Written evidence from Hargreaves Lansdown (APS0059)

Introduction

Hargreaves Lansdown is a leading provider of pensions, both to individuals and through the workplace, as well as being a leading provider of retirement services. Our services are available with and without personal financial advice.

Our purpose is to empower people to save and invest with confidence; building the nation's financial resilience. We want to provide a lifelong, secure home for people's savings and investments that offers great value and an incredible service, and makes their financial life easy. Our experience at providing services to 1.6 million ordinary investors (30 April 2021) and helping them to engage with and manage their pensions and long-term investments gives us a wealth of experience at how to deliver good savings outcomes for individuals.

We're submitting this evidence on behalf of our clients, a high proportion of these are saving for, approaching, or in, retirement, as well as for all UK pension savers and investors. We are grateful for the opportunity to do so and would be happy to discuss further.

Summary

We have covered three key areas;

- Annuities and drawdown between them provide sufficient options to meet later life needs, however annuities have been impacted by low annuity rates, at least partly caused by current monetary policy. In addition, the continued existence of the uncrystallised pensions fund lump sum (UFPLS) may be framing decisions in a way which leads to bad outcomes.
- Advice and guidance are available from a variety of sources, including Pension Wise guidance, regulated advice and provider information. There is scope for more personal targeted information, something the FCA are considering as part of their work on the advice/guidance landscape. This support should be provided throughout the product lifecycle, while making use of key life moments.
- People need to first choose between products using the various tools available and then between the providers of that product. Value is crucial, considering ongoing support and how easy the product is to manage. People can be supported in these choices with information, guidance and advice

We have provided additional details in response to the specific questions asked.

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?

1. People can access pension options which meet their later life needs. Annuities provide income security. Drawdown provides income flexibility. These two products can be mixed as required, for example using an annuity to provide a safe minimum income and then drawdown for variable income or lump sums.

2. Once people have met the normal minimum pension age they can also choose when to access their pension. This has meant that many people no longer follow the traditional route of stopping work and then taking their pension. Some will take lump sums, via drawdown or UFPLS,

for example to pay off a mortgage. Others will access part of their pension to enable them to reduce, rather than stop, employment. This gradual pension access has blurred the line between accumulation and decumulation, complicating decisions and eroding the perception of pensions being for later life.

3. This blurring means the Money Purchase Annual Allowance should be replaced with anti-recycling rules which permit pensions to be rebuilt while still preventing those who wish to avoid income tax and National Insurance from receiving their salary via their pension. While not within the remit of this select committee, this is an issue which should be addressed jointly by DWP and HMT. We can provide detailed proposals of how to do so.

4. As people progress through their retirement and their needs alter, they can change how they take pension income, for example by moving from drawdown to annuity. This could be due to requiring a more secure income, higher annuity rates being available due to age or health, or by sadly no longer needing to provide income for a dependant.

5. An existing, no longer required option, potentially contributing to bad retirement outcomes is Uncrystallised Funds Pension Lump Sum (UFPLS). UFPLS was originally introduced with the Pension Freedoms. It allowed people to access their pension if their pension provider did not yet offer drawdown, essentially a temporary solution. Lump sums can be taken via drawdown, including in a way which mirrors the UFPLS tax treatment. Alternatively, drawdown tax free cash lump sums can be taken without triggering the Money Purchase Annual Allowance. Five years is long enough for those pension providers who wished to offer drawdown to do so, and many have.

6. Most importantly, the existence of UFPLS affects how people see their pensions. It encourages the view that pensions are primarily there to take as lump sums. Although Income Drawdown also allows lump sums to be taken, the framing is completely different. It is income driven with a lump sum option. This framing affects how people think about their pension, their retirement and their later life. We therefore believe UFPLS should be abolished while making it very clear that drawdown will still allow the same lump sums to be taken and that Pension Freedoms are not being rolled back.

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

7. Deferred annuities are a long-life insurance product, designed to provide a guaranteed future income, for example on reaching age 85. Greater use would mitigate several risks, including unsustainable withdrawals, investments loss, lower standard of living due to fear of pension running out or simply people outliving their pension. However, deferred annuities are subject to a more extreme version of the factors which affect standard annuities, such as low interest rates and the fear of losing out on premature death.

8. Branding deferred annuities as longevity insurance like other insurance products may help. In addition, the DWP should consider, in conjunction with HM Treasury, whether deferred annuities should be tax incentivised.

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

9. The main barrier which will prevent people meeting required later life income needs will not be the lack of an appropriate product. It will simply be that their pension is insufficient to provide 20 to 30 years of retirement income. Low interest rates have exacerbated this problem. Although pension accumulation it is outside the scope of this inquiry, it is worth highlighting that there will not be a product that can provide high guaranteed returns or multiply a pension pot at retirement. This will be particularly true for the generation which have neither had access to defined benefit pensions nor the early career benefits of automatic enrolment.

10. Pension consolidation at retirement and partially accessing pensions while reducing working hours can mitigate the impact of under saving. In particular, the lack of consolidation can indicate a lack of joined up thinking, as demonstrated by the number of small pots which are simply encashed. Any new pension or tax legislation impact assessments should include the impact on these mitigations.

