Independent Review of Retirement Income

Report

We Need a National Narrative: Building a Consensus around Retirement Income

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Chapter 3: Supporting savers to make the right choice at retirement for them and their family and how to build on the lessons of auto-enrolment

We will investigate whether it is possible to design a set of good decumulation defaults and default pathways at retirement which will be suitable for most savers, in the same way that a good default investment strategy in the accumulation phase can be designed. Even if this is possible, we accept that it is likely that more people might opt for a different retirement income plan than the estimated 10% of people who reject the default accumulation fund. For example, some retirees might be in poor health and so might choose to access their funds in full at the date of retirement – or over as short a period as possible (staggered to avoid paying unnecessary income tax). Given the complexities of retirement expenditure decision making, we will examine the support in terms of guidance, help and advice that savers need in order to make the right choices for them and their family. Building on the lessons of auto-enrolment, we will examine what nudges would be useful to move people towards making decisions that are in their best long-term interests. We will also consider the barriers, especially the regulatory barriers, to implementing a default. The overriding question that we seek to answer in this Chapter is this: Is it possible to design safe harbour retirement income plans which combine safe harbour products with financial help or guidance (that confirms the suitability of the product for the client) in order to provide retirement income journeys that are good enough for most of Middle Britain?

3. Supporting savers to make the right choice at retirement for them and their family and how to build on the lessons of auto-enrolment

> *'But what am I to do?' said Alice. 'Anything you like', said the Footman, and began whistling.*
>
> Lewis Carroll (1865), *Alice's Adventures in Wonderland*

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3.1 Introduction

The optimal drawing down of retirement assets is a considerably more complex activity than the initial task of accumulating those assets. The two main reasons for this are, firstly, that most savers will not have a good understanding of many of the risks outlined in Table 1.2 and, secondly, the impact of those risks will differ for different people depending on their circumstances. People, for example, differ in terms of the size of their pension pot, the availability of alternative sources of income and wealth, their liabilities, their health status, their family circumstances, their tax position, and their risk appetite and risk capacity. The new flexibilities announced by the 2014 Budget will introduce additional complexity and uncertainty both to the final phase of the of the accumulation stage of DC pension schemes and to the retirement income market itself (i.e., the decumulation stage).

In this Chapter, we examine different ways of segmenting the retirement income market. We look at different spending types, different behavioural types, and the different resources and needs of the different market segments. We propose a retirement expenditure and investment plan that helps to overcome the behavioural barriers that many

people face that prevents them making decisions that are in their best long-term interests. Next, we consider a range of defaults and default pathways that have been proposed to nudge people onto an optimal decumulation strategy. We then turn to the information, guidance and advice that are available for consumers and examine the suitability of each. We examine the role of advisers in the new pensions environment and the impact of technology on advice. Despite Government efforts to provide information to pension savers, we ask whether there is an advice gap for certain segments of the market. The different charging models used by advisers are investigated. The implications of this for a default pathway are considered. This is followed by an investigation of potential consumer vulnerability and the proposed regulatory responses to this. Access and exit charges became prominent issues in the months following the introduction of 'freedom and choice' and we consider media and Government reactions to these. We also discuss pension fraud and the questions of customer engagement and customer responsibility. Monitoring of the pension reforms will be important and we consider proposals about how to do this. The self-employed and non-eligible job holders for auto-enrolment are also examined. We end the Chapter by briefly examining the experience of other countries.

3.2 Understanding the retirement savings market

We begin with some recent surveys of savers covering their attitudes and plans for retirement income.

In November 2014, the Pensions Policy Institute published an analysis, commissioned by Fidelity Worldwide Investment, of the decisions people will need to make, following the introduction of the new pension regime, when they are approaching, at the point of, and during retirement.[356] The report found that 'many of those reaching retirement with a DC [defined contribution] pension pot will have a greater number of options to choose from about how they access their savings. This could make their decisions far more complicated, pushing the burden of managing these risks further onto pension savers, and, in some cases, extending the need for ongoing decision making during retirement'. The report also found that 'decisions about accessing DC pensions are considered the most challenging of pension and retirement decisions and other major financial decisions from across the life course'. This is because people will have to understand 'complex and uncertain' factors such as inflation, investment and longevity risks (and the other risks in Table 1.2) and many people do not have the financial capability or numeracy skills to do this adequately. The report concludes that: 'those with low levels of numeracy will find decisions about accessing pension savings particularly challenging, but will be at greater risk if they also do not have

[356] Pensions Policy Institute (2014) *Transition to Retirement - How Complex are the Decisions that Pension Savers Need to Make at Retirement?*, November; http://www.pensionspolicyinstitute.org.uk/press/press-releases/t2r-how-complex-are-the-decisions-that-pension-savers-need-to-make-at-retirement

the security of being able to fall back on a secure source of private pension income in the form of an indexed DB [defined benefit] pension'.

Using data from the English Longitudinal Study of Ageing (ELSA),[357] the PPI found that people reaching state pension age (SPA) over the next ten to fifteen years vary considerably in their pension and non-pension savings. It identified the groups at greatest risk of making poor decisions when they reach SPA 'if they are not offered adequate support, either through guidance and advice or through the provision of suitable defaults'. It predicted that 700,000 people reaching SPA over the next 10-15 years (12% of the total) will be at 'high risk' of making poor decisions when they retire; this group has significant DC savings (between £19,400 and £51,300), but no additional DB pension. A further 1.6 million (29% of the total) will be at 'medium risk'; this group has £6,300 or less in DC savings and little or no additional DB pension.

In March 2015, the International Longevity Centre – UK (ILC-UK) also published a report based on an analysis of ELSA data.[358] The study analysed the outcomes of four different approaches to using DC pension wealth: (a) annuitising, (b) blowing the pot on big ticket items, (c) putting everything into a savings account, and (d) leaving the fund invested and using drawdown.

The report found that:

- Even if all those approaching retirement were to annuitise, over half of them (1.1 million people) will not be able to secure an adequate income (defined as 70% of final salary), unless they use non-pension assets or receive additional benefits on top of the state pension
- In a scenario where the DC pot is used to buy big ticket items, an additional 350,000 people (1.4 million people in total) will not be able to secure an adequate income in retirement
- Putting everything in a savings account also risks people running out of money before they die. The report predicted that average replacement rates could fall from 66% to 49%. Given that people typically underestimate their life expectancy by upwards of four years, spending savings too early is a real possibility
- Leaving the fund invested also risks people running out of money before death as well as exposing individuals to substantial income volatility. Within a balanced fund of 60% bonds and 40% equities, the report estimated that average annual income in retirement could vary between £18,000 and £12,000, depending on the fund's

[357] ELSA is the largest survey of people living in England aged between 55 and 74. In total, there are 6 million people in this age range and 2 million of them have DC pension pots and are yet to retire.
[358] *Here Today, Gone Tomorrow. How Today's Retirement Choices Could Affect Financial Resilience Over the Long Term*, 16 March 2015;
http://www.ilcuk.org.uk/images/uploads/publication-pdfs/Here_today,_gone_tomorrow_1.pdf

performance. If individuals are unprepared for such volatility, it would be akin to significant year-on-year income shocks (e.g., incomes being lower by 30% one year compared with the previous year) which could adversely impact living standards.

The prospects are even worse for the 850,000 individuals who will rely mainly on a DC pension but have low levels of financial capability. In all the four scenarios above, they will end up with replacement ratios below 40%.

The report warned that 'such income falls coming at the end of life could have disastrous implications resulting in individuals cutting back on expenditure just at a time when they may need it most, i.e., to maintain basic living standards as well as paying for long-term care'.

In January 2015, the Pensions Policy Institute published the results of a set of in-depth interviews with 55 DC pension savers aged 55 to 70.[359] The interviews were conducted by Ignition House and sponsored by State Street Global Advisors. The purpose of the interviews was to determine the preferences for how these savers would draw a retirement income, the financial trade-offs that they are willing to make, and the default products and strategies that could best support them. The new flexibilities are popular with DC savers. However 'once they begin to understand the full scale of choices and trade-offs involved in deciding how to access their DC pension pots at retirement, they can quickly become daunted. This suggests that disengagement and inertia amongst consumers from April 2015 is a key risk without the provision of effective default strategies and appropriate guidance and advice. The idea of their pension scheme or existing provider offering a default investment or drawdown option into retirement resonated with DC savers, with some believing that providers even had a "duty" to offer this – though they recognised the importance of wider individual and household circumstances and the need for there to be some element of choice for those who want it'.

The PPI identified a number of specific risks facing savers:

- Reluctance or inability to plan beyond the next few years, which means locking into a specific course of action either before or at retirement is generally unpopular
- Perceptions that there are 'safer' or 'better' investments they can use outside of pensions, which, when probed, are based on misguided beliefs or have not been properly thought through
- Poor understanding of both spending needs throughout retirement and likely life expectancy and, in particular, the probability of living beyond age 85, which means DC savers are likely to underestimate the importance of longevity insurance

[359] Pensions Policy Institute (2015) *Transition to Retirement - Supporting DC members with Defaults and Choices Up To, Into, and Through Retirement: Qualitative Research with Those Approaching Retirement*, January; http://www.pensionspolicyinstitute.org.uk/publications/reports/transition-to-retirement-defaults

- Lack of engagement (even very close to retirement) – leading to the potential for consumer detriment if the defaults available are not suitable and designed in the best interest of savers.

Digging deeper into investment issues, the study found that the participants are not currently well-equipped to make investment choices. In particular, they are not confident about investing in equity-based products. The implication is that 'left to their own devices, participants would probably put their fund in "safe" investments [i.e., investments with capital protection] or leave it rolling in their pension'. Participants are generally reluctant to make up-front commitments about when they might be willing to lock their money in to a particular strategy. They are also reluctant to hand over significant sums of capital in the early years of retirement to another party. However, after some prompting, most participants would be willing to trade off more risk and indeed some flexibility for the possibility of higher returns. With further prompting, many participants would typically choose a low or medium risk portfolio.[360]

In terms of drawing from the pension pot, participants place a high value on 'ease of access and flexibility to change the amount of income': they would 'prefer to access their pension pots on an ad hoc basis or take money out of these tax efficiently, but there was confusion about how to do this'. It was likely that they would draw a level income or take more income early on.

Participants had a poor understanding of longevity risk and hence a low awareness of how long the pension pot needed to last. The concept of longevity insurance 'was understood and resonated, but a key barrier will be the cost of this'. Participants 'could see the merits of securing an income at some point in the future when they were no longer willing or able to make decisions on the pot any more. However, they were very unwilling to precommit to purchasing an annuity to do this. In addition, they would want to retain as much flexibility as possible, so were not warm to the idea of automatic conversion or rollover to a guaranteed income in later life, especially if this meant locking into an annuity. They would prefer to leave their options open for as long as possible, and are unlikely to want to commit to the option of securing an income until they are in their 70's or beyond'. Nevertheless, many participants 'were warm to the concept of a gradual payment for a longevity insurance product, with participants being able see how this could help them to build up a "safety net" against the risk that they live too long or take out too much income. The biggest barrier mentioned would be the cost, with the majority feeling that ongoing premiums of between

[360] The low-risk portfolio consisted mainly of bonds with some shares and had an expected return of 4%, just enough to beat inflation, but in a bad year could lose 10% of its value. The medium-risk portfolio consisted of 60% shares and 40% less risky assets and had an expected return of 5-6%, more than enough to beat inflation, but in a bad year could fall by 15-20%. With prompting, participants could be persuaded to move away from an all-cash portfolio, which while not falling in value in nominal terms, would generate returns of only 1-2% which would not be sufficient to keep up with inflation. However, there was a reluctance to move to a high-risk portfolio (with 80% in shares) where the expected return was 6-7%, but in a bad year could fall by 25-30%.

£500 and £1,000 per annum, starting at age 65, were not seen as an unreasonable amount to secure a lifetime income, e.g. £5,000 per annum, from age 85 onwards'.[361] But, 'after considering these costs, some still then felt that it would be too much of a "gamble" and they would prefer to take their chance on running out of money'. Death benefits are viewed as a 'nice to have', with individuals more willing to take more investment risk for their partner than their children.

The PPI believes that defaults are a good way of dealing with these problems. The two main justifications are that: (a) most participants did not know and were not interested in how their pensions were currently invested in the accumulation phase and (b) they can also be overwhelmed by the number and complexity of choices around drawing down income. They were also currently in a default through auto-enrolment. So the reason for having a default in the accumulation phase would also appear to hold for the decumulation phase: it is unlikely that people will develop the necessary skills and knowledge to manage investment choices in the decumulation phase. But despite support for the idea of defaults, participants also wanted some alternatives in recognition of the differing circumstances people face in retirement. Nevertheless it was clear that people needed support to make the trade-offs that the new world of 'freedom and choice' will bring: 'given the existing lack of understanding around the underlying investments in default funds, and what the funds are seeking to achieve, it will be important that any defaults and alternatives offered are clearly branded and communicated in terms of their objectives and risk-level'.

The PPI proposes that policy makers, regulators and the pensions industry should work together to address these issues. Alistair Byrne, senior DC strategist at State Street Global Advisors, added: 'We need to begin putting in place arrangements to implement the 'freedom and choice' reforms now, and the PPI's research provides strong evidence to build on. It's clear that default investment strategies in DC plans need to cope with uncertainty around when people will retire and how they will access their retirement savings. The industry needs to put in place well-governed retirement income defaults that provide members with value for money and flexible access to their assets, without overwhelming them with complex choices'.

The uncertainty over how retirement income will be taken is confirmed by a poll conducted by True Potential, the results of which were published in February 2015.[362] The poll of 2,000 pension savers found that 76% of those aged 55-64 did not yet know how they will take an income from their pension, rising to 82% for those over 65. Only 5% planned to buy an annuity, although 40% of respondents believed a consistent income was the most important factor in retirement. Of those of working age, 20% said they had not thought about a

[361] These premiums were generated by discussions that took place in the participant meetings, rather than being based on calculations around realistic premiums for this type of longevity insurance.
[362] Reported in Carmen Reichman (2015) Most over-55s undecided on retirement route – poll, Professional Adviser, 23 February.

pension, with higher percentages amongst the young: 29% of those aged 18-24 and 24% of those aged 25-34.

A survey conducted by Fidelity Worldwide Investment for its *Class of 2015* report published in March 2015 found that only 14% of 525 people interviewed in January 2015 who will be retiring in the next year had done any significant research about their options.[363] A further 10% were waiting to be contacted by their product provider. While most respondents (65%) felt confident about managing their finances, many had not yet considered the basic elements of a retirement income plan. One in ten thought they could make withdrawals from their scheme without needing to contact their provider to establish terms of access. A further 7% reported that they had not even thought about this. In addition, many people did not understand the tax implications of the new pensions regime, with 42% not knowing the threshold at which pension lump sums are taxed and 10% believing they can access their whole pot tax-free. While 56% of those polled said they would access their pension as a cash lump sum, with 18% planning to access more than the tax-free amount, only 4% said they would withdraw the entire pot in one go. Annuities were being considered by 22% of those not wishing to withdraw all of their pot, 25% said they would transfer to a drawdown product, 17% will leave their pension invested and defer taking it, and 13% will use a combination of a drawdown pension and an annuity. Another 20% were still undecided.

Alan Higham, then Fidelity retirement director, said: 'These decisions are complex and we would urge people to seek the appropriate expert help and advice in order to ensure they get the most from their retirement savings; be it through careful research or through an adviser…..if they are less confident. It is alarming that there is a certain hard core of people taking an approach to retirement that they would not take to their everyday life. With neither a rainy day fund, nor idea of a budget nor, indeed, an intention of establishing the best deal or checking the small print on their funds, this group is vulnerable to making a poor choice that could cost them dearly in retirement….[Further], the tax implications of accessing your pension could be the biggest issue for this set of retirees'.[364]

In September 2015, Retirement Advantage released the results of a survey, conducted by YouGov, where the over 50s were asked what they would like from their retirement income product. The findings indicate that 'the need for flexibility and the desire for certainty are valued equally by consumers, though when pressed, certainty is considered more important

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[363] Reported in: Michael Klimes (2015) Just one in seven retiring this year have researched options, Professional Pensions, 23 March; Jack Jones (2015) One in ten retiring this year expect whole pot to be tax-free, Professional Pensions, 10 March; Carmen Reichman (2015) Fifth of near-retirees still clueless about tax on pension withdrawals, research, Professional Adviser, 10 March.

[364] Vince Smith-Hughes, head of business development at Prudential, has also warned that the majority of people accessing their pensions for the first time will be overpaying tax, particularly if they withdraw large sums of cash. This is because HMRC requires providers to apply an emergency tax code on sums withdrawn if they do not have the customer's normal income tax code. Reported in Carmen Reichman (2015) Prudential sounds emergency tax warning on pension pot withdrawals, Professional Adviser, 1 April.

than flexibility'. Around a quarter wanted absolute certainty and were reluctant to take any risk whatsoever with their pension savings, but most were happy to take some investment risk. The implication of the findings, according to Andrew Tully, pensions technical director at Retirement Advantage, is that 'consumers want it all, and as we know, neither an annuity nor a drawdown product on their own meet the need for certainty and flexibility. But a combination of both products can…. Combining annuities and drawdown into one product, offered under drawdown rules, opens up a whole new way of thinking about flexibility of income in retirement'.[365]

In March 2015, Franklin Templeton released the results of its Retirement Income Strategies and Expectations (RISE) survey of 2,000 adults.[366] It found that only 25% of respondents (mainly from the highest income groups) planned to leave some of their pension pot invested on the stock market after they retire, while 42% thought the stock market was 'too risky' as a retirement strategy, and 33% felt they did not have the knowledge to choose the right investments. The main concern was the possible decline in the value of the pension pot: 80% of respondents stated that they would be worried about a 20% decline in their pension savings, while 44% would be concerned about a 5% fall. There was a clear preference for low-risk investments: 73% said they were leaning towards a low-risk approach to their retirement investments, while 88% said stock market investing had no, or only a limited, role to play in retirement saving due to the perceived risks. The key preferred alternatives were tax-efficient vehicles, such as independent savings accounts (ISAs), favoured by 40% of respondents, while 26% thought property would be a part of their retirement portfolios.

A survey by J.P. Morgan Asset Management reported in February 2015 revealed poor investor understanding of how investments generate the income that will be needed to pay for goods and services in retirement. According to Jasper Berens, head of UK funds at JP MAM: 'Given the relentless media attention that record low interest rates have received over the past couple of years, I was genuinely flabbergasted to learn that less than half of UK investors (44%) could correctly explain the term "income investing",…It seems to be the case that, while many investors acknowledge the importance attached to generating income for their portfolios, too few actually know how to achieve this outcome'.[367] A 'worrying' 38% of respondents plan to rely on savings accounts as their 'preferred' source of income, despite the below-inflation returns that these generate.

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[365] Andrew Tully (2015) The whole package: Annuities and drawdown side by side, Retirement Planner, 22 September.
[366] Reported in Carmen Reichman (2015) Most retirees have 'no intention' to stay invested – poll, Professional Adviser, 31 March.
[367] Jasper Berens (2015) Alarm bells: The growing income investor knowledge gap, Professional Adviser, 27 February.

A survey of 1,000 relatively well-off people aged over 55 conducted in March 2015 found the average pension pot was £87,500 and the average amount people expected to take in income each year was £9,000. Even with a growth rate of 5% per annum, this means that the average pot will only last 10 years. Half of those nearing retirement (i.e., aged 55-64) were unable to predict how long their pension income would last. Not everyone surveyed had a pension pot: almost 20% would have to rely solely on a state pension. Around one third would need to continue working to support their retirement expenditure, while 50% could rely on property and other savings.[368]

A survey held in April 2015 by website RetireEasy of 1,572 well-off pre-retirees – who are aged 58 on average, plan to retire partially at 61 and have average private pension assets of £146,000 – found that most felt well prepared for the new pensions regime, despite the fact that only 34% had been contacted by their pension provider about the changes. Despite this, 68% said they were aware of the changes and potential charges. The survey found that 28% plan to withdraw funds before they reach 65. Of those, 90% are only going to withdraw the 25% tax-free maximum lump sum. The same percentage said that they do not have plans to buy an annuity with the remainder of their fund. A similar proportion (91%) of those surveyed plan to supplement their income by working part-time in retirement. Three-quarters (78%) are either fully or partly aware of the difference between capped and flexi-access drawdown. More than one in eight (84%) think that 'freedom and choice' is a 'good idea', although 72% do not plan to take advantage of the freedoms.[369]

The above surveys covered the national population as a whole. Collectively, they reveal that people welcome the new pension flexibilities, but many – especially in the middle market group lying between those who will rely mainly on the state for their retirement income and the well off – will find themselves poorly equipped to make best use of them, not least because they hold beliefs and preferences which are mutually inconsistent, a condition that psychologists call 'cognitive polyphasia'.

Does the picture become clearer if we segment the market more finely?

3.3 Segmenting the retirement income market

When segmenting the retirement income market, we need to recognise that people differ both in their types and in their resources.

3.3.1 People differ in their types

We consider two ways of segmenting the market according to type of customer.

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[368] Reported in Carmen Reichman (2015) Retirees banking on 10% withdrawal rate 'will drain pots in a decade', Professional Adviser, 8 April.

[369] Reported in Jenna Towler (2015) Well-off retirees on top of freedoms despite 'poor provider contact', Professional Adviser, 15 April.

3.3.1.1 Segmentation by type of spender

The first way is to segment DC savers according to their spending objectives. This is the approach taken in the *Aon DC Member Survey*. In December 2014, the results of a nationwide survey of over 2,000 occupational DC scheme members by YouGov was published. The survey was conducted between September and October 2014 and sponsored by Aon Hewitt and Cass Business School.[370] It identified five types of spender as shown in Table 3.1.

'Certainty seekers', who account for 35% of the total, want an annuity so that they can have a secure stable guaranteed income for life. 'Steady spenders', accounting for another 35%, want the same outcomes as certainty seekers. They want an annuity in all but name, but they intend to continue investing their money in retirement to generate a stable income: 'While there are recognised downsides to conventional annuities, with price, compulsion, lack of flexibility and no terminal value all cited as negatives in the current system, there is clearly also a continued appetite for an 'annuity-like' approach' according to the survey. Fifteen percent are classified as 'flexibility foremost'. This group will be relying on the state pension and other sources of income to meet their core expenditure needs and will draw from their DC pot as and when needed. 'Early spenders', accounting for 10% of the total, want either to draw down as soon as possible to spend or invest in assets such as property, or continue to invest their pot to generate income, while enjoying higher spending in the earlier years of retirement. The fifth group, called 'residual required', comprising 5% of the total can be subdivided into either 'care conscious' or 'bequest driven'. Both groups plan to continue investing during retirement to generate a stable income either to provide for possible care costs or to make bequests to the family.

The proportions of the population comprising these different spending types appear to be broadly confirmed by other recent surveys. For example, Aegon's *Second UK Readiness Report*,[371] published in November 2014, found that 40% of retirees want a guaranteed retirement income for life, while 30% said that they would like some combination of a guaranteed income and a cash lump sum. Just 16% said they would take their pension as a cash lump sum. Similarly, a study by ILC-UK called *Making the System Fit for Purpose*,[372] published in January 2015, found that 70% of those approaching retirement wished to use their pension pot to provide a guaranteed life-long and inflation-protected income. Just 7% reported that they would use their pot to buy a car or pay for a holiday, while 5% said they would prefer to pay off their debts.

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[370] http://www.aon.com/unitedkingdom/defined-contribution/dc-member-survey.jsp. Also reported in Sophia Singleton (2014) What do DC scheme members really want?, Pensions Age, December.

