Written evidence from The Financial Inclusion Commission (APS0018)

Executive Summary

The Commission believes the following steps can help improve financial inclusion in pensions:

1. Understanding that the boundary between working life and retirement is increasingly blurred. This puts a premium on helping many more people to understand what sort of financial future they face, and what will determine whether they will be able to live in later life as they expect, or whether they will be disappointed (as many will be as things stand).

2. Addressing the factors that are likely to cause that widespread disappointment, throughout someone's working life, not just at the point of retirement. The main issue is a substantial and increasing disparity in the level of retirement provision between employees of substantial businesses with an historical commitment to providing pensions, and those who work for employers who have only recently started to provide pensions, to comply with mandatory automatic enrolment, or work in the gig economy workers or are self-employed. This is compounded for women by a gender gap in pensions. We will return to these issues in more detail in our response to the third stage of the Committee's enquiry, but the position 'at retirement' would be most improved if people arrived there having had a much clearer picture of where they stood, throughout their working life.

3. Acknowledging that relying on inertia has its limits. The significant shift in responsibility from institutions (e.g employers, the State) to individuals, for adequacy, longevity and investment gains or losses, means that greater efforts should be made to ensure that people know where they stand. Initiatives such as the Pensions Dashboard and Pension Wise are important as long as they are taken up and can therefore make a difference.

4. Promoting Pension Wise which has a particularly important part to play. High levels of satisfaction, and the reports of better decision making ensuing, support this view. It is not necessary to turn people into experts for them to make sound fundamental judgements about their retirement finances. Pension Wise achieves those sound fundamentals and would have a broader impact than pensions alone. For example the take up of unclaimed entitlements to State benefits would be likely to improve significantly. However, the take up levels of Pension Wise are much lower than hoped.

5. To overcome the limits of inertia we suggest that there should be 'automatic enrolment' into a Pension Wise interview at appropriate age/times in career, with the ability to opt out, which we expect would be infrequently used. We appreciate the intent behind the recent 'stronger nudge' consultation paper from the FCA, but on what evidence is available at the moment, think it is unlikely to go as far as the Minister's ambition (which we support) for usage of Pension Wise to become the norm.

6. Accompanying initiatives such as Pension Wise and the Pensions Dashboard with significantly greater promotional effort. There is also a strong case for similar resources to be available earlier in people's working lives, perhaps by the introduction of the 'Mid Life MoT'. It has always proved difficult to convince those who bear the cost, via industry levies, to support generic efforts to improve engagement, despite the likelihood that a more engaged and active membership would save more, and some clear evidence that such promotion can make a crucial difference. A more engaged and aware population would also be less exposed to the risk posed

by the increasing and worrying number of scams. Pension Wise, as identified by the Committee in its report on pension scams, can be an important tool to prevent scams as long as it is known about, and used.

7. Ensuring the success of the 'consolidation of small pots' initiative, stimulated by the Committee. We do not think that the issues around small pots can be solved by behavioural changes made by savers, especially given the typically low (circa £1,000 or, often, less) pot size of people who have only started saving for retirement as a result of automatic enrolment.

8. Setting up a new Pensions Commission. It is now nearly 20 years since the Pensions Commission's thorough review of the whole system. Its mission was to deal with the potential time bomb at the time, that without change, would have resulted in too many in the population relying on means-tested, unfunded, supplements to State Pensions, at a cost unsustainable to the taxpayer. Automatic enrolment addressed that timebomb, brilliantly. However, it does not deal with the shift of responsibility from institutions to individuals, with disparities which are more and more marked, or with the risks, from scams and otherwise, to which a largely disconnected working population is exposed now. Perhaps of particular significance are the different challenges which arise from 'pension freedoms' not envisaged at the time of the Pensions Commission. **It is time for a fresh look, for a new Pensions Commission, looking at the situation of the 2020s not the 2000s. The problems have changed. The solutions need to change, too.**

About the Financial Inclusion Commission

The Financial Inclusion Commission (FIC) is an independent body made up of experts from financial services, businesses, the charity sector, academia and parliamentarians from all major parties https://www.financialinclusioncommission.org.uk/

Our mission is to champion financial inclusion as a policy priority for public bodies, businesses and civil society, and challenge exclusion wherever it occurs. Our vision is for a financially inclusive UK where financial services are accessible, easy to use and meet people's needs over their lifetime, and where everyone has the skills and motivation to use them.

Financial exclusion remains a significant challenge for 21st century Britain which prides itself on being a global leader in financial services.

Just over a million people in the UK do not have a bank account, one in four households lack insurance protection and one in five adults would not be able to cover more than one month of living expenses if they lost their source of income.

Financial inclusion is the means by which people can make their money work well for them, enabling them to maximise opportunities, move into employment, become more self-reliant, and enhance physical and mental wellbeing. Financial inclusion contributes to greater social mobility and levelling up, a more effective welfare system and greater national resilience from economic shocks.

