Written evidence from Smart Pension (APS0048)

Thank you for the opportunity to respond to the inquiry into accessing pension freedoms. It is great that the Committee is looking at this as part of its wider work on pensions as there is considerable work to do to ensure people both save for their retirement and, as importantly, make best use of their savings when they reach retirement.

About Smart Pension

Smart Pension is a master trust that was founded in 2014. We have over £1.5bn of assets under management and over 700,000 members, providing workplace pensions solutions to over 70,000 employers. As well as offering a modern and technologically innovative workplace pension solution, we recently launched our new retirement service, Smart Retire, which we believe is the first of its kind and addresses many of the issues that the Committee identifies in its submission.

Introduction

The introduction of the pension freedoms marked a seismic shift in the UK retirement landscape. The previous system was broken. The annuity market did not work effectively and required individuals to make irrevocable decisions. Furthermore, the restricted nature of how people had to take their savings was leading to sub-optimal outcomes, and, arguably, because of a general reluctance to shop around, people getting ripped off. People with smaller amounts of pension savings could only really cash out or be forced to purchase an annuity, meaning they were restricted in how they took their pension savings. People with larger pots could use a form of drawdown, but this was restricted to those with the largest pots.

So the introduction of the pension freedoms was to be broadly welcomed. The implementation was rushed for political expediency and it has taken time for individuals, providers, regulators and the wider industry to adjust. But overall it was a necessary change to modernise the UK pension system and to give people the chance to obtain better financial outcomes in retirement.

Decision making at retirement has always been complicated and requires individuals to think ahead and make judgements about things which are unknown. This requires a level of engagement and planning which we know that people find hard to do. The lack of knowledge and engagement is a huge cause for concern, and this has only been made more challenging given the use of defaults and inertia to get people saving into a pension through the introduction of auto enrolment.

We know that many people find pensions confusing and struggle to engage with retirement decision making. We would suggest that the Committee looks at the work by Ignition House (sponsored by State Street Global Advisors and The People's Pension) through the New Choices Big Decision series which tracks people's thinking, feelings and decisions through making retirement decisions. That research gives a powerful insight into individuals' behaviour and needs, and shows the need for help during the 'at retirement' phases. A quick glance at the research would deliver the impression that people are confused, daunted and think the decision-making is a minefield. Recent research commissioned by Smart in our Future of Global Retirement Report (which can be accessed from https://www.smart.co/future) also paints a worrying picture of people's lack of knowledge and ability to navigate the retirement conundrum, the overarching conclusion of which is that people want control, but they need help and support, backed by strong user experience and technology, to help them deliver better retirement outcomes.

So while the pension freedoms were a necessary change to a broken system, it has no doubt thrown up a number of complexities and challenges for individuals in how they take their retirement savings. The need for people receiving help and support during this phase is stronger than ever and we need to get people that support and help through better guidance, better guided journeys and, where applicable, into advice.

At Smart Pension we use technology and a relentless focus on user experience and testing to refine our products to try to solve people's problems. That's why we recently added a first of its kind retirement service, Smart Retire, that guides our members during the 'at retirement' phase to allocate their money across four pots. Further information on Smart Retire can be found by visiting https://www.smartretire.uk. The service is live and is an integral part of the Smart Pension Master Trust. We would be happy to arrange an interactive demo of Smart Retire and the thinking behind it if the Committee would find that useful.

Comments on specific questions

Q1. 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?

Q2. Are there other pension options, not currently available in the UK, which would better meet people's needs in later life?

Q3. Are there barriers to providing other pension options which meet a need and are not currently available in the UK?

Q4. Are people receiving the guidance and advice they need to make informed decisions about how they access their pensions?

There are a range of options for people to access their pension savings at retirement and the solutions on the market broadly provide the products that are needed to allow people to invest and manage their money effectively. This is particularly so post pension freedoms which allow individuals to access their retirement savings in a variety of different ways, including mixing and matching where applicable. People with smaller pension pots have had their options improved as previously their options would have been either small pot commutation or a requirement to purchase an annuity. However, there is a big 'but' to this.

While broadly speaking the products are in place, it is the support and guidance around those products that is often lacking. People are often left to go it alone. This is borne out in the Ignition House research series mentioned above, but was also a strong conclusion from the work that Smart Commissioned looking at people's expectations, feelings and attitudes towards retirement. This research, conducted by YouGov and covering over 6,000 people in the UK, US, and Australia, can be accessed here: https://www.smart.co/future. Rather worryingly from these findings 39% of people don't understand what options are available in retirement, with 47% saying they had never received any retirement advice.

