Written evidence from Which? (APS0064)

Summary

1. Which? welcomes the opportunity to submit written evidence to this inquiry into accessing pension savings. Which? fully supports the principles of the 2015 pension freedoms reforms as we believe that giving consumers greater choice over how they access their pension wealth has the potential to lead to better outcomes than pre-2015.

2. However, the 2015 reforms have not been completely successful. On the whole, they are likely to be utilised by those with relatively large defined-contribution pension pots, who can afford to pay for advice when accessing their pension. Which? research has shown that the take-up of advice and guidance remains worryingly low, which in the case of advice, is because for a majority of savers, it is too expensive. These savers, who do not have large pension savings, are forced to make complex and difficult choices with little support. Pension Wise guidance may help, but it inevitably lacks the personalisation that many people require.

3. Faced with the complexity of the market, people move towards the path of least resistance, regardless of whether this meets their needs or gives them good value. Six years on from the Pension Freedoms reforms it is time for the Government to revisit how people access their pension savings, to design a system that protects consumers and is built with the central goal of providing people with a sustainable income in retirement while maintaining their ability to access their savings flexibly.

4. **Which? believes the system for accessing pension savings should be designed to provide good outcomes without expecting consumers to have high levels of understanding and engagement.** A great success of automatic enrolment is that it harnesses the power of inertia to provide pension products that are safe and will provide a decent outcome for most savers. The Government and industry should learn from this to create products that will offer an equivalent for people when they access their pension savings. However, given low levels of consumer engagement and understanding of pensions, and the challenges in increasing take-up of advice, this will only be possible if pension schemes take on greater responsibility for making some of the most challenging decisions for their savers into retirement, including how to manage longevity, inflation and investment risks. As with auto-enrolment, this should be provided on an opt-out basis so that those who wish to take advantage of the pension freedoms can do so at any point, before or after an income has begun to be paid out.

   - ☐ **Recommendation 1: Pension schemes should be required, by default, to provide a sustainable income to savers that is paid out from their selected retirement age**.

5. **Policymakers should also make it easier for consumers to make good choices.** Consumers face a range of difficult decisions at various points of retirement, but numerous aspects of the pension system mean that they are not well prepared to be able to do this. This includes a failure to be transparent about fees and charges when people are saving; allowing people to build up many small pensions across multiple providers; and conflating decisions about accessing tax-free lump sums and providing an income in retirement.

   - ☐ **Recommendation 2: The Government should go further with its proposed mandatory simpler statements by requiring personalised costs and charges information in pounds and pence, in one single figure.**

   - ☐ **Recommendation 3: The Government and the pensions industry should develop a system of automatic consolidation for small, deferred pots**.

- ☐ **Recommendation 4: The Government should decouple the ability of a saver to access their tax-free lump sum from other pensions decisions.**

6. **There should also be better protections for savers even if they have engaged to some extent.** In particular, customers of income drawdown products, which were originally designed for sophisticated investors, should be protected from excessive charges. As the FCA has found, many of these customers have not switched providers and engage little with their savings once in drawdown, with many not actually withdrawing any funds and so not fully utilising the product they have chosen.

- ☐ **Recommendation 5: The Government should require the FCA to introduce a charge cap for non-advised customers accessing drawdown products.**

Section one: The urgent need for further reform of the pensions system

7. Which? fully supports the principles of the 2015 Pension Freedoms reforms as we believe that giving consumers greater choice over how they access their pension wealth has the potential to lead to better outcomes than pre-2015. Prior to this, most people were effectively forced into purchasing an annuity, which may not always be the most suitable option. The pension freedoms have enabled people to better respond to their changing needs, and to consider how their employment, financial and personal circumstances affect how they want to use their savings to support their lives.

8. However, the 2015 reforms have not been completely successful. They are mostly likely to be utilised by those with relatively large defined contribution pension pots, who can afford to pay for advice when accessing their pension. Which? research has shown that the take-up of advice and guidance remains worryingly low, which in the case of advice, is because for a majority of savers, it is too expensive. Which? research from April 2020 showed that a large proportion of consumers had not taken financial advice on their retirement, and only 6% of respondents had taken up a free Pension Wise guidance session pre-retirement.[1]

9. These savers, who often do not have large pension savings, are forced to make complex and difficult choices with little support. Pension Wise guidance may help, but it inevitably lacks the personalisation that many consumers need. Whilst it is difficult to measure the long-term harm for consumers from major financial decisions like this, there is an increased risk of poor outcomes for consumers that do not receive support. The effects of poor decisions in the early stages of accessing pensions can multiply over decades, leaving people well short of their expectations of later retirement.