This means a United Kingdom in which:

- every adult is connected to the banking system, through having access to – and the ability to make full use of – a transactional account of his or her own;
- every adult has access to affordable credit from responsible lenders;
- every adult, young person and child is encouraged and enabled to save, even in small or irregular amounts, to share in the importance of a common savings culture, to help build up resilience against financial shocks and as an additional resource for retirement;
- every adult has access to the right insurance cover for his or her needs, at a fair price;
- **every adult has access to objective, affordable and understandable advice on credit, debt, savings and pensions, delivered via the channel most suited to that individual;**
- every adult and child receives the financial education he or she needs, starting in primary school and carrying on throughout life and into retirement;
- **the overall level of pensions provision – state plus private – in the UK, does not lag behind other developed countries, especially for the low paid;**
- **every adult will have a clear picture of what their income in retirement is likely to be, so they can plan and get 'no surprises'.**

Introduction

The Financial Inclusion Commission welcomes the opportunity to contribute to the second part of the Work and Pensions Committee call for evidence on protecting pension savers: accessing pension savings.

Context:

Although this part of the Committee's enquiry is focussed on accessing pensions savings, we think it is worth setting out the general backdrop of how pensions savings are building up, across the working population currently, to give context to our remarks on the 'accessing' phase. We will develop this fully in our response to the third element of the Committee's work. However we note here that a worrying picture of very substantial disparities in savings patterns and likely outcomes, is emerging.[1] We feel these must be borne in mind when considering 'accessing', because the future position of people at retirement will be determined more by the assets they build up, than by anything else.

Automatic enrolment has transformed the pension landscape, with 10 million more people saving into a workplace pension since 2012.[2] However, people in the UK generally have a poor understanding about what their financial position will be in later life.[3] This level of understanding has changed little over the past decade, which is not surprising when even answering a simple question like 'how much will I have to live on when I retire?' is a complex task. Human nature is to address concerns closer to crystalisation rather than those years away. In addition, around 8.5 million workers are excluded from automatic enrolment because they work in the gig economy, or part time and earn too little, or are self-employed, or work in small firms where they are the only director and there are no other employees.

- A 'league table' is emerging, with, at one end, many of those 8.5 million who have no retirement savings at all, and at the other, nearly 7 million people (6 million of whom are in the public sector) with valuable defined benefit pensions.[4]
- In between, there is a set of graduations, with big differences:
  - Employers' contributions are typically 3-4 times greater for (e.g.) the 5 million people who work for FTSE 100 companies than the circa 10 million people who have been included in pensions for the first time at the minimum level of contributions for automatic enrolment.
  - This difference is almost as marked in medium sized businesses. The average employer contribution available to someone who works for a FTSE 250 company is still typically nearly 3 times the automatic enrolment minimum.
  - For women, these disparities are compounded by the well documented gender gap in provision for retirement. For example, there are 50% more women than men heading for retirement with no pension savings at all. There is a 47% reduction in women's pensions wealth, compared to men's pensions wealth, by their late 50's.[5]
- These disparities are not the only issue. As big, or bigger, *is that most people don't even realise the disparities are there, or understand where in that 'league table' they stand.*

[1] References for data relating to the disparities is drawn from:
(1) Resolution Foundation (January 2021), *Building a Living Pension;*
(2) NEST (February 2021), *Retirement Saving in the UK 2020*;
(3) Willis Towers Watson (July 2020), *FTSE 350 DC Pension Survey 2020*;
(4) ONS (January 2021), *Defined Benefit Pension Provision;*
(5) Department for Business, Energy and Industrial Strategy (October 2019), *Business Population Estimates for the UK and Regions.*

[2] Department for Work and Pension (June 2020), *Workplace Pension Participation and Savings Trends of Eligible Employees Official Statistics: 2009 - 2019.*

[3] For further details see: https://moneyandpensionsservice.org.uk/2020/09/15/3-million-over-50s-will-leave-planning-retirement-finances-to-final-two-years-before-stopping-work/

[4] The Pension Regulator (March 2021), Annual landscape report on define benefit and hybrid schemes 2020.

[5] NOW:Pensions (July 2019), *Facing an unequal future: closing the gender pension gap.* Further data can be seen at '*Insuring Women's Futures*'.

This is one of the consequences of the responsibility for pension outcomes shifting decisively from the State, and from employers and pension schemes, onto the shoulders of individual savers. While this new environment brings real benefits for the minority who are comfortable navigating their options or seeking impartial, professional support with their decision making, analysis from the Financial Conduct Authority supports our view that most do not. Taken together with what is known about UK financial capability and the range of risks facing pension savers, from pension scams to unexpected tax charges and unsuitable product outcomes, it is clear that more can and should be done to help savers.

The impact of the pandemic:

The current pandemic has had a huge impact on employment levels, and even though pensions contributions have had to be continued for furloughed employees, the long-term retirement provisions are harmed for anyone who has become unemployed. This has a large impact on pensions as both their own and their previous employer's pension contributions are interrupted. Even a year or two of missed contributions, especially early on in someone's life, when those contributions could get many years of compound growth, can mean significantly less in someone's pot at retirement. The Financial Inclusion Commission is concerned that many people do not understand these risks and their implications for retirement and too many assume the state pension is enough to meet their needs. But the consequences of not thinking about this are significant in terms of financial inclusion in later life.

