Written evidence from AJ Bell (APS0050)

AJ Bell

AJ Bell is an investment platform, pension provider and investment manager for retail investors. We provide administration services for our customers in relation to a range of tax-incentivised wrappers including Self Invested Personal Pensions, Small Self-Administered Schemes, Individual Savings Accounts (ISAs, LISAs and JISAs) as well as General Investment Accounts. Our platform and investment services are available to direct customers, as well as through FCA registered financial advisers.

AJ Bell currently provides services to more than 346,000 customers representing assets under administration of over £65.2 billion.

Executive Summary

We welcome the opportunity to submit evidence to the members of the Committee on what we consider to be one of the two most important topics relating to today's pensions – the other being how to encourage people to save enough to provide for a comfortable retirement.

We have responded to all of the Committee's questions, but feel that it is worth highlighting two key themes which flow through all of our responses.

<u>The importance of a trident approach to support</u> – we advocate that there are three ways people can get, and should be encouraged to seek, support:

1. Regulated advice
2. Pension wise guidance
3. Good quality provider support

Provider support should be seen as potentially being of equal value. Provision of support via regulated advice and Pension Wise guidance both require a degree of proactivity on the part of the saver, whereas providers are in a more immediate position to provide good quality support because a relationship already exists between them and the pension saver.

Whilst we understand the concerns of some commentators that provider support has historically been associated with a sales/business retention led agenda, we don't accept that this is the current situation, and believe most providers are already providing non-sales-driven support of a high quality to their customers. Rather than discouraging the provision of support in this manner because of a perception that historic issues will be repeated, we believe in encouraging the provision of this support alongside regulated advice and Pension Wise.

<u>The importance of a trident approach to the timing of that support</u> – we believe that people need support:

1. Before they choose their options
2. At the time they are accessing their pension having made a choice
3. After they choose their options

The call for evidence focusses on the second of these points in time, as does much of the regulatory focus that has been devoted to encouraging savers to seek support.

We believe it makes sense to encourage some individuals to seek support at this point in time but, for most people this offer of support will be delivered too late to influence their decision making.

Whilst this 'point of access' support may have some impact after people have accessed their savings, we feel that the effect will diminish over time. Given retirements will now potentially span decades and decision-making after the initial point of access is at least, if not more, important than at point of access, we feel greater focus should be devoted to post-access support.

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?

If the question is considered at a very basic level then, yes, people do have access to a range of pension options to meet their needs for later life.

Options are available which provide a secure and stable income to those for whom security is important. Options also exist which allow pensions to be accessed on a more ad-hoc basis by those who prefer this.

The existence of both these options is important. It's often seen as a binary choice between the two options and it is not. People have the ability to mix and match those options to best suit their particular circumstances and giving them support in how to make use of both options provides the best route forward.

One example might be using some of their pension savings to provide a secure income to add to what they already received from state pension, other savings, and earnings if they continue to work. And then leaving the rest of their pension invested to benefit from investment growth and to remain available to them should they need extra funds for a particular purpose.

Alternatively, some may prefer to use the flexible element at a younger age and then buy an annuity at an older age when it may be more cost-efficient.

The existence of these options is important and reflects changes in people's working lives over the last few decades. We're now far removed from the days when people were expected to work for, and accrue a pension under, a single employer for decades and then buy a secure income when they retired at State Pension Age.

The Government's developments of flexibility in the retirement income market over the last decade simply reflect those wider societal changes. We're sure that we will see a return to more individuals selecting a secure income at some point in their retirement, but it is naïve to assume that this outcome is now best for all.

Although the retirement income options exist, people may lack the financial awareness to know that their pensions can be used in these ways. There is work to be done to improve levels of financial understanding. It is important that Government resources such as Pension Wise are utilised for this purpose. It is also important that firms that provide financial products and services are given the ability to help increase awareness through guidance and advice, with appropriate protections in place to ensure that this message is focussed on improving understanding rather than sales.

Rule of thumb initiatives like the Retirement Living Standards developed by the Pension and Lifetime Savings Association (PLSA) which encourage engagement with these issues to a basic level of adequacy can help here. Many people are scared away from engaging with even the pension basics, which do not need to be complex. It is unfortunate that many choose to deliver a message that 'everything related to pensions is hugely complex and scary' because, whilst this might generate more revenue or work for those delivering this message, it inevitably pushes some people away from even basic levels of engagement.

