny out of your pension fund you had to buy an annuity or go into income drawdown. Thankfully that requirement has gone. People are going to be able to choose to take some money out and use it, but leave the rest there. Most people can just leave it invested, but that is also an important issue because the current lifestyle-type, traditional, default pension arrangements invest your money with the prospect that you are going to buy an annuity at a specific age.

By the time you reach that specific age, either 60 or 65 most typically, your money will all probably be in gilts, fixed incomes of some kind and cash in expectation of buying an annuity. Not only is that not suitable because no longer will people necessarily buy an annuity, it has not been suitable anyway because increasingly people are not retiring and needing to take their pension fund because they are still working at the age that they would have selected 30 years before. In my view, this revolutionises the way pensions as a whole can work, both on the accumulation phase and on what I think will be a more flexible and gradual withdrawal, importantly leaving some extra money for social care that people are going to need but currently have not made any provision for.

Q275 Andrea Leadsom: Dr Altmann, you have a first-class honours degree in economics from UCL and a PhD in economics from the LSE; you were a Kennedy Scholar at Harvard; you have been awarded an honorary doctorate from the University of Westminster; you are a governor of the LSE and a governor of the Pensions Policy Institute; and you have campaigned successfully on change in annuities and on many other issues affecting older people. Do you think it is as pathetic as I do that the Bank of England, the PRA, the FCA, the FPC and the MPC fail to recruit women of any merit? Very specifically, do you think that there are many of the men who are on those bodies who have a far superior CV to your own?

Dr Altmann: I do think it is disappointing that there is not more female representation.

Q276 Andrea Leadsom: Why do you think that? What is disappointing about not having more female representation? Surely men can do it all on their own, as they have done for years with such great success.

Dr Altmann: I must admit that I am a believer in diversity. You can't generalise, obviously, and I had not expected this particular question, but I think there is a difference typically between a female and a male perspective. Finance is very male dominated. The concept of the people at the end of the financial chain all too often perhaps is forgotten, where maybe a feminine input would be more mindful of that. I think about pensions and finance, not just about money. They are about people and I think a lot of women would relate to that.

Q277 Andrea Leadsom: Ms Vass, do you agree with that point? Do you think that women have a contribution to make? I personally completely agree that women do tend to personalise these things and look at the impact on human beings rather than just the sums, but do you think it is a reasonable point that Dr Altmann is making?

Jane Vass: I think that historically the place of women in the family has been a central issue, but also there is a question of family dynamics right through this debate. People exist as part of families, not just one particular individual, and public policy needs to take account of that.

Q278 Andrea Leadsom: Dr Altmann, do you think that having all these degrees, a PhD, an honorary doctorate and so on does not qualify you to speak on any of these regulatory boards or do you think that there is something fundamental in the way that these boards recruit that means they exclude women? Have you ever applied for a job on any of those boards, for example?

Dr Altmann: I did apply in the last round for non-executive membership of the Monetary Policy Committee and I was not successful. I was on the shortlist of I am not sure how many but not many. Of course, I was very disappointed because I would have liked to be able to make a contribution. One of the things that I did stress was that I would like to be able to bring an alternative perspective, perhaps, from the traditional perspective. There is sometimes a danger of group think and, coming back to this particular inquiry, I think there has been group think on annuities. Any of those areas where there has been failure—there has been failure in the past in the financial system and there has been failure clearly, in my view anyway and I think the Committee shares that—in the annuities space, is partly a function of people just talking to each other who all have the same view instead of being able to stand back and say, “Have you thought about it from this angle?”

Q279 Andrea Leadsom: Thank you very much. Coming on to the issue around people in this pensions reform arena, Ms Vass, isn't there is a risk that people can't be trusted with their own finances? The Chancellor said people who have worked hard and saved hard all their lives and done the right thing should be trusted with their own finances. Do you think that that is right or do you think that in fact people can't be trusted with their own finances?

Jane Vass: No. I think people are generally very sensible. They are the ones that lose out if they do not take care with their money and I think people will generally make good decisions. Having said that, there is a real need for them to receive the advice and information they need. I also think that the regulators will need to be more vigilant and possibly more interventionist than they have been in the past to stop people being made fools of.

Q280 Andrea Leadsom: Should there be limits to individual choice, bearing in mind the experience that we have had in recent years has been that, given the opportunity, there will be institutions who will rip off individuals, give them a bad deal and make them much worse off than they need to be? Is there a problem there that means that there needs to be some limits to individual choice to protect people from the worst excesses of the financial markets?

Jane Vass: I think the onus should not be on the individual but on the industry and the regulators to ensure that products that come up are sensible. That will mean a much more interventionist approach than in the past.

Q281 Andrea Leadsom: Dr Altmann, coming back to you, are you impressed that the FCA has started this inquiry of a system that is now completely changing and that they are on the pulse of the pensions reforms and going to be adequately interventionist to protect individual pensioners from the access to their own funds that could inevitably lead to them being ripped off?

Dr Altmann: I welcome the review. I certainly hope that the regulator will ensure that the advice or guidance—I am afraid this word “advice” is a problem, in a way caused by some of the well-meaning actions from the regulator itself—is impartial. The important thing to note is that currently everyone at retirement was paying for advice even though they did not receive any. Even if you bought an annuity from your existing provider, they would deduct around 2% of your fund just for selling you this product that they had no idea was suitable for you. They had no idea whether it was good value or whether it was the right time for you to buy it, nothing. They did not have to ask a question but they could take that money. If you went to a non-advised broking or guidance service, as the Financial Services Consumer Panel uncovered, you could lose 6% of your fund. There is money in the system to pay for advice that has been long needed and is still even more needed as there are perhaps more options opening up.

Q282 Andrea Leadsom: Does the FCA need to be more on top of this industry?

Dr Altmann: I believe the FCA needs to get to grips with how we can deliver cost-effective, impartial guidance or advice that has minimum standards and no product sale link at all. The idea that some insurance companies suggested straight after the budget that their own sales staff or telephone operators, whatever they are called, could provide this guidance is a non-starter for me. This has to be independent, “Here is your range of options”, with perhaps minimum qualifications for the people that are offering that, minimum standards and certain scripts that people have to have gone through to make sure that you have had the right information.

Those people giving the advice could be basic-level advisers, perhaps with a lower qualification. Most people will not need a six-hour, full fact-find about offshore trusts and all other kinds of things that are included sometimes in the IFA conversation.

