

## Written evidence from Age UK (APS0062)

### About this inquiry

The Work and Pensions Select Committee is running a three-part inquiry into the impact of the Pension Freedoms, five years on from their introduction. This major policy change radically altered the way savers use and engage with their pension saving. This is the second part, looking into the impact of freedom and choice – how pension decisions have changed, the impact they have, and what can be done to tackle any arising problems.

### Key points and recommendations

- The freedom and choice reforms have meant that savers are expected to understand pensions and to be perfect consumers. To get the most value from their savings, they need to understand of a range of retirement income options and be excellent financial planners. For most consumers, this is simply not possible.
- Age UK's report 'Fixing the freedoms' (2019) found there has been limited innovation so far, particularly regarding tools to help non-advised customers manage their money.
- While the early cohort of freedom and choice users are still relatively young, in future years we will see an increasing age profile of drawdown customers. This is concerning, as more people will be affected by some form of cognitive decline while simultaneously being expected to take complex decisions about drawing down their savings. There is scant evidence of any planning yet done for this scenario.
- The Government should work with regulators and industry to develop product pathways to alleviate such problems, and help people get the most out of freedom and choice.
- We also need to see other 'nudges' in place, on an opt-out basis. Firstly, everyone should be defaulted into Pension Wise prior to accessing their pension; secondly, the investment pathways, which are already active, should guide people towards the best retirement outcome; thirdly, as noted above there should more help for people to navigate retirement income products, through the design of accessible pathways.
- Pension Wise has proven to be a very effective service, and making sure it becomes "the norm", as the Pensions Minister recently stated the aim, is imperative. The solutions proposed so far have been woefully insufficient and finding a way to get the majority of people to take up the guidance offer should be a priority.

## **About Age UK**

Age UK is a national charity that works with a network of partners, including Age Scotland, Age Cymru, Age NI and local Age UKs across England, to help everyone make the most of later life, whatever their circumstances. In the UK, the Charity helps more than seven million older people each year by providing advice and support. It also researches and campaigns on the issues that matter most to older people. Its work focuses on ensuring that older people: have enough money; enjoy life and feel well; receive high quality health and care; are comfortable, safe and secure at home; and feel valued and able to participate.

## **Introduction**

The pension freedoms have fundamentally changed the way with which people engage with their money, and even affected how the purpose of pension saving is viewed by the public. Many people are having to make difficult decisions about financial products that they have little experience of engaging with, with many experiencing poor deals and some, even worse, being scammed out of much of their lifetime savings. For others, conversely, they have made it easier to use their savings flexibly in a way that meets their needs, and the policy still maintains a positive image among the general public.

The early years of the reforms have highlighted several areas where there are gaps in support and a lack of protection against poor outcomes. These need urgent reviewing by the Government and regulators, and we are pleased this Committee is undertaking this inquiry to influence this dialogue.

## **Inquiry questions**

### ***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?***

This is a multi-faceted problem, with different answers for different groups – some will have access to the products they need, others will not. The biggest difference is between advised and non-advised consumers. Overall, there has been limited innovation aimed at the mass market, as identified by Age UK's 2019 research report, *Fixing the Freedoms*.<sup>i</sup> The findings of this report were based on interviews with people from across the pensions industry as well as consumer representatives.

While product innovation had been limited in the few years since the inception of freedom and choice, it is perhaps more relevant to note the lack of innovation in the tools and support available for non-advised customers. With savers now expected to take decisions and to manage their own pension arrangements on an ongoing basis, the development of such tools was viewed as important by participants from across the pensions industry who took part in our research. It was savers with smaller pots who were viewed as having most to benefit from such developments, and it is disappointing that only limited innovation has taken place.

The decision-making process for retirement income products is challenging for many consumers. The reforms have meant people are expected to:

- access Pension Wise guidance or seek independent financial advice
- maximise state pensions and means-tested benefits
- gain a full picture of all pension and other assets
- consider merging small pots
- be aware of taxation
- consider using DC pensions to repay expensive debt
- maximise income from other financial assets
- decide on which retirement income product they want and whether they prefer the lower secure income from an annuity or the potential for a higher income from income drawdown balanced by the risk of running out of money
- take difficult decisions about income drawdown including where they should be invested and how much they want to withdraw each year, reviewing their choices regularly to ensure that they are on track.
- shop around for an annuity and declare medical details to qualify for a higher rate.<sup>ii</sup>