[371] https://www.aegon.co.uk/news/media-centre/pressreleases/just-6-percent-are-on-track-for-the-retirement-they-want.html

[372] http://www.ilcuk.org.uk/index.php/publications/publication_details/making_the_system_fit_for_purpose

Table 3.1: Types of DC saver according to their spending objectives		
Type	Definition	% of total
Certainty-seeker	Want an annuity so that they can have a secure, stable, guaranteed income for life	35
Steady spender	Want the same outcomes as certainty seekers. But, they plan to continue investing their money in retirement to generate this stable income. Essentially, they want an annuity in all but name	35
Flexibility foremost	Anticipate continuing to invest and will dip into these savings as and when needed. They are likely to be planning to rely on state pension and other sources of income to support their retirement	15
Early spender	Want to take their retirement savings in one (partially taxable) lump sum, or in a series of payments soon after retirement (perhaps to reduce the tax impact)	10
Residual required	Want to ensure a significant element of pension savings towards the end of their lifetimes for long-term care or bequest to family	5
Source: *Aon DC Member Survey*, December 2014		

The *Aon DC Member Survey* also provides insights into how people plan to take money from their pot. Fifty percent of those surveyed said they would use drawdown either in whole or in part. Of this sub-sample, 20% said they would like the drawdown and investments managed within their current scheme, 17% said they would like them managed by another pension provider such as an insurance company, 25% said they would manage the process themselves with the aid of an adviser, and another 25% said they would 'go it alone'.

The survey also asked about drawdown concerns and elicited the following responses to the question 'which of the following would worry you the most with regard to your drawdown pot?':

- 29% – running out of money before I die
- 26% – my money not growing as fast as I need it to in order to meet my income needs
- 25% – seeing the value of my pension fund fall in value, even temporarily, due to poor investment returns
- 11% – not being able to access my pension fund when I need to

- 7% – none of the above would worry me
- 1% – don't know.

What is concerning about these findings is that most people do not appear to be worried about running out of money before they die – even when they are explicitly asked – and this after all is the main protection a properly designed pension plan provides. The key explanation for this appears to be that death is an event too distant for many people to be concerned about. This is a behavioural problem which needs a behavioural solution.

3.3.1.2 Segmentation by behavioural type

The second way of segmenting the market is by behavioural type.[373]

Richard Thaler and Cass Sunstein in their best selling 2008 book *Nudge: Improving Decisions about Health, Wealth and Happiness* define two very different types of consumers – 'econs' and 'humans'. In a retirement expenditure context, 'econs' are fully rational life-cycle financial planners. 'Humans', by contrast, try to make the best decisions for themselves, but are subject to behavioural traits that limit their ability to implement their plans. Thaler and Sunstein believe that very few people are 'econs' and their book provides examples of how to nudge 'humans' into making optimal choices.

If people were 'econs' capable of behaving rationally and were sufficiently well informed, they could calculate the risk-return tradeoff between an annuity and drawdown and choose which was initially better for them and, more importantly, when it was optimal to switch from drawdown to an annuity to guarantee they will not outlive their resources. Econs will be very concerned about this. But most people are 'humans' who neither behave rationally, nor have the technical skills to evaluate the risk-return tradeoff, nor, indeed, many of the other risks listed in Table 1.2. Humans have behavioural biases which prevent them behaving rationally. One particular example is what economists call the 'annuity puzzle', the reluctance of many humans to buy annuities.[374]

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[373] This Section draws on David Blake and Tom Boardman (2013) Spend More Today Safely: Using Behavioral Economics To Improve Retirement Expenditure Decisions With Speedometer Plans, *Risk Management and Insurance Review*, 17(1), 83-112.

[374] In most countries, annuitisation is voluntary as it now is the the UK. The very small number of countries with mandatory annuitisation are: Austria, Bulgaria, Finland, Greece, Iceland, Israel, Mauritius, Netherlands, Norway, Poland and Sweden.
(See European Insurance and Occupational Pensions Authority (2014) *EIOPA's Fact Finding Report on Decumulation Phase Practices*, EIOPA-BoS-14/193, October,
https://eiopa.europa.eu/Publications/Reports/EIOPA-BoS-14-193_EIOPA_s_Fact_Finding_Report_on_Decumulation_Phase_Practices.pdf;
and Dariusz Stańko and Nina Paklina (2014) *Supervising the Distribution of Annuities and other Forms of Pension Pay-Out*, IOPS Working Papers on Effective Pensions Supervision, No.21, December,
http://www.iopsweb.org/WP_21_Supervising-Distribution-Annuities-Pension%20Pay-out%20.pdf)

There are a range of behavioural reasons why retirees do not tend to voluntarily annuitise a sufficient proportion of their retirement wealth:[375]

- Aversion to planning – particularly in respect of large infrequent transactions
- Related to this is aversion to paying for advice
- Inertia and procrastination: people have to make the active decision to start a retirement expenditure plan or purchase an annuity and the default position is to do nothing
- Poor financial literacy: many, if not most, people do not recognise the importance of securing a basic understanding of retirement income provision and planning and, as a consequence, are not sufficiently competent to manage the conversion of their investments to income in old age or are unwilling to make the effort to understand unfamiliar products[376]
- This is compounded by poor estimates of life expectancy and poor understanding of the variability of actual lifetimes: in short, a poor understanding of the nature of longevity risk[377]
- Aversion to dealing with complex problems involving a sequence of choices
- Related to this is the issue of choice overload – having so many choices that you end up making no choice at all[378]
- Illusion of control: people like to feel in control of their capital, but annuitisation leads to an apparent a 'loss of control'
- Unwillingness to contemplate unpleasant events, e.g., dying and leaving behind dependants
- Overconfidence: many people underestimate how much they need to live on after retirement[379]
- Related to this is lack of self-control. A particular advantage of an annuity is that it acts as a valuable pre-commitment device (i.e., is a very valuable behavioural tool). An annuity helps control spending in retirement. Many people are unable to control their spending. A survey by Aviva in April 2014 reveals that 61% will find it difficult to

[375] A similar list of behavioural traits is given in: ideas42 (2015) *Freedom and Choice in Pensions: A Behavioural Perspective*, Association of British Insurers, February, http://www.ideas42.org/publication/view/freedom-and-choice-in-pensions-a-behavioral-perspective/; and Barclays Wealth (2015) *Humanising Pensions: Understanding the Behavioural Effects of Freedom in Pension Choice*.

[376] The Government has encouraged improvements in financial education for years now. See, e.g., HM Treasury (2008) *Thoresen Review of Generic Financial Advice: Final Report*, March.

[377] These issues are discussed in detail in Chapter 4.

[378] Sheena Iyengar and Emir Kamenica (2010) Choice Proliferation, Simplicity Seeking, and Asset Allocation, *Journal of Public Economics*, 94, 530-539; ideas42 (2015) *Freedom and Choice in Pensions: A Behavioural Perspective*, Association of British Insurers, February.

[379] Overconfidence is very common in human decision making. It is particularly common in investment decision making by both retail and institutional investors. Over-confidence can be explained by biased self-attribution, whereby individuals update their beliefs about their own ability as being attributable to skill following good outcomes, but due to bad luck after bad outcomes. They become more overconfident after good past performance, but not less confident after bad past performance.

resist spending the pension pot. They could spend their money too quickly in retirement and be reduced to living on the single tier state pension of £155.65 per week from April 2016.[380] This could involve a massive reduction in their standard of living and they will not even have a rainy day fund to fall back on. A more extreme example is people who are desperate for money at any price as the recent pay day loan and pension liberation cases show

- Too much self-control. There will also be people with the opposite set of behavioural traits, those who take excessive precautions and put everything into a rainy day fund and hence spend their money too slowly. Such people could have enjoyed a higher standard of living in their retirement had they had an annuity, taking comfort from the fact that next month another annuity payment will come in should they live that long
- Hyberbolic discounting:[381] this leads to a poor understanding of the distant future and a poor understanding of the effects of inflation in reducing purchasing power over time: economists call this latter phenomenon 'money illusion'[382]
- Mental accounting. Individuals tend to assign assets to different mental accounts such as 'assets available for current expenditure' and 'assets available for future expenditure'. In terms of the decumulation of pension assets, the pension pot at retirement is likely to be assigned by individuals using mental accounting to the first of the above mental accounts if it can be taken as a lump sum and to the second if it has to be taken as an annuity. Individuals who employ mental accounting are likely to value the annuity less than they value the lump sum
- Framing effects: retirees can be unduly influenced by the way things are communicated to them. If an annuity is explained in an investment frame ('an annuity is like a bond, but you will lose your entire investment if you die'), then people are likely to view an annuity as a highly risky investment, but if an annuity is

[380] This is the maximum: many people will not get this. It has been estimated that more than a million people will not get the full single tier pension when it is introduced on 6 April 2016. Only 45% of people retiring before 2020 will receive the full amount (Reported in Sarah O'Grady (2015) 'Nasty shock' as a MILLION people miss out on full pension, Daily Express, 13 January).

[381] Most people tend to discount (i.e., reduce the value of) future outcomes because they are impatient: one apple today is valued more than one apple tomorrow. Some people might even prefer one apple today over two apples tomorrow. At the same time, the very same people might appear to be willing to display much more patience when choices have to be made at some distance in the future. Given the choice between one apple in 100 days and two apples in 101 days, such people would choose to wait 101 days and receive the two apples. This behaviour is consistent with hyperbolic discounting: people have a high short-term discount rate and a lower long-term discount rate. Hyperbolic discounting leads to behaviour that is inconsistent over time. The apparent long-term patience disappears when the long term becomes the short term. After 100 days, people choose the one apple rather than wait one more day to get two apples. Hyperbolic discounters prefer, for example, a nominal annuity over an index linked annuity since it gives them more money up front and they discount future inflation risk.

[382] Money illusion is the tendency of people to think in nominal or money terms rather than in real terms that takes inflation into account. Many people would prefer to have a nominal rate on their bank account of 5% when inflation is 6% to a return of 2% when inflation is 1%.

explained in a consumption frame ('an annuity allows you to maintain your standard of living in retirement for however long you live'), then people are likely to have a much more favourable view of an annuity. Similarly, choices can be framed in a way that causes people to overvalue the 'large' lump sum in their pension fund at retirement and undervalue the 'small' annuity. The emphasis on the pension pot size rather than the income in retirement is very bad from a behavioural perspective. To many people, a pot size of £28,000 sounds like a lot of money, but it is not when it has to possibly last for the next 30 years or more

- Susceptibility to negative norming, e.g., concerning annuities. Annuities have a bad press in most countries. It is interesting to contrast this with the positive view of DB pension schemes which effectively auto-enrol all pensioners into an annuity. More importantly, studies show that annuities that are bought on the open market by people in good health – rather than the internal or rollover annuities bought by the existing customers of an insurance company's accumulation fund when they retire – represent good value of money.[383] Recent research by the Financial Conduct Authority (FCA) has shown that the 'money's worth'[384] of annuities between 2006 and 2014 to be very high at 94% for a 65-year old, confirming previous UK studies.[385] Further, the chance of running out of money with an annuity before you die is zero. This is not true with drawdown. The FCA study shows that a drawdown scheme that takes the same amount of money at age 65 as an annuity and has a 1% charge has an 11% chance of running out of money before age 85. But as we saw from some of the above surveys, many people heavily discount this possibility
- Related to framing and negative norming is herding or peer effects: if dominant members of a peer group, such as employees near retirement at a company, trash

[383] It is important to recognise that standard annuities do not represent good value for people in poor health. Indeed, there is evidence that as many as 600,000 people in poor health have been mis-sold an annuity. They should have been sold an enhanced annuity which took account of their health status. As a result of campaigns, such as the Daily Telegraph's Justice for Annuity Victims campaign, the Financial Ombudsman Service is considering whether insurance companies should be made to compensate victims without recourse to the courts. Compensation could vary between 20 and 50% of the original price of the annuity (Reported in Katie Morley (2015) Pension redress owed to 600,000, Daily Telegraph (Your Money), 14 March).

[384] The 'money's worth' of an annuity equals the ratio of the expected present value of the future annuity payments to the purchase price. It takes into account the life expectancy of the annuitant as well as the interest rate on assets – typically Government bonds – used to make the annuity payments. The money's worth will always be less than 100% due to administrative costs and the costs of the capital that the insurer incurs. Increasing life expectancy and falling interest rates in recent years have reduced the money's worth. The FCA shows that the increase in life expectancy between 2006 and 2014 has reduced the annuity amount by 7%, while the fall in interest rates has reduced the annuity amount by 11%.

[385] Matteo Aquilina, Robert Baker and Tommaso Majer (2014) *The Value for Money of Annuities and Other Retirement Income Strategies in the UK*, Financial Conduct Authority, Occasional Paper No. 5, December; Edmund Cannon and Ian Tonks (2008) *Annuity Markets*, Oxford University Press, Oxford; Edmund Cannon and Ian Tonks (2009) *Money's Worth of Pension Annuities*, Department for Work and Pensions, Research Report No. 563; Amy Finkelstein and James Poterba (2002) Selection Effects in the United Kingdom Annuities Market, *Economic Journal*, 112, 28-50.

annuities, then this could lead to a herd effect whereby no members of the group choose to buy annuities

- Loss aversion: many individuals wish to avoid making losses and so try not to put themselves into a position where losses might occur, even if this means foregoing large gains with a high probability. A common view is that 'annuities are a gamble'. The probability of dying very soon after purchasing an annuity is very low, but this probability is likely to be overestimated, so the 'loss' is perceived to be high: 'what dying and losing all my capital too!'. Conversely, the significant probability of outliving one's resources if one does not annuitise is underestimated, so the 'gain' is perceived to be low. Hence the 'gain' from annuitising will give only a small welfare benefit, while the 'loss' from dying early will have a large welfare loss. Loss aversion is not by itself a sign of irrational behaviour. However, the tendency to overestimate the probability of low-probability events and underestimate the probability of high-probability events is certainly irrational
- Finally, there is regret or disappointment aversion: individuals might choose to avoid making a decision because they might regret or be disappointed by the consequences of that decision. Again the decision not to buy an annuity might be the result of this type of aversion.[386]

3.3.2 People differ in their resources and needs

The other important way of segmenting consumers is by resources and needs. This is one of the ways in which the FCA classifies consumers into 10 types. The FCA's *Consumer Spotlight* identifies two types of consumer who are retired:[387]

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[386] Loss aversion differs in a subtle way from regret aversion. With loss aversion, individuals are risk-seeking in the domain of losses and risk averse in the domain of gains, relative to an exogenous reference point. Regret aversion implies individuals anticipate ex-ante the regret they will feel ex-post if they made a suboptimal decision; in this case, the reference point is the best decision that could have been made and this reference point is endogenous in the decision process.

[387] Reported in Carmen Reichman (2015) FCA reveals ten types of consumer in bid to drive product design, Professional Adviser, 19 January. The remaining 8 types are: Affluent and ambitious - mostly aged between 35 and 60, they have high incomes, own their homes and work full-time. They are highly educated and financially confident, Mature and savvy - confident and well informed about financial services, has higher incomes and savings than average, and is in full-time work; Living for now - people on low incomes, most working or studying, are internet-savvy but less confident about financial matters - although they will take more risks than average consumers; Striving and supporting - mostly in work and with low incomes, more than half of this group have dependent children, risk averse but can struggle with bills or fall behind with payments; Starting out - slightly below average income, but technologically advanced with a high level of education, this group consists mostly of under 45s who are single and without children, almost all are renting; Hard pressed - on low incomes, many struggling with everyday expenses, Many also have no savings or investments, and are not confident with financial decisions; Stretched but resourceful - likely to own their home, and many have savings, investments and pensions, half have children at home and are generally confident about financial matters, but time-poor; Busy achievers - those on high household incomes, with mortgages, pensions and

- Retired with resources
    - These are mostly retired homeowners who are risk averse and rarely in debt, with high savings and a range of financial products and typically well informed on financial matters. They comprise two groups known as 'mass affluent' and 'high net worth'
- Retired on a budget
    - These are mostly over 65 with low incomes, who are careful with their money and stay loyal to providers. They have limited access to services and information. They are also known as the 'mass market'.

Many of the people surveyed in the above studies belong to this second category.

We can divide income needs into three broad categories:

- 'essential' income: the income required to cover the retiree's minimum basic expenditure needs or 'heating and eating' as it was described to us
- 'adequate' income: the income required to achieve a minimum lifestyle that is acceptable in retirement
- 'desired' income: the income required to achieve the full lifestyle to which the retiree aspires.

Table 3.2 shows household expenditure by gross income quintile group for those aged 65-74. We could, for example, interpret the income needs of the bottom quintile as essential. This amounts to £198 per week per household (or £167 per week per individual). This is approximately equal to the state pension and other benefits received by a recently retired couple (£191).[388] We could interpret the middle quintile as having an adequate income of £484 per week per household (or £249 per week per individual) and the top quintile as having a desired income of £920 per week per household (or £350 per week per individual).

A survey from *Which? Consumer Insight Tracker* released in March 2015 found that 66% of those aged 50-64 are concerned about how much money they will need in retirement. Further, only 41% of retired people say they are living comfortably on their pension.[389] The survey, conducted by Populus, interviewed a representative sample of 2,251 UK adults online between 17th - 18th September 2014 and 2,088 UK adults online between 16th - 18th January 2015.

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some savings, they are in work, albeit largely part-time, with children at home, they can access information and services easily but for them time is very limited.

[388] DWP *Pensioners' Income Series*, July 2014.

[389] http://www.which.co.uk/news/2015/03/which-calls-for-additional-pension-reforms-397246/

Table 3.2: Household expenditure by gross income quintile group where the household reference person is aged 65 to 74, 2011-2013 (£ per week, United Kingdom)

		Lowest twenty per cent	Second quintile group	Third quintile group	Fourth quintile group	Highest twenty per cent	All House-holds
Lower boundary of group (£ per week)[a]			265	462	696	1,078	
Weighted average number of persons per household		1.2	1.7	1.9	2.3	2.6	1.8
Commodity or service		Average weekly household expenditure (£)					
1	Food & non-alcoholic drinks	35.10	49.70	61.90	70.70	93.20	55.60
2	Alcoholic drinks, tobacco & narcotics	6.90	9.30	12.80	14.50	19.00	11.10
3	Clothing & footwear	7.50	11.90	21.40	24.80	41.00	17.30
4	Housing(net)[b], fuel & power	40.20	49.70	52.90	66.10	86.10	53.60
5	Household goods & services	10.60	23.60	33.30	39.00	60.10	27.90
6	Health	3.10	5.80	8.60	13.10	12.60	7.50
7	Transport	15.50	40.40	66.40	86.40	143.00	55.50
8	Communication	6.80	9.70	11.20	14.10	17.80	10.70
9	Recreation & culture	28.30	48.10	87.50	93.00	140.90	66.50

10	Education	-	[0.30]	[0.30]	[3.00]	11.90	1.60
11	Restaurants & hotels	11.70	23.90	38.60	49.20	80.40	32.80
12	Miscellaneous goods & services	15.60	23.00	33.90	45.30	100.60	33.10
1-12	All expenditure groups	181.20	295.30	428.70	519.20	806.80	372.90
13	Other expenditure items	16.50	33.20	55.10	62.10	113.10	45.30
Total expenditure (£)		197.70	328.50	483.80	581.30	920.00	418.20
Average weekly expenditure per person (£)		167.10	194.20	249.00	256.90	350.30	234.60

Notes: This table is based on a three year average.

[a] Lower boundary of 2013 gross income quintile groups (£ per week).

[b] Excluding mortgage interest payments, council tax and Northern Ireland rates.

Source: ONS, *Family Spending 2013*

The *Aon DC Member Survey* discussed earlier appears to suggest that attitudes to both the standard of living in retirement and the age at which retirement takes place are changing. The great retirement deal that the babyboomers could get, namely a pension of two-thirds of final salary from age 65, is no longer regarded as realistic. The survey suggests there is 'a welcome sense of realism among employees about their retirement prospects'. Nearly 50% of respondents expect a pension of between 21% and 50% of their final salary. Similarly, 50% expect to retire between 66 and 70, while 10% anticipate working until their 70s. While 50% still expect to fully retire from all paid work when they leave full time employment, around 40% anticipate easing into retirement by do some part-time work; however, 5% expect they will not be able to ever retire.

3.3.3 Implications of the market segmentation analysis

Together these surveys build up a very interesting picture about savers at retirement. The mass affluent and high net worth segments of the market appear to have the confidence and ability to manage the drawdown of its retirement assets effectively. One of their main concerns will be inheritance planning. Those at the other end of the wealth distribution will have small DC pension pots that would buy very low annuities.[390] Much of their retirement income will be provided by the state and the freedom to choose how to spend these small pension pots will probably be more valuable than a small addition to the state pension that an annuity would buy. Their main concern will be to act in a way that does not increase their income tax or reduce their welfare benefits. However, it is those in between – the mass market that is Middle Britain – who face the biggest challenges from pension 'freedom and choice'. The surveys show that this group:

- are uncertain about when they will retire
- have a poor understanding of their spending needs throughout retirement, but value ease of access and the flexibility to change the amount of income they draw
- lack engagement (even very close to retirement)
- are reluctant or unable to plan ahead
- are reluctant to do research, e.g., on the tax implications of withdrawing cash
- have a poor understanding of life expectancy and, in particular, the probability of living beyond age 85, which means DC savers are likely to underestimate the importance of longevity insurance
- are unwilling to give up their lump sum at retirement in exchange for an annuity
- are unwilling to pre-commit to the purchase of an annuity even at high ages
- are warm to the concept of a gradual payment for a longevity insurance product, with participants being able see how this could help them to build up a 'safety net' against the risk that they live too long or take out too much income

[390] They might also have some DB pension as well, although, in due course, this source of retirement income will disappear as private-sector DB pension provision comes to an end.

- although some are confident about managing their finances, many appear to be very poorly equipped to make investment choices
- prefer low-risk investments
- are likely to be confused by the range of new products and delivery options for receiving retirement income
- at high risk of making poor decisions
- welcome guidance and advice, but are not prepared to pay much for it
- need support to make trade offs
- feel their employer or pension scheme provider has a 'duty' to offer a default drawdown option in retirement, but it must be well designed and they also want alternatives to a default.

We also need to be aware that there is a difference between what people say they will do and what they actually do. The above surveys suggest that many DC savers plan to act quite rationally. They imply that life time annuities ought to remain an important feature of retirement incomes. However, the survey conducted by ILC-UK also found that people had a poor understanding of their retirement income options. Only 50% of those with a DC pension said they understood what an annuity is, only 20% understood what an enhanced annuity is, and only 35% said they understood what income drawdown is.[391]

In addition, financial advisers did not expect annuity sales to be high in future. An Aegon adviser survey[392] of 200 financial advisers found that only 2% of advisers expected annuities to be the market leading product by 2025. One in three believed that risk-managed funds would become the leading product, while 28% thought that guaranteed investment strategies would lead the product list. So there also appears to be a big disconnect between what savers say they will do and what advisers believe that savers will do. Nick Dixon, Aegon investment director, said: 'It's now clear that most [advisers] now think some form of income drawdown or phased retirement will overtake traditional annuities before long. Flexible guarantees, risk-managed funds, and income funds are all becoming central to advisers' toolkits as their clients look to take advantage of the new flexibilities'. An implication of this is that many people will not see the need for longevity insurance, because they cannot imagine the consequences of running out of money before they die. Yet, if they did run out of money before they died, it is equally likely that they would regret this and accept that the strategy that led to this unfortunate circumstance was sub-optimal in the long run.

One of the most important facts to recognise is that the alternatives to annuitisation – principally income drawdown – involve more risk, often much more. People can only get a higher return than an annuity by taking on more risk and the extra return is not guaranteed.

[391] http://www.ilcuk.org.uk/index.php/publications/publication_details/making_the_system_fit_for_purpose
[392] Reported in Professional Adviser, 7 January 2015.

Almost immediately after the Budget, scheme members were being encouraged to take on more risk.[393] Drawdown also has higher charges, in particular, fund management charges.[394] In addition, there are drawdown products that guarantee a minimum income, but long-term guarantees of this kind can be very expensive.

So we are confronted with the following potentially toxic combination: people who do not fully understand the risks that they face, being offered a wide range of retirement income products and solutions, but with a poor understanding of how these products and solutions can help them manage those risks and also their costs. How do we deal with this? First, we should recognise that most people should not be expected to manage the risks in Table 1.2 themselves. This means that the provider must design products and solutions that effectively manage these risks.[395] Second, we need to recall that one of the important lessons from behavioural economics is that too much choice is a bad thing. This means that we should consider introducing defaults with a small number of default pathways (using decision trees) that will lead to good retirement income solutions for people given their circumstances. This will help to overcome the problems of choice overload and poor value for money.