Q283 John Thurso: Jane Vass, can I come to you and follow up on this question of guidance and advice. In their evidence, the ABI reiterated strongly to us that guidance is not the same as fully-regulated, independent financial advice. How much of a danger is there that the guidance, big G/little g, or advice, big A/little a, is all going to get so muddled as to become meaningless for exactly the people you have a concern for in their older age?

Jane Vass: I think we need both guidance and advice. Guidance, in this area, may need to go much further than just the financial issues. For example, issues around whether or not you should retire at all; what to do about housing or debt; the factors you need to take into account. Guidance has a very clear role to play in that, but guidance also has a role in telling people when they should be taking regulated advice.

One factor that I think has not been particularly highlighted in this debate is the fact that it is not a once-and-for-all decision. If you are not taking an annuity, there is an initial decision to make, but then you will need to look at your finances regularly. There needs to be some provision for

ongoing advice that potentially links up with advice earlier in life. For example, BIS is looking at a mid-life career review and it would be great to use this as an opportunity to start to join up all those aspects of advice throughout later life.

Q284 John Thurso: You make a very good point there. In actual fact, if you have had no advice for 55 to 60 years and you suddenly, at age 60 or 65 or whatever, rock up and say, "Right, let us have my guidance, please", it is probably far too late in a lot of areas. The policy outcome that the Government is looking to achieve, which is people having saved in one form or another and then making an informed choice as to how to turn that into the best outcome for the remainder of their life, will require that advice and guidance to have been given much earlier on.

Jane Vass: Yes, but it will still be valuable right into later life. Also, once you have already retired there are overlaps with advice for care. This is not a need that is going to go away after you have retired.

Q285 John Thurso: I think the Chancellor's phrase was, "Everybody who retires on these defined contribution schemes will be offered free, impartial, face-to-face advice on how to get the most from the choices they will now have". He went on to say, "There is a right to advice". What we have explored is they have a right to guidance perhaps, rather more than advice. If we take that at its value as a statement of the Government's desires, clearly there is a need for the Government to state what it is they mean and for that then to be translated into something that is recognisable by the regulators so that we, you and everybody else can hold the regulators to account on delivering that. How difficult is that going to be and what might be the route map to delivering it?

Jane Vass: It is a big job. It will take time. Therefore, I think it is important to set out a direction of travel. We would like to see the FCA running a pathfinder that was testing lots of different routes to getting advice, because face-to-face advice is very important to some. We are running a Financial Services Commission. We have just done some research and we were struck by just how important that face-to-face contact is for a particular segment of the public who perhaps have always been used to going into their bank, but other people will want other routes and no one agency can do it all.

For example, it will be important to link up web advice from people like the Money Advice Service through to telephone advice from the Pensions Advisory Services through to more detailed face-to-face advice. That will need a very strong framework. It will need strong standards but, very importantly, it will also need good ways of handing off people between the different parts of the system and also a way of letting data flow around so that individuals own their own data. Currently, if you go to a financial adviser you have to go through a fact-find and it seems to be their data, but it is important that individuals should own their data and we find an efficient way of using that information.

Q286 John Thurso: Last question if I may, which is very quick because we are short on time. What would you expect of the Government over the next 12 months? When you come back in 12 months' time, what would you like to have seen done that gets this desire by the Government expressed now into a form

that has a possibility of being realistically deliverable? What are the things you want done in the next 12 months?

Jane Vass: I think we would want a commitment to ongoing advice throughout later life. We would also expect all the various bits to start to be joined up, so that at least you know what the various bits are and I am very aware that time is not on our side here. The system that is in place from April 2015 will need to take us some way down. I would expect to see standards starting to be set out. I would expect to see people starting to be linked up. I would expect there to be systems for referring people to regulated advice appropriately. Those would be just some of the factors.

Dr Altmann: I would expect that this could be facilitated in the workplace alongside auto-enrolment. We are basically talking about financial planning and if there was some mechanism to incentivise employers, who have to put people into pension schemes anyway, to help them with this kind of financial planning and then perhaps trustees, I think that could be helpful.

Chair: That might help, yes.

Q287 Mr Newmark: First of all, I just want to put on the record that I totally agree with what Andrea was saying on the lack of women at the Bank of England and, in fact, other financial institutions. Anyway, I just wanted to put that on the forum because I totally agree with her and it is something I have been campaigning on as well. It is not just women that campaign on this, but men as well have EQs.

The pensioner bonds announced in the budget are expected to cost the Government about £335 million over the next five years. Do you think the Government is effectively targeting its support for savers over 65?

Dr Altmann: I must admit I would have hoped that we can find a way to tie some of this pensioner bond money in for social care so that it might form the basis of a family pot that people can put aside in later life to save for social care. Hopefully, it will also throw down a challenge to the industry, "If you want to get some good pensioner money in you have to beat the pensioner bonds". If you have an investment portfolio you should be able to do that. They will not be doing that with a standard cash and gilts portfolio, so they will have to be more imaginative to be able to offer something better than that.

Q288 Mr Newmark: I guess that begs the next question then. Up to £10 billion of these bonds will be issued. Do you think that a one-off offer of this kind is helpful or should it have been staggered in a different way?

Dr Altmann: I think it would be helpful to plan it as some kind of prefunding for social care. I would like to see that tied in with the ISA allowances as well, perhaps. At the point of retirement your pension fund might be earmarked in some way. A chunk of it for care using the pensioner bonds to do that might make some sense. I think people would feel quite comfortable about that and not just make it a one-off, but the industry would know that the Government will come in and take up some of the money that would otherwise be available unless there are more alternative, attractive options.

Q289 Mr Newmark: I am sympathetic with that analysis. Jane, your further thoughts on that, but I would add: would pensioners have preferred an index-linked bond?

Jane Vass: Most people do not have enough money to earmark part of their pot longer term. Indeed, we know, behaviourally, people are very reluctant, if they do not have much money, to put money aside for care because they are not sure whether they are going to need it. However, the pensioners bond is useful and we hope it stimulates competition in the industry. Longer term, I think the solution has to be a broader one about ensuring a proper balance between savers and borrowers' rates. Certainly the question you raise around index-linking is an important one because the lack of index-linked savings vehicles available to people in the general market is increasingly a problem given worries about longevity.

Q290 Mr Newmark: Your solution to that is what then?

Jane Vass: I leave that up to the innovative insurance and financial services industry.