As the impact of the Covid-19 pandemic continues to bite, planning for the long term through pensions may seem far off for many. A report by the International Longevity Centre found that many 'Gen Xers' (people aged 41-56) may be sleepwalking towards financial hardship in retirement, unaware that they're saving too little to achieve the level of income they desire, or relying on forms of income (such as inheritance or downsizing) that may not materialise. Worryingly, nearly 1 in 3 risk reaching retirement with inadequate incomes.[6] This disproportionately impacts women. Recent research from Scottish Widows demonstrates that women in their twenties today are set to retire, on average, with £100,000 less in their pensions than men the same age.[7] Furthermore, there is evidence that the pandemic has eroded confidence further with 78% of employees feeling that they will have to work longer before retiring.[8]

Pensions saving can help prevent financial exclusion and hardship in later life, but financial inclusion is arguably the Cinderella of pensions policy. The recent Pension Schemes Bill, for example, contained nothing about financial inclusion. The Financial Inclusion Commission believes that inclusion must be pushed up the pensions agenda as a priority.

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

There is a wide range of regulated product solutions. It can be argued that, in defined contribution pensions, which are now the prevalent form of retirement provision, at least in the private sector, the range is too wide.

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[6] International Longevity Centre (March 2021), *Slipping between the cracks? Retirement income prospects for Generation X.*

[7] Scottish Widows (March 2021) *The Gender Pension Gap.*

[8] Aviva (November 2020), *Embracing the age of ambiguity: Re-invigorating the workforce in a rapidly evolving world.*

This has a number of origins: attempts by the industry at product differentiation and successive changes in tax, state pensions and regulation, have required different product types to be developed to meet them; changes in the pension vehicles perceived as good value, for example the unprecedented reduction in interest rates has rendered annuities much less popular, despite being the only retirement option that satisfies the requirement for security which is the requirement for most people; and 'with profits' products which predominated until the end of the last century have been almost entirely superseded but will remain in force for many years.

The half-life of a pension product is as long as the longevity of its youngest customers. Many people have a patchwork quilt of them. This contributes to the complexity which is considered by many consumers a major downside of pensions. It is also one of the reasons why it is common to hear people say that they would rather put their trust in property, by one means or another.

It does not help that different pension vehicles are regulated differently, either by the Financial Conduct Authority or the Pensions Regulator. These differences can appear arbitrary and, in defined contribution pensions, as opposed to defined benefits, where the presence of an employer covenant might be seen as a significant fundamental difference, do not seem to make much sense given that the vehicles concerned are meant to serve the same needs and under the skin are virtually identical.

We believe there is a more important question. Are people actually *using* the options most likely to correspond to their wants and needs in retirement? This can only be considered from the individual's perspective, and there is no clear data to help inform scrutiny of this important area. There are known demand-side problems in the pensions and retirement market and these pre-dated the pension freedoms. Pensions access choices are unfamiliar and confusing for many savers, especially for the majority who take these decisions without the benefit of independent, regulated financial advice or impartial professional guidance.

There is a growing evidence base showing people find decisions about accessing pensions difficult (as is the case with pensions generally), including the FCA's Financial Lives surveys, Money & Pensions Service analysis of financial capability and others. As Sir Hector Sants told the Committee in March 2020:

"A significant number of the people who contact Pension Wise will come away saying that, after having spoken to our guidance service, they have concluded that they should do something different from what they had in mind in the first place…There is a figure that suggests that 72% of people are saying they have changed their mind about what they will do as a result of talking to our guidance service. In a way, that is a simple statistic that tells you that the vast majority of people, left to their own devices, will probably make a poor decision."

The same inference can be drawn from research which shows that with a (very) small amount of input, many if not most consumers experience a 'light bulb moment' when their perception changes quite fundamentally and positively about what is important and what is their most appropriate course of action as regards pensions. This was the conclusion of work carried out in 2017 by NMG on behalf of a group of more than 11 Independent Governance Committees (representing the majority of members of contract-based workplace pensions schemes). It was also supported by the findings of ORC International on behalf of Zurich IGC.[9]

The Financial Inclusion Commission is more concerned that regulatory policy should ensure people who need support actually get it, in order to have a better chance of informed decision making. The

[9] This work was peer reviewed by a leading academic and by the Pensions Policy Institute, and was selected by the Market Research Society as the best piece of financial services market research of that year (2017).

evidence, including Sir Hector's assessment, clearly demonstrates that the gap in understanding and confidence amongst savers is considerable, which increases the likelihood of badly informed decisions that deliver financial loss and reduced wellbeing in retirement. More needs to be done to ensure that people, non-advised savers in particular, receive this support and take up impartial guidance from Pension Wise as a minimum.

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

And

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

There are other pension options which might be more suited to people's needs in retirement. However, there is not a great deal of understanding of what people's needs in retirement are, and how they vary hugely according to personal circumstances. Getting a clearer picture of what those needs are, for example the position of someone who has a secure, inflation linked final salary pension, and owns an unmortgaged home is vastly different from someone with little beyond a State Pension who has to pay rent indefinitely, or who retires with an mortgage still outstanding, needs to underpin development of the options available.

