Written evidence from the Association of Consulting Actuaries (APS0029)

I am writing on behalf of the **Association of Consulting Actuaries (ACA)** in response to the above-named consultation issued by the Work and Pensions Committee.

Our key points are:

- We believe that the flexibilities within the pensions system have the potential to provide good outcomes for individuals.
- However, access to the full range of flexibilities is very mixed, with a disjointed system across contract-based group schemes, own trusts, master trusts and personal pensions.
- There is a black hole in the guidance and advice system, which urgently needs to be filled by good value, transparent solutions that link more seamlessly with pre-retirement pensions delivery.
- A combination of regulations, innovation, and greater consolidation will be needed to drive forward a pensions system that serves the needs of individuals in a manner that is easy to navigate and helps people to make the right decisions at the right time.

We trust that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful.

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?

ACA's 2020 annual pension survey (please see https://aca.org.uk/aca-pensions-report-build-back-better/) found around two thirds of employers believe greater flexibility in retirement savings options, covering accumulation and decumulation options, would encourage more saving, and therefore better retirement outcomes.

In terms of decumulation options, FCA data on how pension pots are being used shows only 10% of people are currently buying an annuity at retirement. A further 55% of people are fully withdrawing their DC savings at retirement. This suggests that, at present, the current range of options (ranging from drawdown through to deferred annuities) is sufficient for most savers.

Overall, we consider that the range of options which exist (in both the accumulation and decumulation phases), together with other savings and insurance vehicles, have the *potential* to provide good outcomes for most individuals.

However, we believe there are practical barriers which are restricting the ability of individuals to access these options optimally. These barriers include:

- Complexity (including within the tax regime) – which acts as a barrier for both individuals and also for employers and trustees seeking to offer flexibilities to their employees and members respectively.
- Perceived poor value.
- Low levels of understanding.

- Inadequate (or small) DC savings pots which are potentially a result of consumers' expectations on the outcomes available from auto-enrolment compliance.
- Poor availability of, and access to, tailored, personalised guidance and advice at a transparent, good value price.

A further issue is that individual pension schemes (particularly occupational schemes) do not typically offer their members the full suite of flexibilities through the scheme directly, meaning that accessing different options can be more challenging in practice. An individual effectively needs to "curate" their own route to achieving their desired outcomes.

It is important to note that the current proportion of retirees for whom DC pensions make up the bulk of savings is lower than we would expect in future and is likely to be the reason for 55% of people fully withdrawing their DC savings at retirement, as noted above. As time passes and DC savings become a greater share (or even the only source) of retirement savings for more people, savers are likely to need a wider range of accessible options to allow them to meet their objectives around a secure income that lasts through retirement. In this respect, we note that despite the relatively new flexibilities, a recent PLSA survey found that around 80% of 50 to 70 year olds would prefer a secure income that lasts through retirement.

The recent Pension Scheme Act introduced the potential for a new option to emerge over time from Collective Money Purchase pensions. These arrangements have the potential to address the gap between consumers' needs (i.e. secure income) and how they are currently choosing to use their DC savings (i.e. 10% making annuity purchases). We believe this would reduce the need for ongoing complex decision making, for example around life expectancy and thereby improve outcomes for many savers, such as the self-employed. From a practical perspective, CMP success would require efficient expansion to function as individual savings and decumulation vehicles.

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

Depending on how the funding of social care evolves over time, for many savers ensuring they are able to meet their care needs, should they require them, could become an increasing priority. Where these costs do arise they are potentially very significant for an individual, their families and the state. For example, taxpayers (via local authorities) spent over £22 billion on social care in 2018/19, with self-funded care costs (paid by individuals with savings of greater than £23,250) meeting a further c.£10 billion in costs.

If, over time, individuals will be expected to pick up a greater share of social care costs, these costs could potentially be addressed through some form of social care cost insurance. This approach was supported by 40% of respondents in ACA's 2020 annual survey (see link above).

As mentioned above, a retirement option used in other countries (but currently not used within the UK framework) is Collective Money Purchase schemes which would allow pooling of key individual risks such as life expectancy. CMP Schemes therefore have potential to provide greater income stability for individuals compared to individual DC schemes and at a more efficient cost than DB schemes.

The recent launch and availability of the FCA's default investment pathways could potentially provide some individuals (who especially many years into retirement may have limited appetite to make regular investment decisions) with a "governed", lower cost option to better deliver on their needs.

Finally, some countries do offer additional flexible options earlier in an individual's "pensions lifetime" which may overcome perceived inflexibilities in relation to pensions. In particular, in some countries (Australia being a key example), during the recent pandemic if an individual met certain criteria, they were able to access up to $10k of their superannuation fund.

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

There are several barriers to new providers and products emerging in the market. Key issues tend to be the commercial need to quickly build up scale (and to compete aggressively on price) as well as the important need to meet stringent regulatory requirements when new products are introduced.

For example, for savers in defined benefit schemes, the well-trailed Superfund regime has potential to significantly improve member outcomes if third party capital can be attracted in situations where scheme sponsors are weak (and so reduce the likelihood of schemes entering into the Pension Protection Fund in cases of sponsor insolvency). Another example of a new product with potential to improve member outcomes but not currently deployed in the UK, is the CMP arrangements we mentioned in earlier questions.