Dr Altmann: We could have some pensioner bonds that are inflation-linked as well, of course, and this will be one and three years. It can be an ongoing problem.

Q291 Chair: It is a point that this Committee has already raised.

Mr Newmark: Yes, that is a good point.

Dr Altmann: Yes. I think increasingly people's pension pots will be larger than they are now. In the past the traditional pension was final salary, but as we move forward the defined contribution pension pots that are maturing will grow. We need to cater for the fact that it is not just the current median of £20,000 and the current average of £40,000 but there will be higher amounts in future potentially available.

Q292 Mr Newmark: In looking at fairness out there as to who is getting this, why should only pensioners receive Government-secured rates? Should there be similar offerings on children's bonds? I am just curious and I appreciate your interest is focusing purely on pensioners and everything else, but do you think it should be broadened or not?

Jane Vass: Ideally, one would like to see good savings rates for everybody, hence the importance of a longer-term solution. In the meantime, certainly pensioners with savings have suffered quite a lot. I think it is proportionate to have a solution, which is not a gigantic amount for each individual.

Dr Altmann: The age choice is an interesting one because, of course, women's pension age is still below 65. There are some women who will be retired, do not have much state pension and might welcome this even between the ages of 60 and 65. An age cut-off is obviously quite arbitrary, but I assumed that the intention of this was to have that challenge to the industry to say, "Look, if you guys are not going to offer that these people who saved for so long and have suffered for five years with these terrible interest rates can use then we are going to come in and do that instead".

Q293 Mr Newmark: Given how long you have campaigned on this and it has been a while through both Governments, effectively, and this may be a bit

of a politically-loaded question, why has it taken a Conservative Chancellor to reduce tax on savings from 10% to 0%, helping those on modest savings? I am assuming you were campaigning with the previous Government. What was the resistance to this? Ultimately the cost is fairly de minimis but sends a powerful message that we are trying to help those on very modest incomes.

Dr Altmann: To be fair, the problem of low interest rates has primarily arisen under this administration. Rates for savers are at record lows. They were much higher in the past. I certainly welcome the fact that the Government itself has not any longer just focused on the very well off. This budget has basically helped those at the lowest end who have an income under £15,500 and now it has extended the flexibility that already existed for the very well off pensioners to everybody, which I warmly welcome, but I am not sure why it took so long and I am not sure why indeed this Government took so long. We could have done it three or four years ago.

Mr Newmark: Anyway, you have done it.

Chair: We have arrived anyway.

Q294 Mr Love: I wanted to come back. We are told by the Chancellor and the Chief Secretary that there is nothing to worry about with these pension changes because the new single-tier state pension will be both generous and have the widest possible coverage. How do you respond to that?

Chair: Briefly if you can.

Dr Altmann: The single-tier pension will halve the rate of means testing for pensioners, but it does not get rid of it altogether. However, I do think that people who have saved in a pension would typically not be the ones that will fall back on the state, but there is that risk. I accept that. I think the new single-tier state pension will be very helpful and it was an important part of the picture to try to reform the state pension system to have one that hangs together whereby it is safe to save. We still have the problem of council tax benefit and housing benefit. I do accept that, but at least the issue is less than it was before.

Chair: Rather regretfully, we are going to have to move on, I am afraid. I know that we could have had this conversation for a good deal longer because there is so much interest around the table. We are very grateful to you for coming in, even if only briefly, both of you. Thank you very much. If there are further points you want to add, please put them in writing. We are very receptive. We are going to go straight on to the next session. Thank you very much.

Examination of Witnesses

Witnesses: **Chris Hannant**, Director General, Association of Professional Financial Advisors, **Robin Fieth**, Chief Executive, Building Societies Association, and **Joanne Segars**, Chief Executive, National Association of Pension Funds, gave evidence.

Q295 Chair: Thank you very much for coming in to give evidence and I am sorry that you have been kept waiting just a little longer than planned. Could I begin with a question to you, Joanne Segars? You have referred to these reforms as perplexing. What was perplexing about them?

Joanne Segars: The reforms clearly came as a surprise to us and to everyone. I think what we have said is that these reforms could very well help to increase rates of saving and could help

support auto-enrolment, but there is an awful lot that needs to be got right before these reforms can be fully let loose, as we have heard already today in the evidence sessions that you have had.

Q296 Chair: I just wanted to pin down what it was that was perplexing. Clearly there is a lot of detail to be worked out, but what is perplexing?

Joanne Segars: Given that we have introduced auto-enrolment because people do find it very difficult to make these decisions, we have then said at the end people can have that freedom. What we are saying is we need to make sure that the support is there in place before it is possible to be sure that people will not make poor decisions.

Q297 Chair: Do you agree with what has been, over recent years, pretty much a consensus that the annuities market has been dysfunctional in a number of respects and that there has been consumer detriment as a result?

Joanne Segars: Very much so and we at the NAPF have been leading the charge on that. We produced a report two years ago now that showed that about £1 billion a year leaks out of the annuities market because people do make poor decisions or they do not get the right annuity for them.

Q298 Chair: The extraordinary thing about this announcement is that nobody seemed to be sure quite what might come by way of reform, but now that a radical reform has been announced everybody seems to agree with it. Do you agree with it or do you think this is risky shock therapy?

Joanne Segars: What we have said is, on the one hand, this could very well increase pension saving. It could increase the incentive for people to save. It could increase confidence and it clearly expands the range of choices that people have, but we have also been very clear that with that choice comes responsibility. We know that people find it very difficult to make decisions. We know people do underestimate how they—

Q299 Chair: But you are supporting this decision?

Joanne Segars: We have supported the decision, but we have said that there needs to be the right protections in place and the right support in place to help people make the expanded range of choices they have.

Q300 Chair: I do not think that is in dispute. It is just important to know where people stand on the central question of the decision. Mr Hannant, do you have anything to add?

Chris Hannant: Other than we think it is a good idea, we think people should have control of their money. I think you do not stumble into a substantial pension pot by accident and you should be rewarded for taking the responsibility to save and just the general observation that a lot of people have been talking around the problem of value from small pots. I think the fundamental problem there is the small pot and the fact that people have arrived at retirement without saving sufficiently.

Robin Fieth: I am not sure, from the BSA, we have a particular view other than in general we think the concept of allowing people to have responsibility for their own money makes a lot of sense.

Chair: I think that has been picked up right across the political spectrum as well as the commentariat.