It is easier to see that there are pension options which might meet people's needs in later life better, *if considered simply from an 'economic person' perspective*. For example:

- Products currently tend to have total guarantees or no guarantees. Is there a 'middle way'?
- Products which reflect the differing needs for income in retirement depending on their 'phase' of retirement.

Is there a 'middle way'?

There are products which provide some, if not total, protection against longevity or amount, and hence which permit investment in assets likely to have better prospects of growth or at least matching inflation. These are present in other countries and have, in many cases, been tried in the UK at some point in the past, and are evident in the current proposals for 'Collective Defined Contribution' ('CDC') plans.

Other examples include 'variable annuity' products, which have been very popular in the USA but, despite being given a big push by providers who had succeeded with them there, failed to take root in the UK. With-profit annuities had similar characteristics but were undermined by the Equitable Life problems.

Theoretically, better financial results could be delivered by products providing some security of income, some guarantee of either amount or of duration, but without the total guarantees of annuities or the need to understand the risk/reward characteristics of various forms of asset in drawdown products.

However, getting to the point where these products might be sufficiently acceptable to the mass market is a big ask. The Dutch experience with CDC suggests that people are quite willing to see their returns smoothed up, but are not so keen to see them smoothed down.

Working on a basis of 'simple economic' logic does not work, given the realities made so clear by behavioural economics analysis.

For example, it is probably reasonable for most people, who are entitled to a basic State Pension, which has a capital value of circa £250,000, to take more investment risk with a DC pension pot, than they would do intuitively (especially with DC pension pots often being no more than £25,000). However most people will not come to that conclusion of their own volition.

This raises again the question of how much it is reasonable for a customer to understand, without some form of assistance.

Reflecting 'phase of retirement'

Financial needs in retirement do not usually follow a straight line. Needs can vary, between:

- The early stage of retirement, when many want to enjoy the provision they have made, most actively with a high level of spend.
- Declining activity and declining spend.
- End of life, potentially with high medical or care needs.

Most thinking about pensions provision takes a 'straight line' approach.

Does this need radically new products?

Given that the appropriate use of drawdown vehicles can meet even the widely varying needs of different people, it is difficult to see what would be achieved by more product proliferation. Making it more likely, by having the right sort of guidance available*, and used*, so that people use existing vehicles in a way that makes sense for them (e.g. a mix and match of annuities alongside drawdown) *and that they understand,* feels more important.

Might a 'State Underpin' enable a better match of provision to needs?

The Financial Inclusion Commission has considered whether some form of 'State Underpin' could be provided, to mitigate the downside risks which are implicit in 'pure' defined contribution retirement saving. In some respects, the Basic State Pension, not being means tested, does this, to a point. However beyond that the risk falls on the individual. This forms a cliff edge which might make the saver more risk averse, for longer, than historical returns on different forms of investment might suggest would be in a member's best interests. It may be worth considering whether there is a method of enabling this, without running undue risk of the State being selected against, as is often cited in the case of Australia, where the Age Pension is means tested.

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

No.

Impartial pension guidance usage remains mainly limited to the small minority who self-direct to Pension Wise in order to book an appointment. There are clearly too many non-advised savers making decisions without impartial guidance and this can only serve to increase the risk of financial harm and poor outcomes for these savers.

Regulated advice suffers from distrust, and its perceived cost. These contribute to low levels of take up. The FCA's most recent data suggest only around one in three (36%) savers access their DC pension savings via a regulated financial adviser.

Further, measures to facilitate employers making guidance or advice open to scheme members have not proved successful. Recently announced intentions to differentiate between what an employer can say in the context of a trust-based scheme as opposed to a contract-based scheme, mean this is likely to continue to be little used. Employers might have both types of scheme in force, especially SMEs, which will not have specialist pension departments, and may well have employees in both historical Group Personal Pension Plans and more recent automatic enrolment master trust vehicles. To expect them to discriminate would be demanding; an easier option is to do nothing for either of them.

In addition, by the time many people come to accessing their retirement savings, they have left, frequently long ago, the employer through whom those savings were arranged, and the pensions consultant or other intermediary appointed by the employer will also have gone. This leaves the member and the pension product provider as the only parties left standing. Product providers, with relatively few exceptions dating back to the days of direct sales forces, have had nothing to do with the selection of the pension products by scheme members, and are generally reluctant to go further than giving factual information relating to their own product, when what an individual needs is assistance given their overall situation.

Some providers do go as far as they can to overcome this, but the risk of stepping over the regulatory boundary is a clear and reasonable business constraint.

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

The Financial Inclusion Commission believes that MaPS has a vitally important role to play and should build on the positive impact that Pension Wise is clearly having on those who use the service.

Given the risks facing savers and the clear scope for badly-informed decisions leading to reduced financial security in retirement, the Financial Inclusion Commission warmly welcomes the Government's commitment to achieving a "norm" of Pension Wise guidance usage. If delivered promptly and effectively, this outcome will extend the evident positive impact of this service to thousands of people who are likely to benefit, including many who are clearly unlikely to self-direct to an appointment without significant encouragement to do so. We already know, for example, that financial exclusion and resulting hardship in retirement may be exacerbated further if people don't know of sources of support, don't know who to ask, or are too proud or intimidated to do so.

