Written evidence from First Actuarial LLP (APS0036)

INTRODUCTION

First Actuarial LLP are pleased to respond to this call for evidence from the DWP Select Committee. First Actuarial provide pensions consultancy and administration services to more than 300 defined benefit pension schemes. We also advise more than 500 employers on pensions strategy and provide pensions policy advice to a number of organisations. Importantly for this response, we also speak to large numbers of pensions savers in groups and individually as we deliver our financial wellbeing services funded and provided by employers.

RESPONSES TO QUESTIONS IN CALL FOR EVIDENCE

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 significant difference in the way people's needs are met and not met by defined benefit and defined contribution schemes in the UK.

Defined Benefit Schemes

Defined benefit schemes provide ***a stable and reliable income for life*** which we believe is ***the most important need*** for the vast majority of ordinary working people. Sadly, access to defined benefit pensions is now severely limited outside of the public service schemes. In 2020, only around 1m private sector employees are accruing defined benefit pensions[1]. Many more (almost 10m[2])will be reliant on legacy schemes which will continue to provide a bedrock of support to the current and future generations of pensioners. In the public service schemes, there are around 6m active members with around 10m deferred and pensioners members[3]

Whilst we believe defined benefit schemes provide the best overall fit for most people's retirement needs, we recognise there are some downsides to them. Many schemes are relatively inflexible so may not cope well with changing needs. In part this inflexibility is due to legislative hurdles – it is difficult within the DB legislative framework to provide a pension that steps up or down at different times. But in part it is because defined benefit schemes have chosen not to introduce some of the flexibilities which legislation allows. For example, few schemes allow people to draw a portion of their pension whilst continuing to work for that employer. This is partly because employers have not sought to reinvigorate legacy arrangements but is also because options like these can increase benefit costs and because administration systems and services are not suitably developed to allow non standard benefits.

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[1] Pension Protection Fund The Purple Book 2020 Page 13
[2] ibid
[3] House of Commons Library Briefing Paper 8478 Public Service Pensions Facts and Figures

Defined Contribution Schemes

The vast majority of UK pension savers (over 14m[4]) are now building up benefits in defined contribution (DC) arrangements. These arrangements provide an individual pot of money which the member needs to turn into an income stream by:

a) purchasing an annuity

b) using a drawdown product.

Research has indicated that members struggle to understand these products and can end up unable to decide how to plan or deciding on options which are tax inefficient and high risk when measured against the need to provide an income in retirement which at least maintains its real value[5].

The annuity option appears unattractive to most savers – the costs of investing in very low yield gilts and bonds, paying the insurer's expenses and profit margins and buying an expensive longevity guarantee place this beyond the reach of many trying to provide an adequate retirement income. For example, a recent article[6] in Which using the Money Advice Service annuity calculator shows that for a 65 year old with a £100,000 pension pot, the best available annuity rates were:

Single life non increasing:	£4,703
Joint life non increasing 50% to partner	£4,378
Joint life 3% pa increases, 50% to partner	£2,852

Whilst drawdown products can be very flexible, it is very difficult for anyone to know how best to invest that money or how quickly or slowly to spend that capital to support themselves throughout their retirement.

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

There is scope for the development of innovative products. The Actuarial Research Centre have commissioned some work on tontines[7] and this looks helpful. It would also be possible to design combined products – perhaps a drawdown product for 20 years which includes a deferred annuity for life after that period – so the annuity would be an insurance against a longer life. It is perhaps disappointing that such products have not been widely developed. We may see more innovation in these areas once the amounts in DC arrangements build up to amounts that make this more possible. There are some structural barriers to insurers providing deferred annuities for the later part of retirement in particular the reserving requirements. It might be possible to re-examine these to see if a UK rather than an EU requirement might be set particularly for auto-enrolment products largely serving a domestic customer base.

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[4] The Pensions Regulator DC Trust: scheme return data 2019-20
[5] FCA Retirement Outcomes Review June 2018 MS16/1.3
[6] https://www.which.co.uk/money/pensions-and-retirement/options-for-cashing-in-your-pensions/annuities/annuity-rates-aly8c2z86kds

[7] Modern tontine with bequest: innovation in pooled annuity products by Thomas Bernhardt and Catherine Donnelly ARC

But the most important change that could provide a real alternative for people would be the introduction of a multi-employer / no employer CDC drawdown product. This would provide a "safe harbour" for those with large cash amounts at retirement who want an efficient way to turn that cash into an income for life. People might choose to split their DC pot between an individual drawdown product and a CDC arrangement giving them both the flexibility of DC and the reliable long term income from CDC. An obvious provider of such a product would be NEST.

The current CDC legislation does not permit multi-employer/no employer CDC arrangements and we would urge the introduction of regulations to permit this as soon as possible.

If the industry were able to offer valuable and valued post retirement decumulation solutions, there is the potential for more employers to sponsor cash balance funds that relieve employees from pre-retirement investment risk. This should mean an ability to take greater investment risk, achieve higher returns and ultimately provide better benefits be investing in growth assets. This could mean more investment in wealth and job creation benefitting the economy and society as a whole.

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

One significant barrier to people planning to meet their retirement needs is the lack of clarity about how long-term care works now and in the future. A settled resolution to the question of how the country will address the problems of long-term care would allow people and providers to plan around it.

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

It is relatively easy for high-net-worth individuals to receive paid for advice on how they manage their pension and other assets in retirement.