The use of defaults in decumulation builds on the lessons of auto-enrolment in the accumulation phase of DC schemes introduced in October 2012. However, there are important differences arising from the greater complexity of decumulation decision making.

First, in the accumulation stage, a single default investment strategy could be designed that would be adequate for most people. Because people's circumstances differ, it is unlikely that we will be able to design a single ('one size fits all') default decumulation strategy that would suit most people.

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[393] Chris Torney (2014) Savers should consider taking more risk with their pensions in light of new Government rules, express.co.uk, 23 April.

[394] Fund management charges are included in the total expense ratio (TER). But what is included in the TER are only the visible costs in fund management. There are also a significant number of hidden costs as reported in David Blake (2014) *On the Disclosure of the Costs of Investment Management*, Pensions Institute Discussion Paper PI-1407, May. The investment management industry is now beginning to acknowledge that these hidden costs exist. Daniel Godfrey, then chief executive of the Investment Association wrote on a blog: 'We think [a full list of charges] will avert a continuation of the trap we've all fallen into over the last twenty years with disclosure [of charges] that nobody understands at best and which can be misleading at worst, with spurious assumptions of accuracy being made that could lead to real consumer detriment' (reported in Dan Hyde (2015) We misled savers for 20 years over hidden fees, says fund boss, Daily Telegraph, 11 February). In February 2015, the Investment Association issued a position paper *Meaningful Disclosure of Costs and Charges*; http://www.theinvestmentassociation.org/assets/files/consultations/2015/20150210-iacostsandchargesreport.pdf

[395] At the very minimal, the products and solutions need to have (a) accessibility, (b) investment returns in excess of inflation and (c) longevity insurance (see Chapter 2).

Second, in the accumulation stage, people could be auto-enrolled onto the DC scheme default investment strategy without the need for very much information, guidance or advice. This is clearly not the case with decumulation. The Government has introduced the 'guidance guarantee', a new service called Pension Wise that is free, impartial and aims to help individuals consider their options and make informed choices.[396] However, we need to assess whether 'guidance' – which is a non-regulated activity in the UK – is adequate for the purpose, in which case the customer can avoid the expense of taking 'advice' – which, depending on the type of advice, can be a regulated activity in the UK – from a qualified financial adviser.[397]

Third, in the accumulation stage, people are auto-enrolled at a natural point in their career, i.e., when they have made the decision to start a new job and expect to be filling in forms, etc. There is no a similar clear-cut point in decumulation, especially if people have accumulated a number of pension pots over their career. Any default would, in general, need to be triggered by the member.

We also need to overcome the behavioural barriers that people face which prevent them making decisions that are in their best long-run interests, that is, decisions that their older selves will appreciate that their younger selves made, rather than decisions they will subsequently regret. Further, in a world of 'freedom and choice' and no compulsion, we need to find ways of nudging people towards the best default for their circumstances. Finally, we need to determine whether there are any regulatory barriers that impede the effectiveness of the default, the guidance/advice or the nudging and, if there are, then they need to be identified and removed.

Before doing all this, we briefly consider initial customer reaction when 'freedom and choice' first started.

3.3.4 Initial customer reaction to the introduction of 'freedom and choice'

There was a great of interest from customers when the new pension regime was introduced on Flexiday, 6 April 2015. There were around 60,000 phone calls and 10,000 emails and letters per day to providers, more than double the usual number providers typically receive. Most callers just wanted information, but a number of people exercised their new freedoms and cashed in at least part of their pension pot. The money was spent on a wide range of

[396] https://www.gov.uk/Government/news/millions-guaranteed-the-right-to-free-and-impartial-guidance-on-their-new-pensions-choices. Pension Wise is discussed in more detail in Section 3.6.3.

[397] For those who choose not to use the default, advice would still be highly desirable, although cost is an important consideration, especially if the pension pot is fairly small. These issues are discussed later in the Chapter.

consumer items, most notably, a speedboat, a cruise on the Queen Mary, a Bentley, a holiday home in France and a child's wedding; some paid off debt.[398]

Tom McPhail, head of pensions research at Hargreaves Lansdown, said: 'It will take some time for a clear pattern to emerge in terms of how investors are looking to use the new freedoms. Initial demand has been focused on an investment income rather than buying an annuity, though we do expect this balance to swing back to some extent in the weeks to come. Relatively few people are asking to take all their money out; we'll be tracking the sums involved, however, in the main, we expect it to be at the smaller end of pension pot sizes'.[399]

Table 3.3: What customers telephoned Hargreaves Lansdown about on 6 April 2015	
Topping up/opening a SIPP	8.2%
Taxation (of drawing a pension)	8.7%
Ad-hoc lump sum withdrawals	16.9%
Drawdown	42.1%
Annuities	9.8%
Taking tax-free cash only	6.6%
Taking all their pension pot in one go	7.7%

A breakdown of the calls Hargreaves Lansdown received on 6 April is shown in Table 3.3. Only 7.7% of calls concerned accessing the entire pot. Its customer preferences for products in the first two weeks following Flexiday were as follows: over 85% were about drawdown, around 6% about uncrystallised funds pension lump sums (UFPLS) and only around 7.5% were about annuity purchase.[400]

An analysis of client calls to Fidelity Worldwide Investment concerning the new pensions freedoms revealed the following:[401]

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[398] Reported in Natasha Browne (2015) Providers pick up 60,000 calls a day after flexibilities take effect, Professional Pensions, 16 April; Lisa Bachelor (2015) Speedboats, cruises and holiday homes on pensioners' shopping lists, Guardian, 9 April; Ruth Lythe (2015) A sports car, a hot tub, a cruise on the Queen Mary: Two days into pensions revolution we ask savers what they plan to do with their nest eggs, Daily Mail, 8 April.

[399] Reported in Professional Adviser (2015) Just 8pc eye taking pension 'in one go' - drawdown dominates – research, 7 April.

[400] Email communication from Tom McPhail, 22 April 2015.

[401] Reported in Professional Adviser (2015) Advice rule irritates DB savers as pension freedom trends emerge, 19 May.

- Dominant drawdown: 61% of calls to telephony teams were from customers wanting to enter drawdown and take tax-free cash
- Drawdown deferrers: Half of drawdown customers were deferring income, with many taking the tax free cash element
- Allowance impact: More customers were seeking information around the lifetime allowance
- Overstated cash claims: Just 6% wanted to cash out, of which small pots made up half this statistic
- Annuities agenda: 'In' proved as popular as 'out', with 3% of customers enquiring about cashing in their annuity and a further 3% wanting to purchase one.

Only 1% of the clients of retirement adviser My Pension Expert chose to cash in their pensions completely. Once the tax and longevity risk implications were explained, the majority of its clients avoided the lump sum option in favour of drawdown and annuities.[402]

Within two months of Flexiday, the proportion of Scottish Widows' customers looking to take their pensions as cash had fallen from 70% to 50%. Around 85% of requests were for pots of less than £30,000, with an average withdrawal of £20,000. Robert Cochran from the company said: 'It's still too early to draw definitive conclusions about the longer term impact of pension freedoms due to the pent up demand of those who deferred until April 6th to access their money….However, our site activity data also tells us that customers are still looking for more help in making the right decisions, given the wide range of options now available to them'.[403] Blackrock reported that 1,152 over-55s had accessed their BlackRock workplace pension pots (valued at £13.4m) over the same period and 83% took all their pension saving in cash. One client withdrew £300,000, and while 25% of this was tax-free, the rest would be taxed at a marginal rate of 45%.[404]

In June 2015, the chancellor George Osborne announced that 60,000 pension savers had withdrawn more than £1 billion from their pension pots in the first month of 'freedom and choice', an average of £17,000 each. He said: 'These unprecedented freedoms have been widely welcomed…It is a sign that this is a real success, but we have to make sure that people get the best advice, that the market responds and that companies up their game in helping customers make use of these freedoms. We will be watching these things very carefully'.[405]

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[402] Reported in Professional Adviser (2015) Tax hit dissuading savers from taking pensions as cash, 19 May.

[403] Reported in Natasha Browne (2015) Cash requests tail off as pension freedoms bed down, Professional Pensions, 2 June.

[404] Reported in Jenna Towler (2015) BlackRock client takes tax hit after £300k pension withdrawal, Retirement Planner, 10 August.

[405] Reported in Daniel Grote (2015) Pension Freedom - savers withdraw £1 billion, Citywire, 16 June.

The amount withdrawn in the first two months was £1.8bn according to data released by the Association of British Insurers (ABI). The details are as follows:

- Savers took out more than £1bn in 65,000 cash withdrawals from their pension pots. The average pot taken was £15,500. Most were uncrystallised funds pension lump sum (UFPLS) withdrawals
- Savers took out £800m from income drawdown policies in 170,000 withdrawals
- Savers put in £630m to buy 11,300 annuities and a further £720m to buy 10,300 income drawdown policies
- The average annuity was purchased with £55,750 and the average fund put into drawdown was £69,900.

So 52% of the total sales were annuities and 48% drawdown. This compares with 2012, the peak year for annuity sales in the UK when monthly sales were £1.2bn (90% of the total) and only £0.1m per month was put into income drawdown products (10% of the total).[406]

The amount withdrawn in the first three months was £2.5bn according to the ABI, equivalent of £27m a day.[407] The details are as follows:

- Savers took out more than £1.3bn in 65,000 cash withdrawals from their pension pots. The average pot taken was £15,000. Most were UFPLS withdrawals.
- Savers took out £1.1bn from income drawdown policies in 264,000 withdrawals, with an average payment size of nearly £4,200.
- Savers put in £990m to buy 17,800 annuities and a further £1.3bn to buy 19,600 income drawdown policies.
- The average annuity was purchased with £55,600 and the average fund put into drawdown was £68,000
- 55% of annuities were bought from the existing provider, compared with 45% of drawdown products.

The amount withdrawn in the first six months was £4.7bn according to the ABI.[408] The details are as follows:

- Cash withdrawals:
    - £2.5bn was paid out in 166,700 cash lump sum payments, with an average payment of just under £15,000

[406] Reported in Carmen Reichman (2015) Savers extract £1.8bn in first two months of pensions freedom, Investment Week, 15 July.

[407] Reported in Carmen Reichman (2015) Providers paying out £27m a day since pensions freedom, says ABI, Professional Adviser, 3 September.

[408] Reported in Professional Adviser (2015) Pension freedoms: £4.7bn paid out in first six months, says ABI, 3 November.

    - £2.2bn was paid out via 606,000 income drawdown payments, with an average payment of £3,600
    - In 95% of cases where savers accessed a cash lump sum, they withdrew the entire fund. Four in five cash lump sums were paid to those under 65, with three in five under 60
- For funds being invested:
    - £2.85bn was invested in 43,800 income drawdown products, an average fund of almost £65,000; 60% of people changed provider when buying an income drawdown policy
    - £2.17bn was invested in around 40,600 annuities, making the average fund invested nearly £53,300; 40% of customers who bought an annuity changed provider.

So 60% of sales were drawdown and 40% were annuities. ABI director for long term savings policy, Dr Yvonne Braun, said: 'Despite some ringing the death knell for annuities, this seems to have been premature. An increasing number of people are recognising the value of a guaranteed income, with annuity sales rising this quarter. There are also initial signs that the number of people accessing their pension pot as cash is beginning to settle down, with larger pots continuing to be used to buy retirement income products'.

In August 2015, Royal London discovered from a survey it conducted that 69% of people making use of the pension freedoms took their pension pot as a cash lump sum. Of these, 16% said they would use the cash to clear their mortgage or other debts, while 23% intended to put the money into a bank, building society or cash ISA account which was likely to pay a lower rate of return than their pension pot was earning. The remainder planned to use an alternative savings or investment vehicle. The company called on the FCA to increase awareness of the tax implications of cashing out a pension pot at retirement. Fiona Tait from the company said she was worried the results reflected a wider industry trend: 'Royal London does want the pension freedoms to work, but not at the financial detriment of customers. Where customers are looking to pay off debts or spend the money on a vital purchase, the tax charge may well be a price worth paying. However, if the intention is for the cash to just stay in a savings account, consumers are potentially paying a tax charge for no additional financial benefit. Having extra focus in the retirement risk warnings framework would help to ensure that customers appreciate all the options they have within their existing pension. This is particularly important for those customers who are not willing or able to access financial advice'.[409] On the other hand, a survey of Zurich's clients, also published in August 2015, found that only 9% of over-55s had accessed their pension pots. The rest were either not ready to make a decision, were keeping their pensions invested and spending other assets like cash savings first, or were worried that they could run out of

[409] Reported in Natasha Browne (2015)FCA pressed to highlight tax hit as savers cash out to put money in the bank, Professional Pensions, 20 August.

money.[410] According to calculations made by Hargreaves Lansdown for for BBC News, the Treasury will net an extra £700m in tax in 2015-2016 as a result of the cash withdrawals.[411]

Paul Green from Saga said: 'It's great to see so many people taking advantage of the new pension freedoms and that people are being savvy with savings and shopping around for the best deal. David Cameron and George Osborne were right to trust people with their own money. Treating adults like adults leads to better outcomes for society and individuals – we have happy citizens and a welcome boost for the economy'.[412]

However, others have warned warned against using amounts withdrawn as a 'measure of success' of pension freedom. For example, Adrian Walker, retirement planning manager at Old Mutual Wealth, said: 'The UK has a problem with saving, not spending, so care needs to be taken when deciding how to measure the success of the pension freedoms. I would suggest that a more appropriate measure of success will not come for many years, when those people who have withdrawn money from their pensions are still enjoying the retirement they planned and saved many years for'. Tom McPhail also pointed out that 'less than one in ten of people [are] currently choosing to buy an annuity, compared to eight or nine in 10 only a couple of years ago', implying that most people exercising their pension freedoms are not protected from outliving their resources.[413]

The *Retirement Planner Inquiry for August 2015* invited advisers to provide feedback on how their clients were using drawdown products. Only 3% of advisers reported that their clients were choosing to take income from natural yield[414] only, 15% said clients were drawing from capital, and the remainder (82%) said it was a combination of income and capital. Long-established drawdown clients tended to restrict income drawn down to no more than natural yield, while high-net worth individuals 'tend not to require a monthly income drawdown and as such the majority strip out gains from capital growth when appropriate'.

The inquiry also found that 'the popularity of multi-asset funds is set to increase as more people remain invested throughout their retirement. Many fund managers have launched or repurposed multi-asset funds to capitalise on pensions freedom'. Around 40% of advisers had increased allocations to multi-asset funds since April 2015 or were planning to do so. The main reason was to increase diversification and reduce the volatility of the fund value.

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[410] Reported in Tim Wallace (2015) Savers reject the high life despite pension freedoms, Daily Telegraph, 31 August.

[411] Reported in Professional Adviser (2015)Treasury to net £700m in pensions freedom tax windfall, 7 July.

[412] Reported in Carmen Reichman (2015) Savers extract £1.8bn in first two months of pensions freedom, Investment Week, 15 July.

[413] Reported in Carmen Reichman (2015) Chancellor reveals £1bn cashed in since pensions freedom, Professional Adviser, 16 June.

[414] That is, the pay-out of dividends, coupons, and rent etc from income-generating investments – see Chapter 2.

Around 17% of advisers were also recommending enhanced income funds where yield could be as high as 7%, while another 50% said they were considering doing so.[415]

3.3.5 Initial scheme reaction to the introduction of 'freedom and choice'

A survey of 70 trustees and advisers by Linklaters in May 2015 found that nearly 20% of company DC pension schemes will offer flexible drawdown as a result of the 'freedom and choice' reforms, while 46% will offer some degree of access to the UFPLS option, though the majority preferred a one-off withdrawal. A survey from Sackers of more than 50 UK schemes also in May 2015 found that two-thirds of DC schemes were offering members some form of pension flexibility. Of these, 94% were allowing members to cash out their pots through the UFPLS, while only 14% were providing flexi access drawdown. Of the one-third of schemes not currently offering any flexibility, 54% said they were considering it, while 38% said they had no plans to do so.[416]

However, trust-based DC schemes appeared to be more conservative in their approach than contract-based schemes and were still in a 'wait-and-see mode' concerning at-retirement options, according to Nils Johnson, director of retirement at Spence Johnson. He anticipated that over the next three years, 'cash and drawdown' would become the two main options being offered.[417]

Others agreed that 'now is not the right time [for trust-based DC schemes] to offer in-house drawdown'. According to Richard Butcher, managing director of independent trustee PTL: 'They've got no commercial imperative to do this… so they were quite happy to wait and see what happens. In any event, [schemes not offering drawdown] hasn't frustrated "freedom and choice" because people have always had the right to statutory transfer'. Gregg McClymont, head of retirement savings at Aberdeen Asset Management, said: 'It's such a big change, isn't it? There are so many questions around the ongoing potential role of trustees that I don't think it's a surprise that there's not been a rapid move towards a post-retirement framework for scheme members….My own view is that it would be unfair to point the finger at trustees, because they are trying to manage a situation which has changed overnight without consultation, and something that potentially fundamentally changes the nature of a pension'.

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[415] Reported in Jenna Towler (2015) RP Inquiry: Advisers on the post-April drawdown boom, Retirement Planner, 27 August.

[416] Reported in Natasha Browne (2015) Two-thirds of schemes offering pension freedoms, Professional Pensions, 22 May.

[417] Michael Klimes (2015) Nils Johnson: Trust-based schemes have not embraced pension reforms, Professional Pensions, 24 September.

There are five reasons why trust-based DC schemes are not currently offering drawdown to their members:[418]

1. Sponsor reluctance – enterprise risk
   Providing drawdown means trustees and sponsors will be taking on more enterprise risk (organisational risk). According to Richard Butcher: 'Their concern is for the welfare and wellbeing of their staff – not people who retired 30 years ago. I think most trustees of single-employer schemes said: "We don't need to do this, we don't particularly want to do it, there's a risk to doing it, so why should we bear that risk and cost? Let's just leave it to the commercial market". It's going to be the large schemes that do it if anybody does it. J.P. Morgan got quite well advanced with their plans on it, but then the Americans decided against it because of enterprise risk'. Steve Budge, principal DC and savings at Mercer UK, agreed: 'Clearly there's a nervousness in the market in terms of clients and schemes wanting to offer some flexibility but, because of the nature of drawdown, it exposes members to a lot more risk in terms of running out of money'.

2. Governance challenges
   In-house drawdown also creates an ongoing governance challenge for trustees. As Gregg McClymont explains: 'Generally speaking, trustees' jobs stopped at retirement and so [in-house drawdown would represent] a big shift towards the trustees having a significant role in governing options for retirement income'.

3. Lack of appetite from members
   There is little demand from members for drawdown – most retirees have been taking their DC benefits as cash, since they have very small DC pots (although they may also have a DB scheme).

4. Lack of product innovation
   Pension scheme members would like both flexibility and security of income, but as Gregg McClymont said: 'That's not straightforward to achieve, so I'm sympathetic to the challenges trustees are facing. In terms of the product side of things, asset managers are developing income products and multi-asset products, but that product innovation is at a relatively early stage, not least because those at retirement at the moment are, according to all the evidence, tending to take cash in larger quantities than investing in markets'. Steve Budge agreed: 'There's definitely a lack of product innovation. I don't think anyone's at fault here, there just hasn't been much time to put things together'.

[418] Sara Benwell (2015) Five reasons trustees should avoid providing drawdown solutions, Pensions Insight, 4 December.

5. Lack of scale

   The final issue relates to the inability of many schemes to generate sufficient scale to provide true value for money with in-house drawdown. Helen Ball, head of defined contribution at Sackers, argues that only the big master trusts or perhaps some of the very largest single-employer schemes will ever be able to achieve the necessary scale: 'Over time, it is more likely that they'll think about some of the new flexibilities, because they've the scale to provide the funding to do it'.

A way around this problem in due course would be to work with an established provider of drawdown solutions. Mr Butcher explains: 'The trust could buddy up with a commercial provider or perhaps a commercial master trust, so the individual can move across from the single-employer trust to a commercial master trust and gain access to drawdown'.

The slow response of trust-based DC schemes to 'freedom and choice' was confirmed by Willis Towers Watson's *Pensions Flexibility Study* published in January 2016. Of the 222 trust-based schemes surveyed, 61% did not provide access to any form of flexible drawdown, 7% provided flexi-access drawdown within their trust, while the rest (32%) allowed members access to a drawdown facility by transferring their assets to one or more pre-selected drawdown providers. However, 71% of the schemes allowed members access to one lump-sum payment without the member having to transfer their DC assets, while 19% allowed up to two withdrawals. Further, 62% of the trust-based schemes continued to target tax-free cash and annuity purchase as their default option for members. This contrasts with the contract-based schemes surveyed, where 80% were offering a blended strategy that aims to accommodate a range of member-retirement choices.[419]

The May 2015 Linklaters survey cited above found that around 70% of trustees and advisers agreed that DB pension scheme members should be allowed to transfer out, with 44% of employers having already been contacted by members about moving their pot.[420] However, there was little sign that DB schemes would offer such flexibilities as drawdown at this stage. In September 2015, Aon Hewitt published the results of a survey of more than 200 DB schemes. Eight out of ten have taken some action in response to the new regime. One third automatically provide retiring members with transfer quotes, and a further 20% intended to do so soon; 40% of schemes providing quotes in retirement packs also offered members access to financial advice. It was mainly the larger schemes that were doing this. Ben Roe, head of liability management at Aon Hewitt, said: 'Large schemes have generally been at the forefront of introducing risk reduction measures, so not surprisingly they have also led on

[419] Reported in Kristian Brunt-Seymour (2016) Nearly two-thirds of trust-based schemes have not embraced drawdown, Professional Pensions, 26 January.

[420] Reported in Natasha Browne (2015) One in five schemes to offer flexi drawdown, Professional Pensions, 11 May.

making changes in response to the Budget, as more than a third are planning to quote transfers in the retirement pack. This, in turn, can lead to significant savings against funding and long-term targets. There is evidence that some companies are also taking advance credit for likely liability gains in their profit and loss'. But the survey found less than 10% of schemes were making any additional support available to members at retirement. Mr Roe said: 'What is disappointing is the relatively low numbers of schemes which are offering meaningful support to members on what is now a more complex decision for them. Not only does additional support lead to better member decisions but our statistics show that this also leads to more members taking a transfer, which ultimately means more cost and risk reduction for companies'.[421]

An analysis of requests for information made by Portal Financial between September 2014 and September 2015 on behalf of its clients to their pension schemes indicated that scheme members could wait up to three months to receive the information in the case of DB schemes and up to 5 weeks in the case of DC schemes. Managing director Jamie Smith-Thompson said: 'Currently, many pension schemes are unable, or unwilling, to support the new pension flexibilities and, therefore, members of these schemes need to transfer to a provider that can. However, a transfer cannot take place until we are in receipt of the latest information and, only at that point, can we provide the necessary advice on a possible transfer. It is, therefore, incredibly important that it is provided in a timely manner. Clients simply don't understand the delays, as it just doesn't seem possible to them that their financial services providers don't have the information at the touch of a button. The delays can be very stressful and many scheme providers urgently need to improve their response times. We believe that action is necessary and pension transfers should be as simple as changing bank accounts with clear service levels and timings that need to be adhered to'.[422]

3.4 A retirement expenditure and investment plan that helps to overcome behavioural barriers

To overcome the behavioural barriers which prevent people behaving optimally in retirement, we need a plan to help people manage their retirement expenditure. One example of such a plan is a SPEEDOMETER (or Spending Optimally Throughout Retirement) retirement expenditure plan.[423] The term SPEEDOMETER is used to reflect the fact that spending optimally is related to the speed with which assets are drawn down and a SPEEDOMETER is a useful device both for measuring and influencing speed.

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[421] Reported in Jack Jones (2015) Eight in ten DB schemes adapt offering for pension freedoms, Professional Pensions, 17 September.

[422] Jenna Towler (2015) DB schemes' 'slow' response time holding back pension transfers, Professional Adviser, 12 October.