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

11. Although it is important to be able to clearly differentiate between information, guidance and advice, if only so their provision can be adequately regulated, the starting point should always be what people need rather than the correct label. For this reason, we have used 'support' to cover information, guidance and advice.

12. Most people are receiving the support they need to make informed decisions about pension access. The latest FCA retirement income market data[1] shows that in the six months to March 2020 two thirds of people who started drawdown, purchased an annuity or took their first UFPLS payment received either regulated advice or Pension Wise guidance. Everyone will have been given support from their pension provider in the form of information and mandated risk questions.

13. For support to be effective it can't be just given and received, it needs to be accepted and engaged with. Support is there to bring people towards money maturity, where they are comfortable with how their personal finances work for them, wherever they are in life. Support should be provided throughout the product lifecycle, and even that should be built on basic financial knowledge. Support can then be targeted at key moments, when people are more likely to start thinking about the future, for example first jobs, marriage, house purchase or having children. People would then know whether they are under saving while there is still time to act. They would know to build up accessible savings before they run into financial difficulties. Retirement option support then builds on existing money maturity rather than being a sudden, potentially overwhelming, plunge into complicated decisions.

14. There is no single standalone support service which will provide money maturity. It should come in multiple forms and from multiple sources. Regulated advice and life event targeted guidance is important, but so is information from pension providers. The quality of this information

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[1] https://www.fca.org.uk/data/retirement-income-market-data#full (excludes those who take a full withdrawal)

provision demonstrates the value added by a pension provider. For example, the PLSA retirement income targets are a useful way of visualising what people need in retirement, but people also need something else, such as HL's pension calculator to estimate how much to contribute.[2]

15. We know from The Stronger Nudge Evaluation Report[3] that making support easier to access can significantly increase take up. During the trial, people who called one of three providers were either given the option of allowing the provider to book a Pension Wise appointment on their behalf or being transferred to Pension Wise to book their own appointment. A third control just mentioned Pension Wise as a source of guidance and directed the people to the Pension Wise website or helpline. Of the people who received one of the two interventions 11% went on to attend a Pension Wise appointment, compared to just 2.8% in the control group, almost a fourfold increase.

16. The report also highlighted[4] that when people were offered support was also important. In the control group, 1.21% of those who were asking about a specific decumulation options went on to attend a Pension Wise appointment, compared to 6% of those who were still exploring retirement options. This exact breakdown wasn't included in the final report.

17. HL believes that there is scope to improve this landscape further following the FCA's call for input on consumer investment markets. In the consideration of the advice/guidance boundary there should be a role for more tailored guidance to help individuals make better informed decisions.

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

18. The Money and Pensions Service should not only support people accessing pensions for the first time, but also at other key moments. As mentioned in paragraph 16, guidance is more likely to be accepted before a decision is made. This could include a mid-life financial MOT. People using MaPS should be able to make use of pension dashboards and the dashboards should refer to MaPS as a possible guidance source. However, MaPS is only one possible source of support. Advisers, providers and government awareness campaigns have their part to play.

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

19. We first need to establish needs and only then whether these needs are best met by information, guidance, enhanced guidance or limited advice. These regulatory definitions will then provide protection, ensure high standards and set expectations.

20. Although regulated financial advice is valuable it can be expensive to provide. Personalised guidance (information tailored to the individual) could significantly reduce the advice cost, allowing more people to access it. This would narrow the advice gap with minimal impact on the

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[2] https://www.hl.co.uk/pensions/pension-calculator
[3] https://maps.org.uk/wp-content/uploads/2020/07/maps-stronger-nudge-evaluation-report-july-2020.pdf
[4] https://maps.org.uk/wp-content/uploads/2020/07/maps-stronger-nudge-evaluation-report-july-2020.pdf p25

advice market. Simplified advice (narrow advice based on limited specific consumer information) would have a lesser impact as it would still come at a cost.

21. Pension providers, as well as MaPS or specialist firms, should be able to offer personalised guidance or simplified advice. Ongoing FCA work on advice and guidance is important and should continue.

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

22. Automatic enrolment has been successful for two reasons. The first is that it is easier to remain in a pension once automatically enrolled then it is to opt out. More importantly it is a single solution for a simple problem with a low risk of bad consumer outcomes. The problem of under saving for retirement is addressed by putting more people into pensions.

23. Investment pathways were primarily introduced to help non-advised drawdown consumers who struggle to make investment decisions using a prescribed choice architecture.[5] They were neither designed to help people decide which pension product was right for them nor how much income to take. Although it has only been a few months since the launch of investment pathways, early indications are that over 90% of our clients applying for drawdown have chosen to retain their existing investments rather than choose an investment pathway or other new investments.

24. Many traditional pensions did have the default retirement option of annuity purchase. This provided an acceptable outcome. Any bad outcomes were generally due to not shopping around for a higher income or not obtaining the appropriate features, such as ensuring the income continued to a dependant on death. It wasn't a perfect outcome for everyone, defaults rarely are, but it did provide certainty. Although ever lower annuity rates reduced the popularity of annuities, the 2015 introduction of Pension Freedoms delivered the decisive blow.

