Written evidence from the Pensions Management Institute (APS0030)

Introduction

PMI is the professional body which supports and develops those who work in the pensions industry. PMI offers a range of qualifications designed to meet the requirements of those who manage workplace pension schemes or who provide professional services to them. Our members (currently some 6,000) include pensions managers, lawyers, actuaries, consultants, administrators and others. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response. Due to the wide range of professional disciplines represented, our members represent a cross-section of the pensions industry as a whole.

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?**

   Currently, members of Defined Contribution (DC) pensions arrangements have three options available to them on decumulation:

   - **Annuitisation** is the traditional retirement option for DC members. All or part of the accumulated pension pot is used to purchase a Lifetime Annuity. This provides a guaranteed regular lifetime income stream and so represents a particularly secure option. There is also flexibility in that part of the member's pot, usually up to 25% of the total, may be accessed as tax-free lump sum.

     However, due to a range of factors such as low interest rates, annuity rates have fallen in recent years to the point where this type of financial product has come to be seen as representing poor value for money. There is also a lack of flexibility in that the purchase of an annuity is an irreversible decision.

   - **Flexi-Access Drawdown (FAD)** is one of the options introduced by George Osborne's 'Freedom and Choice' reforms introduced in 2015. This is the latest version of the 'income drawdown' concept, which first became available following the Social Security Act 1973 (SSA 73).

     With FAD, the member has the option to 'designate' (select) part or all of the accumulated pension pot for drawdown. Up to 25% of the designated fund may be taken as a tax-free lump sum. Part of the remainder is drawn down at regular intervals to provide the member with a regular income.

     This approach is commonly perceived as a preferable alternative to annuitisation in that income levels are generally higher than would be the case with an annuity. There are no restrictions on the amounts that may be drawn down. Additionally, any unused funds may be passed on to a dependant or other nominated beneficiary on the member's death.

     However, FAD does not incorporate any form of longevity risk pooling: there is a finite amount of money with which to fund the whole of retirement. The absence of any means to predict member mortality presents a very real risk that the fund could become exhausted during the member's lifetime. Alternatively, a cautious member could underspend and so have a lower income throughout retirement than was necessary, possibly resulting in financial hardship. It should also be remembered that once FAD payments commence, the Money Purchase Annual Allowance (MPAA) is triggered. This will restrict new tax-exempt contributions into any DC arrangement to just £4,000 pa, which will significantly restrict scope for restoring a depleted fund.

In practice, FAD is a complicated and expensive process to maintain that requires expertise such as is provided by a regulated adviser to be managed effectively. It also requires the fund on designation to be large. This means that FAD is really only an option for wealthier individuals.

- **Uncrystallised Funds Pension Lump Sum (UFPLS)** was the second new option introduced by the Osborne reforms. This allows the member to make a single or series of lump sum withdrawals from the accumulated fund. In such cases, the first 25% is tax-free and the remainder is taxed at the member's marginal rate.

  This approach is simple and flexible and can be effective for funds of any size. However, UFPLS triggers the MPAA. It can cause individuals to be pushed into a higher rate tax band. As with FAD, there is no longevity risk pooling and so there are the same risks with funds having the potential to be exhausted before death.

All decumulation systems are geared towards existing retirement patterns. Whilst there is scope for early and phased retirement, there is little flexibility for accommodating those who might seek to move back into employment at older ages. It may be that future retirement systems need to be sufficiently flexible to accommodate temporary withdrawal from the labour market at relatively lower ages, and other periods during which income and the availability of funds to place into a pension arrangement fluctuates considerably.

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

The most obvious option would be to expand the use of Collective Defined Contribution (CDC) schemes in the UK. Whereas the Pension Schemes Act 2021 (PSA 2021) has permitted the Royal Mail to establish the UK's first CDC scheme, this option will initially only be available in the form of single trust schemes within the private sector. Expanding CDC into other areas, such as the Master Trust sector, would have the potential to improve significantly the retirement options for millions of employees.

CDC requires fixed rates of contributions to be paid by both employees and the scheme sponsor. However, contributions are not paid into individual funds, as is the case with conventional DC, but into a single central fund, as is the case for Defined Benefit (DB) schemes. Members accrue a pension over the course of active membership, as with a DB arrangement, but this is not guaranteed. Instead, a 'target' pension accrues, whose value may be adjusted both before and after retirement in order to accommodate the scheme's funding position.

As with a DB scheme, benefits are in the form of a scheme pension. This allows longevity pooling and so offers members the guarantee of a lifetime benefit (albeit, as mentioned above, subject to potential change in amount to reflect the scheme's funding position).

In addition to removing the need for members to choose between multiple options at retirement, CDC also removes the need for members to make complex investment decisions in respect of their funds. This simplicity is, however, at the cost of the flexibility that choice allows.

CDC has proved to be particularly successful in the Netherlands and Denmark: two countries consistently ranked most highly in the annual Mercer CFA Institute Global Pensions Index.