Q301 Mr Ruffley: Ms Segars, do you think the exceptionally low interest rate environment prompted this full-scale pension reform?

Joanne Segars: I think it is one of the factors that has clearly prompted it, but another factor that has depressed annuity rates is, of course, the good news that we are living longer. That has clearly had an impact on rates, too. I think the work that we have done, the work the Financial Services Consumer Panel has done and the work the FCA itself has done in lifting the lid on some of the annuity pricing practices has also been one of the prompts to this review.

Q302 Mr Ruffley: What would you say is the biggest headache or challenge with this pension reform that your average member firm has?

Joanne Segars: Our members are clearly companies who provide occupational pension schemes to their members and, for them, the big issue is around the implementation of this. We have, by next April, to be providing guidance and we have talked already today about what that guidance means and exactly who provides it, but that duty to provide guidance does not just fall on commercial pension providers. It falls on trustees, too. For our members the issues are: what does that guidance mean, how is it going to be provided, who is going to pay for it, and what responsibilities they fall back on trustees as a result of providing that guidance.

Schemes are looking at their default investment policies that sit around their defined contribution funds because, as we heard from Dr Altmann, they are predicated on people annuitizing and, therefore, being in gilts and cash towards the end of the period. If people do not do that, that then throws up a whole set of questions around default investment policies. This has raised a huge set of issues for our members and we are tackling them at this very moment.

Q303 Mr Ruffley: You have 12 months within which to bottom all those problems out.

Joanne Segars: That is a very short space of time, as you know, for introducing any kind of pensions policy and there is a huge number of unknowns about this. We do not have any clarity on the guidance guarantee. We will not know what the legislation for this is going to be for some time. We will not know the secondary legislation for some time. That leaves schemes a very short period of time in which to implement these changes and, of course, again as we have discussed in this Committee, these are not the only changes that pension schemes are implementing at the moment.

Auto-enrolment is being introduced for smaller firms this year. Defined benefit pension schemes are implementing changes to end contracting out, to implement the very great changes that are being brought about through state pension reform. As I said, default investment policies are now having to be looked at and, of course, last week we heard about the price cap, which again poses new challenges for a number of pension schemes. There is a great deal of work for our members to be doing at the moment.

Q304 Mr Ruffley: Just one final question. A couple of months ago some of the biggest life insurers in the UK were talking about their increased appetite for infrastructure, Legal & General being one example. There has also been

speculation since the budget that, as a result of these pension reforms and what it might do to the profitability and business model of some life insurers, they may have less of an appetite. I am not particularly referring to Legal & General but all those of your members that were looking at infrastructure investment. Is there a sense that that infrastructure investment might be under threat? Have you heard that from any of your members? Have they expressed concern about that?

Joanne Segars: Of course, my members are not those insurance companies. My members, in the context of infrastructure investment, are large defined benefit pension schemes who might want to invest in infrastructure as part of their de-risking strategies. There are some questions posed in the consultation document, in the paper that came out with the budget, about whether or not these reforms should be extended to defined benefit pension schemes.

One of the arguments the Treasury suggests why they should not be extended to defined benefit pension schemes is because of the impact on pension funds' appetite for infrastructure as a de-risking instrument and also the gilts market. We need to work with our members to ascertain what the impact would be and what the quantum impact might be, but for the moment our members remain very interested in investing in infrastructure.

Q305 Mr Ruffley: Being a defined benefit, there are no nasties in this that would lead your members and your trustees to say, "We are not so keen on some of this Government infrastructure"?

Joanne Segars: I think we need to work with our members to find out and work through what the impact would be on pension funds' investment policies if these changes were extended to defined benefit pension schemes. At the moment, I think it is too early to tell. We need to crunch through the numbers. We need back from Treasury some of their modelling so that we can work with the Treasury to help understand what the impact might be.

Q306 Mr Ruffley: Just one final question. Obviously this budget announcement relates to defined contribution and you have talked about the extent to which, further down the road, defined benefit might be pulled into the net. Is that a discussion that you have had with anyone in Government?

Joanne Segars: The consultation document itself poses the question whether and, if so, how the freedoms that were announced in the budget should be extended to defined benefit pension schemes. We have had some very initial discussions with Government. We need to continue those discussions and, most importantly, we need to speak to our members who are processing this information as well as the other announcements that came out last week on pensions from the UK Government and from Europe. We need to talk to our members to work through and to model what some of the likely impacts might be. I think at the moment it is a bit early to say.

Q307 Mr Ruffley: But from where you sit now as Chief Executive of the NAPF you are probably thinking this is likely to come about in time, judging from what you have heard from Government?

Joanne Segars: I think the steer in the paper is that there could be risks if this was extended to define benefit pension schemes, in particular for demand for infrastructure and gilt investments, but we need to work through the proposal. I think we just need to do some more number-crunching. We are happy to share that with the Committee once we have done that, but at the moment we need to work through it.

Q308 Andrea Leadsom: Mr Hannant, do you think there is a chance that this market reform could mark the extinction of the annuities market altogether?

Chris Hannant: I do not think so. It will obviously have a significant effect. Your product choice at retirement varies on you. A good advice process will take in your needs, your accounts and your risk appetite and for some people who are very cautious an annuity might provide them with the comfort and the security that they need. I also think there will be a transition through stages of retirement.

If you look at the current makeup of the advised population, the majority are between 50 and 70. People are managing their investments well into retirement, but as they get older they move away from that and you could see that people will, as they move through stages of retirement, seek to buy an annuity later to provide them with the comfort and the income they need when they have less ability to actively manage their investments.

Q309 Andrea Leadsom: You think it might just change the way in which the market provides as opposed to potentially meaning it goes altogether?

Chris Hannant: I do not think it will be wiped out altogether. I still think there will be some appetite there. It could be much smaller than it currently is. I don't know.

Q310 Andrea Leadsom: You are specifically talking from the buy side, aren't you, as in demand for annuities will remain?

Chris Hannant: I think some demand for annuities will remain, yes.

Q311 Andrea Leadsom: Ms Segars, do you think that supply of annuity products will also remain? Is there a possibility that pension reforms means that annuity providers just think, "We can't create a proper market here and, therefore, we will just stop offering annuity products"? Is that a possibility?

