Written evidence from Aon (APS0038)

Aon is pleased to submit its response to the Work and Pensions Committee's call for evidence on "Protecting pension savers: Five years on from the Pension Freedoms: Accessing pension savings".

Aon is a leading global professional services firm providing a broad range of risk, retirement and health solutions, with more than 50,000 colleagues in 120 countries. We work with the trustees and sponsors of around 1,000 UK pension schemes. Globally, we work with more than 2,300 clients with assets totalling $3.8 trillion.

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?

Unfortunately, the ability to access an appropriate range of pension options depends materially on the circumstances of the individual, meaning that significant groups of savers are denied options that others enjoy. Two examples are:

(i) Collective DC (CDC)

Our 2018 DC and Financial Wellbeing Member survey* highlights that 60% of DC savers want an income for life in retirement, but their only way of achieving this is via an annuity, which according to FCA Retirement Income data (Sept 2020) only 10% purchase. This illustrates that the need is not being met. One solution to this problem is CDC, but initial regulation will only allow single employers and groups of connected employers to set up their own CDC schemes. This will limit access to the employees of the largest employers, whereas the need is universal. Therefore, the government need to legislate for multi-employer CDC and commercial CDC, which would open the door to all employees including the self-employed.

* Aon's 2018 DC and Financial Wellbeing survey was based on a nationwide survey, of over 1000 DC savers, conducted in conjunction with Ipsos.

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(ii) Protected pension ages and lack of flexibility

Current legislation does not allow DC members with a protected pension age to use their savings for drawdown, so they have to transfer out of the scheme (individually) to access the drawdown product. It's not clear why these rules were not amended when the pension flexibilities were introduced as this has the effect of channelling members who want to retire prior to age 55 into annuity purchase or taking all their savings as cash.

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

(i) Long term care

One of the primary unmet needs in later life is having savings earmarked for long term care costs. Aon has raised this previously in our response to HMRC's 2015 consultation on "Strengthening the incentive to save". Our views are unchanged in that we see a need to link saving for care costs to pensions given that pensions are about saving for the long term.

Our proposal, in essence, was to allow an additional £5k annual allowance for contributions towards later life deferred annuities and long-term care. In our 2015 consultation response, this was part of a much wider proposal for changes to the pensions tax regime. However, in principle, allowing an additional annual allowance for contributions towards products aimed at meeting the costs of long term care could be added to the existing pension tax regime.

For example, the additional annual allowance could be made available to those who contribute to a later life annuity type product (which delivers an income from an advanced age such as age 75) or as a premium or payment towards the cost of long-term care. Such products could also be taken outside the scope of the Lifetime Allowance, which will start to impact increasing numbers of people with the latest 5 year freeze.

(ii) Evolution of the annuity market

Annuities are viewed as being an inflexible and expensive means of accessing pension savings and this tends to deter savers from this option. As a result, we have seen this market contract considerably since pension freedoms. We see a need for this market to transform fundamentally and offer better, more equitable, financial terms for savers. We see this being achieved by a combination of government support – incentivising firms to enter the market - and firms investing in the development of more innovative and flexible products. A first step towards this would be some independent research to test the size of the target market for such products – which would help to justify spend on incentives and innovation.

We provide some examples of market transformation below:

<u>Ability to convert drawdown to a deferred annuity (blended solution):</u> savers who initially select a drawdown product may prefer certainty of income via annuity purchase at a later age when they may be less able to manage investments and prefer to remove both investment and longevity risk. Drawdown products with a deferred annuity bolt-on may better meet changing needs in retirement.

Ability to change the shape of an annuity once in payment: if the annuity is no longer suitable for the changing needs of the saver, there should be a way that the saver can cash it in or swap it for a drawdown product without financial penalty. As one example, we currently have fixed term annuities that pay out a guaranteed lump sum at the end of a selected term, however these are not widely understood by savers or promoted. It is also arguable that the market may not be sufficiently developed and therefore pricing may not be attractive to savers.

Ability to offer a different annuity design at the time of purchase: annuity providers should be encouraged to provide different annuity designs based on overall saver demand. A couple of examples are: a) offering annuities that increase every X years instead of annually, or not at all. b) offering annuities that have income step changes to allow for savers being more active in the years following retirement and less active thereafter e.g. higher income in the first Y years, and lower income in the latter X years.

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

As noted above, pensions and tax legislation can either prevent certain pension options or insufficiently support them. Linked to this will be FCA expectations and guidance to the market regarding product development to better meet the changing needs of savers, as well as the requirements on product providers about reserving and funding which will have an impact on growth and innovation in the annuity market.