For median and lower earners, access to guidance and advice is far more difficult as:

a) there are a limited number of IFAs willing to give advice and they are not well trusted by the public

b) the interaction of pensions and the benefits system is complex and at time arbitrary. IFAs are not in general experts on the benefits system and so can be ill equipped to assess the effect of different options on an individual's overall income and outgo

c) as noted earlier, giving advice is very difficult when the future of long term care is not known

d) IFAs may not be able to provide advice at an affordable cost especially to those with very low pension benefits

e) There is a popular and professional confusion about the boundaries between guidance, advice and regulated advice. Regulated advice is expensive and difficult to source. But unregulated advice and guidance can be provided much more cost effectively and is often what people need. Unregulated advice could lead an individual to the conclusion that they need a drawdown product. Once they know they need a drawdown product, people can often "self-serve" in finding one through cost comparison sites. So people could get to the right outcome without regulated advice. But employers, pension scheme trustees and ordinary working people are very risk averse in these areas and wary of being criticised or challenged legally for having given the wrong advice. It is time that we reclaimed the word "advice" as a generally good thing. People do not worry about giving advice about what kind of television to buy or how to get to a destination in the easiest way and we need to give people confidence that they can do this too. Regulated advice covers a very narrow spectrum and making clear how narrow this is (and perhaps giving it a more technical term) would be a real benefit.

We believe that financial guidance and advice can best be provided through the workplace. Especially now with auto-enrolment, employees see the workplace as being the primary site through which pension benefits are provided and accessing advice and guidance through the same channel would be natural. We see the provision of financial advice and guidance as being one of the key employment benefits that should be expected of any good employer.

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 welcome the fact that everyone with DC benefits has access to a guidance session with the Money and Pensions Service. We would like to see them develop more online tools (such as robo-advice and modellers) as people do need further help and to have the messages repeated. Providing these through the MPS rather than within commercially provided pensions dashboards would we believe increase the confidence of users.

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

Our experience is that many members of pension schemes have very little knowledge of how pensions work. We frequently come across individuals who have been in a pension scheme for many years but don't understand how much it costs them or the benefits provided by the scheme. We feel that the population as a whole would benefit from general guidance and education on how pensions work.

As pension scheme members approach retirement, then very important financial decisions must be made which will affect the individual's financial position for the remainder of their life. The cost of obtaining financial advice can be prohibitively expensive for many people, and it is often only the higher earners that take some form of financial advice at retirement. Some employers commission financial guidance or financial advice sessions for employees approaching retirement, but many employees receive very little assistance at all. We believe it would be very helpful for the Money and Pensions Service to offer enhanced guidance or limited advice to individuals faced with making a decision about their retirement choices.

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

This does depend largely on the meaning of the term “success”. Auto-enrolment has been successful in that millions of workers now have an auto-enrolment product. For many those savings will be inadequate but people have been given the impression that their pension needs have been met. If we interpret “success” as meaning something has happened to people, then investment pathways can work in making savers choose one of them. Whether they have chosen correctly or understood their choice will be far less obvious but must surely be part of the judgment of success or otherwise.

People generally need help in making choices and that help is best provided by people. Ideally that would be face to face but an online conversation would be a good second best. Investment pathways are necessarily a limited presentation of choices. It is possible to design online modelling tools that would allow people to look at more tailored pathways and we would like to see modelling tools like this more widely available.

Within auto-enrolment schemes typically 90% - 95% of assets are invested in default funds. This suggests that many people are not engaged at all with their pension. The two solutions to this are to empower people to be able to and to want to take control themselves or to provide a good default for drawdown as well as build up. Currently it is not obvious what a good default for decumulation is. Investment pathways could work well alongside a good default that provided a reliable income in retirement – a CDC drawdown product could do this. But investment pathways are not sufficient on their own.

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

Savers need to see how different products deliver in different circumstances such as:

- Long, short or medium longevity
- Periods of high inflation, low inflation and volatile inflation
- When the individual’s circumstances change

Again we think online modellers can help savers to understand more about these effects.

Customers also need a better understanding of the taxation system for pensions and other savings vehicles. Not understanding the tax relief available on pension contributions and investment returns can mean savers think property investment or ISAs are a better way to provide for retirement.

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

We see a wide range of communications issued to members approaching retirement and many of these communications can be lengthy and complicated. It can be common for a retirement pack for a defined benefit scheme to be over 50 pages long with several different options and pages of supporting notes. For the vast majority of the population who are not familiar with how pensions work this can be very confusing.

For DC schemes (whether trust or contract based), members are often presented with multiple pages of material and many different options and projections.

We believe that the communications issued to individuals at retirement need to be simplified across the industry. Alternative forms of media and communication should be considered when explaining the choices available to an individual at retirement. This could include for example a QR code which the member could scan to access a video explaining their statement.

Again we would see the primary driver of changes in these areas being employers. Savers "buying" a pensions product are not in general focussed on the service they might receive at the end of the savings journey. Auto-enrolment means employers are contributing significant sums to pension arrangements and it is in their interests to ensure that they get the best value from this spend by ensuring their provider does offer a high-quality service to members on exit. We would like to see NEST setting the highest standards in this area.

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

We think it unlikely that the small pots problem will be solved by members acting alone. In the absence of a resolution through legislation, there needs to be industry collaboration to find ways to encourage members to consolidate their savings. Employers could also provide a stimulus here by providing financial education as part of the onboarding process for new employees.

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