Turning to the future, we would not expect the fundamentals referenced above to change. These issues already apply. They will though become relevant to a greater number of people as the dynamics of the pension market switch from one where older individuals are more likely to have defined benefit or other secure income pension savings, to a position where more people choose the flexible pension income options.

Whilst it is not strictly a 'pensions options' issue, and we would not necessarily advocate that a pension is the right solution, the Committee may also wish to consider social care requirements when looking at needs for later life. We believe pensions are there to support a wide range of later life income needs, which may include a care element as part of those wider income needs. Pensions are not the right, or most appropriate, solution when looking to specifically address a shortage in social care funding.

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

There is broad acceptance that provision of later life needs is met within most countries through 'three pillars' of retirement income:

- A state-run pension system, providing basic income needs.
- Occupational pensions under which employers and individuals contribute.
- Private pensions and other long-term savings products funded entirely by the individual.

Those options are all available in countries across the globe, with the most significant difference on a state-by-state basis being the extent to which each pillar is relied upon.

Some countries may place more reliance on the state-run pension income than the UK, others less so. We see this as a matter for the UK Government to consider.

We don't believe it is our place to comment on the extent of reliance on each option, but believe there is clear value to the Government in encouraging people to take advantage of the options available to them in the third option by making them as straightforward as possible.

One way that the Government can achieve this is by avoiding introducing more complexity into the UK pensions market by introducing even more options for savers to consider.

Complexity is a problem in part because the rules and options need to be explained to everyone, even if they are only relevant to a small proportion of savers.

At the moment if someone asks a simple question such as 'How much can I save in a pension each year?', the answer could depend on various complex concepts such as their adjusted income, threshold income, relevant earnings and whether or not they've accessed their retirement pot flexibly.

Whilst firms can communicate this by saying that a particular situation will apply to most people, the need to qualify that statement because complexities could be relevant can create doubt and confusion.

We have a concern that more choices, as well as the uncertainty caused by regular tinkering with pension rules, could lead to disengagement.

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

As indicated in our previous answer, we are not convinced that, at least within the third pillar of pension saving, there is an unmet need. The main need which is not being met is in the provision of support regarding how best to use the pension options which are already available.

As we move on to explain, this gap can be met through advice, Government-provided guidance services, and also by providers themselves. Provision of support by providers is not currently adequately recognised, but barriers to the provision of that support also exist because of regulatory concerns around over-stepping the mark and being deemed to have provided advice.

We recommend the application of a test to any new option which is considered as to whether the risks of adding complexity within the market will outweigh the meeting of a perceived unmet need.

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

The best outcome in terms of both guidance and advice is for people to receive the help they need before they reach a decision on which of the pension options available to them is right; and at the point they access that pension; and also after they make that choice.

Looking simply at Government statistics on the provision of regulated financial advice and the take-up of services such as Pension Wise, the answer in relation to support at point of access from advisers or Pension Wise is a clear no - people are not receiving the guidance and advice they need.

However those statistics don't take any account of support provided to people from other sources. They also don't do a very good job of addressing the extent of support provided to individuals both before they've made a decision, and after they've taken benefits. They focus on support at point of access.

Even when guidance offered by pension providers and the helpful information which is widely available through reputable financial support websites on the internet is taken into account, a significant support gap still exists.

Given that multiple options already exist in how that support can be obtained, including from pension providers and reputable financial support websites on the internet, the main reason people are not receiving this guidance is because they are not choosing to seek it out/ask for it.

If this is accepted, the obvious next question is whether individuals should be compelled or 'nudged' – for example through an automatic enrolment-type mechanism - to obtain guidance and, if not, what more can be done to increase demand.

We do not believe compelling individuals to Pension Wise guidance appointments is the right answer, especially at the point of access. This policy would ignore the existence of a significant number of individuals who are sufficiently financially literate to make decisions about their own pensions. It would also ignore the significant number of individuals who would refuse to engage with the guidance provided to them because they'd view it as an example of a nanny state.

Outside those groups it would create a level of demand on Government-provided support services for which it is not possible to recruit and/or which would not be considered affordable. It would also ignore the fact that good quality, non-sales focussed guidance is already being offered to customers by some providers, something which isn't factored into official statistics regarding guidance uptake.

Perhaps, if the Government is concerned with the guidance offered by providers, it could arrange for this to be assessed by an independent body. If the quality of the guidance was rated and published it would incentivise providers to offer good quality, non-sales-focussed help. There would be a challenge in setting appropriate standards and monitoring. However, if a provider has the opportunity to say that it offers 'Gold' standard guidance to its customers this would offer an incentive to do things properly because of the opportunity to attract and/or retain customers based around the support provided.