25. Given annuity unpopularity it may seem attractive to default people into drawdown using default investment pathways. This would be a mistake as over recent years many of the drawdown protections have been removed.

26. Originally, annual drawdown withdrawal was limited reducing the risk of running out of money in retirement. For people who started drawdown before 2015 this limit still exists as capped drawdown. We have clients who prefer capped, rather than flexible, drawdown as it helps them feel comfortable with the amounts they're withdrawing.

27. When Flexible Drawdown was first introduced the risk of allowing unlimited withdrawals was mitigated as it could only be accessed by people who had secure pension income of at least £20,000 a year. This minimum income guarantee ensured that if people did deplete their drawdown fund due to excessive withdrawals or investment loss, they still had this guaranteed income. This guaranteed income requirement was first reduced and then removed as part of the Pension Freedoms.

[5] https://www.fca.org.uk/publication/policy/ps19-21.pdf paragraph 1.8

28. Combining investment pathways with capped drawdown would provide both default investments and default income levels. Even then this would not be an appropriate default retirement product. It would have the potential to provide a higher lifetime income than an annuity, but the trade-off is that there is still investment risk. Poor investment performance would lead to the pension fund being depleted, resulting in a lower, or even negligible, income.

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

29. To make a fully informed choice about different retirement products people first need to choose the appropriate product and then choose between the providers of that product.

30. Currently available online tools help people choose. HL's Pension Drawdown Calculator[6] enables people to see how long their pension fund might last depending on growth rates, withdrawal amounts and charges, all of which can be varied. Crucially, it will also show average life expectancy which people can vary to fit their expectations. A simple table of best buy annuity rates[7] can then be used as a comparison before obtaining annuity quotes tailored to their circumstances, including health and lifestyle. Alongside these tools there is enough information for people to understand the comparative risks and benefits of each product, including the different treatment on death.

31. Once someone has chosen their preferred product type then they need to look at the difference between providers. Costs are a factor and relatively easy to compare, but value is more important. Drawdown providers need to make their products easy to manage and support people making decisions. Investing for income requires active, not passive, fund management. Providers can't effectively do this if they are purely judged on costs and fighting to be the cheapest.

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

32. There are differences in the communications provided by different scheme types and there should be. Pension schemes should be able to tailor the information using their understanding of their client base. People who have been automatically enrolled without any engagement will be starting from a different place to people who have already made active decisions about their pension, for example investment choices, contribution rates or whether to transfer to a new provider.

33. Although some standardisation is desirable this should not be overly prescriptive and should take communications other than literature and websites into account. Telephone calls to helpdesks or conversations with workplace financial well-being specialists are examples of effective communications.

34. Effective communication is where true innovation is already taking place. Information and choice architecture should be clear and uncluttered, based on understanding what people consider when making decisions. Unread or misunderstood information is counterproductive. It is not only wasted effort, but also discourages engagement. Providing information about phased

[6] https://www.hl.co.uk/retirement/drawdown/calculator
[7] https://www.hl.co.uk/retirement/annuities/best-buy-rates

drawdown or partial annuitisation can be useful, better a more effective starting point is making it clear that people don't have to take their entire pension at once.

35. We established that many clients looking to access their pension through drawdown were looking to take lump sums via tax-free cash, leaving the rest of their pension invested and so we adapted our drawdown application process to take this into account. Moving income decisions to later in the process lightened the clients' cognitive load as they were no longer being confused by the parts which didn't matter. The proportion of applications with a mistake dropped from 40% to 10% and the proportion of clients taking partial, rather than full, drawdown rose from about a third to over half. Improved framing of the same information resulted in better consumer outcomes.

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

36. Failure to solve the small pot problem risks disengaging pension savers, undermining the success of automatic enrolment. When changing jobs, employees should be given the right to have their workplace pension contributions paid into their existing workplace pension. This would drive engagement placing pension investors rather than the pension provider or the employer at the heart of the pension system. People would have <u>their</u> pension for <u>their</u> retirement.

37. Pension providers would be incentivised to provide pensions which people would want to take to their next employment, rather than relying on the fact that when employees change employment they are usually replaced. A successful pension provider would therefore engage their members as early as possible. They would need people to care enough about their pension so they actively choose to keep it as their workplace pension whenever they change employer.

38. Employers could focus on their current employees rather than those who left their employment decades ago, but still have small deferred pots in the company pension scheme. The company default automatic enrolment pension scheme would be targeted at current employees who haven't yet engaged with their pension.

39. This won't be quick behavioural change, but nor does it need to be. Before the people who have been enrolled today reach their pension access point, they will have had thirty or forty years of pension providers doing all they can to engage them with their pension.

40. As a backup for those who don't engage, deferred pension pots below a specified value should be automatically transferred into a consolidator scheme. This could be a single publicly or privately run consolidator or one from a panel of consolidators. Ongoing work on pension dashboards and making pension transfers simpler will also drive engagement and consolidation amongst those who already have multiple small pots.

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