Joanne Segars: I think, as Mr Hannant said, there will be some demand for annuities. Treasury has suggested 70% of people will still annuitize. I think only time will tell. What we would expect to see and what we would hope to see is more innovation in this market with products being developed that lead into long-term care products, for example, that are much more flexible and perhaps more accurately match the spending patterns that people face in retirement. I think there is potential here for more innovation and then it is for those pension providers—as I say, not my members but those pension providers, those insurers—to meet that new demand, to rise to that challenge.

Q312 Andrea Leadsom: In fact, in a way, you are both saying, if I can put words in your mouth, that the demand will be more discerning and the supply should be more creative, which, overall, surely must be a very good thing for the annuities market. Mr Hannant, would you comment?

Chris Hannant: I would agree with that but the caveat I would put on it is just a question of scale. I would not like to hazard a guess at whether we are talking about 50% or 25% or 75% of the current market, but I think it should be a market that generates products that are better tailored to the needs of the consumer.

Joanne Segars: I would agree with that. The big unknown in all of this, of course, is how much demand there will still be for annuities in whatever form going forward.

Q313 Andrea Leadsom: Would the extinction of the market be a disaster? Would it be a disaster if there were no more annuities market?

Joanne Segars: Fundamentally there are large number of people who, in retirement, want a regular income. They want that certainty of a regular income with some inflation-linking perhaps, with the ability to leave something to their spouse or partner. When you ask people what they want, lots of people say, "What I want is a regular income for the rest of my life and I can leave something to my spouse".

Q314 Andrea Leadsom: We do not want to see it end. We want to keep a successful, creative, more innovative, smaller annuities market. Is that fair?

Joanne Segars: Also one that offers better value to consumers.

Chris Hannant: I would agree with what Jo said and I would just add to that. A lot of people want certainty and what an annuity can do is provide people with this certainty.

Chair: The public sector in general and civil servants and MPs in particular are examples of people with options to opt out into DC schemes, but they all seem to prefer their DB schemes.

Q315 Mr McFadden: The exam question on these reforms has been phrased as, "Do you trust people with their own money?" I am personally not sure whether that is the only exam question around this. I think I do trust people with their own money but I am not sure I trust the financial services sector who are selling them the products. If it is all about trusting people with their own money why would we have pension schemes at all, Joanne Segars?

Joanne Segars: I suppose auto-enrolment answers that question. We have introduced auto-enrolment in order to encourage people to save.

Q316 Mr McFadden: Following the logic of this reform, what is the point of auto-enrolment? It is policy pulling in two directions. We are saying we do not trust them when they are young but we do trust them when they are older.

Joanne Segars: Fundamentally that is what is being said as a result of this policy, that once people do build up a sum of money they will be trusted and that we do trust them not to buy the Lamborghini, I suppose.

Q317 Mr McFadden: The Minister said it was okay if they bought a Lamborghini, but how you get one for £20,000 I am not sure.

Joanne Segars: Maybe a toy Lamborghini, I do not know. I think evidence does suggest and, if we look at Australia, we do see that there the people are not blowing it all in one go. Clearly it is not possible to make exactly like-for-like comparisons, but we do see that financial responsibility grow with age but also as people's pension pots grow. We have heard already that people's pension pots will start to grow over the next 20 or 30 years as auto-enrolment comes in, but I think what is critical to this is making sure that when people do have that freedom to use their

pension pot as they will, whether that is buying an annuity, an income drawdown product or whatever, that people have the right support and guidance to take them through that process.

Q318 Mr McFadden: Why do people need all this guidance and advice?

Joanne Segars: Because there are some quite complex decisions. We know that people underestimate how long they are going to live, women by four years on average and men by two years. We know that people underestimate exactly how much they have in their pension pot and what exactly that will buy them and there are some quite complex issues to consider. If you took your money in one lump you might end up paying tax, whereas if you annuitize it throughout your lifetime you might not. There are issues to do with the interaction with social care, for example. If you end up taking the money as one lump sum, that could count against you if you need social care benefits. There are quite complex issues to be considered.

Q319 Mr McFadden: It is not just a matter of trusting people with their own money. It is a matter of addressing the enormous information imbalance between the purchaser and the seller of various options.

Joanne Segars: But it is the interaction with a much wider set of issues than just purchaser and seller. It is the interaction with the tax system and the interaction with the social care system.

Q320 Mr McFadden: To return to the series of questions that Mr Ruffley was asking, what is the logic of not extending this to defined benefit schemes? That is a bit like an annuity in a way. It guarantees you a certain income throughout your retirement. Why not allow people there to just make a calculation of the whole pot and do what they like with it?

Joanne Segars: This is a question that is being asked in the consultation paper. On the one hand, you might argue it creates a level playing field and industries tend to like level playing fields. Politically, it might be difficult to argue that we trust you with your money in a DC pot but not if you are in a DB pot. On the other hand, there are these issues to consider in terms of the impact on DB scheme funding and some of the macroeconomic demand for instruments. They are all part of the mix that we are working through with our members.

Of course, at the moment people do have the right to shift their DB pot into a DC scheme and then in future they will be able to do what they want with that. At the moment, of course, they have to abide by the rules as they current exist and schemes do use that at the moment as a sort of de-risking valve, but we need to consider what the likely demand might be for members of DB schemes and what the impact might be flowing forward. As I said, at the moment it is too early to say. We are still working through those numbers with our members.

Q321 Mr McFadden: Mr Hannant, can I just ask you a question about this discussion we have been having all morning about guidance and advice? You represent financial advisers.

Chris Hannant: Yes.

Q322 Mr McFadden: The Government has set aside £20 million for this. I will leave aside for the moment the quite important difference that has been

pointed out between guidance and advice in terms of the consumer rights. What do you think the cost is of providing this to every consumer in a DC scheme?

Chris Hannant: I would observe that I think the £20 million has been set aside to pump-prime it and the obligation will fall on the pension providers. It is hard to tell because we do not have the dimensions around what guidance is required.

Q323 Mr McFadden: I just mean the cost for one person. You do not have to give me all the details.

Chris Hannant: When we surveyed our members, the average one-off charge for a full advice process of someone coming to purchase an annuity is about £680 or 2% of the pension pot. That is for a focused bit of advice around an annuity purchase rather than a full review of someone's situation.

Q324 Mr McFadden: £680 for a choice that is not normally even made at the moment. For a broader range of choices, which these reforms are absolutely intended to bring in, what do you think that would cost per person?