MaPS' Pension Wise user evaluations show the impact of the service among users. For example, 77% said they were very satisfied, 17% satisfied and just 5% fairly or very dissatisfied, with 93% of users feeling very or fairly well informed of their pension options, compared to 60% among non-users. Crucially, 97% said they would recommend the service to others or had already done so. Similarly high levels of sentiment have been found in each of the annual user evaluations since Pension Wise was established in 2015.[10]

These figures contrast with the level of usage. The FCA's most recent data show that of the nearly 700,000 Defined Contribution pension pots accessed between April 2019 and March 2020, just 14% of these pots were accessed after Pension Wise guidance had been used. A further 36% of pots were accessed after a regulated financial adviser had been used.[11]

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[10] MaPS (September 2020), *Pension Wise service evaluation Experiences and outcomes of customers using Pension Wise in 2019/20*.

[11] FCA (September 2020), *Retirement income market data 2019/20.*

It is a source of major concern to us that around half of those people accessing their DC pension benefits are doing so without impartial guidance or regulated advice. As with financial decision making at other life stages, significant losses can follow hasty decisions, made without a good understanding of the available options and their attendant risks and benefits. But the risks are even greater in relation to pensions access, when low awareness can have a profound and enduring negative impact on outcomes for savers. Speaking to an informed, impartial professional can make the difference between a good decision, that leads to a contented and financially secure retirement, and a life-changing bad one.

There is a clear need for impartial support for savers and the supply of guidance needs to be increased. This should not focus only on the point at which savers access their pension, but seek to direct DC pension savers to a Pension Wise appointment, or to similar, relevant, impartial guidance, such as postulated in a 'Mid Life MoT', earlier in their savings journey, when impartial guidance on their pensions access options could have the greatest positive impact. The levers for controlling demand for guidance sit with the Financial Conduct Authority and Department for Work and Pensions, rather than MaPS. It is their rules that will influence take up of Pension Wise and, as we explain in our answer to Question 7, we believe there is a need for stronger measures to ensure more people take up their appointments.

Ideally, take up of Pension Wise would be accompanied by a significantly greater promotional effort, even though it has proved difficult over time to convince those who bear the cost, via industry levies, to support generic efforts to improve engagement, despite the likelihood that a more engaged and active membership would save more.

Evidence from Sweden, examined by behavioural economics Nobel Laureate, Richard Thaler suggests that, contrary to widely expressed doubts, a sufficiently effective promotional effort would make a significant difference in prompting action.[12]

We understand that MaPS believes that significant promotional effort could boost take up substantially, but that such an effort would be likely deemed 'too expensive'. We suggest that the expense should be seen in proportion to:

- The amount lost to pension scams, estimated at £10 billion since 2015 by the Pension Scams Industry Group.[13]
- DC Funds under management: £471billion.[14]
- Charges deducted: circa £2 billion per annum.[15]

Pension Dashboards

We believe that Pension Dashboards will play an essential part in enabling people to move from relying mainly on institutions including an employer, the State (when pensions are earnings-related) or insurance guarantees, to having to bear the risks themselves.

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[12] Conqvits, Thaler and Yu (May 2018), *When nudges are forever: inertia in the Swedish Premium Pension Plan.*
[13] Work and Pensions Committee (March 2021), *Protecting pension savers—five years on from the pension freedoms: Pension scams, (p.3).*
[14] Pensions Policy Institute (September 2020), *The DC Future Book, (p.37).*
[15] Department for Work and Pensions (January 2021), Pension Charges Survey. The survey provides the average charge of 0.48% across all members. Applying this charge to the aggregate funds of £471 billion suggests cicra £2 billion.

However, making the information available alone will not be enough on its own. The project is still years from completion, so will not be available in time to help any of the 1.2 million people who will access pension benefits for the first time in the next two years. Even when it is available, the extent to which it does increase engagement, understanding and appropriate action is an unknown. In the meantime, Pension Wise is available, and every effort should be put into ensuring DC pension savers make use of this vital and effective source of impartial support.

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

The Financial Inclusion Commission believes the primary challenge relating to MaPS' pension propositions is to address the continued low levels of Pension Wise guidance appointment usage. The service has received consistently excellent feedback from the small proportion of savers who use it. Most importantly, these evaluations show a demonstrable improvement in users' understanding of their pensions access options compared to non-users. These benefits need to be extended to a much greater number of people.

There is always going to be scope for improving and refining MaPS' impartial pension guidance propositions, but the priority should be on addressing low levels of usage. The point at which meaningful progress has been made towards the Government's welcome objective of a "norm" of Pension Wise usage, and assuming that 'running' improvements are made when practical, as experience builds, the point when there are much higher levels of usage would seem to be the right time to consider broader reviewing and refining the service. At the present time the priority should be to ensuring people receive the benefit of their "guidance guarantee" appointment.

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

To a large extent, yes. The experience of savers making understandable but potentially financially damaging decisions with their retirement pots, for example by incurring tax charges when they need not, or by moving money out of a tax relieved, soundly invested, pension product into a current bank account because they have greater confidence in the latter, suggests that having a default approach is more likely to give better results for pension savers overall.