[423] David Blake and Tom Boardman (2013) Spend More Today Safely: Using Behavioral Economics To Improve Retirement Expenditure Decisions With Speedometer Plans, *Risk Management and Insurance Review*, 17(1), 83-112.

Given that most people are 'humans' rather than 'econs', we should recognise that the retirement stage of a pension plan is just too complex for most people to deal with without any outside support. We also need to recognise that retirees: have different expenditure needs during different phases of their retirement and need to pace their spending throughout retirement in order to optimise the use of their lifetime assets and income and their ability to make intended bequests. It is important to recognise that a retiree needs to work out the desired spending pattern in retirement before deciding on the appropriate investment strategy for their pension pot.

With these considerations in mind, a SPEEDOMETER plan has the following five components – and is an example of what is known as a 'layering' plan:

1. First, make a plan. This can be done, either by being auto-enrolled into one as part of the retirement planning service offered by the plan member's company, or by an online or telephone-based service providing generic financial information and guidance, or, if wealth permits, involving a financial adviser whose role is to assist with making and implementing the plan and conducting annual reviews. Key components of the plan are budgeting and projecting expenditure. The remaining components implement the plan. Ideally, planning should occur throughout the accumulation phase. It is very important as retirees approach retirement for planning to take place to determine the optimal age for securing a guaranteed life-long income.
2. Second, secure 'essential' income. The plan needs to take a holistic approach to managing all assets and income sources in retirement and not just pension assets and income, with the aim of securing, as a very minimum, a core inflation-protected income sufficient to allow the retiree to meet 'essential' needs for the remainder of their life.
3. Third, have insurance and a 'rainy day' fund to cover contingencies. The plan uses insurance, when available and cost effective, to cover contingency events, such as repairs to white goods, central heating and car. Some expenditures in retirement will be lumpy (e.g., holidays and car purchase), so it is important to have a 'rainy day' fund of liquid assets in order to retain as much flexibility as possible with retirement assets. The lower the level of insurance used, the greater the 'rainy day' fund needs to be. Care costs are potentially the greatest spike to expenditure. There is currently a limited insurance market for care costs other than immediate-needs annuities that can be purchased when retirees enter care homes. This lack of pre-funded long-term care insurance requires the mass affluent to retain a considerable fund against this possibility.[424] For those with limited means, the state will provide care and this

[424] Psychological barriers, due to loss aversion, to buying long-term care insurance might be partially overcome through bundling the insurance with an annuity, as suggested by Christopher Murtaugh, Brenda Spillman, and

illustrates the need for retirees to be aware of how they can maximise means-tested benefits to their advantage.

4. Fourth, secure 'adequate' income. Many people will, of course, wish to secure a higher standard of living in retirement than the essential level if they have sufficient resources to meet their needs and wishes throughout retirement, including desired bequests.
5. Fifth, achieve a 'desired' standard of living and make bequests. The plan offers a simplified choice architecture for managing any residual wealth with the aim of achieving a 'desired' standard of living in retirement, while allowing part of the remaining wealth to be bequested at a time of the retiree's choosing.

A SPEEDOMETER plan deals with the behavioural traits that people face:

- Critically, the plan utilises inertia and procrastination, since, once enrolled, individuals do not tend to change their minds
- The plan accepts individuals suffer from overconfidence and have self-control problems and would benefit from using commitment devices
- If annuities are used in stages 4 and 5 of the plan, they could be capital-protected or money-back annuities, since these deal with the aversion to losing control of and the fear of loss of capital on early death. Such annuities have the following advantages:
    - They remove the single biggest consumer objection to annuities: 'If I die soon after I retire, the annuity provider will keep my fund'
    - The 'live or die' guarantee of getting your money back provides a simple underpin
    - They are very easy to explain and for consumers to understand
    - A lump sum repayment rather than the continuation of current income for a guaranteed period of 5 or 10 years is easier for people to understand and is generally more highly valued
    - The cost of the guarantee is transparent and allows consumers to make an informed choice.
    - They automatically phase pension funds into full annuitisation (up to the limit specified by the annuitant).
    - They remove a significant barrier to pre-retirement saving: people won't save voluntarily if they don't believe that it pays to save.
- The phasing of annuitisation deals with the aversion to making large transactions and possible regret about getting the timing wrong

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Mark Warshawsky (2001) In Sickness and in Health: An Annuity Approach to Financing Long-Term Care and Retirement Income, *Journal of Risk and Insurance*, 68, 225-54.

- The plan is a universal one, although only the mass affluent will be in a position to make use of all five stages. Except for plan members who reveal themselves to be extremely risk averse, the annuity will not be the most prominent feature of the plan for the mass affluent in their early years of retirement. For most mass affluent plan members, what will be discussed first will be the management of retirement assets in accordance with the member's attitude to risk. Annuities will merely be one component of the management of retirement assets. This helps to overcome framing effects.

3.5 Defaults and default pathways

In this Section, we examine some proposals for defaults and default pathways that reflect differing individual and household circumstances. In particular, we need to consider how nudging and the use of a choice architecture in decision making – ideally also combined with guidance or advice – can be used to help 'humans' make optimal solutions for themselves.

3.5.1 Default and default pathways with SPEEDOMETER plans

It would clearly be better if a retirement expenditure plan like the SPEEDOMETER plan were to be adopted by a fully engaged consumer working closely with an adviser. But could someone who was not engaged or not willing to seek advice be auto-enrolled or defaulted onto the plan?

The experience of auto-enrolment in accumulation would suggest that the best if not the way that a plan like SPEEDOMETER will work for the mass market is if they are automatically enrolled into one during a pre-retirement guidance or advice surgery arranged through their employer, their pension provider or following a discussion with Pension Wise. There needs to be a co-ordinated approach to overcome inertia and procrastination, the two key behavioural barriers to effective decision making. Similar strategies can be used to get them to start the plan as was used to get employees to start a SAVE MORE TOMORROW (or SMART) plan, e.g., sign up now for a plan that starts on the retirement date in six months' time, with the option to drop out at any time beforehand.[425] Everyone would have the right to opt out until the point at which longevity insurance kicks in.

For the mass affluent and high net worth segments of the market, the first key nudge of the plan is to get pre-retirees to talk to an independent financial adviser. The extent and timing of the annuitisation will depend on the initial assessment by the adviser and the subsequent

[425] Shlomo Benartzi and Richard Thaler (2004) Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving, *Journal of Political Economy*, 112, S164-S187. A SPEEDOMETER retirement expenditure plan is the natural counterpart to the SAVE MORE TOMORROW (SMART) plan introduced by Benartzi and Thaler to help people save more for their retirement and which was adopted by the Government when it introduced auto-enrolment in the UK in October 2012.

realised investment performance. Couples will need more flexibility than singles. High net worth retirees will need more flexibility than the mass affluent.

For all market segments, the guidance or advice surgery needs to collect information on:

- Pension pot size
- Other sources of lifelong income (especially any state and defined benefit pension)
- Other sources of wealth (such as housing equity)
- Liabilities (e.g., mortgage, credit card debts)
- Health status
- Family circumstances, including bequest intentions
- Given other income sources, health status and family circumstances, decide the levels of expenditure that are considered essential, adequate and desired
- Tax position
- Risk attitude
- Risk capacity.

Given this information, the following default pathway can be established:[426]

- Given total assets and liabilities, decide whether or not to use part of the pension pot to pay off any debts (e.g., mortgage)
- Decide how to fund essential life-long expenditure if this is above the level that can be supported by the state and DB pensions. The only secure way of doing this is via an index-linked lifetime annuity or a guaranteed drawdown product offering inflation uprating.[427] There might well be a temptation to delay the purchase of an annuity if the individual retires at an early age and the value of the annuity does not look 'good' at this age, but it remains a matter of when, not if, part of the pension pot is used to provide a secure life-long income to meet essential expenditure – if essential really means 'essential' – unless the member is single and in extremely poor health. If the member is partnered, a joint life annuity should be considered.
- Decide on the level of insurance to cover contingencies or alternatively the size of the 'rainy day' fund and in what type of liquid investment this will be held. The member should be aware that any cash withdrawn from the pension pot above the tax-free amount might have tax consequences

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[426] This is similar to the 'goal segmentation' approach of Moshe A. Milevsky (2009) *Are You a Stock or a Bond? Create Your Own Pension Plan for a Secure Financial Future*, Pearson Education, Upper Saddle River, New Jersey.

[427] This proposal has industry support, see for example, Jamie Smith-Thompson, managing director at Portal Financial: 'If a client has a pot of £300,000 and needs £10,000 a year to live on, they can underpin their pot with an annuity or a guaranteed income product. This ensures they are safe and can take more risks with the rest of their pot' (quoted in Nicola Brittain (2015) Income funds - Will they solve the pensions freedom conundrum?, Professional Adviser, 29 January).

- Decide how to fund adequate expenditure needs. There are two possible solutions depending on the degree to which the member wishes to guarantee the level of adequate expenditure. The first solution, for those wishing to have an absolute guarantee, involves annuitising another segment of the pension pot. The annuity could be a capital protected, inflation-linked, fixed, investment-backed, variable or enhanced, depending on the degree of risk tolerance, level of wealth and health status of the member. The second solution, for those who want more flexibility and do not believe that annuities represent good value for money or who are prepared to reduce their expenditure if investment performance is poor, involves a drawdown programme with this segment of the pension pot invested in, for example, an 'income fund' that predominantly generates income, although has some growth potential. A further alternative is guaranteed drawdown[428]
- Decide how to fund a desired standard of living and make planned bequests. Depending on risk attitudes, the investment is likely to be some kind of 'diversified growth fund' with drawdown as and when required. However, to ensure that they are met on a life-long basis, the residual pension pot devoted to these expenditures would need to be annuitised. There are three ways of doing this: use a percentage of the pension pot (e.g., 10%) to buy a deferred annuity coming into force at, say, 75 or 80 if the plan member lives that long, pay for the deferred annuity in monthly instalments (this deals with the behavioural problem of giving up a capital sum), or hold a reserve fund which is used to buy an annuity at age 75 or 80. The advantage of this third method is that there is more flexibility over when the annuity is purchased. The disadvantage is that the member will not know what the income from the annuity will be until it is purchased. Guaranteed drawdown is again an alternative to annuitisation
- Decide on any further annuitisation (e.g., into a voluntary life annuity or an immediate-needs annuity to cover long-term care costs) to reduce the variability around the level and timing of any desired inheritance.

When should the default process begin, given the reality that for many people, retirement does not occur on a single date, but instead is a process that is phased in? The default in contract-based schemes is that the funds stay with the provider. The same is true in trust-based schemes, although trustees have the power to force decumulation when a member reaches a certain age – in other words, they could inform the member that they will arrange the purchase of an annuity for the member unless they hear otherwise. It seems appropriate that the member should trigger the default process. This is why some call this a 'quasi-default' rather a true default which requires no action at all by the member.[429]

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[428] As discussed in Chapter 2.

[429] See, for example, Yvonne Braun (2015) *Identifying the Challenges of a Changing World*, Association of British Insurers, February;

Ideally, the plan also involves annual reviews with the adviser covering: needs (including medical and care needs), state benefits, drawdown strategies for non-pension assets (such as housing equity release), inheritance, and tax. A key task of the adviser is to assess the initial attitude to risk of the member in order to determine the appropriate investment strategy for assets that have not been annuitised and to consider whether this has changed since the last annual review.

It is also important to take actual investment and health experience into account at each annual review. Similarly, it is important to recognise that attitudes themselves can be flexible. Attitudes to annuitisation can also change. Once a retiree has held an annuity for some time, they can appreciate better the value of annuitisation and be less averse to further annuity purchases.[430]

If the member does not have an adviser, it should still be possible for the member to choose from a set of well-designed default pathways using a decision tree.

3.5.2 Other default proposals

3.5.2.1 Age UK proposal

In December 2014, Age UK proposed a default plan with the following components:[431]

- 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:
    - Consumers will need to decide (with or without the help of a financial adviser) whether they prefer the lower secure lifetime income from an

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https://www.abi.org.uk/~/media/Files/Documents/Publications/Public/2015/Pensions/Retirement%202050%20Identifying%20the%20challenges%20of%20a%20changing%20world.pdf

[430] Studies show that people with annuities are happier: they can spend their annuity payments in full each period, knowing they have full longevity risk protection (e.g., Constantijn Panis (2004) Annuities and Retirement Well-Being, in Olivia Mitchell and Stephen Utkus (eds) (2004) *Pension Design and Structure: New Lessons from Behavioral Finance*, Oxford University Press, Oxford).

[431] Dominic Lindley (2014) *Dashboards and Jam-jars: Helping Consumers with Small Defined Contribution Pension Pots make Decisions about Retirement Income*, Age UK, December;
http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/money-matters/dashboards_and_jamjars_helping_modest_savers_December_2014.pdf?dtrk=true

annuity or take the risk that entering an income drawdown plan could see them having to reduce their income or run out of money. For some, they may want to choose a mixture of these two options or enter income drawdown with a view to buying an annuity at a later date

- Take difficult decisions about income drawdown:
    - Consumers should try and avoid high-charging income drawdown products and understand how their pension should be invested and how much they want to withdraw each year to avoid running out of money. They should think about what income they would live on if their DC pension ran out. These decisions will be difficult for them to undertake on their own
- Shop around for an annuity and declare medical details to qualify for a higher rate
- Integrate decisions about small DC pots with decisions about state pensions: It is essential that decisions about how to access small DC pension pots are aligned and integrated with decisions about when to access state pensions and whether to use some or all of their DC pot to buy additional state pension.[432]

3.5.2.2 The Strategic Society Centre (SSC)

In a report published in March 2015, *Default Reform: Preventing Low Incomes with an Automatic Income Plan*, the SSC proposes a default 'automatic income plan' that would deliver 'predictable, secure (guaranteed) and good-value income' in retirement.[433] It believes that this is necessary to protect savers who have little experience of investment. The SSC's own research found that only a quarter of 55- to 65-year-olds keeps track of the stock market, while only one in three say they are aware of inflation levels. Furthermore, only 12% of low-income pensioners have an investment product and 34% do not even have a savings account. James Lloyd, SSC director and author of the report, say: 'The results of the Government's April pensions revolution will ultimately depend on the financial capability and decision-making of millions of UK workers. However, this detailed research on the financial capability of DC pension savers approaching retirement shows worrying levels of financial disengagement, raising questions as to how effective people will be in seeking

[432] The Age UK report also discussed the following proposals:

- Pensions Dashboard: Consumers should be provided with a Pensions Dashboard which should be able to gather data electronically from all their schemes. The Dashboard should display details of all of the consumer's DB and DC schemes in one place alongside their state pension entitlement.
- Pensions Jam-Jars: Pension providers should develop new tools to help people budget, control their spending and set aside money for future goals. These could also help them manage the inevitable trade-offs and conflicts which exist when taking a retirement income. These tools could help consumers decide how much money to take out of their pension each year. Once consumers have made a plan, specific alerts can be used if consumers are departing from it or at risk of running out of money or triggering a higher rate tax charge.

[433] James Lloyd (2015) *Default Reform: Preventing Low Incomes with an Automatic Income Plan*, Strategic Society Centre, March; http://strategicsociety.org.uk/wp-content/uploads/2015/03/Default-Reform-Preventing-low-incomes-with-an-automatic-income-plan.pdf

good-value, appropriate products throughout retirement, that protect them from changes in inflation and investment risk….Our research suggests the Government's pension freedoms could repeat the experience of countries like Australia, where 'freedom and choice' for retirees has ultimately resulted in lower incomes and growing calls for reform'. The report warns that there is a 'significant risk that the April 2015 changes to DC pension taxation will result in an increase in pensioner poverty' with many pensioners running out of money before they die.

3.5.2.3 Adrian Boulding's three step proposal[434]

In January 2015, Adrian Boulding, chairman of the Pension Quality Mark, proposed a default that uses McKinsey's 3 x 3 rule:

- Give people a set of three choices
- Then another set of three choices (based on the first choice)
- Followed by no more than a set of three choices.

In a retirement income context, savers are given the following three choices about their pension pot:

- Take it all at once
- Leave it all invested and draw a regular income
- Give it to an insurance company and get an income for life.

If the saver chooses the second option, the next set of choices relate to the type of investment fund they want to use:

- Low risk, drawing 4% a year
- Medium risk, drawing 5% a year
- High risk, drawing 6% a year.

The third set of choices relate to protecting against the pension pot running out before the member dies:

- Make a single payment of £5000 to an insurance company, which will guarantee payments of £200 per month starting at the age of 85
- Regular payments of £25 a month to an insurance company, which will again guarantee payments of £200 per month starting at the age of 85
- Do nothing and rely on other sources of income

Mr Boulding also proposes minimum standards for flexible drawdown products:

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[434] Laura MacPhee (2015) Three steps to navigating pensions freedoms, Pensions Insight, 27 January; http://www.pensions-insight.co.uk/Story.aspx?storyCode=1474426&source=Adestra

- A simple fund range
- Low charges
- A suggested withdrawal rate
- A slick operation for changing monthly payments or taking one-off lump sums
- Ongoing reviews
- Strong governance.

3.5.2.4 Retirement Security Project proposal: Automatic Trial Income[435]

A study from the Retirement Security Project in Washington DC in 2008 proposes that 'When they retire, individuals would have a proportion of their DC pot allocated to a two-year trial annuity unless they opted out. After two years, the annuity would convert to a permanent one, unless members dropped out. Employers would choose both the annuity provider and negotitate a group annuity rate. They would also choose the type of annuity, such as level or index linked'.

3.5.2.5 Michael Johnson's auto-protection proposal

Michael Johnson from the Centre for Policy Studies published *Auto-protection at 55* in February 2015. The proposal – which could also be called auto-annuitisation – is for a default option for people approaching private retirement age whereby their pension pot would be automatically enrolled in a not-for-profit national auction house for index-linked annuities, the same model that is used in Chile. This would stop them running down their savings too quickly.

Mr Johnson argues that: 'There are legitimate concerns that some people may fail to purchase suitable retirement income products. People approaching retirement need to be encouraged to purchase retirement income products that limit downside risks, notably longevity, investment and inflation risks that almost all of us are incapable of managing by ourselves. People would either opt-out or find themselves with a deferred lifetime annuity, which would be a joint-life policy if they are married. That is exactly what goes on in several other countries, places like Singapore and Switzerland. All aspiring annuity providers, which could include the state, would be required to participate [in the auction]. Initially only a limited number of standardised single and joint-life, inflation-protected lifetime and deferred annuity contracts would be listed. Pre-auction aggregation of small pots by the house would encourage stronger bids'.[436]

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[435] William G. Gale, J. Mark Iwry, David C. John and Lina Walker (2008) *Increasing Annuitization in 401(k) Plans with Automatic Trial Income*, Discussion Paper № 2008-2, The Retirement Security Project, Washington DC.

[436] Quoted in Sam Brodbeck (2015) Govt urged to default savers into deferred annuities, Money Marketing, 20 February.

There was little industry support for this proposal. A *Pensions Buzz* poll in Professional Pensions showed that only 25% of respondents supported the idea of defaulting people into an index-linked annuity.[437]

Supporters of the proposal made the following comments:

- Although they will need to understand what this means for them (and their spouse) assuming it's a single life annuity?
- As long as the default includes a market listing of the available annuities and the default is the best value after they have completed a health assessment
- But we have seen how politics can override good sense
- Freedom of choice is important, but a sensible default option that works for most is even more important
- I would also remove the option to take any tax-free cash and the op-out option! Maybe this would encourage them to remain in contact with administrators
- It is surprising this was not introduced in 1997, when limited price indexation (LPI) became compulsory for DB Schemes
- Something is better than nothing even if it is a very small growth
- There is a need for a great deal of education here
- Yes there should be a default option. For most ordinary working people, the new 'freedoms' will present a horrifying dilemma about financial matters that they just do not understand.

Opponents of the proposal made the following comments:

- A thousand times no! Inflation-linked annuities would be appalling value for money, and would lead to more pensioner poverty than just leaving them to use their own common-sense (and their computer)
- And they should be required to make a calculated decision on something as important as this. This default option is unlikely to be the best one
- Annuity rates – especially if inflation linked are very poor value
- As that is definitely not what most people want or need, it is a daft idea
- Definitely not. These are apt to be particularly poor value for money
- Depends on individual circumstances. A default approach would encourage lack of involvement in a vital decision
- Few members are likely to purchase an annuity on reaching retirement age
- Firstly, index linked annuities are of questionable value. Secondly, there is no need for a default at retirement. People will have to make a choice, otherwise they get

[437] Michael Klimes (2015) Industry figures reject inflation-linked annuity default, Professional Pensions, 26 February.

nothing, and I would favour forcing a choice rather than drifting into an unsuitable option. Why have 'freedom and choice' if you are going to do otherwise?

- In a world where the mantra has long been 'freedom of individual choice' this is possible the most ridiculous and repellent suggestion yet
- Individuals need time to decide what benefits are right for them – defaulting them into an arrangement which may not be appropriate for them, and difficult/impossible to get out of
- Inflation linked annuities are poor value. You have to live for about 15 years to break even. What about ill-health, lifestyle, joint? Who chooses the provider? There should be no defaults. We need to encourage engagement. If people are ready, or don't want to receive a retirement income, it shouldn't be forced on them. Would trustees take on the liability for making financial decisions for members, which turn out to be wrong? They had better increase their liability insurance PDQ. MADNESS
- It is bad enough that the majority get lumped into a default fund that someone has decided is best for them!
- Make them do something if they want to take money
- Members have to make a choice at this point, even if their understanding is not great
- Surely the Budget 2014 changes have overtaken this approach?
- The annuity should be flat rate
- The bewildering landscape of pensions along with jargon and policies of big pension providers will be such that savers are bamboozled into following a route they did not wish to. Only by the time they realise it will be too late to reverse
- The choice should be between capped drawdown and an annuity, with the pot remaining invested if the member fails to make a choice
- There should be no default option; whilst it is just about supportable from an investment angle, the retirement choice has to be individual. The decision is too important – at some point the individual has to take ownership for their future
- They must show the options and let the member choose
- They need to be forced to decide or the pension system will get the blame when they feel they have lost out in some way, don't decide then nothing comes your way in retirement, that should get the message through
- This is a backwards step and unlikely to be the best option for members. Inflation-linking is a gambol [sic] and the provider is the bookmaker
- This seems reasonable enough, but great care must be taken to ensure that the default is always one of the best value annuities available on the market, otherwise there'll be tears
- This would be far too prescriptive
- Why? It is better if they make an active choice with the right advice.

In the light of these criticisms, on 6 March 2015, Mr Johnson changed his default from an annuity to drawdown, whereby 5% of the pension pot is drawn down each year from the age of 55, unless the member instructs otherwise. His justification for the change was that he had given insufficient weight to the value of flexibility. The revised proposal could have automatic annuitisation later in retirement.[438]

Supporters of layering plans, such as the SPEEDOMETER retirement expenditure plan, would argue that both of Mr Johnson's proposals were in fact sensible, but for different segments of retirement expenditure. The proposal to default into an index-linked annuity is sensible for essential expenditure. As previously mentioned, if 'essential' means what it says, then there is no real flexibility in how to meet it. Further, if essential expenditure is inflation linked, as it will be and is required for as long as the member lives, then there is no real alternative to buying an an index-linked annuity, however 'expensive' this may be, or a guaranteed drawdown product offering inflation uprating. Just because something is 'expensive', does not mean that it is bad value. Flexibility, on the other hand, is valuable when it comes to meeting adequate and desirable expenditure and contingent expenditure such as a repair bill. However, there would probably be disagreement with one aspect of the proposal and that is about the starting time. It would not make sense to begin the decumulation process at age 55 regardless of the wishes of the member. It should start when the member wants it to start.

3.5.2.6 Automatic deferred annuitisation

With this proposal, starting at some age, typically in the 40s, an increasing share of pension contributions would go to purchasing units of a deferred annuity that would be received when the person retired and started receiving benefits.[439]

The idea comes from the US and the first company in the US to introduce it – with the name Lifetime Income Strategy – was United Technologies (UT), an aerospace and building technology company with around 200,000 employees.[440] UT automatically enrolls employees into the strategy, which was designed by AllianceBernstein, unless they choose to remain in their existing equity, bond or target-date mutual fund until they retire at an assumed age of 65. At age 48, the employee's savings are gradually moved into variable annuities with a guaranteed minimum level of lifetime income for life from age 65. The

[438] Jack Jones (2015) Johnson backtracks on default annuity proposal, Professional Pensions, 6 March.