Chris Hannant: I would guess it would cost a bit more. I would say that there is a difference between providing guidance and advice, as has been explored. It depends on the dimensions around guidance, about what is required, but it could obviously be delivered at a lower cost if it was an advice firm providing it, by a para-planner for example. It might be a briefer chat. It could be delivered in volume. As regards the guidance and how it is framed, that will drive the cost.

I think there is a risk that the FCA should not become too prescriptive around what it all looks like because ultimately the consumer does not have to engage with that process. The industry needs to engage with the consumer and with the greater flexibility that they have to do that we will see what works and what does not work. It should be outcome driven. Providers should be tasked with achieving certain outcomes.

Q325 Mr McFadden: You did not quite answer what it is going to cost.

Chris Hannant: I don't know because until you frame what it is—

Q326 Mr McFadden: Let me try one more angle. Who is going to pay the cost?

Chris Hannant: My understanding as at present if the obligation is on the pension product provider then that is where the cost would lie, but obviously that is—

Q327 Chair: The consumer always pays, doesn't he or she?

Mr McFadden: Ultimately the consumer will pay.

Chris Hannant: Ultimately the consumer pays.

Chair: Brooks Newmark has some more questions in this field, if that is all right, Joanne Segars. I expect he will bring you in.

Q328 Mr Newmark: Well, yes. I am not going to focus on the cost side. It is more the language. I guess this is to Chris. The ABI reiterates that guidance is not the same as fully-regulated, independent financial advice. Is there a danger that the waters are being muddled between the two?

Chris Hannant: I think there is a risk. There needs to be clear signposting from one to the other, but I also think there needs to be a clear handoff. I don't think the consumer wants to be left stranded once they have had a conversation with someone about guidance, so they have a sense of what their options are. If they are then abandoned and left with a website to find an adviser if they want that investment product that is going to provide a suitable vehicle for their savings I think it need to be integrated and I advice does need to be at the heart of it. Obviously the people providing the guidance side of it need to have a clear understanding of when they should be encouraging the client to move over to a proper advice service, saying, "This is beyond my remit".

Q329 Mr Newmark: Isn't guidance in opposition to what the Retail Distribution Review was meant to achieve?

Chris Hannant: There is potentially an element of that. As the representatives of the FCA said earlier, they are currently looking at all this space, the non-advised/advised distinction, in another thematic review. We tend to use the term "advice" in two different ways in the industry itself. One is "advice" in terms of the commonly understood phrase, planning, "What do you want to achieve in life? What does that mean you have to save?" That is what some financial advisers will do. Then there is the second, the technical bit, where they sell you a product that is also labelled "advice". There is already a bit of a blur within the industry as to the use of the—

Q330 Mr Newmark: Yes, but guidance is much more general signposting. Isn't advice is a little bit more robust of a statement, or not?

Chris Hannant: Yes, I would agree with that.

Q331 Mr Newmark: Right. Are we going backwards or forwards here?

Chris Hannant: In order to manage the costs then I think you need to start off with a general conversation with people about the options, but as people want to discuss something specific about themselves and about their needs then it has to hand over to an advice process.

Q332 Mr Newmark: Right, okay. Do you think guidance will be enough for consumers making choices after the pensions reform?

Chris Hannant: Not on its own, no. In order to get the product they are either looking after themselves or they are going through an advised process. I think they would get a better result from an advised process.

Q333 Mr Newmark: I am going to go over to Joanne because I can tell she is itching here. Before you do, what impact do you think the Government's proposals will mean for the level of advice consumers may now need? Joanne, you can answer on whatever you wanted to before plus answer that.

Joanne Segars: Quite clearly, whether it is advice or guidance, they need a lot more support, just to add an additional word into the mix, just to help them deal with the choice that they are now faced with. I think there are a couple of points. First of all, we need to be clear that the duty does

not just fall on commercial pension providers to provide this guidance guarantee. It falls also on trust-based DC pension schemes. The question of who pays and how that is paid for is critical to all of this.

Picking up on some of your points, we have been talking about the distinction—

Q334 Mr Newmark: When you say “who pays for it and how it is paid”, what do you mean by that?

Joanne Segars: Whether it is the scheme, whether it is the employer.

Q335 Mr Newmark: We are not stupid. That is obviously the bit of the market, but at the end of the day the customer pays.

Joanne Segars: The customer pays.

Mr Newmark: The customer always pays. It is a question of how much those extra costs are, which I think is the point Pat was making.

Joanne Segars: How much those costs are, indeed. I think there is also a concern that consumers tend to confuse “Guidance” and “Advice” and that is, in itself, an issue.

One of the other concerns, I suppose, in terms of talking about handing people off to a regulated advice service is that very often—and part of the problem that we have at the moment with the annuities market—very many people simply cannot get that advice. The pension pots are too small for them to be profitable for advisers or brokers to want to deal with and that is not just a problem for individuals. It is a problem for small trust-based pension schemes trying to put annuity broking services together or trying to provide support to their scheme members. The question of that handoff is again very critical. What sits within this guidance service is going to be—

Q336 Mr Newmark: There is a wider question that maybe Chris can step in on as well. Is there enough capacity in the market, and the advice market specifically, to provide the level of advice needed following pension reforms? Are there enough people there? Is there enough bandwidth in the people that already exist or are we going to have to find other people to provide advice as opposed to guidance?

Chris Hannant: To pick up on a point that Jo made, I know there are firms out there who can provide advice cost-effectively at pension pots less than £10,000, of about £5,000, but there is a problem at the bottom end. Is there enough capacity? If everyone who retiring next year was to seek full advice I think there would probably be a challenge on capacity. Probably about 20% are already advised. That is a very back-of-the-envelope calculation. It is a question of scaling up. There would need to be a clear signal early in terms of what is expected in terms of the industry to prepare. I believe there is scope in the industry to deliver advice more cost-effectively through the use of more junior staff and overseen by fully-trained, qualified advisers.

Q337 Mr Newmark: It still sounds to me like there is going to be a gap in terms of timing in terms of, first, the number of people; secondly, the quality of advice that is going to be needed; and, thirdly, leads on to the potential for

errors or abuses along the way because of the lack of people that exist today to provide the level of advice as opposed to guidance that is necessary here.

Chris Hannant: Yes. One of the recent things that we know as a consequence of—

Mr Newmark: The market as a whole is going to have a problem with mitigating that risk, which means the regulators are going to have to keep a sharper eye on things at least over the next two to four years as the market evolves to deal with that skills gap.