The simplifying of investment choice at retirement is, however, more problematic than during the accumulation stage. While a single default fund makes sense in accumulation, the diverse range of situations in which people might find themselves, and different objectives they might have, points to the investment pathways approach being needed. This will allow people to choose between one of 4 high-level outcome-focused objectives (consumer research shows a high level of satisfaction: 90% found an investment pathway which matched their needs).[16]

But even with pathways such as those now required for members of contract-based schemes regulated by the Financial Conduct Authority, and overseen by Independent Governance Committees, there is a need for impartial support to ensure the broad nature of benefits and risks of each of their options are reasonably understood. It is also important that the risk that people may stick to their existing provider without a full consideration of the pros and cons, is overcome.

[16] Legal and General Investment Management and NMG Consulting (2021), *Walk this way: Pension savers' views on the FCA's Investment Pathways*.

Simply having default products through pathways would not obviate the need for support. We believe, though, that similar pathways should be mandated for members of trust-based schemes. It seems illogical that a difference should exist when, in most practical terms, they are identical.

We believe that to harness inertia towards positive ends people accessing their savings should be 'automatically enrolled' into an appointment if the Government's ambition of Pension Wise usage being the norm is to be achieved. They would, as with automatic enrolment pensions, be able to opt out, although the same approach as was taken with pensions, to require opting out to require some effort and consideration, would be wise. We appreciate the intent behind the recent 'stronger nudge' consultation paper from the FCA, but on what evidence is available at the moment, think it unlikely to go as far as the Minister's ambition (which we support) for usage of Pension Wise to become the norm.

Ideally, this would be accompanied by effective and, initially at least, extensive promotion. Efforts to use messaging via providers or employers have not yet shown that they can produce the scale of increase needed. Promotion would ideally accompany even automatic enrolment into an interview, because the level of opt-outs would be likely to be greater than is the case with automatic enrolment into workplace saving, because even if an appointment is made automatically, the person concerned still has to take action, by attending it.

Once people have had impartial support to understand the attendant risks and benefits of their pensions access options, they should be better placed for retirement decision making, whether they are considering investment pathways or any of the other options available to them, not just with their pensions savings, but taking into account their broader money and life needs.

Overall, we believe that it would be better to test, extensively, different approaches to see what works, rather than pick on one approach – the stronger nudge – and wait to see whether it does deliver a 'new norm'. If it does not deliver the quantum change needed, many hundreds of thousands of people will access their pension saving sub-optimally. Testing could be akin to that used by FMCG businesses wanting to assess the best approach to the launch of a new or changed major product line.

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

We believe it is important to focus first on the saver's wants, needs and understanding. What does the person want to do in retirement? How much money will they need? Over what time horizon? What is their capacity to be able to accept what degree of risk? Can they see their pensions savings in the context of their whole financial position in later life? This includes seeing the element of risk implicit in their pensions savings in the context of their whole financial position, not just as if the pensions pot existed in a vacuum.

An effective assessment of product options can only be undertaken once these fundamental factors have been considered. As the timescale is unknown and the pensions access options unfamiliar, this is no simple undertaking. Impartial guidance or regulated advice is a valuable key component part of the decision-making process.

Whereas a consumer may take out multiple mortgages, or be at least to an extent familiar with general insurance purchases, most savers will have no prior experience of pensions access. The range of variables such as investments, inflation, longevity and strength of behavioural biases mean that decision making is hard, even for those familiar with the issues. If unfamiliar, it can be a nightmare and more intimidating to consumers who may be influenced by a permanent or transitory vulnerability, which may severely reduce the chances of making a good decision. All of these factors make access to Pension Wise or similar guidance even more crucial.

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

In general, we believe not. This can be seen more by looking at how members are behaving, than by trying to assess the effectiveness of communication by examining the material produced for them or the efforts put into trying to communicate. Despite a good deal of effort by some in the industry and by some employers, '*90% of people saving for their retirement are pension apathetic*' according to research published this year by Aviva.[17]

The following section looks at communication efforts for employees during their working life rather than at retirement, but we don't think the impression will vary a lot. The low take up of Pension Wise would seem to support this view.

Looking at communications broadly, we think that the degree of effort put into communication has more to do with the size and beliefs of the employer (as regards the value of the scheme to them as an employer, in terms of attracting and retaining employees) than it has to do with whether it is trust-based or contract-based.

Looking at larger schemes, there are a great number of well-considered and valuable efforts made to communicate with members. But even with these, the effectiveness of communication has to be doubted. An acid test of the effectiveness of communication is how many employees, offered an employer match to their contributions, take it up. This is not a statistic which is often discussed. On a small sample and anecdotal evidence, we believe that the incidence of the take-up of higher levels of employer match is typically 40% - 50% of the people to whom that option is available. This is about the same proportion as 'non-joiners' of workplace pension schemes before the advent of automatic enrolment (even of Defined Benefit schemes which are now described as 'gold plated').[18]

This aspect of pension provision needs further research to establish firm figures and clear evidence of the underlying reasons. One commonly assumed reason is that 'non-joiners', now 'minimum contributions only', employees can't afford the contributions. That assumption did not stand up to scrutiny for non-joiners and we doubt it does now.