[439] The proposal was introduced in J. Mark Iwry and John A. Turner (2009) New Behavioral Strategies for Expanding Lifetime Income in 401(k)s, in William G. Gale, J. Mark Iwry, David John, and Lina Walker (eds) *Automatic: Changing the Way America Saves*, Brookings Institution Press, Washington, DC.

[440] Reported in Tara Siegel Bernard (2012) A 401(k) That Promises Never to Run Dry, New York Times, 13 November;
http://www.nytimes.com/2012/11/14/your-money/a-401-k-that-promises-income-for-life.html?pagewanted=all&_r=0

variable annuities continue to invest in equities and bonds – although in decreasing amounts – but also guarantee that employees can withdraw a minimum sum each year, even if the market crashes. By the time the employees reach 60, all the investments have been switched into a secure income fund.

The annual income is a fixed percentage of the market value of the secure income fund. For example, if the fund was valued at $200,000 and the payout rate was set at 5% – which is based on the average rate at which the deferred annuities are acquired by UT over time – a 65-year old retiree could withdraw $10,000 annually for the remainder of their life, irrespective of market conditions, including the case where the account becomes depleted. The level of guaranteed income is recalculated annually on the employee's birthday or when new contributions are made. Three insurers – Prudential (US), Lincoln Financial and Nationwide (US) – bid every quarter for UT's annuity business and the annuities are insured up to a cap by state guaranty associations. Employees can choose a joint benefit to cover a partner, in exchange for a lower payout rate. Further, any residual fund on death can be bequested.

The fees are lower than for standard variable annuities whose fees have been described as 'notorious'. Workers below age 48 pay 0.13% p.a. charges on the underlying index funds. The insurance cover provided in the secure income fund costs 1% p.a. So total costs, including investment and insurance fees, are 0.21% of the fund value at age 48, rising to 1.24% at age 60 and above. Fees of this size take a substantial amount out of the value of the pension pot when compounded over a 30 year retirement, but it would be worse if the retiree took out a large lump sum part of the way through retirement since they would be paying for a longevity protection guarantee that they never used.

Although UT was the first US company to use automatic deferred annuitisation, it is not the first to combine target-date funds and annuities. Prudential (US) has offered this combination under its IncomeFlex plan since 2008. In this case, the fixed minimum payout is 5% p.a. irrespective of market conditions. This guarantee costs 1% on top of fund management fees. More than 73,000 employees in more than 7,000 pension schemes participate in the plan, with some now being auto-enrolled. According to a survey of more than 500 large US employers conducted by Aon Hewitt in 2012, 16% offer products within their 401(k) plans, such as annuities, that allow retirees to receive a lifelong income stream. The survey revealed that more employers would offer such insurance-related options if US regulators made it easier for them to do so. Employers are concerned about breaching their fiduciary duties to employees, given the much higher probability of insurance company insolvency in the US than in the UK.

The success of automatic deferred annuitisation in the US is very encouraging and suggests that, if it can work in the US, it can also work in the UK.

3.5.2.7 The Murray Report's proposal for a comprehensive income product for retirement

In November 2014, the Australian Government published the Final Report of the Financial System Inquiry,[441] known as the Murray Report after its Chair, David Murray. The Report proposes a default pathway for both the accumulation and decumulation stages – see Figure 3.1.

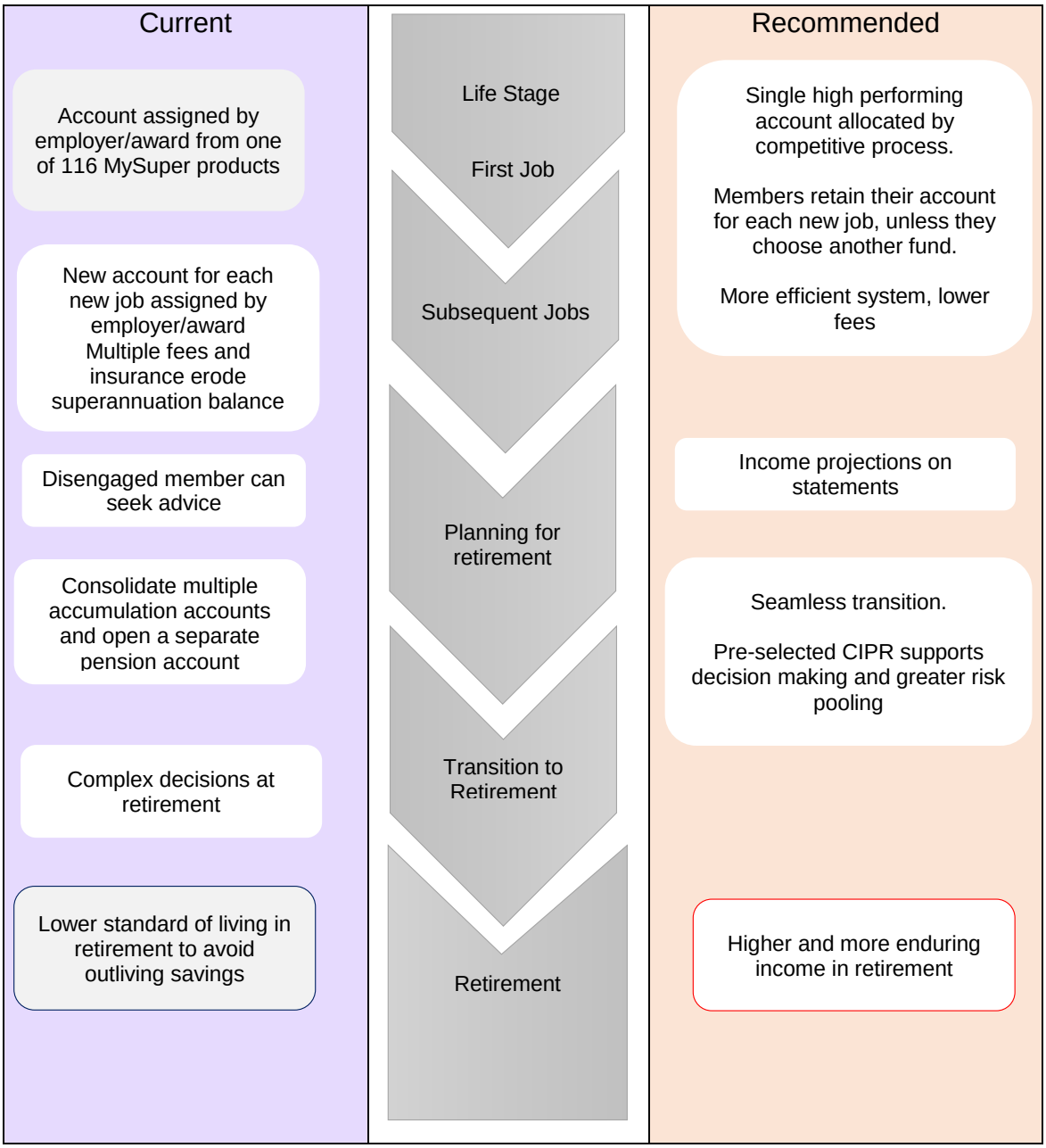
The Report argues (p.91) that:

> *Greater use of risk pooling could significantly increase retirement incomes generated from accumulated balances. This could allow individuals to allocate consumption throughout their lives better (greater dynamic efficiency) by reducing the savings required to achieve a target level of income in retirement. This could be achieved by:*
>
> *Removing barriers to new product development.*
>
> *Using behavioural biases to encourage rather than discourage the use of products that provide longevity risk protection.*
>
> *This recommendation would involve trustees pre-selecting a comprehensive income product for retirement (CIPR) option for their members. Pre-selected options have been demonstrated to influence behaviour but do not limit personal choice and freedom. They would bring the policy philosophy at retirement closer to that of the accumulation phase.*
>
> *Managing longevity risk through effective pooling in a CIPR could significantly increase private incomes for many Australians in retirement and provide retirees with the peace of mind that their income will endure throughout retirement, while still allowing them to retain some flexibility to meet unexpected expenses. An enduring income stream would give retirees the confidence to spend in retirement, which would help to sustain economic growth as the population ages and reduce the extent to which longevity risk falls on the taxpayer.*

The Murray Report proposal is an attempt to reverse the experience in Australia of 50% of Australians taking a lump sum at retirement and 25% of these running out of funds before they reach 70.

[441] http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf

Figure 3.1: A default pathway for Australian pension scheme members[442]



[442] Source: Figure 6: The superannuation system for default fund members

In October 2015, the Australian Government accepted most of the Murray Report's recommendations, in particular:[443]

> *Inquiry Recommendation 11 — The retirement phase of superannuation*
>
> *Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.*
>
> *The Government agrees to support the development of comprehensive income products for retirement and will facilitate trustees pre-selecting these products for members.*
>
> *Trustees' pre-selection of such products will help guide members at retirement. Comprehensive income products for retirement could improve outcomes for retirees, including through increased private retirement incomes, increased choice and better protection against longevity and other risks.*
>
> *The range of products available at retirement is currently narrow and does not always meet individuals' needs and preferences.*
>
> *We will continue work to remove impediments to retirement income product development.*
>
> *Further consultation is required to develop a principles-based framework for pre-selection of a comprehensive retirement income product by superannuation trustees. This framework will be developed with regard to the outcomes of the Tax White Paper process and the Retirement Income Streams Review.*

David Murray said he was pleased the Government had agreed to remove impediments to the development of annuity and annuity-like products, as well as mandate that all pension schemes 'soft default' members into a CIPR when they stop working instead of offering them a lump sum. The proposals were also supported by Challenger, Australia's largest provider of annuities. Its chief executive Brian Benari said: 'CIPRs will help people manage complex decisions at retirement by allowing retirees to opt-in to a retirement solution, which suits their circumstances including a stable income stream, flexibility and longevity risk protection'. David Knox, senior actuary at Mercer, said mandating CIPRs was 'one of the most important steps' the Government could take to improve the system. However, David Whiteley, Industry Super Australia chief executive, said it would be 'absolutely critical' that

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[443] Australian Government (2015) *Improving Australia's Financial System: Government Response to the Financial System Inquiry*; http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx

there be strong oversight to ensure default-account-based pensions are designed to be in the best interest of retirees rather than market providers.[444]

3.5.3 Support for a default

Academic behavioural economists have supported defaults for a long time.[445] Think tanks and wide segments of industry also support the use of defaults.

3.5.3.1 Pensions Policy Institute[446]

The PPI argues that industry needs to put in place well-governed retirement income defaults that provide members with value for money and flexible access to their assets, without overwhelming them with complex choices. The interviews it conducted with DC savers found that many were 'daunted' by the array of choices on offer and want providers to offer them a default investment or drawdown choice, alongside appropriate guidance and advice. Indeed, many thought that providers had a 'duty' to offer a default, although they also recognised the need for some element of choice for those who want it.

The PPI's proposed default had the following key features:

- Simplicity – defaults should aim to broadly meet a range of needs for most of the people most of the time
- Value – defaults need to provide good quality and value for money. Value for money is a likely consequence of solutions being designed to deliver good outcomes for the majority, as opposed to being highly bespoke and more expensive to deliver. Solutions that work for the majority will also benefit from economies of scale
- Freedom to opt out – default arrangements should not lock individuals in, but flexibility may be more of a priority in the earlier years of retirement than it is in the later years
- Clear choice architecture – the default is one option located within a set of straightforward alternatives that won't overwhelm savers.

It also identified six principles to inform the design of default retirement solutions:

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[444] Reported in Sally Rose (2015) Annuities and private pensions to replace lump sums as default for retirees, Sydney Morning Herald, 20 October.

[445] See, for example, John Beshears, James Choi, David Laibson, and Brigitte Madrian (2008) The importance of default options for retirement saving outcomes: Evidence from the United States, in Stephen J. Kay and Tapen Sinha (eds.) *Lessons from Pension Reform in the Americas*, Oxford University Press, Oxford.

[446] Pensions Policy Institute (2015) *Transition to Retirement - Supporting DC Members with Defaults and Choices up to, into, and through Retirement: Qualitative Research with those Approaching Retirement*, January; http://www.pensionspolicyinstitute.org.uk/publications/reports/transition-to-retirement-defaults

1. Living longer than expected and running out of money is the key risk in retirement and a critical input into retirement income solutions
2. Savers should expect to spend most or all of their pension pots during their retirement
3. Income should be stable and sustainable
4. Managing investment risk is crucial as volatility can be especially harmful in income drawdown-type arrangements
5. Providers should look to offer flexibility and portability wherever possible
6. Inflation risk should be managed but not necessarily hedged.

3.5.3.2 The International Longevity Centre – UK

The ILC-UK supports a default strategy with annuities playing a key role:[447]

> *In the face of complexity, many individuals are likely to do nothing which means that their retirement incomes will be dependent on whatever happens to the fund. We would argue that for a significant number of people, and especially for those who have high DC wealth concentrations, buying an annuity is still the right option and should form the backbone of any default strategy. However, annuitising is likely to remain an irreversible decision, so individuals need to be given appropriate warning that they will have part of their fund annuitised (perhaps 75% of the fund so as to retain some flexibility) if they do nothing. For this reason, consumers must be given a year's warning, and the default must not kick in before they reach their respective State Pension Age. Up until this age, the pension fund should be invested in a balanced portfolio of safe and risky assets to allow for continual growth in the fund.*

However, it recommends that annuities must be rebranded as 'safe guaranteed income for life' products.

3.5.3.3 The Strategic Society Centre (SSC)

The March 2015 report of the SSC discussed above was followed up by an empirical study published in July 2015 which showed that the level of wellbeing experienced in retirement was related to the level of guaranteed income they enjoyed in retirement.[448] The SSC analysed data from the English Longitudinal Study of Ageing on over 2,000 retirees in England in receipt of a private pension. The analysis found statistically significant positive

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[447] The International Longevity Centre – UK (2015) *Here Today, Gone Tomorrow. How Today's Retirement Choices Could Affect Financial Resilience Over The Long Term*, 16 March; http://www.ilcuk.org.uk/images/uploads/publication-pdfs/Here_today,_gone_tomorrow_1.pdf

[448] Will Parry and James Lloyd (2015) Income Security and a Good Retirement, Strategic Society Centre, 14 July; http://strategicsociety.org.uk/income-security-and-a-good-retirement/#.Vaasr60w-70

relationships between an individual's level of private pension income and a range of retirement outcomes such as:

- Spending habits (such as being able to go to the cinema or own a mobile phone)
- Sense of autonomy and control
- Life satisfaction
- Participation in community and civic society.

However, the analysis also found that the level of financial wealth was not associated with any of these outcomes.

At the same time, the SSC published a policy paper which considered the implications of the research for UK private pension policy and for the Government's position of neutrality regarding how individuals use their DC pension savings.[449] The paper argues that by adopting a position of neutrality, the Government may oversee reductions in the wellbeing of the older population as a result of the April 2015 changes to rules on DC pension savings.

The main policy recommendation is that the Government should ensure that a decent guaranteed income is the default option for DC pension savers. Other recommendations include:

- Actively promote the receipt of a guaranteed income in pension policy to improve the well-being of retirees
- Educate savers before retirement about the role of guaranteed income for a good retirement
- Include information about the importance of guaranteed income to wellbeing in retirement in Pension Wise guidance and information
- Undertake regular research into the effect of the April 2015 changes on older people's wellbeing.

Stephen Lowe, group communications director at Just Retirement, said: 'This report provides unprecedented insights into how people derive wellbeing from guaranteed income throughout their retirement. With so much attention being focused on the option to access pension savings as cash, the findings demonstrate the real benefits of treating pension savings as just that – a source of guaranteed pension income for life'.[450]

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[449] James Lloyd (2015) *Income, Security and Wellbeing: Helping savers choose a good retirement*, Strategic Society Centre, 14 July; http://strategicsociety.org.uk/wp-content/uploads/2015/07/Income-Security-and-Wellbeing.pdf

[450] Quoted in Helen Morrissey (2015) Think tank calls for guaranteed income DC retirement default, Professional Pensions, 14 July.

3.5.3.4 National Association of Pension Funds (NAPF)

A report published by the NAPF in January 2015 as part of its Understanding Retirement Research Programme concluded: 'To give savers the best possible chance of managing their money, we will need to give them three things:

- Clear pathways that are easy-to-understand and provide access to good-value solutions
- Visible and easy-to-obtain guidance that makes savers aware of their options, and
- High-quality products designed to meet the needs of savers.

The NAPF's own research showed that '82% of the retired and 78% of the working people in this group said they would rather have a secure income for retirement than a pot to dip into', implying that 'lifetime annuities remain the most obvious mechanism for achieving this'.[451] Graham Vidler, director of external affairs at the NAPF, concludes that 'what's really needed is a default retirement pathway'.[452]

We participated in a NAPF seminar on 27 January 2015 which discussed the above report. We list the key comments made at the seminar:

- Government talk is about 'freedom and choice', but the pensions industry (schemes, employers, providers) believes that there is a pressing need for default solutions that combine drawdown with longevity insurance
- The mass market is the group with the most urgent need for default solutions
- There is a real danger that if people are not nudged/defaulted, they will withdraw all of their pot because they believe that they can 'do better' themselves and also because they do not trust pension providers. The biggest danger is that they will fall victim to scams
- The idea is to establish a simple set of default pathways. Possibly three options. But many will choose the middle option, which in effect becomes the default-default
- There needs to be realism about the extent of member engagement. The reality is that most are defaulters – they will not engage. Fiduciaries (trustees and investment governance committees (IGCs)[453]) will have to choose the default. This will be low-risk because they will be worried about liability

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[451] National Association of Pension Funds (2015) *The Unpredictability of Retirement, Understanding Retirement: An NAPF Research Programme*, January (http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~/media/Policy/Documents/0425_understanding_retirement_first_report.pdf);
Jackie Wells (2015) Uncertainty ahead for DC members, Engaged Investor, 9 February 2015 (http://www.engagedinvestor.co.uk/uncertainty-ahead-for-dc-members/1474457.article)

[452] Graham Vidler (2015) Helping hand: Why ordinary savers will need more than Pension Wise, Professional Adviser, 1 April.

[453] Discussed later in the Chapter.

- We need to decide what 'good' looks like. It has to be good for the majority, it cannot be good for everyone. It needs to be well understood (in term of risks, guarantees, etc), demonstrate value for money and have clear guidelines on the maximum percentage of the fund that can be withdrawn. So the default-default might be capped drawdown plus longevity insurance
- The NAPF research shows that consumers in mass market want a secure lifetime income, but this is made more difficult by the 'freedom and choice' regime, the lack of affordable regulated advice, and the lack of suitable products
- Consumers do not understand the implications of marginal tax rates or longevity risk (the dispersion around the average). So the Government message 'it's your money' requires a complicated caveat '… but subject to marginal tax rates and to how long you will live' etc. Guidance is not enough – people need clear and simple to understand solutions; most will not engage
- There is no need for policy intervention to allow defaults, as schemes can do this now (according to a pensions lawyer present)
- Many employers/schemes will not want responsibility for default products – they need a third-party solution, i.e., to make the default a transfer to an outside scheme – most likely a master trust
- Governance is crucial. There is a vital role for DC scheme trustees and IGCs. There also needs to be strong backing from regulators and policy-makers. We need to build on the NAPF's quality mark. However, there are serious challenges:
    - Putting the right governance in place will be challenging – the governance issues are far more complicated than with accumulation
    - Who is responsible for governance? Employers unlikely to want this liability; trustees/IGCs will be worried about liability too
    - The NAPF's quality mark involves a charge cap, yet there is widespread provider/adviser opposition to a charge cap in decumulation
- It was noted that there is very little sign of product innovation. This was put down to first-mover disadvantage in a completely new landscape
- There was general view that longevity insurance needs to be sorted out at the point of retirement/drawdown, with around 10% of the pot being used for a deferred annuity
- There needs to be a minimum degree of engagement with members, since schemes do not know members' bank account details because contributions come via the employer's payroll system
- Camilla Barry, partner at Macfarlanes, argued that a default option would help to remove the risk that trustees and employers face in terms of making decisions and giving advice: 'It may be useful to think about having a default as well as pathways. People that don't make choices would be tipped into the default option which may be capped drawdown with the purchase of deferred annuity – a model product that will work for most people'. Patrick Heath Lay, chief executive officer at B&CE, said

'while trustees would need to ask people which route they would want to do down, they would also have to pick a centralised route with an element of risk removed'.[454]

3.5.3.5 National Employment Savings Trust (NEST) Consultation

Further support for a default option was contained in response to a NEST consultation released in March 2015.[455] Paul Todd, assistant director of investments at NEST, said: 'There is a remarkable consensus for big groups of people who have been automatically enrolled for some straightforward choice architecture and not too much confusing choice and definitely, in large groups, the need for default pathways… I think the two main things which have come out are the need for flexibility in the early years of retirement and the point that people at some point in their accumulation phase need to get some insurance for living longer than expected. I think the emerging consensus was that at some point you need to protect people from longevity risk'.

3.5.3.6 Steve Webb

While Steve Webb, the former Pensions Minister, dismissed the idea of creating an at-retirement default withdrawal system, he has conceded that this might be appropriate at a later time in retirement: 'It is good to give people financial flexibility in their early 60s, but the question is whether we want people to have to make active financial decisions throughout what could be a 30-year retirement'.[456]

3.5.4 Opposition to a default

A *Pensions Buzz* poll in Professional Pensions in March 2015 showed that a significant minority opposed a default retirement option.[457] In response to the question 'Should there be a default for DC members when they reach retirement age?', 49% answered 'yes', while 46% said 'no', with the rest undecided. The main reason given for supporting the default was the recognition that many people, while needing an income product, did not want to or were not able to manage their investments, particularly as they got older: 'As an industry, we must be able to design an "annuity plus" product', but 'the default should exist as a safety net, as a last resort'. Typical reasons for opposing the default were: 'Default option absolves individuals of responsibility. Who takes ownership and deals with problems caused

[454] Reported in Stephanie Baxter (2015) Default option for decumulation 'is crucial but challenging', Professional Pensions, 27 January.

[455] Reported in Michael Klimes (2015) Industry supports DC retirement default says NEST, Professional Pensions, 16 March.

[456] Reported in Taha Lokhandwala (2015) Defined ambition not just an 'academic exercise' – Steve Webb, Investments & Pensions Europe, 8 June.

[457] Reported in Michael Klimes (2015) Industry questions value of at-retirement default option, Professional Pensions, 13 March.

by lack of understanding?' and 'A one-size-fits all approach would disadvantage a large minority of retirees'.

The poll also showed strong opposition to a default retirement option that was not initiated by the scheme member. Responses to the question 'If there were such a default, what should it be?' were:

- 64% – stay invested until member makes an active decision
- 13% – index-linked annuity
- 9% – capped drawdown followed by annuitisation at 75
- 9% – flat annuity
- 4% – capped drawdown
- 2% – cash/cash-like fund.

The general view was that peoples' circumstances were too varied and complex to create a comprehensive default suitable for everyone.

3.6. Information, advice and guidance

An important feature of the success of any retirement expenditure plan will be the information, advice and guidance received by the member. While this would appear to be obvious, there are important regulatory distinctions between information, advice and guidance in the UK. It is possible that customers will get confused by the distinctions.

3.6.1 The distinction between information and advice

The FCA's guidance consultation *Retail Investment Advice: Clarifying the Boundaries and Exploring the Barriers to Market Development*[458] in July 2014 defined the difference between 'information' and 'investment advice'. The difference involves an element of opinion or judgement on the part of the adviser, either in person or online. The provision of information, such as facts about the performance of investments, the terms and conditions of investment contracts, or the price of investments, does not constitute giving regulated advice if the investor alone decides whether to act on the basis of this information. Regulated advice, on the other hand, involves recommending a course of action or giving an opinion or making a judgement on the merits of, say, buying or selling an investment. If information is provided in a way that seeks to influence or persuade, then it may be classified as regulated advice. For example, if the provision of information about the price of an investment is given at the same time that the firm is indicating that it is a good time to buy, then this may constitute regulated advice.