Given the perennial challenges of trying to ensure that members make appropriate choices when faced with options (see answer 4 below), adopting CDC within the Master Trust sector would in most cases allow the perfect auto-enrolment pensions model, with effective defaults being possible during the induction, accumulation and decumulation phases.

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

As noted above, UK pensions law will only allow CDC to be established for single-employer trusts within the private sector.

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

There is widespread concern that far too many individuals are making life-changing and irreversible retirement decisions without having received adequate guidance or advice. The PensionWise service was developed in response to the introduction of Freedom and Choice and provides individuals with generic information about their decumulation options. However, there continues to be concern about both the adequacy of generic information compared with bespoke advice and the numbers of individuals making decisions without any form of support at all.

Many members of DB schemes are attracted to the flexibility of Freedom and Choice and so are making pre-retirement transfers to DC arrangements. The FCA is on record as stating that far too many such transfers are made following unsuitable financial advice. Another continuing problem is the risk that members may be scammed when making a transfer and lose their retirement savings altogether.

It is clear that standards of guidance and advice need to be improved and that members should be dissuaded from making irreversible decisions without having received suitable support beforehand. Additionally, more safeguards may be required to prevent the number of unsuitable – and possibly fraudulent – pension transfers. One of the challenges this presents is the cost of providing the required assistance versus the value of the funds in the pension arrangement. One possible solution might be to require that a fund of a minimum size be required before the full range of benefit options becomes available.

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 Money and Pensions Service (MaPS) has a crucial role to play in ensuring that retiring members are adequately informed about their decumulation options. This should include helping individuals source regulated advice. There will never be a role for MaPS or any other authority to offer financial advice on any individual basis.

The extent to which MaPS will be able to offer support via the pensions dashboard will of course be determined principally by the extent to which the dashboard has been developed at any given time. It seems likely that any presence that MaPS is able to achieve on an early version of the dashboard is likely to be very limited.

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

It is important here to make a formal distinction between 'guidance,' commonly understood to mean generic information, and 'advice,' which is formally regulated by the Financial Conduct Authority (FCA). We do not believe it would be desirable to introduce any form of easement which allow advice to be provided by individuals who are not subject to FCA regulation.

Nevertheless, there have been many advances in the quality and availability of guidance for members and this trend should be encouraged. There still remain blurred edges in practice between guidance and advice and it would be helpful if the FCA would offer a service to advise schemes and providers definitively upon which side of the line a particular proposed form of communication would fall.

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

In the context of traditional DC schemes, investment pathways offer a simplified path through the maze of decumulation. Since February 2021, providers have been required to offer members entering drawdown four options on how they might use their pension savings with a suitable investment strategy for each one. Whilst providing valuable assistance to individuals seeking a non-advised decumulation option, the approach cannot be appropriately be compared with auto-enrolment. The success of auto-enrolment stems largely through the operation of a process of defaults, and it is hard to see how the investment pathways approach could be safely adopted to facilitate a default decumulation strategy.

It is however worth noting that in (2) above, we suggested that the introduction of CDC into auto-enrolment would provide individuals with a default retirement option that would not involve the minefield of conventional DC decumulation.

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

Perhaps the single most important factor to be considered is post-retirement longevity. Research shows that this is commonly significantly underestimated and consequently members at retirement will have a significantly unrealistic assessment of how long their retirement savings will have to last. Another important issue is an accurate assessment of their regular outgoings after retirement. In particular, there should be an allowance for the 'U curve:' a phenomenon in which expenditure is high during the early years of retirement (to pay for holidays), lower during the middle years and then high during the final phase (to pay for long-term care).

Wealthier members will also need expert advice on estate planning if they intend for any unused retirement savings to form a legacy.

Once consumers have a clear idea of their post-retirement income requirements, they (or, more pertinently, their advisers) will be in a position to assess which decumulation option or options best meet their requirements.

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

Much good work has been done in recent years to improve the standard of communications provided to members. This is as true of contract-based schemes as it is of trust-based arrangements.

However, as noted earlier, the options for DC scheme members are both greater in number and significantly more complex than those under DB schemes, and present greater challenges around effective communication.

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

It has been estimated that millennials will have an average of twelve separate jobs over the course of their working lives. In the era of the gig economy, this may prove an underestimate as many young people pursue multiple simultaneous forms of employment rather than a single job. This will see them – and, to a less extreme extent – the preceding generation accrue a succession of small pension pots. This is far from ideal, and successive governments have considered options for allowing easy consolidation.

As Pensions Minister in the Coalition Government, Steve Webb explored 'Pot Follows Member.' The current Government is seeking to launch the Pensions Dashboard, which is intended to allow individuals to keep track of all their separate pension savings. The problem here is not what is technologically possible but rather identifying what course of action best suits an individual's needs.

At first glance, automated consolidation might appear to be an obvious solution for everyone. However, complications arise when considering what might be lost through effecting a transfer. Whilst technology might make the process of consolidation, expert analysis and advice is still required to determine if this is necessarily in a member's best interests. Persuading the public that consolidation is (generally) desirable is perfectly possible, but there is a need for caution as this approach is by no means a panacea.

May 2021