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 already plays a valuable, if under-utilised, role in supporting people at point of access.

However, it is one body offering support currently focussed around a single guidance session. Any expansion of that role must be complementary to the role played by advisers, providers and wider financial resources. The role of Pension Wise should not be considered in a vacuum which doesn't take into account this wider support.

The starting position for Government should be that people need help, and it is a positive if they obtain that help from any one of regulated advice, Government-provided guidance, or provider or wider support. The discussion needs to be widened beyond how MaPS can support people, to how they can receive support from one of the three avenues. If a saver obtains the support they require through a medium other than regulated advice or Pension Wise guidance it should be viewed as a positive. It is unfortunate that such a customer's experience would be viewed negatively in regulatory statistics when this is unlikely to be an accurate representation. We recommend that information should be gathered about the uptake of this wider support, to more accurately reflect a complete picture of the support individuals are receiving.

A more negative outcome will arise if someone chooses not to ask for the support they require from their provider if they have been put off from asking questions because the outdated 90s-tinged picture that they will just be sold to has been implanted in their head.

One hugely important point – which is central to our views in relation to the enquiry - is that the focus on support and guidance solely at point of initial access to benefits must reduce.

Having just referenced a 90s-tinged picture, the focus which regulators have on support at point of access also appears based on a very annuity-centric, 90s-tinged way of thinking.

The focus on point of access is understandable in a world where annuities are chosen by most people because, once benefits have been taken, the customer is tied to the annuity provider for life. It is a one-off decision made at point of sale. That is not the case with drawdown.

This is important because customer needs for support – whether that is helping them with the choices available within the drawdown plan, or encouraging them to consider switching to a more appropriate or cost-effective drawdown plan with another provider – will potentially be ongoing for decades.

It isn't helpful that one of the key ways in which the success of regulatory measures is considered is the percentage of customers switching provider at the point they 'buy' their drawdown product. This encourages regulators to target their interventions at that point of access because, if a customer switches provider a year before entering drawdown or a year after, they haven't switched at the point of sale which is measured in regulatory statistics, making the regulator's policies appear less effective. This creates a vicious cycle of belief that more regulatory measures are required at point of sale because previous ones have failed, whilst ignoring the obvious point that attempting to intervene once the customer has already decided to access their pension in a particular way will always be the least effective point in time to do so.

The main focus of most people once they have made contact with their provider about initial access is on obtaining their tax-free cash as quickly as possible. Any intervention which is perceived as causing a delay in receipt of that tax-free cash is, as evidenced by the Stronger Nudge research from MaPS in Summer 2020, largely going to be pushed aside by those individuals.

So, unless the customer is looking to withdraw all of their funds immediately AND this is going to lead to a negative outcome, point of access is arguably the worst time to try to educate or nudge the customer about wider matters. For customers who are going to retain a pension fund after they've received their tax-free cash, it is likely to be far more effective attempting to engage with them after they've received their tax-free cash and are now interested on focussing on 'what comes next'.

The pensions dashboard will help people to understand the bigger picture in terms of the breadth of different pension plans they have accumulated during their working life. However, it may have limited value at point of access in terms of helping people understand how much total pension wealth they have built up. It isn't helpful that it will show people how much they may be able to receive as a lifetime annuity after taking benefits, given this will not be the choice of most individuals with defined contribution plans.

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

The FCA is in the process of reviewing the provision of enhanced guidance and limited advice to help close the financial support gap. We support this important work, particularly the development of enhanced guidance.

That work shouldn't be focussed on solely enabling the Money and Pensions Service to deliver that guidance/advice, but should have an aim of support being more widely available from a variety of sources. At the same time, the work shouldn't prevent the Money and Pensions Service from offering enhanced guidance. MaPS should be seen as one of the outlets through which enhanced guidance can be delivered, in collaboration with providers and wider sources.

Provision of limited advice is potentially a different matter because of considerations around the financial liabilities which could sit with MaPS.

If any party, MaPS included, is going to offer limited advice then it needs to employ professional people to do what is a professional job. It is our understanding that employees at MaPS often have limited financial experience beyond the very tightly defined areas which their work covers, and that the salary offered in these roles is unlikely to be sufficient to attract recruits with wider financial knowledge and who have obtained the qualifications which advisers require. If this means that those delivering the limited advice are not able to consider anything 'off-script' the risk of poor outcomes for those receiving the limited advice may be too high.