[458] Financial Conduct Authority (2014) *Retail Investment Advice: Clarifying the Boundaries and Exploring the Barriers to Market Development*, Guidance Consultation GC14/3, July; http://www.fca.org.uk/static/documents/guidance-consultations/gc14-03.pdf

Two additional criteria need to be taken into account before deciding whether or not information is classified as regulated advice: 'suitability' and 'appropriateness':

- If, based on a consideration of a person's circumstances – which would cover their knowledge and experience in the investment field, their financial situation, including ability to bear losses, and their investment objectives, including risk tolerance – an investment is presented as being 'suitable', then this may still constitute a personal recommendation and, hence, regulated advice, even if the firm has a clear, prominent and understandable disclaimer stating that no advice or recommendation is being given. A suitability report needs to consist of three elements at a minimum: the client's objectives, why the advice is suitable, and what could be the disadvantages. The suitability test also applies to a firm that sells and manages investment products
- Whether a product is considered 'appropriate' for a customer will depend solely on their knowledge and experience in the relevant investment field. Customers might have to demonstrate that they have sufficient knowledge and experience to understand the risks attached to any product they are considering buying.

Table 3.4: Pre-sale suitability and appropriateness assessments under MiFID II

Type of sale	Type of product	Test required	Factors to be considered
Advised	Complex	Suitability	Knowledge and experience in the investment field Financial situation, including ability to bear losses Investment objectives, including risk tolerance
	Non-complex		
Non-advised	Complex	Appropriateness	Knowledge and experience in the investment field
	Non-complex	None	None

Source: Financial Services Consumer Panel (2015)

Although assessing product suitability for a particular client does not constitute advice, it will still be necessary to do this to determine whether a firm is able to recommend the purchase of a 'complex' MiFID (Markets in Financial Instruments Directive) product. Under MiFID II, which is due to come into force in January 2018, it is expected that many pension

products, such as drawdown, will be classified as ‘complex’ which means that they cannot be sold on a non-advised (i.e., execution-only) basis to inexperienced investors. Instead, providers will have to conduct an ‘appropriateness test’ to assess whether the customer is in the position to make an informed decision about the product. But the test will not determine whether the product is suitable for their particular circumstances. Table 3.4 summarises these requirements. The only ‘non-complex’ products once MiFID II comes into effect will be plain vanilla shares, bonds and unit trusts.

According to Matt Connell, head of regulatory developments at Zurich UK Life, advisers could be required to assist providers in their appropriateness testing. Advisers who offer both non-advised and fully advised services could be asked to help providers with some of the information gathering about customers. He said: ‘The idea is if you have a [pension] wrapper that includes guaranteed returns, it is a bit like a derivative. Products that are more expensive, but with less volatility, might be less risky for consumers, but the question is do consumers understand them. It's bringing the whole channel closer together. There will be more requirements on product providers and advisers to talk to each other on a non-advised basis. Consumers will enter conversations with providers over appropriateness not with the adviser, but then may have to go back to the adviser if the provider says 'no'. Advisers should think about how they collect information and send it to providers. They may have to capture information for which they do not yet have the right systems in place’. The practical consequence of this is that, once MiFID II comes into force, most customers might not be able to buy a drawdown or other complex product without first taking advice.

According to the FCA: ‘Pensions liberalisation could give rise to new risks of inappropriate sales of insurance-based investments to consumers, as well as MiFID II investments’.[459] The Tax Incentivised Savings Association (TISA) is concerned about how MiFID II will operate in practice, particularly in terms of appropriateness, suitability and product governance. It said it would establish guidelines on how advisers and providers should address these issues. In particular it will look at:

- The definition of complex versus non-complex products
- What does best practice look like for product governance?
- What does it mean by target market? What will it look like?
- Information flows between manufacturer (i.e., provider) and distributor?
- How can technology be used and what will the impact be?
- What is the impact on execution-only closed-end funds?
- What will appropriateness look like in practice?
- What are the implications for clients?

[459] Reported in Carmen Reichman (2015) Advisers could be caught in MiFID II 'appropriateness' testing, Professional Adviser, 13 May.

Jeffrey Mushens, technical director at TISA, said: 'The directive makes it very clear that firms, which manufacture or distribute a product, will also be expected to have appropriate organisational arrangements that specifically address the issue of product governance. Whilst there has always been a requirement to understand the products under advice, this is now required to be more organised and formal, thus, the directive increases expectations on existing systems and controls'.[460]

The FCA has a long-standing concern about the failure of the industry to meet suitability requirements. In 2011, it issued a 'Dear CEO' letter to wealth management firms, following a previous suitability review. Its 2015-16 business plan released in March 2015 announced a thematic review of 'improvements in suitability standards across wealth management', focusing on managed portfolios and their suitability in respect of clients' risk profiles, attitudes to risk, and capacity for loss.

The FCA is particularly concerned that the proliferation of new complex retirement products could confuse older consumers who have little experience in taking decisions about their income and who typically underestimate their longevity: 'Firms may develop decumulation products or services that could highlight certain product features or the price at the expense of other important information, or be difficult to compare due to hidden costs and fees and include barriers to exiting, There is also a risk that these could result in increasingly complex products or a mix of products that require ongoing servicing and potentially higher costs, which some financial advisers may recommend in a bid to generate higher fees'. According to Neil Walkling, from regulatory consultancy Bovill: 'The FCA is still finding some firms have not done much to improve suitability standards and the way they gather information from clients. There is the sense [the FCA has] run out of patience'.[461]

In December 2015, the FCA published the findings from its thematic review of the suitability of retail investment portfolios provided by wealth management and private banking firms.[462] Although a number of firms had taken steps to demonstrate that their clients' portfolios are suitable, the FCA found that, in 60% of the sample portfolios they investigated, the composition of the portfolios they managed did not truly reflect the investment needs and risk appetite of their customers, especially those who have a limited capacity for, or desire to expose themselves to the risk of, capital loss. Many firms also still have to make substantial improvements in gathering, recording and regularly updating customer information to support the investment portfolios they manage for customers. The

[460] Reported in Carmen Reichman (2015) TISA to hammer out clear MiFID II guidelines, Professional Adviser, 30 June.

[461] Reported in Dan Jones (2015) Wealth managers risk enforcement actions as FCA 'runs out of patience', Investment Week, 30 March.

[462] Financial Conduct Authority (2015) *Wealth Management Firms and Private Banks: Suitability of Investment Portfolios*, Thematic Review, TR15/12, December; https://www.fca.org.uk/your-fca/documents/thematic-reviews/tr15-12

FCA also warned firms that they need to ensure that their governance, monitoring and assessment arrangements are sufficient to meet their regulatory responsibilities in relation to suitability.

The FCA investigated 150 files from 15 firms. It found that:

- 23% indicated a high risk of unsuitability
- 37% were unclear
- 41% showed a low risk of unsuitability.

Megan Butler, FCA director of supervision, investment, wholesale and specialists, said: 'Getting suitability right is fundamental to providing a portfolio management service that meets customers' needs'.[463]

The FCA has five key tests for investment advice:

1. Does the service being offered constitute a recommendation?
2. Is the recommendation in relation to one or more transactions in financial instruments?
3. Is the recommendation at least one of the following:
    a. presented as suitable
    b. based on the consideration of the person's circumstances
4. Is the recommendation issued otherwise than exclusively through distribution channels or to the public?
5. Is the recommendation made to a person in his capacity as one of the following:
    a. an investor or potential investor
    b. an agent for an investor or potential investor.

If the answers to all these questions is 'yes', then it is investment advice.

In January 2015, the FCA released a complete list of its definitions of advice.[464] These are listed in Table 3.5.[465] Between the clear and unambiguous extremes of execution-only and personal recommendation/regulated advice come generic advice or information, focused advice (which is requested by the customer) and simplified advice (a service specified by the

[463] Reported in Laura Miller (2015) FCA finds 60% of wealth managers' portfolios close to unsuitable, Professional Adviser, 9 December.

[464] Financial Conduct Authority (2015) *Retail Investment Advice: Clarifying the Boundaries and Exploring the Barriers to Market Development*, Finalised Guidance FG15/1, January; http://www.fca.org.uk/static/documents/finalised-guidance/fg15-01.pdf

[465] The Table reflects differences in the definitions of regulated advice at the EU level under the Markets in Financial Instruments Directive and the Regulated Activities Order (RAO), The FCA applies both in the UK, but the former requires regulated advice to be a personal recommendation (otherwise, it is generic advice), while the latter does not.

firm, but falling short of regulated advice although might involve a personal recommendation).

Table 3.5: Financial Conduct Authority's definitions of advice		
1	Execution-only	A service consisting of the execution and/or reception and transmission of client orders relating to particular financial instruments at the client's initiative. The firm does not give any advice on investments or assess appropriateness.
2	Generic advice	Advice or information that does not relate to a particular investment or does not otherwise meet one of the characteristics of regulated advice.
3	Focused advice or limited advice	Advice focused on the provision of personal recommendations relating to a specific need, designated investment, or certain assets. As requested by the customer.
4	Simplified advice	Advice focused on the provision of personal recommendations relating to a specific need, designated investment, or certain assets. The firm sets out the boundaries of the service it provides and uses streamlined and/or automated advice processes to provide customers with a personal recommendation, based upon their personal and financial circumstances.
5	Personal recommendation	A recommendation relating to taking certain steps in respect of a particular investment, made to a person in their capacity as an investor or potential investor (or their agent), which is presented as suitable based on a consideration of the person's circumstances.
6	Regulated advice	Advice relating to a particular investment given to a person in their capacity as an investor or potential investor (or their agent) and relates to the merits of them buying, selling, subscribing for, or underwriting (or exercising rights to acquire, dispose of, or underwrite) the investment.
Source: Derived from FCA Finalised Guidance 15/1 (2015, pp. 2-3)		

3.6.2 Generic advice

In 2007, the Treasury conducted an experiment on the effectiveness of generic financial advice as part of Otto Thoresen's review of generic financial advice.[466] Around 5,000 people took part in a 12-week trial involving a free, impartial generic financial advice service

[466] H M Treasury (2008) *Thoresen Review of Generic Financial Advice: Final Report*, March.

providing information and guidance on money matters. The service was offered by A4e (as Money Fitness) and Consumer Direct (in partnership with Citizens Advice). The preliminary findings revealed that many people lack the confidence to buy savings and investment products without advice, and do not have a clear idea of which products would suit them. However, generic financial advice can act as a prompt for people to take action. Within a week of using the service, 80% of the people who took part in the experiment had taken at least one follow-up action, with 20% contacting a new supplier of financial products.

The results of the exercise indicate that generic financial advice is potentially beneficial to all demegraphics, not just low-income groups.[467]

3.6.3 Guidance

'Guidance' is not specifically listed in Table 3.5. The Government is offering a free 'guidance guarantee', called Pension Wise, to all those about to draw on their pension pot.[468] The guidance offered by Pension Wise will involve taking stock of people's assets and liabilities and explaining the options available to them. This is achieved through a six-step process which 'help you understand how to turn your pension pot into income for your retirement':

1. Check the value of your pension pot
2. Understand what you can do with your pension pot
3. Plan how long your money needs to last
4. Work out how much money you'll have in retirement
5. Watch out for tax
6. Shop around for the best deal.[469]

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[467] Reported in Professional Adviser (2007) Generic Financial Advice would work – survey, 24 December.

[468] https://www.pensionwise.gov.uk. Pension Wise was set up by HM Treasury, but in September 2015, the Government announced that the Department for Work and Pensions (DWP) would take over responsibility for Pension Wise.

[469] Initial comments about the Pension Wise website expressed disappointment. For example, Katie Morley argued that 'It is deluded to think that people with such basic literacy abilities could be expected to read Pension Wise, process the information, and relate it to their own personal pension circumstances. Knowing how complex the rules are, how opaque providers are about their products, and that the average person now has 11 different pension pots, most people's arrangements are likely to be anything but simple to sort out. To make it easier for people to relate to, the website needs to present information in a much more personal way. What use is reading up on the intricacies of income drawdown – if you don't know how the rules apply to you, for example? Pension Wise is also in desperate need of some basic useful tools. Ones which would allow people to enter their personal details to produce meaningful figures. Numbers go over people's heads unless they related directly to them and their money. Core calculators missing from the site include showing people how long they're likely to live, how much tax they will pay on their pension, and how much income they can afford to take from their pension per year. There is no way someone can begin to properly plan their pension without these basic ingredients.' (quoted from 'I tried Pension Wise - and this is why it won't work', Daily Telegraph, 23 February 2015).

In terms of content, a guidance session will:[470]

- inform consumers of the scope, purpose and limitations of the session
- inform consumers about the pension entitlement and other personal and financial information that the designated guidance provider may request from them during the session
- request information from the consumer about their accumulated pension pots
- request information about the consumer's financial and personal circumstances that is relevant to their retirement options
- alert the consumer to other sources of information and advice as appropriate and at relevant points during the session
- identify for the consumer and provide them with information about:
    - the options relevant to the consumer
    - to the extent that they are relevant to the consumer's options
    - the potential tax implications or debt obligations
- set out the next steps for the consumer
- provide consumers with a record of their guidance session.

The Pension Wise service is run by two designated guidance providers The Pensions Advisory Service (TPAS) which offers phone-based guidance and Citizens Advice (CA) which offers face to face guidance sessions,[471] each lasting 45 minutes. The FCA has introduced the following standards for designated guidance providers:[472]

- ensure that the guidance is impartial, consistent, of good quality and engaging across the range of delivery channels
- create consumer trust and confidence in the designated guidance providers and content of the guidance so that consumers actively use the service
- ensure that the framework works for both contract-based and trust-based pension schemes
- deliver helpful guidance for consumers that considers their retirement options and refers them to specialist advice or information where appropriate.

[470] HM Treasury (2015) *Delivering Pensions Guidance: January 2015 Update*, 12 January; https://www.gov.uk/Government/publications/delivering-pensions-guidance-january-2015-update/delivering-pensions-guidance-january-2015-update

[471] From more than 500 locations in England and Wales.

[472] Financial Conduct Authority (2014) *Retirement Reforms and the Guidance Guarantee*, Policy Statement PS14/17, November, http://www.fca.org.uk/static/documents/policy-statements/ps14-17.pdf

Individuals delivering the guidance must:

- have the skills, knowledge and expertise necessary for the discharge of their responsibilities – including good interpersonal skills (including listening skills and verbal communication skills) – and have knowledge that includes the following:
    - the different types of pension schemes
    - the impact of fees and charges for both accumulation and decumulation pension products
    - the options available to consumers when accessing their pension savings
    - the factors relevant to the selection of options when accessing pension savings, including the impact of guarantees, special features, restrictions or conditions, protected rights, and exit charges
    - the tax treatment of pensions and income generally
    - the circumstances when a consumer may require further specialist help, for example debt advice, or regulated advice
- cover other issues that are relevant to consumers considering their retirement options, for example, long-term care needs, sustainability of income in retirement and life expectancy, and
- understand the conduct that a designated guidance provider may engage in.

Consumers must have access to a complaint management system that is fair, consistent and prompt. The Parliamentary and Health Services Ombudsman (PHSO) will handle any complaints about Pension Wise as a last resort. Initially, there was no recourse for people who receive guidance from TPAS or CA, since neither guidance nor the designated guidance providers are regulated by the FCA.[473] However, in July 2015, the FCA – which has been made responsible by the Treasury for setting standards for the delivery and for monitoring the delivery of the guidance – clarified the issue by stating that where redress is due, it will be paid by TPAS or CA. The FCA said it can 'make recommendations' to the Treasury and the PHSO to order guidance providers to pay out: 'We expect a recommendation to make redress to be comparatively rare. We would expect such a recommendation to follow our general process for making recommendations with the calculation of the level of redress based on the size of detriment experienced. Where a consumer has already received adequate redress, as set by the Parliamentary and Health Service Ombudsman, we would not require it to be paid again as a result of our recommendation'.[474]

In July 2015, the FCA announced that it would, for the first time, distinguish between advice and guidance in the way it records complaints. Previously, the FCA categorised complaints against financial services firms under the headings 'misleading advice/guidance', 'arranging',

[473] Complaints involving financial advice are handled by Financial Ombudman Service.

[474] Reported in Carmen Reichman (2015) FCA - Pension Wise providers liable for guidance guarantee redress, Professional Adviser, 3 July.

or 'inappropriate sales technique'. Going forward, it said it would categorise complaints as either 'unsuitable advice' or 'unclear guidance/arrangement'. This will give the regulator a clearer picture about how many complaints were made specifically about regulated financial advice and how many related to guidance, Christopher Woolard, director of strategy and competition at the FCA, said: 'Our rules will help deliver the quicker, easier and fairer resolution to complaints that consumers want. Getting this right is also vital for firms. A properly resolved complaint can keep a customer happy, and protect the firm's reputation. But, more than that, effective complaints handling systems can act as an early warning system for firms'.[475]

Early evidence suggests that affluent investors were not using Pension Wise. A survey by Suffolk Life of its own relatively well-off clients who started a drawdown programme during April and May 2015 found that only 2% contacted Pension Wise. Three quarters took advice, while the rest acted without seeking advice. The average fund size of a Suffolk Life SIPP is around £330,000.[476]

In July 2015, the Treasury announced that Pension Wise had delivered 18,000 guidance appointments since its launch. It also reported that 925,000 visitors had visited the Pension Wise website. However, this was only 15% of the total appointments available. Hargreaves Lansdown has previously said that only one in seven of its customers were using the service.[477] Also in July 2015, the Government announced that the minimum age for accessing Pension Wise was being reduced from 55 to 50.[478]

A survey of 700 companies by Close Brothers Asset Management in August 2015 found a third did not have a clear understanding about Pension Wise or how it could help retirees, while 13% did not feel confident recommending the service. Only 9% said it has been a huge support in offering help to employees. Jeanette Makings, head of financial education services at Close Brothers, said: 'Four months after the pension reforms were introduced, it's clear that there is still some confusion. It's crucial that if employers are directing their staff towards Pension Wise, they really understand the support it can provide and that the guidance it gives is not advice and so should sit alongside financial advice rather than competing with it'. On the other hand, the survey also found that 20% of companies were actively trying to improve their support network for staff approaching retirement, while 37% said the reforms had encouraged them to play a greater role in financially educating their employees. Ms Makings said: 'Options at retirement have become all the more complex, and education is the key to helping employees navigate their new freedoms. A financial education programme – whether this is through seminars, clinics or one-to-one advice – can

[475] Reported in Carmen Reichman (2015) FCA splits advice from guidance in new complaints rules, Professional Adviser, 23 July.
[476] Michael Klimes (2015) Affluent investors not using Pension Wise, Professional Pensions, 8 June.
[477] Ollie Smith (2015) Pension Wise has delivered 18,000 guidance sessions since launch, Citywire, 23 July.
[478] Reported in Professional Adviser (2015) Pension Wise access extended to begin from age 50, 8 July.

help to build up understanding and engagement and can lead to them taking action to improve their financial wellbeing'.[479]

Research published by the NAPF in October 2015 revealed that only 10% of people considering their retirement options had turned to Pension Wise, although 20% of people who had accessed their pension pot had used the service. The research was based on a focus group of people who had accessed some or all of their pot, and had used Pension Wise. According to Graham Vidler, NAPF director of external affairs: 'The problem is not one of quality of service, because late on in the process we started nudging people towards Pension Wise, and when they went and investigated, they liked what they saw. The problem is one of awareness and knowing the service is there and can be used. We really need to crack through because at the moment there's a service out there that is not being used by people who in most cases could do with some expert guidance and support'. Instead, people were using informal sources of support such as the media, family, and friends. There is a big group of people who are looking at their options and they do not know what to do. One of our responders, June from Bristol, was typical – she said she felt "paralysed" by the choices on offer'.[480]

In September 2015, TPAS reported that those who used the service recently were most concerned about avoiding tax, accessing pension freedoms, and the lifetime allowance. They were also considering their options more carefully than those who approached TPAS at the beginning of 'freedom and choice' in April 2015 and were looking to access their money as quickly as possible. Charlotte Jackson, head of information and guidance, said: 'What we are seeing now is that people are more considered and taking their time. Around 20% of people are saying to us they want a combination, the security of an annuity and a degree of flexibility'.[481]

In December 2015, the Government announced that Pension Wise guidance was costing £496 per client to deliver. The cost of the service in 2015-16 was £39.4m, with advisers contributing £4.7m. Steven Levin, chief executive of Old Mutual Wealth's investment platform, said this represented 'poor value' compared with full personalised advice, which cost around £175 per hour. He said the industry needed to see better value for the £4.7m it is being asked to contribute.[482]

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[479] Reported in Stephanie Baxter (2015) Many employers failing to engage with retirement processes, Professional Pensions, 19 August.

[480] Reported in Jack Jones (2015) Only 10% exploring retirement options turning to Pension Wise, Professional Adviser, 15 October; and Mark Cobley (2015) Three-way split on 'pension freedoms', Financial News, 15 October.

[481] Reported in Michael Klimes (2015) TPAS: Tax, LTA and accessing freedoms top concerns for members, Professional Pensions, 23 September.

[482] Reported in Carmen Reichman (2015) Pension wise session cost branded 'poor value', Professional Pensions, 18 December.

Steve Webb, now policy director at Royal London, believes that the resources put into Pension Wise would have been better used giving retirees vouchers for financial advice: 'Given the tens of millions that have been spent on Pension Wise, maybe that money should have been spent on £500 advice vouchers, so you can access financial advice and start to understand the value of the service. That might be the direction the Government should be going in'.[483] In January 2016, the FCA said it would support a move for Pension Wise to provide a more personalised service for its clients.[484]

3.6.4 The implications for members of DC schemes

The *Aon DC Member Survey,* published in December 2014, of 2,000 occupational DC scheme members made the following predictions (which turned out to be a fairly accurate indicator of what actually happened in the first few months after Flexiday):[485]

- Only 12% of the respondents to the survey said that they would make use of a 'web-based Government guidance service'.
- One third of the survey respondents intend to make important decisions about their retirement on their own, or with the help of friends and family. But the very high proportion of DC members that currently invest in their default DC investment option probably indicates that members do not engage much with the investment process prior to retirement.
- Another quarter of the respondents said that they would seek the help of an independent financial adviser (IFA).

According to Keith Churchouse, director of Chapters Financial, it is very likely that 'for some, this guidance [from Pension Wise] will be extremely useful, for others it will be like receiving the instructions for a flat pack furniture unit'.[486] According to financial solutions firm LEBC, the guidance guarantee will do little more than deter people from 'doing stupid things' with their pension pots, it will not help them plan for their retirement.[487]

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[483] Reported in Rebecca Shahoud (2015) Webb: Pension wise was not worth the money, Professional Pensions, 5 November.

[484] Reported in Carmen Reichman (2016) FCA backs Pension Wise move to 'personalised guidance', Professional Adviser, 8 January.

[485] Reported in Sophia Singleton (2014) What do DC scheme members really want?, Pensions Age, December. http://www.aon.com/unitedkingdom/defined-contribution/dc-member-survey.jsp

[486] Keith Churchouse (2014) Why this adviser thinks pensions 'guidance' is the IKEA wardrobe of financial services, Professional Adviser, 22 July.

[487] Reported in Carmen Reichman (2014) Guidance guarantee plans not good enough, LEBC warns, Professional Adviser, 30 July.

TISA, in an initiative supported by 50 firms and trade bodies, wants the FCA to introduce a 'common sense' standard for the delivery of guidance to consumers.[488] This is because the rules around simplified advice and the boundary between guidance and advice are 'just not clear'. The initiative, part of the Savings and Investments Policy Project (TSIP), wants the FCA to establish a set of 'kitemarks', using, for example, decision trees, which will help advisers guide consumers based on what 'people like you' should do. Currently, advisers are 'too afraid' to guide consumers unless it is part of full regulated advice.