10. There are a plethora of options for consumers to consider when accessing their pension. Faced with the complexity of the market, people move towards the path of least resistance, regardless of whether this meets their needs or gives them good value. More than half (56%) of pension pots in 2019/20 were withdrawn into cash.[2] Many fully withdrawn pots are put in savings elsewhere.[3] The FCA has found that low trust in the pensions industry – stemming from a range of factors including past pension scandals and frequent changes to pension rules and tax treatment – has to some extent contributed to people's decisions to withdraw their money into cash.[4]

11. Around three in ten (29%) pension pots moved from their pension scheme into an income drawdown product in 2019/20.[5] Prior to the pension freedoms these products were restricted

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[1] Which? (2020), *Money Magazine September 2020*

[2] FCA (2020), Retirement income market data 2019/20

[3] FCA (2018), *Retirement Outcomes Review: Final report*, p.5

[4] FCA (2018), *Retirement Outcomes Review: Final report*, p.5

[5] FCA (2020), Retirement income market data 2019/20

to people with high guaranteed incomes. Whilst savers can benefit from remaining invested, they also face the risk of markets falling. Many savers do not engage significantly when choosing an income drawdown product or once having opened one. The FCA found that 94% of consumers who accessed their pots without advice accepted the drawdown option offered by their pension provider, compared to only 35% of advised consumers.[6] By not switching providers to one offering better value for money, these consumers could lose a significant part of their savings.

12. Evidence from the ABI and FCA have shown that whilst there are recommended rates of withdrawal, actual rates of withdrawal are on average higher. The FCA also found that more than 60% of consumers not taking advice were not sure or only had a broad idea of where their money was invested.[7]

13. The FCA's research shows that there is a direct correlation between the lack of take-up of advice and non-advised consumers choosing the drawdown option offered by their pension provider and that many people 'fall' into income drawdown products as a consequence of accessing their tax-free lump sum. As we discuss below, charges for these products are much higher than for auto-enrolment schemes, which are protected by a cap on charges.

14. Providing people with the freedom to choose what they do with their money should not mean that we are apathetic about the outcomes that result. Nor should the freedom to choose mean that savers should be ripped off. Six years on from the Pension Freedoms it is time for the Government to further reform how people access their pension savings, to design a system that protects consumers and is built with the central goal of providing people with a sustainable income in retirement while maintaining their ability to access their savings flexibly.

Section two: Designing a system that delivers good outcomes without high levels of consumer understanding and engagement

15. Whilst increasing the take-up of advice and guidance can go some way to resolving issues, more structural changes must also occur in order to help consumers. A great success of automatic enrolment is that it harnesses the power of inertia to provide pension products that are safe and will provide a decent outcome for most savers. The Government and industry should learn from this to create products that will offer an equivalent for those looking to access their pension savings.

16. Since consumers often suffer from behavioural biases and an asymmetry of information, this will only be possible if pension schemes take on greater responsibility for making some of the most challenging decisions for their savers into retirement, including how to manage longevity, inflation and investment risks. The alternative is to leave complicated investment and income decisions to consumers that very often have very little understanding of pensions products and how to plan financially over long periods of time.

17. Given low levels of consumer engagement and understanding of pensions and the challenges in increasing take-up of advice, pension schemes should take on greater responsibility for making some of the most challenging decisions for their savers into retirement. Which? believes this will create an environment conducive to better outcomes for consumers. As a point of principle, schemes should be set up to provide good outcomes in retirement, rather than savings vehicles which are designed to provide people with a pot of money to take elsewhere.

18. Which? welcomes the introduction of Nest's Guided Retirement Fund,[8] which aims to make available a stable and sustainable level of money which savers can withdraw until age 85,

[6] FCA (2018), *Retirement Outcomes Review: Final report*, pp.5-6

[7] FCA (2018), *Retirement Outcomes Review: Final report*, p.5

[8] https://www.nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/other-fund-choices/nest-

leaving a separate pot that can be used to purchase a guaranteed income for life. Throughout, Nest customers are able to access their savings flexibly. However, we understand that Nest is currently prevented from paying out a sustainable income automatically, so savers are still required to actively withdraw the designated sustainable income.