However, to be successful, providers will likely need to build up scale as well as meet stringent authorisation requirements. At present this market appears to be emerging only very slowly, which means there is potential for suboptimal outcomes if capital cannot be allocated efficiently.

The disparate nature of UK pension arrangements (FCA-regulated contract-based schemes, TPR regulated trust-based schemes, with 1000s of individual schemes operating their own arrangement) means that decision-making and governance is very decentralised. We often hear from providers and investment managers that the UK market is hard to reach scale in for new innovations, as it is not practical to "get in front of" the wide range of governance bodies that exist. This may be overcome by master trusts to some extend (DB and DC).

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

Advice and guidance are key components to individuals making informed decisions. Alongside this, it is important for the products themselves and the communications around them to be understandable to individuals. We strongly believe that at present, large numbers of individuals are not receiving the guidance and advice necessary.

At present we believe there is potential for inequality in the level of support and access, with typically larger and more proactive employers, providers and trustee boards providing more support to individuals. However, even in these cases the support can be quite "scheme / product focused" rather than more holistic guidance and advice.

In addition, our view is that engagement needs to start generally much earlier in an individual's working lifetime, building throughout before ramping up several years before retirement so as to enable individuals to make important decisions in the accumulation stage (for example around savings levels and fund choices). This would also mean individuals were likely to more engaged and informed at the point of converting their pension savings into retirement income.

We would also note that this is part of a wider issue around low levels of financial education and understanding generally, not limited to pensions. Initiatives to improve financial awareness in general would be welcome.

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

We see roles for MaPS in the following areas:

- Providing individuals with sufficient impartial information to be able to understand the options available to them (at a headline level) around their retirement and their differences, for example explaining the difference between drawdown and annuities.
- Helping people identify where they can find additional information if needed.
- Supporting individuals with gathering the right information and questions they need to take to an adviser.
- Providing tools that are balanced and objective such as the existing pension calculator, adjustable income tool, investment pathways drawdown comparator tool and an annuity comparison tool.

In the short term we would like to see the pensions dashboard prioritised so individuals have easier access to the whole picture, so they can make better informed choices. In our view, the priority for the dashboard project should be to have a functioning/viable product to support DC arrangements before extending to other forms of pension provision e.g. DB and State Pension etc.

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

Given the current cost of full IFA advice, we see that enhanced guidance or limited advice from MaPS could support people make the right decisions in a more cost-effective way, particularly for those with less complex financial circumstances.

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

Yes. Please see Q2 above. We believe a low-cost default option is likely to better deliver on the needs of individuals who, especially several years into retirement, may have less appetite to make regular investment and life styling decisions.

However, we note the following caveats:

- Increasingly we will see “retirement“, or rather benefit withdrawal, involving a number of decisions over time, rather than just at one point in time. Given that pathways have been developed to provide an investment solution to people based on answering a question at a one point in time around their future plans, the investment pathways may not be suitable in all cases.
- The investment pathways launched to date are of mixed quality. A clear governance framework will be necessary in order to ensure quality arrangements can be provided across the industry.

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

Cost is only part of the consideration when making retirement choices and can often be misunderstood. In our view a better measure would be “value for money” in the context of the consumer’s objectives.

In order to make this assessment, consumers need to fully understand their income needs and the risks they face through later life and how the various products align with these requirements. For example, they would then also need to understand the suitability and appropriateness of the various fund choice options available to them.

We believe there is currently a degree of inconsistency in the legislative requirements for advice in decision making around retirement. As an example, a DB pension scheme member with a cash transfer value of £30,000 is required to have independent financial advice to transfer this benefit out. However, another consumer with a £0.5m savings pot (perhaps some years after taking a transfer) would not be required to take advice on whether or not it was suitable or appropriate to transition this pot to a drawdown arrangement with a potentially higher risk investment strategy and higher charges.

In future, especially as retirement incomes are increasingly derived from DC only sources (and DB to DC transfers become less prevalent) it will be important for advice needs to be met where they are most material and consequential to retirement outcomes. It is important that any requirements for advice when making decisions in relation to DC savings pots are proportionate to the size to the pot so as not to create a barrier to individuals combing smaller pots.

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

As mentioned in Q4, there is a potential inequality in the frequency and comprehensiveness of the communication materials and support provided to consumers. There may be an opportunity to encourage or require providers to provide a minimum level of support to consumers.

Additionally, we note the following points:

- As Master Trusts grow and look to win new business and retain existing clients in a competitive market, they have developed their engagement propositions and communications. We expect they will continue to invest heavily in this area, but do not see contract-based schemes investing as heavily, and hence their communication can be less effective. The variance in communications from own trust schemes is large; often determined by budgets, and the paternalism of the company behind the scheme.
- Annual benefit statements only require for a pension projection under the assumption that a member purchases an annuity at retirement. Without the requirement to highlight the additional flexibilities at retirement (e.g. drawdown) these statements do not help members understand fully their options.
- The regulations around information to be included in communications vary for Master Trust versus contract-based schemes.

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

Auto-enrolment, higher job velocity and the prioritisation of other savings (e.g. house deposits) in early years are structural changes which mean the number of small pots are expected to continue to increase.

One solution for the issues around small pots is to make it practically easier for consumers to combine small pots, potentially through the use of technology. Current processes are cumbersome and time consuming and it is hoped that the introduction of pensions dashboards could help facilitate these behaviours by increasing individual awareness of their retirement provisions.

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