In May 2015, MGM Advantage released the results of a survey conducted by ComRes of 1,000 UK residents aged 55 and over who are not retired. The survey found that 65% thought that financial advice at the point of retirement should be compulsory. Only 11% said they were 'very comfortable' managing their pension in retirement, while 35% said they were not comfortable doing this and indicated they needed on-going advice. Andrew Tully, pensions technical director at MGM Advantage, said: 'People are making difficult, life-changing decisions, made all the more complex by the new pension rules. We're seeing the majority of people recognise that without financial advice they may fail to realise the full implications and make decisions that end up costing them dearly. The Pension Wise guidance service is a good starting point for people. The service can help people understand the options available, but it may not be enough to help them make the choice that's right for their personal circumstances…We need to continue to work hard to promote the benefits of people actually taking the next step and getting proper regulated financial advice. This is the only way we can remove the status quo, ensure we improve the outcomes for people at-retirement and make sure the new rules benefit as many of them as possible'.[489]

In May 2015, IFA software provider Intelliflo published the results of a survey of 1,000 adults earning at least £40,000 on their attitude to regulated financial advice. Around 39% said they would need a pension pot of at least £100,000 before they would consider seeking regulated financial advice, while 24% said between £50,000 and £100,000, 11% between £25,000 and £50,000, 11% between £10,000 and £25,000, and 14% if they had less than £10,000. However, 43% of respondents said they intended to manage their pension pot themselves.[490]

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[488] Reported in Carmen Reichman (2015) FCA under pressure to agree on 'common sense' guidance principles, Professional Adviser, 11 March.

[489] Reported in Professional Adviser (2015) Advice at retirement 'should be compulsory', say over 55s, Professional Adviser, 5 May.

[490] Reported in Professional Adviser (2015) Retirees set advice threshold at £100k savings, Professional Adviser, 22 May.

3.6.5 The implications for members of DB schemes transferring to DC schemes

The Pension Schemes Act 2015 distinguishes between 'flexible' or 'safeguarded' benefits.[491] Flexible benefits comprise DC and cash balance benefits, while safeguarded benefits are DB benefits. The Act gives members a statutory right to transfer each category of benefit from their current scheme to another scheme. Members with DB benefits must have ceased accrual and made an application to transfer those benefits (following receipt of the statement of entitlement). Schemes do not have to provide the new flexibilities themselves. Further, existing scheme rules may not permit them. To enjoy the new flexibilities, members might have to transfer their benefits to another provider. However, if trustees do wish to offer the new options, they can now amend the scheme rules by resolution (with employer consent) or use a statutory override of the scheme rules.

Trustees are required to give the following information to members with DC benefits at least four months before their retirement date: [492]

- A statement of the options available to the member under the scheme rules
- A statement that they have the opportunity to transfer flexible benefits to one or more different pension providers
- A statement that different pension providers offer different options in relation to what the member can do with the flexible benefits, including the option to select an annuity
- A statement that different options have different features, different rates of payment, different charges and different tax implications
- A copy of the guidance that explains the characteristic features of the options that has been prepared or approved by the regulator
- An estimate of the value (or cash equivalent transfer value (CETV) if relevant) of the affected member's flexible benefits (if the benefits are 'transferrable rights' in accordance with the disclosure regulations), the date that this was calculated, an explanation that this is not guaranteed and information about any guarantees or features, restrictions or conditions that could affect the value, and
- A statement that there may be tax implications associated with accessing flexible benefits, that income from a pension is taxable and that the rate at which income from a pension is taxable depends on the amount of income that the member receives from their pension and other sources.

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[491] See The Pensions Regulator (2015) *Regulatory Guidance: DB to DC Transfers and Conversions*, April; http://www.thepensionsregulator.gov.uk/docs/db-dc-transfers-conversions-regulatory-guidance.pdf

[492] *The Occupational and Personal Pension Schemes (Disclosure of Information) (Amendment) Regulations 2015* (https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/405622/occupational-and-personal-pension-disclosure-of-information-draft-amendment-regulations-2015.pdf); The Pensions Regulator (2015) *Communicating with Members about Pension Flexibilities*, March (http://www.thepensionsregulator.gov.uk/docs/draft-essential-guide-pension-flexibilities-march-2015.pdf)

In the case of DB benefits, trustees are required to inform members that they have the right to DB benefits and how they can access information about them. Trustees must also direct members to Pension Wise on the options available to them, provide them with generic risk warnings on each option, and inform them that they should consider taking independent advice to help them decide which option is most suitable for them if they have flexible benefits, and must do so if they have safeguarded benefits.

A poll of consultants to DB schemes conducted by Towers Watson showed that many members want to know what their transfer value is. Trustees should therefore consider the most cost-effective way of doing this, such as adding transfer values to all retirement letters rather than responding to individual requests. The poll indicated that around 20% of schemes had decided to automatically quote transfer values at retirement, 40% had decided not to, and around 40% were still undecided.[493]

Fidelity's Retirement Service announced in October 2015 that there had been a 'significant increase' in interest in DB-to-DC transfers since April 2015, although the take-up had been small so far: 12% of its calls were about this topic. Richard Parkin, head of retirement at Fidelity International, expected partial transfers to become more popular than full transfers: 'If you have £25,000 [in DB benefits] and you trade in £5,000 for a pot of money, it's much easier to have conversations about that, because you're not giving up your guaranteed income'. Some customers were concerned about the tax treatment of their DB benefits when they die, believing that it would be better to transfer to DC. Others just wanted to get their hands on the cash. But overall, there has also been a general increase in interest in pension planning since April. Mr Parkin went on to say: 'One thing I've started to think about recently is that, as an industry, we're very nervous about DB-to-DC transfers because of what's happened in the past. We've tended to say that we can't do it – but that doesn't mean we shouldn't check. Are trustees or sponsors of DB plans really serving members properly by not looking at whether a transfer value makes sense? For example, if members are single or sick – or both – then DB may not be giving them value. We should be giving DB members much better retirement help rather than just saying "you've got a gold-plated pension, so you're lucky". DB is great quality, but you can't just make the assumption that that's always the case. Plan sponsors have an interest in doing that, because if they can reduce their liabilities in a way that also works for the members, then it's good for both sides'.[494]

Matthew Arends, partner at Aon Hewitt, speaking at the NAPF annual conference in October 2015, said that while transfer quote requests had risen since Flexiday, fewer than

[493] Reported in Lydia Rowson (2015) Emerging reality on pension freedom - What can sponsors and trustees expect in the new pensions world?, Towers Watson Trustee Briefing, 8 June.

[494] Reported in Stephanie Baxter (2015)DB to DC transfer enquiries double in just one month, Professional Pensions, 3 November.

1% of members had actually taken up the option. He questioned whether only 1% of people are better off by transferring out of their DB scheme. He argued that DB schemes needed to employ different communications methods – such as telephone and online chat facilities as well as online modellers – if members are to understand options such as transfers to DC schemes. He pointed out that 40% of schemes that provide CETVs to members also provide access to independent financial advice, but despite this, take up of this advice remains low.[495] However, in December 2015, Xafinity reported that the number of people transferring out of DB pension schemes each month had doubled since January.[496]

The FCA's review of enhanced transfer values (ETVs) published in July 2014 found that advisers had failed to assess whether the transfer was suitable for customers for a number of reasons including:

- generic templates which were inadequately 'tailored' so the advice did not reflect specific member circumstances or give sufficient priority to the members' own requirements
- advice where the outcome focused solely on critical yield analysis[497] without full consideration of wider member circumstances
- not establishing adequately the level of risk a member is willing and able to take
- fund recommendations which did not match the assessed risk profile of the member
- the use of default receiving schemes (in some cases, with uncompetitive charging structures) and limited consideration of the suitability of a member's other existing pension arrangements, and
- limited consideration of the tax and, in a small number of cases, means-tested benefit implications of accepting the offer.[498]

There were also failures concerning disclosure, such as:

- incomplete record keeping
- the 'annuity risk' of transfer from DB to DC not being fully explained
- over-emphasis on the possible 'flexibility' under a DC scheme in undertaking the transfer analysis

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[495] Reported in Helen Morrissey (2015) NAPF 2015: New communication approach needed for DB-DC transfers, Professional Pensions, 16 October.

[496] Reported in Professional Pensions (2015) Defined benefit transfers double since January, 3 December.

[497] The critical yield is the investment return which is required in the new arrangement to match the existing scheme benefits. The analysis also makes a number of assumptions about factors which will impact on both the pension received from the DB scheme and the cost of matching the benefits. This will include assumptions made about the various indices which will impact on the revaluation of the pension and also factors such as gilt yields which will impact on the conversion of the pension fund to an income.

[498] Financial Conduct Authority (2014) *Enhanced Transfer Value Pension Transfers*, Thematic Review TR14/12, July.

- offers being structured against a reduced transfer value and therefore appearing artificially generous, and
- no consideration of the members' additional voluntary contribution (AVC) funds as part of the advice process.

Clive Adamson, director of supervision at the FCA, said: 'Transferring from a DB to a DC scheme is an important decision for consumers. It is disappointing that our review saw failings in the advice given, particularly when incentives [such as a direct cash offer[499]] have been provided to transfer. All firms active in this complex area of pension transfer activity should think very carefully about the quality of the advice process and assurance framework required to deliver fair customer outcomes'.[500]

The same FCA review found that 59% of members who accepted an ETV from a DB scheme did so as an 'insistent client' against their adviser's recommendation.[501] The FCA wants advisers to ensure they have recorded the client's reasons for wanting to transfer out of the scheme and have discussed the risks involved as well as alternative options.

Those who want to transfer pension pots worth less than £30,000 are not required to take advice. While this would lead to cost savings for trustees, it was not without risk for scheme members. According to Stephen Green, senior consultant at Towers Watson: 'The fact that advice isn't required for small pensions does not mean that this is a decision to be taken lightly – especially where people have little else besides their state pension to fall back on. But if someone's other final salary pensions will provide them with a good income in any case, their desire to swap a small pension for a pot of capital that they can access as they like may have overridden any financial advice not to do so.'[502]

The situation could be even worse for people living abroad who want to transfer their UK pension scheme. According to a FCA rule update published in July 2015, they might have to pay twice for advice. This is the interpretation given by Intelligent Pensions technical director, David Trenner: 'While most focus has been on the definition of safeguarded benefits and the need for a pension transfer specialist, there is a small section in the FCA feedback document which seems to have passed without comment. This is the section dealing with overseas residents and that they may end up having to pay for two advisers and therefore paying twice'. This is because there are two stages in the advice process: (a) is a transfer suitable? and (b), if it is, where should the money be transferred to? The FCA points out that UK-authorised advisers may not have knowledge of local tax regimes and

[499] The practice of offering cash has now been outlawed.

[500] Reported in Laura Miller (2014) FCA probe slams ETV pension transfer advice, Professional Pensions, 24 July.

[501] An 'insistent client' is someone who acts against some element of the advice received. Typically the advice was to remain in the DB scheme, but the member transferred despite this recommendation.

[502] Quoted in Natasha Browne (2015) FCA introduces emergency rules to prevent mis-selling from April, Professional Pensions, 26 January 2015.

pension rules, and says that it is in discussion with the DWP to consider whether amendments should be made to the rules for non-UK residents. Mr Trenner added: 'While we can have some sympathy with clients needing to pay two advisers, it is absolutely essential that the requirement for a UK-registered transfer specialist is retained. We have in the past seen overseas advisers transferring DB values into QROPS [Qualifying Recognised Overseas Pension Scheme] with no benefit comparison and the only "reason why" given being that they are no longer in the UK, so they would not want their pension to remain in the UK. A professional firm will set up an arrangement with offshore specialists to ensure that the UK adviser understands all of the relevant aspects of the overseas jurisdiction, and the resulting team will be stronger than the sum of the two parts'. The key reason was to protect consumers: 'We were approached by a couple who had emigrated to Dubai, but decided it was not right for them. They were only in Dubai for two years, but this was long enough for a local adviser to transfer benefits from two DB schemes (one the NHS Pension Scheme), and to deduct 12% in hidden charges. It is essential that the rules are not watered down in any way'.[503]

In July 2015, the Government accepted that some consumers were frustrated by the new legislative and regulatory requirements to seek financial advice in certain circumstances, although it said there was no legal requirement to follow the advice offered. It believed there was 'insufficient clarity' on when advice was required and said that this issue would be raised as part on a Treasury consultation on pension transfers and early exit charges.[504]

Also in July 2015, The Pensions Regulator (TPR) announced that it was considering bringing its guidance to pension scheme trustees on communicating the new retirement flexibilities into line with the FCA rules. Previous TPR guidance was to give members only generic information if they were considering accessing their pension pot, while the FCA rules say providers of contract-based products must give tailored risk warnings. The reason for the initial difference was that trustees were concerned about 'straying too close to giving financial advice' which could be avoided by giving only generic warnings. Going forward, particularly for large DC schemes and master trusts that plan to offer the full suite of drawdown options to members, TPR will discuss with the DWP and the FCA whether trustees 'should also be able to offer specific risk warnings which would be as similar as possible to the FCA's second line of defence for providers'. TPR believes it is 'important for regulators to work together to make sure there was no regulatory gap'.[505]

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[503] Reported in Jenna Towler (2015) Overseas residents hit with double pension transfer advice charge, Professional Adviser, 2 July.

[504] Reported in Scott Sinclair (2015) Govt says savers in a muddle over mandatory advice rules, Professional Adviser, 30 July. The Treasury consultation is discussed later.

[505] Reported in Jack Jones (2015) PBUK 2015 -TPR explores aligning 'freedom and choice' risk warnings with FCA rules, Professional Pensions, 1 July.

3.7 Opportunities for advisers

The new pensions environment was seen by some as a 'huge opportunity' for advisers. Not the least of these was Steve Webb when he was Pensions Minister. Speaking at the Retirement Planner Forum and Awards 2014,[506] Mr Webb said 'the guidance guarantee would only get people to the starting line, giving them just a basic understanding of what their options are and issues such as taxation and longevity. [T]here was only so much that could be covered in such a limited conversation, which would only equip them with the very basics of retirement planning. There are some in the advice community who see this as a threat. I see it as a huge opportunity. I liken the guidance guarantee to wine tasting and you, the advisers, are a vintage wine. When people realise what choices they have; when there is innovation in product, which I am sure there will be; when people start to consider all their retirement wealth and income and all their partner's retirement wealth and income and all the different permeations of the new freedoms they have got, I think many people will want to talk further to someone who can help and that seems to me to be an adviser…who can give them personal tailored advice'.[507]

3.7.1 Opportunities for advisers in regulated advice

Others agree and see an important role for regulated advice going forward. For example, Duncan Jarrett, retail managing director at Aegon, said: 'There's a massive opportunity for advisers, as 65% of people don't understand the pension reforms and even those who do are likely to require support selecting the right combination of income products. Advice has never been so important and to help advisers we've introduced Your Retirement Planner to bring customer options to life and the tool responds based on the combination of income options they select. We expect advised customers will want to take full advantage of the new flexibilities and combine a range of different income options'. Aegon said consumers using the site direct would be more likely to seek regulated advice afterwards.[508]

Similarly, Richard Nuttall, head of compliance policy at SimplyBiz Group, said: 'It is expected that one of the main outcomes for these individuals [from the guidance guarantee] will be to obtain regulated financial advice. For those firms wishing to engage in this activity, it represents a great opportunity. Where individuals require, or are guided towards, regulated

[506] Which was well before evidence of the low usage of Pension Wise emerged.
[507] Quoted in Jonathan Stapleton (2014) Webb: Guidance guarantee will fuel appetite for the vintage wine of independent advice, Professional Adviser, 11 June.
[508] Quoted in Jenna Towler (2015) Aegon launches pensions freedom website and modelling tool, Professional Adviser, 4 March.

financial advice, the Money Advice Service will have a directory of advisers for the individual to access'.[509]

Standard Life's head of platform and wealth propositions, David Tiller, also believes that pensions freedom has handed advisers their biggest business opportunity ever on account of 'the fact that pensions can now be fantastic for wealth transfer and supporting the next generation on their retirement savings is a compelling opportunity to open clients' eyes to the art of financial planning'.[510] According to Mr Tiller, retirement planning has become much more complex, but it is filled with opportunity for three reasons:

1. Baby boomers reaching retirement means demand will remain at an all-time high for some time.
2. These people are the wealthiest retirees this country has ever had.
3. For many, choices are now so complex they may find it challenging to get good outcomes by themselves.

Mr Tiller estimates that drawdown was about 5% of adviser business in 2014, but by 2024, it could be 80% of adviser business. He believes that the key to coping with this increase in demand is what he calls a 'centralised retirement proposition', which will cover:

- Tax advice policy – having established client needs around income and wealth transfer, working out the best tax wrapper to take this from. Subject to using tax allowances, this is often going to mean taking from the pension last (turning previous advice on its head)
- Cashflow modelling – how much income can they take given total assets and any goals on wealth transfer. With the removal of GAD limits, many advisers are using GAD as a proxy, but we are seeing different standardised approaches to projecting assets and sustainability of income
- Investment advice – creating an investment strategy for clients who may live off their portfolio for 30 years is a sophisticated multi-goal investment challenge. Many advisers have already developed disciplined CIP [centralised investment proposition] processes around accumulation; it is now about doing the same thing for decumulation
- Accessing investment solutions – creating a decumulation CIP will inevitably demand accessing new investment solutions that manage volatility and sequence-of-returns risk in retirement (pound cost ravaging)[511]

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[509] Richard Nuttall (2015) Everything advisers need to know about Pension Wise, Professional Adviser, 23 January; see Appendix.

[510] David Tiller (2015) Has pensions freedom given advisers their biggest opportunity yet?, Retirement Planner, 25 June.

[511] Sequence-of-returns risk is explained in Chapter 2.

- Withdrawal policy – setting clear customer expectations of how their income will change over time – streamlining annual reviews as expectations already set and avoiding difficult conversations when significant changes happen as the customer expectations set.

The new pension freedoms have encouraged a number of advisers to extend the range of services they offer to well-off clients, with a new focus on wealth management and financial planning. There had already been a major change in advisers' business models following the introduction of the Retail Distribution Review (RDR)[512] in 2013, with a move to discretionary services and away from the low end of the advised market. Examples include:

- Brewin Dolphin expands financial planning business (May 2014)
- Rathbone launches private office (February 2015) and acquires independent financial advice network Vision Group (October 2015)
- Charles Stanley refocuses business entirely on wealth management (April 2015)
- Investec Wealth launches private office for 'under-served' investors with a minimum of £10m (April 2015).

By contrast, life assurers – which traditionally had a dominant role in providing retirement income solutions – have responded to the new pension environment by offering a 'vertically integrated' service that has been put together through acquisitions. Examples include:

- Old Mutual acquires the Intrinsic network (July 2014) and launches national advice business called Old Mutual Wealth Private Client Advisers (October 2015)
- Standard Life buys adviser Pearson Jones with the aim of building up a face-to-face advisory service in addition to telephone and online advisory services. The new service will be called 1825 (February 2015).[513]

In November 2015, Tilney Bestinvest and Saga introduced a financial planning and investment service offering regulated advice, guidance and execution-only services to the over-50s. The service is aimed at the estimated 12.5 million people who have made no financial plan for retirement. Customers can 'do it on their own' with free online and telephone support, take one-off guidance, or have a longer-term relationship with a professional adviser. Initial adviser charges range from between 1% and 3% – depending on complexity – plus ongoing fees of between 0.75% and 1.25% per year. Nici Audhlam-Gardiner, Saga Investment Services managing director, said: 'By combining Tilney Bestinvest's investment expertise with Saga's 60-year history of improving the lives of the over-50s, we have created a service that will help make investment easier to understand

[512] RDR ended the practice of advisers being paid by commission from product providers and replaced it with customer-agreed adviser charging from the beginning of 2013.

[513] Reported in Anna Fedorova (2015) Wealth firms step up 'full service' offerings as client demand grows, Investment Week, 28 April.

and more accessible, particularly for those who have been underserved by the financial services industry in the past'. Customers will also have access to flexi-access drawdown.[514]

Another trend that is developing is increasing collaboration between advisers and accountants as the demand for tax planning increases following the introduction of 'freedom and choice'. These findings came from a poll of 120 advisers conducted by Prudential in August 2015. Vince Smith-Hughes, director of business development at Prudential, said: 'Pension freedom has underlined the importance of independent financial advice….Markets which might have been closed before are potentially opening up, but there is a realisation that advisers may need additional expertise. Working with the ICAEW [Institute of Chartered Accountants of England and Wales] financial services faculty, we hope to explore the opportunities presented by pension freedom legislation for advisers and accountants'.[515]

3.7.2 Opportunities for advisers in simplified advice

John Porteous, head of client proposition at Towry, argues that 'simplified advice is a clear missing link between guidance and full advice, but there are numerous challenges, 'validation' [or suitability] among them…. [T] technology-led innovation around the principle of simplified advice creates an opportunity for firms to reach out to different client segments'.[516]

The greater use of existing IT and computer-generated advice is critical to the success of simplified advice,[517] not least because of the significant decline in advisers post-RDR to around 22,500.[518] The FCA has offered help to advisers to build simplified advice models, by giving them an 'informal steer' on, for example, how to clarify the boundary between guidance and advice. This is part of its Project Innovate and will be managed through Innovation Hub, launched in October 2014. Innovation Hub was set up both to help firms negotiate the regulatory landscape and to allow the FCA to assess what it can do to promote

[514] Reported in Scott Sinclair (2015) Financial planning service for over-50s launched, Professional Adviser, 9 November.

[515] Reported in Carmen Reichman (2015) Advisers align with accountants as tax planning demand rises, Retirement Planner, 19 October.

[516] John Porteous (2015) The unavoidable challenges facing simplified advice, Professional Adviser, 5 February.

[517] This is discussed in the next Section.

[518] Reported in Brendan Llewellyn (2014) Standard Life's O'Dwyer: Increase advisers' productivity to narrow advice gap, Professional Adviser, 31 July.

innovation in financial services.[519] This is in response to advisers' fears about possible 'systematic mis-selling' using simplified advice models.[520]

At the lower end of the market, companies, such as Scottish Widows, have established online guidance and a call centre to help those who want to transfer, but do not have a financial adviser. Peter Glancy, head of corporate propositions at Scottish Widows, said: 'Traditionally, it has been people with hundreds of thousands of pounds who really know what they are doing [using drawdown]. Now we are going to be working with people who just want to get some money out and may be putting it into drawdown by default without realising the tax implications. We need to make sure we're engaging with them more intuitively and not allowing them to do anything silly'.[521]

As discussed in Chapter 2, Prudential has launched a non-advised drawdown product for customers who want to take advantage of pensions freedom, but choose not to consult an adviser. Its Pension Choices Plan offers access to its PruFunds range, its Dynamic Portfolios, and its cash fund. The minimum investment is £25,000.[522] Similarly, Zurich has launched a non-advised drawdown product with a minimum investment of £30,000, as has Blackrock.[523] Aegon's online Retirement Choices platform has a drawdown option which requires customers to take advice, but the firm is planning to introduce a simplified non-advised version.

Just Retirement has launched a simplified telephone-based advice service for providers to offer to their clients when they retire. Stephen Lowe, group external affairs director, said: 'The service is designed for clients with simple, straight-forward needs and savings of between £30,000 to £40,000. It's aimed at life companies that want to ensure their pension savers are more actively engaged in the decision-making process at retirement, while passing on the responsibility for the regulated advice. Charging structures for the service will be agreed with the individual life companies and will be charged separately from other products, but clients will only have to pay if they act on the recommendation. Clients opting for the service will receive personal recommendations about how to use their pension savings to generate income or access lump sums. The advice will also look at whether clients should keep funds invested based on their attitude to risk and capacity for loss or whether they should defer taking benefits. Simplified advice is set to be a cost-effective way of giving

[519] Reported in Carmen Reichman (2014) FCA offers advisers 'informal steer' on simplified advice, Professional Adviser , 28 October 2014.

[520] Jenny Towler (2014) Advisers raise 'systematic mis-selling' risk of simplified advice models, Professional Adviser, 11 July.

[521] Quoted in Peter Davy (2015) Complexity and Cost will limit pensions freedom, Financial News, 16-22 March.