However hard the employer and trustees might be trying to communicate, there is a significant proportion of employees who are not benefitting from higher total remuneration and lower tax and NI costs but are oblivious to that fact. If this is the case, the communications are not working well enough.

It is necessary to mention that it is not axiomatic that employers want to communicate well, if the result is that their total remuneration costs go up. The attitudes of finance directors may be different from those of Human Resources directors. It has been established for some years now that 'Save

[17] Rach, S. (March 2021), *Pension savers rank ESG issues as top concern*, *Money Marketing.*

[18] We have asked the Pensions Policy Institute if they have data to hand which would allow a more accurate gauge of the incidence of non-take up of employer matches. Definitive evidence is not readily available, but they pointed us to research by Hargreaves Lansdown in 2019 which is consistent with this impression. https://www.thisismoney.co.uk/money/pensions/article-6951501/Should-employers-forced-match-higher-worker-pension-contributions.html

More Tomorrow' ('SMART') initiatives (which allow members to commit future pay rises, rather than immediate contributions, to be gradually increased) can result in significantly higher employee, and hence employer matching, contributions. But we think there is little evidence of them being put in place. Further:

- In medium sized schemes, we believe the degree of provision and accompanying communication efforts can depend on the industry sector in which the employer has to seek and retain employees

- The overwhelming majority of smaller employers have only minimum contribution automatic enrolment schemes. In these, there is effectively no attempt to communicate. Most of the new generation of employers, small and micro, who have enrolled their employees into a pension scheme for the first time because of automatic enrolment have done so as a result of compliance, not because of a belief that it is their best interests as an employer to defer part of the remuneration of their employees by paying into a pension scheme rather than into their pay packet. With behavioural economics having shown that a pound today is valued irrationally higher than the value of two pounds deferred, this is not surprising. The latest NEST Insight report which, after noting that 98% of its employers have fewer than 50 employees, says that '*the vast majority of employers' contributions are made at the minimum rate*'.[19]

If a business's employees would, as demonstrated by their behaviour, rather have £1 in their pay packet today, than £2 put into a savings scheme, it is logical for that employer to adopt the less costly course. Employers, especially small employers, are unlikely to do anything above the minimum levels unless they think that by doing so, their employees will value an employer's pension contribution on a par with immediate cash. There has been a significant amount of behavioural economics research into understanding what does and doesn't motivate employees as regards pensions. An equivalent study of what drives (or doesn't) employers' actions would be valuable.

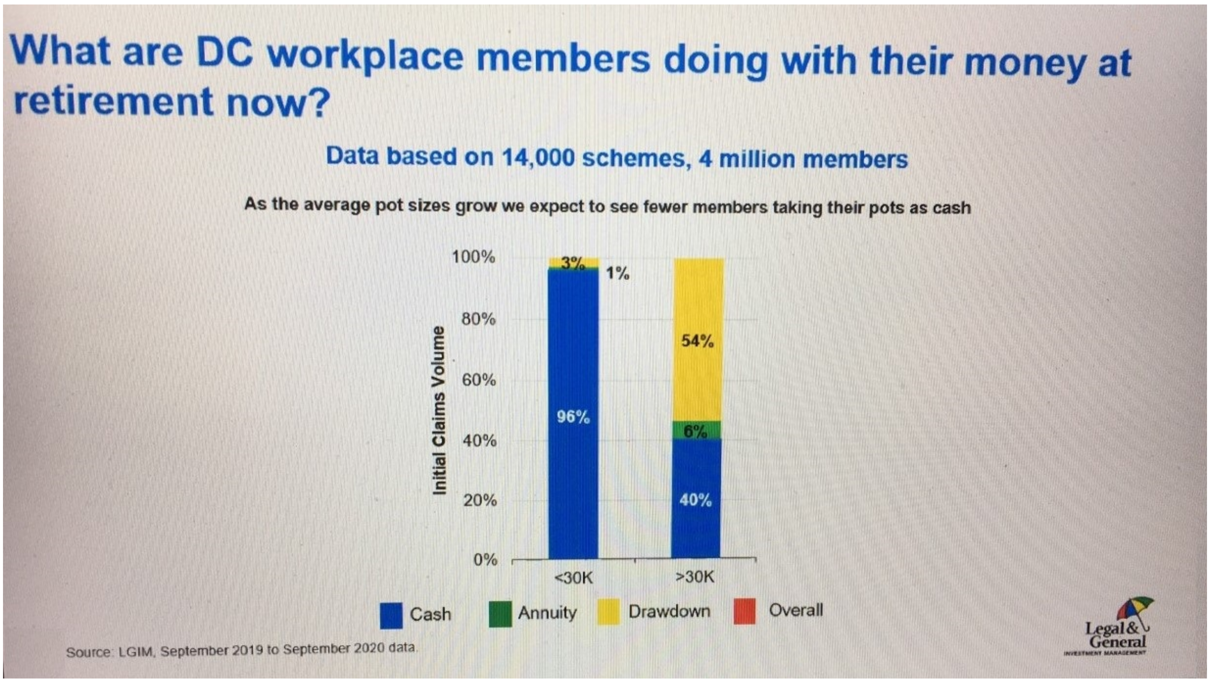
But what about people who have left?