19. We also welcome proposals by the PLSA for the creation of a new statutory obligation for schemes to support their members with decumulation decisions.[9] The PLSA's proposal includes a default investment strategy for those that don't engage, but this would not appear to include a sustainable income being paid by default, so consumers will still be required to make complex decisions about how much to withdraw to ensure their savings are sustainable.

20. **Recommendation 1: Pension schemes should be required, by default, to provide a sustainable income to savers that is paid out from their selected retirement age**. As with auto-enrolment, this should be provided on an opt-out basis so that those who wish to take advantage of the pension freedoms can do so at any point, before or after an income has begun to be paid out. Or they could choose to alter their selected retirement age to change the point in time that the income would be paid out. Such an approach would remain consistent with the pension freedoms, but it would also ensure that savers can be assured that their savings will be converted into a fair income.

Section three: Making it easier for consumers to make good choices

21. Consumers face a range of difficult decisions with regards to their pension savings, but numerous aspects of the pension system mean that they are often not well prepared to be able to do this. This includes a failure to be transparent about fees and charges when people are saving, allowing people to build up many small pensions across multiple providers, and conflating decisions about accessing tax-free lump sums and securing an income in retirement.

Better information for consumers whilst they are saving

22. We strongly support the Government's plan to introduce a mandatory approach to simpler statement templates for defined-contribution schemes used for automatic enrolment. This will help to improve standards across the sector and ensure greater comparability for consumers when looking across their different pension schemes. We also welcome the Government's intention to introduce a statement season, whereby pension statements will be sent out during a particular period. The evidence from Sweden, which has both a simpler statement that is widely adopted and a statement season, suggests this could help to improve engagement. The Pensions Policy Institute cites survey evidence which found that in Sweden around three quarters of the envelopes are opened by members and around half are read in some part.[10] This compares to 60% of UK adults with one defined contribution pension who recall receiving their annual statement, and 44% who also say they have read it.[11]

23. However, the Government should go further by requiring all defined-contribution pension schemes, rather than just auto-enrolment schemes, to use the new statement template. The Government should also require personalised costs and charges information in pounds and pence, in one single figure within the statement.

24. Currently, people are given insufficient information while saving into a pension and the information they do receive is often confusingly presented. Customers should be told how

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guided-retirement-fund.html

[9] *DC Decumulation: Evolving the Pensions Freedoms - Final Recommendations, 2020*

[10] Pensions Policy Institute (2018), Charges, returns and transparency in DC - what can we learn from other countries?

[11] Note, the Swedish and UK surveys take different approaches, which may explain some of the differences. FCA (2018), Financial Lives Survey, pension accumulation table, table 21

much they pay for their pensions, just as they are told for almost every other good and service in their life. It makes no sense for people to only be exposed to the nature of pension fees and charges at the point of accessing their pension, when they are expected to make complex decisions including regarding value for money for pension products.

25. **Recommendation 2: The Government should go further with its proposed mandatory simpler statements by requiring personalised costs and charges information in pounds and pence, in one single figure.**

Enabling greater consolidation of small pension pots

26. Small pots are inefficient to manage and increase pension scheme costs, but they also add complexity for savers. This is likely to reduce engagement and make it harder for people to make good choices when accessing their pensions.

27. The small pots problem cannot be solved through behavioural changes by savers. It requires a process of automatic consolidation to be introduced. The increasing incidence of small, deferred pension pots is creating numerous harms for pension savers. These pots are uneconomic to provide and so require cross-subsidisation from larger pots. This increases costs across the industry, to the detriment of all savers. In addition to this, small pots are likely to harm decision making when an individual accesses their pension savings. Holding many pension pots adds complexity to decumulation decisions, which is likely to reduce engagement and lead to worse decisions. The FCA's 2018 Retirement Outcomes Review[12] found that there is a strong tendency for people to cash in relatively small pots, while recent qualitative research has also found that people with multiple defined contribution pots are likely to cash in small pots, rather than take a holistic view across their pension wealth (DWP, 2020)[13].

28. Which? participated in the DWP's recent Small Pots Working Group and we support its conclusions that member-led solutions will not be sufficient to resolve the small pots problem. We hope that the development of pensions dashboards will encourage personal choice and engagement, but engagement will remain most likely among those with larger pots and greater pension wealth. There is a widespread consensus that mass engagement in which savers consolidate millions of small, deferred pension pots is inconceivable.