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

No.

The success of auto-enrolment is that greater numbers of individuals have saved based on a foundation of a lack of any action on their part. A failure to engage has led to them saving money that, without auto-enrolment, they would not have saved.

Even where choices can be exercised, they are typically binary – do I opt out, yes or no; do I remain in the default, yes or no. The success of auto-enrolment is built on individuals not engaging with those questions, so not opting out but remaining in the default.

Investment pathways are not accessible to individuals until an individual has already made several choices, so are reliant on some engagement. Those choices are also more complex than those which limited numbers choose to make through auto-enrolment, so you can expect smaller numbers to make those choices.

As a basic point, unless we revert to a system where individuals are defaulted into accessing their pension at a retirement age which they may have chosen 40 years earlier, people don't access their pensions unless they make a somewhat obvious choice – to access that pension.

They then have to choose how much of that pension they wish to access – the whole pension or only a part of it.

A further choice is then required about how they access the pension (annuity, drawdown, scheme pension, lump sum).

It is only once they've made those choices that people will enter the investment pathway journey, which in turn requires further choices around what people intend to do with their drawdown fund over the next five years.

Auto enrolment and investment pathways are simply not comparable. One relies on lack of choice and has an impact on the amount of money which is saved into a pension. Investment pathways are reliant on choice and have no impact on how much is held in the pension, but instead may impact how the funds which remain held in the pension are invested.

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

If the question is genuinely asking about the information which customers 'need' rather than that which they may 'want', then the focus must be on the areas where lack of information causes them the most harm.

And if we ask ourselves the question of what has the potential to cause the most harm to consumers, then the biggest risk is in poor cashflow planning, primarily through taking out too much money too early, sequencing risk leading to poorer investment returns, or through buying a secure income too early in their retirement journey (or a secure income which doesn't account for health and lifestyle factors), meaning that the income is lower and so potentially insufficient to cover a person's needs throughout retirement.

Cashflow planning would be followed by investment choice in terms of scope for harm. Either taking too much or too little investment risk both have the potential to cause harm, though not as much as poor cashflow planning, because each choice may have an impact on how long funds will last.

Information about costs is important, but costs isn't where the largest risk of harm is caused. Too much cost may mean that customers experience sub-optimal returns, but costs are generally much lower than they were in years gone by, and small differences in cost between providers – an exception can be made here for historic legacy pension outliers where the differential will be greater – is not likely to have as material an effect on the average pension pot as withdrawing too much too soon.

More actual harm will be caused by running out of money too quickly or investing in a product which isn't suitable for the choices the customer wishes to make about their retirement income and/or their attitude to risk.

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

We don't believe there is a clear division between the methods of communications of trust-based and contract-based pension schemes, primarily because examples of each type of scheme can be found in most sectors of the pension world.

Differences can be found if you divide the pension world in various ways, but these differences are only problematic if the key differentiator is the quality of communication.

By this we mean that it isn't problematic if an investment platform SIPP operator communicates to its customers in a different way to the way in which the trustee of a small occupational scheme communicates with the employee members. Problems lie in situations where one trustee and/or SIPP operator is doing a good job in communicating with members/customers in a way that works for that audience, but another is doing a poor job.

The way to deal with this is not to be overly prescriptive in the requirements which are imposed on pension schemes. The problem with any overly prescriptive regulation is that it tends not to work in what is a fragmented pensions market, because the greater the prescription, the less scope is available to firms to tailor the communication to the specific needs of their audience.

There is a need to deal with those who do a poor job in communicating with members, but this isn't dealt with by introducing new regulations which the stragglers will still either choose to ignore or not be able to cope with. It needs to be tackled by the enforcement arm of the regulatory bodies taking action to improve existing communications.

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

Behavioural changes have the potential to do some good, but are notoriously difficult to drive, so are unlikely to completely solve the problem – though the fact they won't offer a complete solution doesn't mean they should be ignored. If it is accepted that behavioural changes can help, the question of how to drive those behavioural changes remains unanswered.

The only complete solution to the problem would be based around compulsion or automation. However an option as significant as forcing the movement of pension pots to a different home must not be introduced without a significant amount of behavioural testing, as it could drive adverse outcomes, with movement to a scheme charging a significantly greater amount arguably being the most obvious.

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