Fixing the freedoms concluded:

*“The Government and the FCA cannot expect that the market will deliver innovative, appropriate and good value products for these consumers. There needs to be a far more proactive approach to ensure that these consumers get a good deal and that when a market storm hits it does not destroy trust in pensions and the hopes of thousands of consumers for a comfortable retirement. The onus should be on Government to make it easy for people to take reasonable decisions, through increased use of default options.”*

### **Older drawdown customers**

The main difference in future will come with a significant rise in the number of older people using drawdown. The reforms went live only six years ago, which means that the vast majority of flexi-drawdown customers are still aged 70 or under. As people age cognitive ability, on average, declines, making it more difficult to make complex decisions about

using pension savings. More will need to be done by providers and regulators to ensure that people do not find themselves in difficult circumstances.

### **Nest**

One specific reform that could help large numbers of savers is allowing Nest to offer retirement income products. The scheme has 4.5 million members, and as it stands all these savers are approaching retirement without being able to access an appropriate retirement solution from their pension scheme. This will leave them to navigate the open marketplace to find the best deal – a challenge even for many highly engaged savers. We believe that given its status as a government-backed scheme, if Nest was allowed to enter the marketplace it would not only help existing members, but would also help set a benchmark standard for good quality retirement income products, particularly those on lower incomes.

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

Far too few people are using Pension Wise, with the FCA figures stating only 14 per cent of pots were accessed after using Pension Wise.<sup>iii</sup> Although the DWP claim that take up of the service has increased over the past year, it still falls woefully short of being “the norm” – as the Pensions Minister has claimed it is intended to become.<sup>iv</sup>

The ‘stronger nudge’ trials run by the Money and Pensions Service, were a small step in the right direction, but overall made only a small difference. In spite of the DWP claiming the measures “significantly increased” take up, in fact the report states that for each of the two interventions piloted, around 8 per cent more people than in the control group subsequently had a Pension Wise appointment.<sup>v</sup> This means that if a ‘stronger nudge’ solution is implemented a significant majority would still be accessing their pension without any support.

The recent FCA consultation paper seems to acknowledge this failing: *“The trials also show that even after the implementation of the Act provisions, take-up is likely to remain low. [We also] explore what else can be done to encourage consumer take-up of guidance at the right time in their journey”*.

Pension Wise has been shown to be a valuable service, receiving high approval ratings from users and helping a majority change their mind about their best course of action. The most recent evaluation shows that:

- 94 per cent of appointment users were very or fairly satisfied with their overall experience of Pension Wise (77 per cent of whom said very satisfied and 18 per cent fairly satisfied)
- 88 per cent of appointment users said Pension Wise helped improve their understanding of their pension options
- 70 per cent of Pension Wise users correctly answered eight true/false statements relating to their pension options compared to 43% of non-users.<sup>vi</sup>

We believe that a system of auto-enrolling savers should be implemented. From five years prior to being eligible to access their pension (i.e. currently age 50), all savers should have an appointment automatically created, which should be repeated each year unless they take the appointment or opt out. We believe the Government and the FCA should implement this or a similar solution.

The length of time taken to implement a solution is also unacceptable. The Financial Guidance and Claims Act gained Royal Assent on 10 May 2018, already over three years ago. With the FCA due to make a Policy Statement in Q4 2021, it is likely that the fourth anniversary will come still without an appropriate solution in place – several million people may have missed out on guidance, and be worse off in retirement, as a result.

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

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

The main role that MAPS should play in supporting people is by ensuring the continuation of a good quality Pension Wise service.

Age UK supports pension dashboards, which could help raise engagement levels and understanding of pensions among users. However, it is unclear how widespread usage will be, and we are concerned it is unlikely to make a substantive difference unless it operates alongside other initiatives and better consumer pathways.

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

Investment pathways for non-advised consumers are a clear step in the right direction, and we are optimistic they will help many savers. However, they are only one part of the required support system – ideally, we would see a triad of such support ‘nudges’ in place:

- 1) As people first choose to access their savings, they are defaulted into a Pension Wise appointment.
- 2) Once savers have decided how they want to access their pensions in future, they are placed on an investment pathway to maximise returns against their desired outcome.
- 3) When the money is accessed, people's income should be smoothed to meet their requirements, using product pathways that are designed by providers (who are well placed to understand their customers' needs) in conjunction with the FCA.