29. Given this, it is essential that the pensions industry prioritises action to develop a large-scale, low-cost transfer process that will facilitate a process of automatic consolidation for small, deferred pots. As with other aspects of automatic enrolment, this should be introduced on an opt-out basis and member safeguards will be needed to provide proportionate protection, but not act as a barrier. While the onus is on industry to develop solutions, it is important that the Government be ready to take action if progress is too slow, or if guidance or even legislation is proven to be needed to reach a solution.

30. In the meantime, we see no reason why there cannot be speedy progress on consolidating multiple pots held with the same provider. Such an approach is already taken by certain Master Trusts. For example, Nest operates a 'pot for life' policy whereby once a member has one account with Nest, they save into the same account regardless of which Nest accredited employer they work for. This process is automated, based on member data such as National Insurance number, name and date of birth. In order to maintain a sufficient level of member protection, certain frictions are in place, with Nest taking a cautious approach to matching accounts, being "very conscious of the risk and cost of wrong matches", and proceeding "within a tightly defined risk appetite." Such an approach brings cost benefits to Nest as well as consolidation and accumulation benefits to members.

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[12] Financial Conduct Authority (2018), *Retirement Outcomes Review Final Report*

[13] Department for Work and Pensions (2020), *Pension Freedoms: A qualitative research study of individuals' decumulation journeys*

31. **Recommendation 3: Government and industry should develop a system of automatic consolidation for small, deferred pots**.

Providing flexibility to access some savings without requiring engagement with the rest

32. The ability to access up to 25% of a pension pot tax-free is a major driver of consumer behaviour. However, many consumers focus solely on taking their tax-free cash and do not engage with the decision of what to do with the rest of their pot. Consumers who want to take a tax-free lump sum potentially need to transfer out of their accumulation product and buy a new product with a drawdown feature. This means that they are forced to engage with a complex market that prior to the pension freedoms was only available to wealthier and more sophisticated investors, even if they are not seeking to make further withdrawals.

33. **Recommendation 4: The Government should decouple the ability of a saver to access their tax-free lump sum from other pensions decisions.** If individuals are given the right to access their tax-free lump-sum without having to leave their pension scheme then it would preserve their ability to access some of their savings flexibly without forcing them to make complex decisions about what they do with the rest of their savings. It would also mean that people remain protected by the auto-enrolment charge cap.

Section four: Introducing better protections for savers that have engaged to some extent

34. There have been very high levels of people accessing their pension pots, and many people have opted to remain invested via income drawdown. However, the existence of some engagement at a point in time should not mean that we expect these consumers to remain engaged. We still need to provide robust, ongoing protections for these consumers.

35. Which? welcomes the recent introduction of 'investment pathways', which require individuals choosing drawdown without first taking financial advice to choose on of four options about what they intend to do with their savings in the next five years: leave it alone, take the lot, buy an annuity, or drawdown in the next five years. These safeguards will help to ensure that the investment strategy is appropriate at the outset. Much can change in someone's circumstances, though, and their actual behaviour may not correspond with what they state at the outset. It is therefore crucially important that providers continue to remind their customers of the approach that they have opted for and how their use of the product, and their withdrawal rates, correspond to this.

36. However, these safeguards on investment strategy are not accompanied with safeguards against excessive charges, despite the FCA's finding that there were as many as 44 different administration charges associated with some income drawdown products, alongside an array of tiered charges and fees. The FCA found that almost a quarter of non-advised consumers were paying 1.5% or higher in charges for income drawdown, which is more than twice the level allowed when they are saving via auto-enrolment.[14] Customers of income drawdown products should be protected from excessive charges.

37. **Recommendation 5: The Government should require the FCA to introduce a charge cap for non-advised customers accessing drawdown products.**

About Which?

Which? is the UK's consumer champion, here to make life simpler, fairer and safer for everyone. Our research gets to the heart of consumer issues, our advice is impartial, and our rigorous product tests lead to expert recommendations. We're the independent consumer voice that influences politicians

[14] Financial Conduct Authority (2018), *Retirement Outcomes Review Final Report*

and lawmakers, investigates, holds businesses to account and makes change happen. As an organisation we’re not for profit and all for making consumers more powerful.

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