The removal of barriers would need to be done with care. For example, we generally do not support options that would allow pension savings to be taken out before retirement and we note that the introduction of such an option in Australia in response to the pandemic has not generally been seen as successful.

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

Our 2021 DC and Financial Wellbeing employee survey* highlights that 70% want support from their employer on what to do when they reach retirement age. Within this sample, this would appear to suggest that the majority of employees are not receiving the guidance and advice they need to make informed decisions about how they access their pensions. However, this statistic should be considered in light of legislative requirements for trustees to signpost savers to MaPs; this may further suggest that a proportion of those savers are not making use of the free pension guidance available to them.

In connection with in-scheme pension flexibilities, many single employer trust-based schemes allow members to take partial UFPLS's prior to retiring fully. Whilst many schemes have focused on putting pension flexibility policies in place, few have focused on the regular messaging to savers about these options and the risk and benefits of the options. As such, our expectation is that there will be savers who access their funds in this way without having sought guidance or advice about the tax implications or impact on living standards later on in life due to depletion of funds.

We believe that targeted education and guidance by trustees, with support from sponsors, and by providers of contract-based arrangements about retirement options throughout the retirement journey could support savers in making better-informed decisions at the right time. In addition, we support pension scheme investment designs that encourage members to make a decision about how they intend to use their savings some years before retirement i.e. just before the point that the strategy starts to de-risk into investments that better match annuity, or drawdown or cash. This approach is also one that encourages members to start thinking actively about their savings and to take earlier and more timely decisions.

The need for guidance and advice is further illustrated by the uptick in pension scams during the pandemic.

An additional observation is that even when members have a clear vision of how they would like to put their pension savings into payment (e.g. knowing they want to transfer to a drawdown product, having reached that decision with, or without, guidance), implementing that decision can be very difficult and an impediment to maximising outcomes. Identifying receiving arrangements and completing the array of paperwork required by the ceding schemes and receiving schemes is difficult, particularly where an individual is looking to transfer to an external drawdown arrangement. This is further complicated where the member has built up a pre-6 April 2006 Protected Pension Commencement Lump Sum, which can only be paid by the original scheme. Assuming that the level of protections required for ceding and receiving schemes is appropriate, one solution to this is that MaPS has a wider remit to support the member with completion of the paperwork.

* Aon's 2021 DC and Financial Wellbeing survey was conducted in conjunction with YouGov, who surveyed over 2000 employees across a wide range of age groups, incomes and industries.

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

Our experience is that savers of the larger schemes (with a high proportion of active members) will generally be better catered for with good communications, modelling tools, briefing sessions, and potentially all the way up to paid-for access to an Independent Financial Advice. Conversely, members of smaller schemes would potentially only have access to government backed services like MaPS. We note that usage of this service has been low since inception and we support the "stronger nudge" initiative that will require trustees to incorporate booking an appointment with MaPS into their savers retirement journey. We also support Guy Opperman's observations about the lack of effectiveness of the pensions advice allowance and agree that this does not appear to be meeting savers' needs.

We believe that the role of MaPS should be expanded (see our response to Q6) and that MaPS should support all the savings identified on the pensions dashboard so that more of a holistic guidance/advice service is provided for the saver.

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

Enhanced guidance and limited advice is likely to strengthen the image of the service; however, we expect that the "stronger nudge" regulations will encourage a greater take up rate too. We expect that the enhanced service is more likely to better support members with their retirement decisions and extend support to those savers who are not currently receiving support from their employer or their scheme. It will be important also to emphasise the fact that the enhanced guidance service is free to consumers. However, the consequence is that the additional costs of an enhanced service would fall on general levy payers, something that would need careful oversight.

In terms of the limited advice service we believe that consideration should be given to whether this should be charged for or not. Part of the issue is that savers generally do not understand the value of financial advice; government funds may therefore be better spent educating savers on the merits of paying for advice in light of the more complex decisions they need to take at retirement. The main message being that the initial cost of financial advice could yield a much better financial outcome throughout retirement.

However, we do not support the concept of "auto enrolling" savers into a MaPS appointment as they approach retirement simply due to the additional costs that this would lead to e.g. from the likelihood of missed appointments by members who have not realised they are auto enrolled into this process.