All of these would be designed as opt-out solutions, so consumers who wish to make a positive choice for different options can do so. We believe a system of opt-outs is the correct choice architecture because it is in keeping with the policy intention behind the pension freedoms, while providing a strong steer to (the majority of) consumers who are unfamiliar with retirement income products and who would benefit from extra support and guidance.

We believe measures such as these would help people get the most out of the pension freedoms.

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

Costs are an important element of the decision-making process, and should be front-and-centre of all pension decisions. However, there are still a significant number of people who are unfamiliar with financial products and who will need additional support in order to navigate their way through.

The freedom and choice reforms have changed the nature of the game. Prior to its introduction, for most consumers the worst that could happen was failing to shop around and missing out on a better annuity rate, or failing to claim an enhanced annuity – both in themselves poor outcomes. However, far worse is that it is now possible to be scammed out of your savings and lose everything.

Helping people make an informed decision is a complicated procedure, and ultimately they will need to be aware of all the factors highlighted in our response to Q1. This is very challenging for non-advised consumers.

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

The main aim of at-retirement communications should be to encourage or nudge savers towards receiving independent advice or guidance. Too many consumers are not engaged with their pension saving or decumulation choices, and have little or no experience of dealing with retirement income products. This makes it challenging for providers to meaningfully engage with customers and have a positive impact on their decision-making.

Research by the Pensions Policy Institute suggests that many people approaching retirement are lacking in confidence, and that accessing a pension can take about eight months of research and consideration before taking a decision.<sup>vii</sup>

We understand there has been considerable investment in communications following the changes to the ‘wake up’ packs announced by the FCA, as well as firms implementing learnings from their own freedom and choice experience. However, these alone are unlikely to be sufficient to guarantee good outcomes, it is still important to ensure that people are receiving, at the least, impartial guidance from Pension Wise.

**Older customers**

Similar to the point we raised in response to Q1, we are concerned that there are insufficient mechanisms in place to help older drawdown customers. Declining cognitive ability can affect some older people’s decision-making, and while the cohort of early adopters of freedom and choice are still relatively young, we have a growing concern of a lack of investment in developing both product-based and customer service-based solutions to help people when or if they start to be impacted by declining mental faculties.

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

This would need to be tested by pilots looking at ways of ‘nudging’ savers towards consolidating their pots. With 27 million small pots forecast by 2035,<sup>viii</sup> there is clearly an issue that needs solving. The DWP has made significant progress in developing possible solutions and gathering consensus around how to take them forward. However, the DWP’s Small Pots Working Group report found:

*“Member-led solutions can only achieve a limited amount of change, due to many members being relatively unlikely to engage in the consolidation process.”<sup>ix</sup>*

There is no perfect solution, with each proposal having pros and cons. We commend the DWP for taking the ‘lifetime provider’ off the table – this would ultimately undermine auto enrolment by segmenting the marketplace into engaged (often) higher earners who would

leave their workplace scheme, and non-engaged (often) lower earners who would stay with their employer's choice, making those that stayed less commercially desirable.

The 'pot follows member' (PFM), 'member exchange', and 'consolidation' models each have merit. Overall and based on the available evidence, we lean towards PFM, however even this has limitations – there must be a guarantee that savers are not being moved to a notably poorer performing scheme. This relies on reaching a broadly accepted definition of value for money, which is an extremely slippery concept and will prove difficult, especially with the current debate about how to capture illiquid investments within the DC charge cap. 'Member exchange' may also have merits but would need to be explored further, as outlined in the DWP report.

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<sup>i</sup> Age UK (2019) Fixing the freedoms, available at <https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/33a.-fixing-the-freedoms---age-uk-discussion-paper-june-2019.pdf>

<sup>ii</sup> Age UK (2019) Fixing the freedoms

<sup>iii</sup> FCA retirement data (September 2020)

<sup>iv</sup> Polling commissioned by Just Group (2021) found that the public considered "the norm" to mean 67%.

<sup>v</sup> <https://moneyandpensionsservice.org.uk/wp-content/uploads/2020/07/maps-stronger-nudge-evaluation-report-july-2020.pdf>

<sup>vi</sup> *Pension Wise service evaluation 2019/20* (MaPS, October 2020)

<sup>vii</sup> Pensions Policy Institute (2017), Consumer engagement: the role of policy through the lifecycle

<sup>viii</sup> <https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf>

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[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/945319/small-pots-working-group-report.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945319/small-pots-working-group-report.pdf)