Chris Hannant: There are people out there who have left the industry because we know, as a consequence of RDR, there has been a reduction in adviser numbers. I do think there is a potentially a challenge to bring some of those back. I also think the regulator could do more to lower the cost of regulation to help advice firms invest in new talent. For example, I think it is mentioned in the Treasury document that the Treasury wants the regulator to look at that explicitly in the chapter on guidance.

Q338 Mr Newmark: I know that cost is an issue for many people in the industry. What conversations have you had with the FCA to try to help drive down those costs and paperwork? You obviously need to have a balance between the need for regulation, the costs associated with that regulation and people in the advisory side of things to be fit and proper and delivering the right sort of advice that is needed for consumers. There is a fine balance but I appreciate there has been an issue with a number of people in the advisory side of things dealing with costs and paperwork. You had discussions with the FCA on this?

Chris Hannant: We have had conversations that are not about reducing consumer standards. It is about the cost of the bureaucracy of the regulator, the reporting, the fees and the approach to the handbook. For example the consumer credit thing coming in today, which is not an activity principally of advisers but because the boundaries are blurred many advisers have a consumer credit licence as a precaution, and that is an extra compliance challenge for those. They are not lending money and they are not providing debt advice but, because the borders are indistinct, they have the permission just to make sure that they do not go to jail, because it is a criminal offence to—

Q339 Mr Love: Coming to you, Ms Segars, earlier on when you were talking about the guidance system you said there is a huge number of unknowns. The Government is allocating £20 million over two years to set up this system, not to run it. Is that enough?

Joanne Segars: I think it rather depends on what the system is going to look like and who is going to provide it. There are about 400,000 people who annuitize each year, so that is about £25 per person. I think the key to this is finding out very quickly what the guidance is going to look like, how it is going to be provided and who is going to provide because the requirement is that those 400,000 people should be offered, although they do not have to accept it, face-to-face advice. That is clearly at the more expensive end of the advice channels. We have to find out exactly what that is going to look like before we can answer the question whether the £20 million is enough to set it up, because we do not know what the “it” is yet.

Q340 Mr Love: Those adventurous people are suggesting the employment of 500 additional people at £120 million. Is that miles away from where you would take an early guestimate of where we might be?

Joanne Segars: From some of the number crunching we have done, it looks like it might be in the right ballpark but, again, without knowing what the “it” is that we are being required to provide—

Q341 Mr Love: Everybody seems to be suggesting that this should be a responsibility of the pension funds. Do the pension funds agree with that? If they do, how do we overcome the obvious conflicts of interest that might arise from the provider providing the advice or guidance, if we are getting it correct, to people that are annuitizing?

Joanne Segars: I suppose this come down to the rather semantic point around guidance and advice, around what is impartial and what is independence. I think Treasury might help by defining that for us. From my members’ perspective, from the trustees who are running defined contribution pension schemes, again they are looking at this and thinking, “What exactly does this mean? What will we have to do directly? What will have to do actively? To what extent are we a channel through which the guidance guarantee is provided? What assurances do we have as trustees, as employers offering these schemes?

One of the things that we are looking at is whether company pension schemes should be provided with a safe harbour if they are required to provide that guarantee by the Government.

Q342 Chair: There has always been a little resistance to safe harbour.

Joanne Segars: There has indeed, but I think this is placing a new duty on trustees to provide the guidance guarantee, which currently we do not know very much about. There are issues, as we talked about, with capacity. We do not know what the guarantee is going to look like and how that will fall.

Q343 Mr Love: I have one more, Mr Hannant, and it is following up comments made to Brooks Newmark. There are new lower-cost channels of delivery of advice that your organisation and others are developing. Could they fill the gap here? Is this something that could be made available that would bridge that gap between advice and guidance and do it in a way that protects the consumer?

Chris Hannant: It is possible. One of the things we are seeing is greater use of technology that can help lower costs and there are some firms out there who are looking to try to provide an entire computer-generated advice process. In the future that may help, although a lot of people still want the face-to-face service. Yes, there is a challenge for our sector to become more efficient and reduce the cost of advice.

Chair: We do have some questions for Mr Fieth and I am very pleased to see he is putting on his glasses.

Q344 John Thurso: Mr Fieth, could I firstly just ask a quick couple of questions regarding the pensioner bonds? What effect do you think this will have on other providers, such as your members, in the savings market?

Robin Fieth: Like so many of the questions today, there are some imponderables in that. If we start at the headlines and go slightly wider than the pensioner bonds, if I may, to the NS&I target for the next year of £13 billion. If we took that as the share of net cash savings market for the current year, on our assessment it is about 25% of the net cash savings market. It is a fairly large chunk and when you then look at the rates that the pensioner bond is offering, which are markedly higher than the best rates available for similar products in the market at the moment, then we can certainly anticipate some impact on the savings market. There are two big imponderables here. The first is, do the Chancellor's initiatives right across from increasing ISA rates and the reforms there through to the pensioner bonds and so on increase household savings or not? Past experience says that it probably will not have a huge effect, but there is that.

Q345 John Thurso: This is the heart of the point I was getting at. Is this going to be a redistribution or will it—

Robin Fieth: The second point is, if it is going to be a redistribution, where is it going to be redistributed from? Is it going to come out of existing cash savings? Are the over-65s going to take their cash ISA or deposit accounts or whatever they might be and put them into pensioner bonds? Are they going to recycle out of existing NS&I products, which then calls into question how NS&I are going to fill the rest of the £13 bill target, or are they going to use investment and other funds that will have a far smaller effect on the cash savings market. Those are the imponderables we are looking at, but what is clear is that this was a large move.

Q346 John Thurso: If it were simply a recycling, part of that could be from deposits in building societies. There are some perfectly sound ones offering around 2% at the moment, which is way above what a bank could offer. They presumably do that to ensure that their balance sheet has the strength of those deposits to match their lending. If suddenly there are lots of products that beat that and people move from those building societies into the NS&I product, that has quite a consequential knock-on on the balance sheets of those building societies, or is that not something your members are particularly—

Robin Fieth: That is certainly one of the scenarios we are considering and not just building societies because it is the banks as well. The question is, how do the banks and building societies respond in terms of attracting savings? Perhaps the most important factor for building societies in this is that they are required by law to be at least 50% funded through retail deposits and most, of course, are much higher than that. Most are in the 70% to 100% level. Will they have to put up savings rates in order to attract sufficient cash and retain sufficient cash? Of course, the flipside of that is whether that will have an impact on mortgage rates because the only other consequence is it has an impact on profits, which is therefore the building up of reserves in order to lend more in the following year. There is a whole equation to balance there.