It's the lack of people taking advice that is very worrying and the barriers to people getting such advice. Getting a personalised recommendation on the basis of a full fact find and appraisal of one's circumstances will maximise the chances of someone getting a decent retirement outcome. However, the cost of advice, especially for those with smaller pots, and people not having the confidence to engage with an adviser, both mean people often feel they need to go it alone, which is why wider communications and guided journeys become so important for people.

However, it is well documented that there are issues concerning where the regulatory perimeter is drawn, with providers sometimes reluctant to innovate for fear of approaching the regulatory boundary or being deemed to give a personal recommendation. Call centre staff can't even suggest when someone is going to do something that is against their interests for fear of breaching the rules. In a world where people aren't getting enough help and support, and don't have access to advice, this needs fixing. By looking again at this and being pragmatic about the outcomes that we are looking to achieve there is the potential to draw the regulatory perimeter more optimally and allow firms the space to innovate and support their customers.

According to the Financial Lives Survey[1] there is lack of trust/ confidence in pension providers. As an industry there is more to do to build trust, since the provider will often be the first point of contact and has the potential to ensure a consumer seeks guidance first. There needs to be a stronger link between providers and MaPs/PensionWise to ensure the consumers receive guidance before making important decisions. A seamless appointment system between providers and pension wise would increase the update of these valuable services. In the same way a consumer needs to take advice if their DB pension is above £30,000, we could have similar rules for consumers who are accessing funds without advice, with guidance being the minimum requirement. This is why we are supportive of the stronger nudge to PensionWise initiative mentioned later in this submission.

In light of the pandemic, we also need to consider those who are accessing benefits earlier than their planned retirement age, to deal with low financial resilience. If a product provider has limited options available for a consumer they may lean towards cashing out their full pot. Offering a more holistic guidance approach has the potential to appeal to consumers. There is a danger desperate consumers are making decisions without understanding the bigger picture and long term implications[2]. And there is the added risk that more consumers will fall into the vulnerable customer category due to the pandemic.

In terms of products not currently available we think that there might be scope for innovation around deferred annuities and, potentially, CDC. On deferred annuities the received wisdom is that people get to a certain age when it makes sense for them to insure against longevity. However, making decisions at that age becomes more complicated and tricky given the well-documented decline in people's capacity to make financial decisions as they get older. Deferred annuities, within a strong choice architecture, could certainly have a role to play in helping providers and individuals manage that longevity risk. The same applies to the potential for CDC in the 'at retirement' space - pooling to manage investment and longevity risk can make a lot of sense for some individuals and it will be interesting to see how the Royal Mail proposals develop over time and what lessons can be learned from that.

---

1 FCA: Financial Lives Survey

2 This was raised in this ABI report

Q5. What role should the Money and Pensions Service have in supporting people accessing their pensions for the first time, including through pension dashboards?

Q6. Should the Money and Pensions Service offer enhanced guidance or limited advice for people making decisions about their pensions?

The impartial Money and Pensions Service has a central role to play in helping people understand their retirement options and, importantly, understand where they can go for further help. The PensionWise service receives good feedback, but take up hasn't yet become routine, although the latest figures show that this is increasing. We see PensionWise as an important part of the customer journey that complements the role of financial advisers and providers, and are supportive of initiatives to make PensionWise the norm through the 'stronger nudge' initiative.

The introduction of Pension Dashboards, and, in particular, the non commercial dashboard that will be provided by MAPS, also provides a great opportunity for MAPS to engage more widely and use the platform of the dashboard to get more people into guidance and to share information. The more tailored (eg by age) this information is, the more effective and engaging it will be and the MAPS dashboard will certainly have the opportunity to get people the help and support they need.

Q7. Can the success of auto-enrolment in helping people save into pensions be replicated for people in retirement through investment pathways?

There are many positives to auto enrolment, but as we note later in this submission one of the unintended consequences of auto enrolment is that it can lead to people disengaging with their pensions and longer term saving. The challenges that people face 'at retirement' are fundamentally different to the saving phase and outcomes can only be optimised with a degree of personalisation as different people will want different things from their retirement savings. So some form of engagement, particularly around understanding objectives and trade offs that people face, is needed to optimise outcomes.