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

We are interpreting this question as meaning that a default post retirement option might be provided for savers unable/unwilling to make a choice at retirement, in a similar way that a default option is provided for savers who are unable/unwilling to make an investment choice upon joining a scheme. In this context, we agree that a default investment decumulation option (or more than one, based on established principles related to the profile of the saver) could have similar success; our expectation is that a default post retirement drawdown option would be beneficial for savers who are unable to take decisions about options at retirement, and who do not seek advice or guidance and who would otherwise be worse off as a result.

The rationale for this is as follows:

(i) an increasing number of savers are selecting drawdown products; and many schemes now have default strategies that target drawdown. Our 2018 DC and Financial Wellbeing Member survey shows that over three times as many employees expect to access their DC funds using drawdown (65%) compared to buying an annuity (20%) or taking a single cash lump sum (14%). This is consistent with the latest FCA Retirement income market data that shows how savers are accessing their savings.

(ii) as highlighted by the FCA Retirement Outcomes Review (2017) there is significant inertia when it comes to selecting a product, with 94% of non-advised savers remaining with the same provider for drawdown, and only 6% shopping around. So, in effect, even where trustees do not put a preferred drawdown provider in place, members may behave as if they have, and assume the provider selected for accumulation is also a good choice for decumulation.

We believe the overall positive effect of having an identified and reasonable default decumulation option outweighs the negative that individuals' needs will be very diverse in retirement (more so than in the accumulation phase) and so the default may not suit certain individuals.

One point to note is that the Organisation for Economic Co-operation and Development (OECD) is separately consulting (via its Revised OECD Roadmap for the Good Design of Defined Contribution Retirement Savings Plans) on principles for DC pensions worldwide. One principle suggested is that the default outcome from DC savings is an income for life in retirement, which the UK would therefore currently fail to comply with.

CDC addresses the problem this question raises because investment decisions rest with the trustees of the scheme not the members themselves.

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

There are two layers to improving understanding among savers as follows:

a. differences between i) annuity ii) drawdown and iii) cash, and the available combinations.

b. differences between different annuity products, or different drawdown products.

Savers need to better understand the generic pros and cons of annuity and drawdown, and this should be communicated whilst they are building up their retirement savings. This communication best sits with trustees and providers of contract based arrangements. This will also give savers the opportunity to re-assess regularly whether they are in the right accumulation investment strategy for the product they are targeting.

Drawdown: Where savers select a drawdown product, we believe that many will not appreciate that investment and longevity risk remains with them throughout their retirement unless they purchase a more expensive guaranteed drawdown product. We believe that many will find it difficult to understand the relationship between fund size, rates of withdrawal and net investment performance and so will fail to act upon this information in an informed manner. Guidance is needed to adequately convey these risks and uncertainties. As guidance would be required in the accumulation phase, this best sits with trustees and providers of contract based arrangements and may require the respective regulators to jointly develop the communication principles such that a streamlined approach is taken by schemes.

Our views stem from the large proportion of savers that we see in a default strategy prior to retirement which is largely indicative of many not wanting or feeling empowered to take investment decisions. We believe that this theme could carry through into retirement with savers mistakenly assuming others will be managing their investments in the same way that trustees manage them prior to retirement.

Savers should also be encouraged to review their investments at regular intervals throughout their retirement and be signposted by trustees and providers of contract based arrangements to guidance or drawdown specialists. In connection with the costs of a drawdown product, savers should be able to identify how these costs have been compiled and how they are likely to vary year on year.

<u>Annuity</u>: Savers should be made aware of the different types of annuities available: standard traditional, fixed term, enhanced annuities. In terms of the latter, savers should also be made aware that there are potentially hundreds of qualifying health and lifestyle conditions and so these are not exclusively for the very ill savers, and that a combination of these conditions could make a significant difference to retirement income. We see this requirement as sitting predominantly with annuity providers, independent financial advisers and PensionWise.

Where savers are presented with a combination of annuities there is a real possibility that the saver selects the annuity that provides the highest income without understanding the underlying differences, and so assumes a risk that has not completely been understood e.g. non-escalating annuity, when the saver may have an expected post retirement lifespan of 20 years.

<u>Cash</u>: savers need to be able to better understand the tax implications of taking all their savings as cash. For example, they need help understanding how to manage the tax bill that arises when a series of partial UFPLS payments are taken, and the implications for future contributions as a result of the much reduced MPAA. Where pension flexibilities are offered through the scheme, there should be a requirement for trustees to educate members in a generic fashion so that better-informed decisions can be taken. This could be achieved throughout the retirement journey or at the time that members make an application to use such flexibilities.