The above considers communications with members who are, in the main, still active employees of the employer through whom their DC pension benefits are provided. Although the trustees of occupational schemes have to take into account the best interests of all members, deferred as well as active, this obligation does not apply to the employer. Considering that most people have a number of different jobs and will, increasingly, have a number of different pension pots, the situation regarding communication with deferred scheme members needs particular consideration.

This links into the consideration of the proliferation of small, in many cases micro, pots being accumulated as a result of automatic enrolment. It makes even more important the task of finding a sound, low cost method of aggregating multiple small pots to form one, or a small number of, substantial pots.

For a provider, the economics of putting significant effort into communication are much sounder if the cost represents a smaller proportion of the pot. For the member, research from Legal & General shows that the extent to which a pension pot is used for its primary purpose is (at least in these quite early days of the transition from Defined Benefits to Defined Contributions) sharply different according to pot size, as is shown in the chart below from Legal and General Investment Management.

[19] NEST (February 2021), *Retirement Saving in the UK 2020.*



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

The success of automatic enrolment has brought in many millions of people not previously pension savers. Many of these work for smaller employers or are agency-type workers with high turnover rates. One result is the proliferation of small, some very small, pension pots. The DWP estimated in 2012 that by 2050 there would be 50 million deferred small pots and the PPI confirmed and refined this figure, estimating 27 million by 2035.[20] The proliferation of small pension pots is a key issue to the financial inclusion of people in retirement, and for auto-enrolment to build on its success so far we need to manage the current situation and develop a lasting solution.

A proliferation of small pots is bad for all concerned. For members that is not least because it makes it difficult for them to see their overall situation. It is currently a nightmare for people to keep track of what they've got. The Pensions Dashboard should assist with this is due course, but even when it is in place, the problem of understanding issues like the risk and return characteristics of a multiplicity of small pots and what makes a sensible overall investment mix, may well remain.

We do not believe this can be solved by behavioural changes by savers. A solution is required which facilitates the aggregation of the multiple small pots, of amounts trivial in the context of realistic retirement provision, into meaningful amounts, without requiring people to make active decisions, or to make them frequently on, for example, changing jobs.

Although the size of pots will grow over time, NEST, for example, reported this February that its median pot size at March 2020 was £525 for a man and £433 for a woman. Amounts of this size are very difficult to deal with economically, even for NEST which has the benefit of long term Government loans at low interest rates, to support its Public Service Obligation, without which an automatic enrolment system could not work.[21]

[20] Department for Work and Pensions (December 2020), *Small Pots Working Group Report.*
[21] NEST (February 2021), Retirement saving in the UK 2020.

For the millions of people new to pensions as a result of automatic enrolment, there is not, for the foreseeable future, an option which requires member engagement to achieve amalgamation of pots, which would be economically viable. The effort required to: first, engage them on a topic which most find inaccessible; then, take them through the factors which should be taken into account, so that they have not just made a decision, but are comfortable that they understand the risk/reward characteristics of that decision; would result in costs unacceptable as a proportion of the size of their pot.

Even for people with larger pot sizes in longer established schemes, achieving engagement and ensuring that members are not vulnerable to scams, is challenging.

The DWP 'Small Pots Working Party' which reported in late 2020 identified a range of possible solutions and is now working through those which seemed most likely to be effective and practical. The 'pot follows member' option, which was worked up in legislation, but not implemented, had a lot to recommend it, but, harking back to the crucial difference which a positive employer can make to the provision for its employees, risked divorcing pensions provision from the workplace. Similar positive results to 'pot follows member,' but without that possible downside, might be achieved by adopting a system in which a member, whilst working for an employer, is enrolled into, and can benefit from the full range of benefits available, but on leaving has his or her pot transferred into a 'default consolidator' chosen by or allocated to the member. Given the extensive scrutiny now applied to default options, member detriment should be minimised although member choice, for those who wish to exercise it, would be freely available.

Conclusion

The Work and Pensions Committee call for evidence on protecting pension savers touches on a number of barriers for pension savers. Perhaps the most important is obtaining guidance and advice.

We are concerned that current regulatory policy is not supporting those who need it, to get help to allow informed decision making. The evidence clearly demonstrates that the gap in understanding and confidence amongst savers is considerable. This increases the likelihood of badly informed decisions that deliver financial loss and reduced wellbeing in retirement. The Financial Inclusion Commission believes more needs to be done to ensure that people, non-advised savers in particular, receive this support and take up impartial guidance from Pension Wise as a minimum. Once people have had impartial support to understand the attendant risks and benefits of their pensions access options, they should be better placed for retirement decision making.

To date, pensions have largely been absent from the financial inclusion debate, even though they are a major factor in ensuring people are financially and socially included in retirement. As part of its vision for a financially inclusive UK, the Financial Inclusion Commission believes this must be front and centre of policy. Tackling these barriers for pension savers is key to ensuring people are financially included in retirement.

May 2021