The investment pathways work lands in a nice middle ground as the pathways are framed around outcomes and objectives, and not the underlying features of the product which is a positive innovation. This is akin to the type of approach that we have used in developing our

Smart Retire retirement solution. However, the problem with the FCA investment pathway approach is that it treats decision making as a ‘point in time’, discrete, event, whereas what people need is flexibility and the ability to adapt what they do as their circumstances change. This need, plus guidance to help people understand the trade offs, is what we have delivered through our new Smart Retire solution.

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

The majority of members when faced with different retirement products have little, or no, prior knowledge of the characteristics, features and benefits of the generic retirement options available to them. We think that MAPS is well placed to proactively raise understanding of the generic retirement solutions, (Flexible Drawdown, Annuities etc) and to promote these terms being consistently applied across retirement products.

The information consumers need in order to consider different retirement products depends on the question they are seeking to answer. All will involve costs, but some questions can be considered at an individual pensions level and others require a far more holistic approach.

The scope of the information required will vary depending on each scenario, the member’s financial literacy and the time they have to evaluate their options. Example questions;

- I am post aged 55 and seeking to generate a lump sum, while I continue to work.
- I am seeking to understand the total pension savings I will require in order to generate the sustainable retirement income I think I will need.
- I have a number of pensions that offer Flexible Drawdown and I want to manage all of my pensions savings in one place

Which is why strong guidance and guided journeys are so important to providing people with the help and support they need at retirement.

The Pensions Dashboard has the potential to support members to understand their holistic situation, which will better inform all of their retirement saving decisions. It’s at this level projection tools on ‘life-expectancy’, ‘projected income’, ‘project income needs’ will be most powerful in helping members to make informed decisions about their retirement products.

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

Six years on from the pension freedoms the industry has come a long way in improving ‘at retirement’ communications, but there is still more to do. We need to think of better ways of engaging with people and helping them to understand and navigate the various trade offs that they face in retirement. At Smart Pension, the approach we take is to blend the latest technology with a relentless focus on testing and refining the user experience to create the best possible architecture for people to make decisions. This has been the underpinning driver behind the launch of our Smart Retire solution.

We wouldn’t draw the distinction between trust and contract based schemes as we think this could lead to false generalisations. Some contract schemes communicate well, others less so. The same is true of master trusts and single trust schemes. The key differentiating factor here is different regulatory regimes and, quite often, different saver profiles meaning that different approaches may be appropriate in different circumstances. Where there is a fair distinction to be drawn it is at the smaller end of the single employer trust market, where the costs of innovation and continuous improvement can be prohibitive for positive change.

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

Auto enrolment has been a game-changer for the UK pension system. Harnessing inertia and the use of strong defaults the policy has been incredibly successful in getting more people saving more for their retirement. There is still work to do to build on this success and we would urge the Government to set out a firm timetable for implementing the recommendations of the 2017 review into auto enrolment, particularly the recommendations around removing band earnings and lowering the age of participation to 18.

However there are a number of consequences to harnessing interia and the structure of the auto enrolment rules, two being the lack of engagement from individuals and the proliferation of small pots.

On the former, using defaults helps with participation, but people then quickly become accustomed to not interacting with their pension. In the early years of pension saving this results in people not keeping contact details up to date and assuming they are saving enough for retirement because of the quasi compulsory nature of the scheme. In later life and as people approach retirement this manifests itself in people suddenly having to take control of their finances and work out how to take their money.

On the latter, the small pots issue is driven by the interaction of the auto-enrolment rules and the nature of the UK labour market, particularly in industries where workforces are particularly transient in nature. While the introduction of pensions dashboards will make it easier for people to keep in contact with and track down their pension savings, we can't rely on engagement and action by the saver alone to solve the small pot problem. The DWP working group on small pots plotted a positive way forward on this, focussing first and foremost on the cost and effectiveness of the transfer system when dealing with small pots. We certainly see this as a precursor to reignite the debate about what policy interventions are required to enable better consolidation. Building on the lessons of auto enrolment, we think that some form of auto consolidation for the smallest pots is inevitable, whether that be in the form of schemes acting as consolidators of small pots or through some form of pot follows member. Relying on member engagement alone to solve the small pots problem is unlikely to solve the issue.

Thank you for reading our submission. We hope you find our response helpful. We are, of course, happy to answer any questions you might have or give evidence to the committee as required. As mentioned above, we are also happy to run a demonstration of our new Smart Retire product that we think addresses a number of the issues that the Committee is looking to address in this inquiry.

May 2021