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

Our 2018 DC and Financial Wellbeing survey found that savers were keen for their employer to provide guidance on retirement, and half of respondents did not think their company was trying to optimise their savings for retirement. This concern was more prominent in those towards the middle of, and later on in, their career. Our survey showed that 57% worry about running out of money in retirement. Based on this survey alone, it would suggest that schemes are not communicating options in a way that savers understand. However, we also expect the extent of any effective communication and support to be correlated to both the size of the scheme and the proportion of active to deferred members.

There are key differences between (single employer) trust-based and contract-based schemes which we highlight below:

(i) regulatory requirements for contract-based schemes mean that information about options naturally gets passed to savers at pre-defined intervals e.g. 5 yearly wake-up packs and investment pathways. Neither of these are a requirement for trust-based schemes, most of which only issue a wake -up pack in the 6 months prior to retirement.

(ii) the contract-based market is made up of providers that have large portfolios of schemes and a commercial interest which is likely to drive any additional communication activities they undertake. Trustees on the other hand are focused on the accumulation phase - security of accrued pots and delivering value for members.

In terms of what different trust-based schemes are doing, the picture is mixed. It depends largely on factors mentioned earlier and on the scheme seeing a need to embark on communication activity in addition to the legislative requirements, as well as availability of resources and budget. In the last couple of years we have seen schemes consider how they can better support their members with their retirement options. We generally see one or more of the following:

- Annuity broking service
- Selection of an IFA
- Education seminars
- Selection of a preferred drawdown provider
- Delivery of messages through normal member communication channels (e.g. Newsletter, FAQs on websites)

With all types of trust-based schemes, there can be a conflict for trustees between trying to provide a supported pathway for members to access their retirement option, and the risk of this being classified as a regulated activity and/or the risk that the trustees are assuming additional governance responsibilities. For instance, we are aware that some trustees are reluctant to signpost members to a third-party drawdown provider for these reasons, despite this simplifying the transition to retirement for their members

Even where communication activity is high for a scheme, the challenge is whether members have read and understood the information. Not all schemes follow up on such activity and obtain the necessary metrics to help inform better engagement decisions going forwards.

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

We have identified the "issues around small pots" as relating to savers being generally disengaged with smaller pots, carrying the risk of savers losing track of those pots when they move jobs and/or not knowing what action to take to improve their retirement outcomes.

We believe that the auto-consolidation initiatives that the Small Pots Co-ordination Group are now taking forward will help drive behavioural change with savers taking more of an interest in the retirement savings of larger pots. However, this alone would not be expected to improve retirement outcomes.

Savers would need the right support at the right time, and this would need to be delivered in a way that enables them to engage easily and understand the actions they need to take, and the possible outcomes related to those actions. These pots, even if consolidated, may still be smaller than average if based on current AE contribution rates.

And savers who traditionally have these pots may feel less comfortable making product decisions. It may therefore be more likely that any consolidated pot will be accessed as cash with a corresponding penal tax rate where taken in the same tax-year. In order to mitigate the risk of cash being taken as a last resort, default annuity/drawdown products could be offered by Master trusts and/or providers who meet certain requirements (relating to costs and charges, and investment strategy) for these products, although it is difficult to see the business rationale for the receiving vehicles given that they would be administering small sums.

Note on members of Defined Benefit pension schemes

The comments provided above focus on the situation of DC members because the flexibilities brought about by freedom and choice affect them directly. However, freedom and choice is also relevant to DB members if they transfer to DC before retirement, so the needs of DB members cannot be ignored. In general, many of the same comments apply to DB members as DC members but we have summarised a few observations that relate specifically to DB members below:

- DB members are already required to get IFA advice before they can transfer to DC and take advantage of the resulting options available, so to that extent the advice issue does not apply. However, the FCA's successive changes to the criteria for positive transfer advice risks increasing the costs of advice (which is already significant in the eyes of typical members), thereby limiting access only to those who can afford it. So questions of fair access to options remain for DB members.

- The range of benefit options in retirement that DB members are offered varies between schemes. Invariably, schemes will offer pension or pension plus lump sum options, or a transfer. But some will also make available a Pension Increase Exchange (PIE) option that allow members to change the shape of their retirement income. Once again, it is down to circumstances whether individuals have access to a PIE option or not.
- Even where a PIE option is available, it suffers from many of the same issues as DC annuities highlighted above, with a straight choice between an indexed or a flat pension, with no other shape of income over time permitted – generally speaking as a result of legislation.

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