Q347 John Thurso: There is a lot of interesting work to be done around that.

Robin Fieth: Yes.

Q348 John Thurso: The FCA recently produced their report on consumers' ability to repay interest-only mortgages and mortgages in general that had, at least on the face of it, some mildly startling stuff around how indebted we all

are. Does this ability now to not go to an annuity but draw down cash create an instant “get out of jail” card for that problem?

Robin Fieth: I do not think it creates a “get out of jail” card, but I think it adds another dimension to that equation as well. Already, of course, people can draw down 25% as a tax-free lump sum and for some people that is the solution. That is their plan. The issue we are concerned about more than whether the reforms will make a change here is that very small number of interest-only mortgagees who are refusing to engage with their society or their bank. They are keeping their heads firmly in the sand and, therefore, you get to the end of that period when the mortgage is due to be repaid and what happens next is the question: if they all carry on paying interest as if nothing had changed what happens? There are some interesting discussions going on with the regulators and with societies about those sorts of scenarios.

Q349 John Thurso: Turning lastly to the savings side, before the budget the BSA called for the Government to encourage new savings and particularly by offering people an incentive to save and open their first ISA. You said the Chancellor should have a budget for savers and the Chancellor said he has had a budget for savers. Do you agree with each other?

Robin Fieth: We absolutely do agree with each other and the wider reform of ISA is something we have been campaigning for over many years, particularly the ability to have a single ISA limit—agnostic as to whether it goes into cash or investments—and indeed the ability to move funds within an ISA envelope back from investments into cash. With the theme we have had so much this morning on pensions that is another useful element of managing your investments and certainly we see that as an attraction for those heading towards retirement who perhaps want to come out of quite so much equity.

The issue on what we call the first ISA, as opposed to the new ISA, is that the evidence out there is 32% of households have no savings whatsoever and 47% of households have less than £1,500 of savings. That is a group of people who are typically the most vulnerable in society, typically the poorer households in society. We did suggest to the Chancellor that now would also be a good time to introduce some Government support to get people onto the savings ladder. That did not come through this time but no doubt it is something we will return to in future budgets.

Q350 John Thurso: Looking at what you just said there, is it not the case that people who are the most vulnerable in society and probably are living on benefits or the minimum wage or whatever, just getting a bill paid on a daily, weekly or monthly basis is challenge enough without being able to save. Aren't savings products always going to be aimed at people who have at least a margin above what they need to live?

Robin Fieth: I think there is an element in that. I think we all know that you need something set aside for when the unforeseen happens. It might be as simple as the washing machine breaking down, but you need some money set aside for that. Otherwise the resort is, particularly if it is an essential piece of expenditure, you either, if you have credit cards, overpay on them and do not repay them, you get an unauthorised overdraft or you go to a very high-interest lender. We would argue if you can keep at least a small amount set aside it covers those sorts of things.

Q351 John Thurso: We are very short on time and all of you have been very generous with your time. This is a huge field and I could sit here and ask you questions for half an hour on the detail. Can I cheat and just say to you, if

you look at all the issues there are, is the limit of £15,000 right? Are the stocks and shares right? What will the effects be? I could go through a long list. Can I ask you to say are there any points in these changes on the ISAs that you particularly applaud or think particularly pose a risk?

Robin Fieth: I think we absolutely applaud the simplification. The removal of the barrier from moving from investments back to cash and the equalisation of cash ISA with investment of a single £15,000 a year limit I think we absolutely applaud. We did not find anything much to fault in the ISA proposals at all. £15,000 is a good limit in the current environment. You would expect us to encourage the Chancellor to increase that incrementally in future years, but we thought it was a very good move.

Q352 Chair: You mentioned simplification. Do you think there is merit in the principle that people should only be taxed once on their savings?

Robin Fieth: Yes, I think there is merit in that. There is the question, of course, of then trying to distinguish between income that has been earned and then goes into savings and is taxed and the income that comes from untaxed sources in the first place. That is perhaps a complication.

Q353 Chair: But one can apply that principle to both those sources of income. Do you think that these reforms take us towards that?

Robin Fieth: I guess they are a step along that path and when you look at the majority of households, if we take out the households that have a lot of wealth who will probably almost never come into that category, £15,000 or, as a couple, £30,000 a year is a considerable sum to be able to put aside.

Q354 Chair: As John Thurso was alluding to in an earlier set of questions, in a sense the pensions and ISA reforms are coming together in this space of taxing savings once, it seems to me. Does anybody disagree with that? Maybe I will just go through the line. Do you agree with that, Mr Hannant? Have I come to the right conclusion or not? Then I will ask Joanne Segar.

Chris Hannant: Broadly, yes. There is still—

Q355 Chair: Which is the narrow bit that is not right?

Chris Hannant: I am not saying it is not right. I think it is right. The ISA currently will offer far more flexibility, but I think it is right that people are nudged towards a framework for the long term so it is there until you are 55. I also think the taxation on the drawing down rather than paying in is important. Good tax planning will help negate the Lamborghini problem because it will be you are better off spreading that pension pot over a number of years rather than taking it all at once.

Q356 Chair: Is there anything you want to say to qualify or challenge the tax principle we are discussing here, Joanne Segars?

Joanne Segars: No, I agree very much with what Chris and Robin have said. Clearly one differentiator, and it is an important differentiator with pensions, is the ability still to take 25% as a tax-free lump sum and that in itself is a big incentive for people.

Q357 Chair: You want to keep some that is not taxed at all?

Joanne Segars: We would certainly want to keep some that is not taxed at all, yes. We would like to have rather more of it that is not taxed, but we would certainly like to keep the tax-free lump sum because, again, if we are talking about the incentives for people to save for retirement in the first place, that is a big incentivisor.

Q358 Chair: Your qualification is you would like there to be single taxation of savings with the exception of the lump sum?

Joanne Segars: I think the only question is the timing of that, whether with ISAs, it is at the front end or a tax. With pensions you pay the tax at the back end.

Chair: With the sunny uplands of this happy future ahead of us where we are only taxed once on our savings, which we are a long way away from, I think this will bring the session to an end. Thank you very much indeed for giving evidence on what is now this afternoon.