[522] Reported in Jenna Towler (2015) Prudential enters non-advised drawdown market, Professional Adviser, 30 September.

[523] Jenna Towler (2015) Zurich rolls out non-advised drawdown for workplace savers, Retirement Planner, 1 December.

retirees, who usually wouldn't choose to engage in accessing advice, the helping hand they are going to need in the future. The majority of these Middle Britain pension savers won't have complex requirements, so a simplified advice service should be a good option'.[524]

Hargreaves Lansdown has introduced a restricted advice service which has allowed it to simplify its fee tariff and remove the minimum portfolio size for advice. It will now advise clients over the telephone, regardless of the size of their portfolio, for a minimum fee of £495. Face-to-face advice costs a minimum of £1,495.[525]

AllianceBernstein's Retirement Bridge product, which covers members between age 55 and 75, includes 'embedded advice'. Tim Banks, managing director of the Pensions Strategies Group, said: 'You can take out any amount of money you like as cash any time, but the impact of you taking additional lump sums is clear, because you sell 'units' in the fund and can see what income you are swapping for cash.' [526]

3.7.3 The frequency of advice

There is also a question about how often advice is needed. Many advisers felt that there is more to retirement planning than can be covered in a single meeting. For example, Buck Consultants said: 'The implication…that the guidance…can be delivered on one occasion, at which the member will take decisions on all aspects of their retirement planning, is not credible - even if the expected outcome, in most cases, is that the member will choose to select a packaged solution. [Employers could hold] regular informal discussions with groups of employees on pensions matters [so when specific situations arise, individuals can take professional advice which can be] focused and kept to a minimum, [thereby reducing costs]'.[527]

Clients apparently want to receive communications from their advisers 11 times a year, according to a survey of client satisfaction conducted by NPG Wealth Management, SEI and Scorpio Partnership in which 3,113 investors globally were questioned. Clients who only see their relationship manager 6 times a year gave a poor satisfaction score. On the other hand, more than 13 annual contacts was considered too much. Most 'heavily invested' clients preferred to deal directly with their adviser, while those with less than a quarter of their assets with a wealth management firm prefer to contact product specialists or use a digital

[524] Carmen Reichman (2015) Just Retirement launches simplified advice for life company customers, Professional Adviser, 13 April.

[525] Reported in Laura Miller (2015) Hargreaves Lansdown dumps independent advice; overhauls charges, Professional Adviser, 1 October.

[526] Quoted in Peter Davy (2015) Complexity and Cost will limit pensions freedom, Financial News, 16-22 March.

[527] Quoted in Carmen Reichman (2014) Revealed: What advisers told the Treasury about pensions 'guidance', Professional Adviser, 12 August.

service. The two main reasons for a contact were to discuss overall progress and to consider relevant portfolio changes.[528]

Others suggest less frequent contact is acceptable if this is what the client wants. According to Paul Harrison, head of business consultancy at Prudential, advisers should tailor their ongoing services to their clients and do not need to see all of them annually to satisfy an unwritten rule about treating active customers fairly. While the core service a firm offers should be consistent – and have the charging structure for it – advisers should think about modifying how often they see their clients and through which channels in order to free up capacity. For instance, some clients may not require annual check-ups and could be seen every two or three years. Others could be serviced over the phone or online to supplement face-to-face meetings. Nevertheless, many advisers are concerned about the FCA's attitude to adviser charging for ongoing advice. In its reviews of the implementation of RDR in April and December 2014, the FCA found evidence of firms receiving an ongoing adviser charge, while not providing a genuine service in return. It said that the value of an ongoing advice service acted as an 'important motivator' in consumers' decisions to pay for financial advice in the first place.[529]

3.8 The impact of technology on advice

Technology was at the heart of affordable advice, according to a poll of advisers conducted during a Professional Adviser web-seminar on 6 October 2015. Around 91% of advisers polled thought technology was important or extremely important when trying to provide affordable advice. Just 3% thought it was unimportant and the rest were non-committal.[530]

3.8.1 Platforms

'Platforms will be the primary facilitator for many pensioners and advisers in managing retirement funds', according to Alistair Wilson, head of retail platform strategy at Zurich. Advisers need to be aware of the functionality of different providers' platforms in terms of:

- Access to income through flexible access drawdown, some may also offer annuities
- Taking the whole pot as a cash lump sum
- Partial (ad-hoc) lump sums without crystallising the pot
- Existing capped drawdown plans on their platform going forward
- Transfers of existing capped drawdown plans on to their platform

[528] Reported in Carmen Reichman (2015) Clients want contact 11 times a year – survey, Professional Adviser , 4 June. The results are dominated by US customers.

[529] Reported in Carmen Reichman (2015) Advisers don't need to see every client every year - Prudential's Harrison, Professional Adviser, 16 July.

[530] Reported in Jenna Towler (2015) Technology at heart of 'affordable advice', adviser poll reveals, Professional Adviser, 7 October.

Mr Wilson adds: 'Where a client wants to have a fixed monthly payment, this should be relatively simple, but where the payments may include ad hoc requests, the dynamics become very complex. Understanding what at first glance appears to be a piece of trading functionality becomes ever more important. And so, it is important to look in detail at the challenges relating to platform functionality and associated costs when taking an income, especially if these costs change if income is stopped, reduced or restarted. Add to this, understanding the "in-flight" events such as corporate actions and the impact these can have on income, there is an increasing amount to be considered…Providing clients faster access to their cash, or at the very least, not imposing processes that delay access, comes to the fore. Clients don't expect technology to slow down access and, for some platforms which don't prefund some transactions, this is exactly what can happen….The problem is further compounded by the fact that many clients will be expecting to stagger their entry into retirement, such that, at the same time as withdrawing funds as efficiently as possible across tax wrappers, they may also still be making contributions. It goes without saying clients are not going to be happy to have to pay extra and wait longer for their cash if they could also face a scenario where there is insufficient cash to pay income on time….Those platforms that support cash management automation will come into their own with pension freedoms, providing clients and advisers with an additional safety net'. The following costs also need to be taken into account: setting up and management of pension income, ongoing fees for effectively 'payroll' administration, ad-hoc payments, and additional costs when releasing individual pots.[531]

Richard Budnyj, director of Platform Action, considers the pricing challenges facing platforms in the post-RDR world. The client needs to pay for the services offered by the adviser (if the client is advised), the investment manager and the product provider's platform. Mr Budnyj discusses these in turn:

- Advisers:
    - Pre-RDR, advisers typically received 50bps in commission from the product provider. Post-RDR, though many advisers have fared well by adapting their business models and segmenting their clients to focus on those who believe in the service value they bring, not enough clients have been willing to pay directly for advice. As a result, we have seen a rationalisation of advisers. We are also left with a great swathe of clients who, due to the size of their investment pots, are not a viable proposition for advisers anymore, but who do need advice. Yes, there are people out there who can 'DIY', but a large population have been left in limbo, leading many providers to see this as an opportunity and set up direct-to-consumer (D2C) propositions

[531] Reported in Retirement Planner (2015) New world - How platforms are adapting to pensions freedom, April 14.

- Investment managers:
    - The investment managers have had to deliver new fund classes, but overall one could argue they have not had to cut their cloth to the same extent as providers are having to. I suspect they'll argue they are about value and that the net return given to investors is the most important thing. As an investor, I am happy to pay the value premium
- Product providers
    - The product provider level is where we are seeing significant pressure for reductions in price, with some calling it a race to the bottom. But for how long can they sustain this position? We currently have a number of smaller independent wrap platforms who arguably have the right business model but are struggling to make profit because they don't yet have the required scale. To succeed long-term, they need to increase assets under management and their low-cost base means the break even point is far lower than platforms with a life company heritage. But, given the huge influx of assets onto platforms in recent years, successful independent platforms are likely to be those which can now attract assets transferred from other platforms. For the platforms which have grown out of traditional life companies, although they have the scale in terms of assets, they also have the high costs associated with servicing legacy business and so are also struggling to make a profit. These companies are under greater pressure to scale further as their breakeven point is much more challenging.

Mr Budnyj believes that updated technology alone cannot create long-term profitability for many platforms and he proposes two solutions: greater operational efficiency within the life companies (with new digital technology at the core) and consolidation with the smaller players, through mergers and acquisitions.[532]

Standard Life's David Tiller also predicts a contraction of the platform market from 25 to about 15 platforms by 2018, but only around six of these will cater to advisers. He warns advisers to avoid being trapped in dying platforms which may find it hard to find a buyer. This is because rival platforms would find it difficult to integrate systems and so would only be interested in the assets not the rest of the business. Adviser platforms would therefore have to switch to a D2C or workplace model or become 'zombies', closing to new business but limping on as has happened in Australia. Advisers who become trapped in such platforms risk falling behind their competitors which have their clients' assets invested on more modern platforms. Mr Tiller argues that there are nine things advisers should be looking for in their platforms:

[532] Richard Budnyj (2015) Platforms - Why the old life company model just doesn't work, Professional Adviser, 18 May.

1. The advisers using the platform have progressive business models, are successful, compliant and are growing ahead of the market
2. Operating a successful UK adviser platform is core to the business strategy and commercial model of the platform owner
3. The platform has access to capital funding from committed long-term owners
4. The platform has seen sustained new business growth from advisers, as opposed to direct or workplace assets
5. The platform has a stable pricing position and business strategy
6. The platform has maintained a consistent level of service and support for advisers as it has grown
7. There is a track record of continuous enhancement of the platform, such as by investment in the underlying technology
8. The platform has a clear business plan and roadmap of further development for advisers
9. The platform has proactively embraced the RDR and helped advisers adapt to it.[533]

Average platform costs have fallen by 18% over the last five years, according to a study published in July 2015 by Steve Nelson and Terry Huddart called *Platform Pricing Prophecies: Past, Present and Phuture*.[534] For an average sized portfolio of £200,000, the annual platform cost has fallen since 2011 from 0.38% to 0.31%, or by £140. The main explanations for this are: RDR, competitive pressure, a focus on due diligence among advisers, and a significant migration of assets to platforms enabling scale economies to be passed on to customers.

Nevertheless, it is hard for advisers to compare platform costs and this could help to explain why cost appears to be low on advisers list of priorities when recommending a platform, with the study finding 'no real evidence pointing to a disproportionate amount of assets flowing into cheaper propositions'. Instead, advisers choose platforms based on factors other than price, such as suitability to their clients and their own business requirements. The study predicts that the price falls seen in recent years will come to an end as platforms fail to see them translating into more business. On the other hand, the study argues that the asset management charge is an item to look at if the cost to the customer is to be reduced further: 'let's be honest, there is more fat to cut here'.[535]

As a result of price pressures, poor back-office systems, and outdated front-end technologies, some even predict that platforms in their current form are finished. This is the view of the lang cat consultancy in its report *Platforms are Dead* published in October 2015.

[533] Reported in Carmen Reichman (2105) Standard Life urges advisers to check platform deals to dodge 'zombies', Professional Adviser, 18 September.
[534] http://langcatfinancial.co.uk/blog/price-only-important-in-the-absence-of-clear-value/
[535] Reported in Laura Miller (2015) Platform pricing report: Average costs cut by 18% vs. pre-RDR, Professional Adviser, 13 July.

Mike Barrett, consultancy director at the lang cat, said: 'We're convinced that platforms – at least in the guise that we've known them for the last decade and a half – are dead. With most of the sector's 25 platforms now operating for at least a decade, more should be running at a profit and with clear strategic objectives and charging structures. There's an urgent need for platforms to improve back-office systems and processes to reduce costs, and to improve their online offerings. In several cases, a platform's customer portal requires you to use a PC with Internet Explorer, and even then you can only get a valuation. That's just crazy. In a digital world, customers expect much more and a number of direct platforms are starting to address this'. Mr Barrett also agrees that future platform consolidation is limited by technology: 'With six main suppliers providing the necessary systems for most platforms – Bravura, FNZ, GBST, IFDS, JHC Figaro and SEI – and with re-platforming between providers operating different systems so difficult, this could affect consolidation'. He does, however, believe that an increasing demand for advice following Flexiday have thrown a lifeline to platforms: 'Those platforms that enable advisers to deliver their advice proposition in a manner befitting the digital age will flourish'.[536]

An example of an online platform launched to give scheme members access to 'freedom and choice' is Bigblue Touch 4life from Aon Employee Benefits. The following services will be offered to those reaching retirement: an annuity broking service to compare prices and select the provider and annuity which matches their needs; flexible drawdown, access to cash and a range of investment funds and strategies; online modelling tools; and access to advice if needed. Debbie Falvey, head of DC proposition, said: 'With increased freedoms since April this year, there is now a great deal, more choice, but this needs to be supported and guided responsibly. Bigblue Touch 4life helps members make sense of their options. It allows them to make fully informed decisions and to structure their retirement savings in a way that has previously been impossible'.[537]

In January 2016, Zurich reported the results of a survey of 120 advisers which found that 64% of them were reassessing their platforms as a result of concerns over functionality and the range of products on offer. Pension freedoms have put greater demand on providers for additional services, such as automated processing of funds and being able to split funds over different risk profiles. Advisers want the platform they use:

- To offer the full range of drawdown options (flexi-access/ capped / UFPLS) – Advisers are most worried about whether or not their platform offers all products accessible through pension freedom. Legally all products do not have to be provided, so some platforms have decided to offer a selection only, However, advisers seem to mind, as

[536] Reported in Scott Sinclair (2015) Platforms are finished, hard-hitting report to suggest, Professional Adviser, 22 October.

[537] Reported in Michael Klimes (2015) Aon launches online retirement platform to deliver freedoms, Professional Pensions, 14 September.

45% thought this issue was very important, compared with only 6% who said this was unimportant

- To allow the adviser to amend income levels online – Equally important for advisers is whether they can make adjustments to their clients' income levels online. For 18%, it was of utmost importance.
- To allow the adviser to select more than one model investment portfolio[538] for an individual client – Pension planning can involve a range of different risk profiles, as it combines long and short-term planning. Advisers wanted to be able to have multiple portfolios on the go. The majority of advisers were concerned about this, while 8% thought it very important.[539]

3.8.2 Robo-advice

'Robo-advice' is portfolio management advice, typically derived from Modern Portfolio Theory (MPT),[540] with the following characteristics:[541]

- Automated with little, or no, human intervention
- Delivered online
- Self-service
- Use algorithms to match portfolios to clients, based on assessed risk tolerance and other factors such as age, and
- Confined to relatively simple portfolio construction matters.

It therefore operates without the features of traditional face-to-face advice, namely questioning, explaining, reassuring and guiding clients. However, some believe that the term robo-advice is a misnomer. An example is Adam Jones, senior consultant at Altus Consulting, who believes that it should be separated into two components, 'automated advice' and 'automated investing'. According to Mr Jones, 'the first of these is the automated or partly automated delivery of the advice process. Many of the solutions still involve real advisers to some extent, but aim to take the steps of the advice process that we know and love, and execute them automatically. This is creating propositions which are cheaper to operate for firms and thus cheaper to procure for customers….Importantly, this type of service is most definitely regulated financial advice. It results in a personal recommendation and carries with it all of the liability associated with that…. [The] second type of proposition is a service where the customer picks a goal, a timeframe and a risk rating. The customer is then presented with a suggested portfolio (usually from a range of pre-packaged investment

[538] See Section 3.11.
[539] Reported in Carmen Reichman (2016) Worries flare over pension product range on platforms, Professional Adviser, 18 January.
[540] In MPT, investment portfolios are constructed to reflect the risk preferences of investors in a way that minimises risk (through efficient diversification) for a given target expected return.
[541] Source: Finametrica.

solutions) and a proposed investment amount. If the investor chooses to go ahead, their contributions are invested into the selected portfolio and it is managed for them in line with the agreed investment strategy, rebalancing as required. Importantly, clients using these services do not provide lots of information about themselves, and the companies providing these services usually argue that they do not constitute regulated advice, as they are not providing a personal recommendation'.[542]

Robo-advice has been used in the US since around 2005. The key US providers are Financial Engines[543] with assets of $104bn and an annual charge of $150 per year, Guided Choice with assets of $12bn and an annual charge of $500, Vanguard's Personal Advisor Services with assets of $10bn and a charge of 30bps, and Wealthfront with assets of $2bn and a charge of 25bps. In the case of Vanguard, clients need a minimum of $50,000. Vanguard also offers more human intervention than the existing offerings: clients with more than $500,000 will have a dedicated adviser, while those with less have a team to draw on. Advisers will design a financial plan for the client based on attitude to risk, objectives and investment horizon. Clients can monitor their portfolio's performance and will receive a quarterly report. Fund management charges are in addition and, the case of the Vanguard funds, range from 5bps to 19bps.

In May 2015, the US financial regulators – the Securities and Exchange Commission and Financial Industry Regulatory Authority – issued a warning to investors and advisers to beware the limitations of automated investment tools:[544]

- Be aware that an automated tool may rely on assumptions that could be incorrect or do not apply to your individual situation. For example, an automated investment tool may be programmed to use economic assumptions that will not react to shifts in the market
- Which questions the tool asks and how they are framed may limit or influence the information you provide. Be aware that a tool may ask questions that are over-generalised, ambiguous, misleading, or designed to fit you into the tool's predetermined options
- An automated investment tool may not assess all of your particular circumstances, such as your age, financial situation and needs, investment experience, other holdings, tax situation, willingness to risk losing your investment money for potentially higher investment returns, time horizon for investing, need for cash, and investment goals.

Pauline Vamos, CEO of the Association of Superannuation Funds of Australia, speaking at the NAPF annual conference in October 2014, said that Australians had already moved

[542] Quoted in Adam Jones (2015) Is this a better name for robo-advice?, Professional Adviser, 5 November.
[543] Started by Professor William Sharpe, one of the founders of MPT.
[544] Reported in Professional Adviser (2015) Robo-advice alert issued in the US, 18 May.

towards self-service pension advice models. She warned that internet-based comparison sites were driving decisions, rather than third-party advisers: 'You don't know who the organisation is behind the comparator….Unless you capture the member early in terms of giving them simple advice services, simple tools that they will use, they will soon be able to get those sorts of services outside. And that may not be in the best interests of the members'.[545]

Robo-advice is not yet common in the UK, although a number of companies have set up in recent years to offer simplified advice. We report the following developments:

- Nutmeg was the first to launch in 2011-12
- Wealth Horizon started in 2014 with a portfolio structuring service on the Parmenion platform on the basis of simplified advice for clients with assets between £10,000 and £150,000, with a charge of 0.75% annually (plus a 0.25% set-up fee in year one). Advice is delivered online and, where required, over-the-phone by CF30 registered advisers
- Wealth Wizard. In August 2015, insurer LV= bought a majority stake. It said it would inject additional capital to assist with its plans to develop a 'white-label' automated advice platform and expand its own CORA (clear online retirement advice) service. Richard Rowney, managing director for life and pensions at LV=, said: 'The way people fund their retirement is changing and so is the way that people access their savings. This deal is a great opportunity for us to support the development of digital solutions to meet the evolving demands of retiring consumers'[546]
- Saidso, owned by Chapters Financial, offers an online, three-stage financial planning service charging £299 for a full report which records users' circumstances, objectives, attitudes to investment risk and tolerance to loss before suggesting solutions. It caters for retirement, investment and protection needs
- Postcard Planning which has a minimum charge of £149 for investment, retirement or regular savings advice, and a maximum charge of around £5,000 for wealthier clients
- Echelon Wealthcare's Fiver-a-Day which charges an upfront fee of 0.5% plus an ongoing flat rate of 0.7% (0.25% of which represents the cost of advice)[547]
- In August 2015, BlackRock announced that it had bought a San Francisco-based robo-adviser which it will use to give mass affluent clients 'holistic' personalised advice on their investment and pension accounts and the management of taxes

[545] Natasha Browne (2014) Rise of self-service advice 'poses threat to UK pensioners', Professional Pensions, 16 October.

[546] Reported in Jenna Towler (2015) LV= steps into robo-advice with Wealth Wizards stake, Professional Adviser, 3 August.

[547] Reported in Scott Sinclair (2015) Four advice gap pioneers the Government must speak to, Professional Adviser, 3 August.

accrued in their portfolios. It will recommend BlackRock's multi-asset model portfolios and investment products, as well as the products of other asset managers. FutureAdvisor will operate within BlackRock Solutions, BlackRock's technology and risk business. Tom Fortin, head of retail technology, said: 'As demand for digital wealth management grows, we believe that our combined offering will accelerate our partner firms' abilities to serve the mass affluent in a convenient, scalable way'. The nascent robo-advice market in the UK is typically associated with giving simplified advice, but BlackRock believes that the acquisition of FutureAdvisor is consistent with its 'mission to help clients solve their most complex investment challenges through technology'[548]

- Intelliflo plans to launch a simplified advice service for advisers which will be embedded in its existing Personal Finance Portal (PFP). This will enable advisers to service a broad base of clients, regardless of the size of their assets. The service will use investment risk profiling tools and several pre-defined investment portfolios. It will also allow the construction of bespoke risk-rated portfolios by advisers for their individual clients. The tool will 'red flag' clients with high value assets or requirements that are not straight-forward, automatically directing them to their adviser to seek more personal advice. Nick Eatock, Intelliflo's executive chairman, said: 'It's a form of robo-advice that keeps the adviser central to the process'[549]
- Towry is launching online services for clients, to supplement its existing face-to-face restricted advice service. Clients will be able to make transactions electronically. Rob Devey, chief executive, said: 'We, like many other wealth managers, have been a face-to-face driven service. The whole of the services industry is changing, people's expectations are changing. The iPad has changed everything. We need to respond to that'[550]
- Charles Stanley is also investigating the possibility of introducing a low-cost automated advice service[551] as is Investec Wealth & Investment
- In January 2016, Royal Bank of Scotland, Lloyds and Santander UK announced that they were entering the robo-advice market in an attempt to reconnect with the lower value mass market customers they dropped following the Retail Distribution Review.[552]
- FinaMetrica has launched a robo-advice toolkit targeting investors with under £100,000 to invest. Investor Profiler creates investor scores which link to a range of

[548] Reported in Carmen Reichman (2015) BlackRock US acquires robo-adviser, Professional Adviser, 27 August.

[549] Reported in Laura Miller (2015) Intelliflo to launch simplified robo-advice service, Professional Adviser, 14 October.

[550] Quoted in Professional Adviser (2015)Towry eyes online services for iPad generation, 20 April.

[551] Reported in Scott Sinclair (2015) Does this extraordinary list of robo-advisers show there's a market for automated 'advice'?, Professional Adviser, 14 April; Professional Adviser (2015) Vanguard launches 30bps 'robo' advice service for £33k clients, 7 May.

[552] Nicola Brittain (2016) Banks muscle in on robo-advice market, Professional Adviser, 25 January.

multi-asset portfolios. The tool is intended for advisers who have clients with simple investment goals, or for use by directly consumers. It bases its investor scores on a 12-question scientific risk tolerance test and questionnaire, which takes into account investors' time horizons, capacity for loss, risk tolerance, knowledge of investments and investment experience.[553]

There are very mixed views about the value and future of rob-advice in the UK. We now consider these.

Mark Loosmore, executive general manager (wealth) at technology group IRESS, argues that most consumers are now very comfortable with accessing information online and with using price comparison websites. An IRESS report entitled *Data, Disruption and the Digital Consumer* found that 80% of consumers now carry out research online before making a significant purchase or investment decision, 39% said it makes interacting with firms more convenient, 21% said it speeded the process up, and almost a quarter said they wanted to view their financial world – bank accounts, mortgages, investments, insurance – in one place. The report found that consumer appetite for both conducting financial activity online and seeking financial advice varies depending on wealth and the type of transaction: 25% of respondents across all income groups are willing to pay for financial advice, while this figure rises to 42% in the case of those with a household income above £60,000. Mr Loosmore believes 'there is an opportunity for advisers here: as well as harnessing the benefits of digital in their own work, they can also shape their proposition to help efficiently deliver this style of advice to a wider audience…[D]igital or 'robo' advice can be implemented as part of a 'menu' of options, with the ability to switch channels as required…Personal input will always be necessary, but this could then be focused on taking the time to develop relationships with the client'.[554]

Andrew Storey, technical sales director at eValue, believes that advisers who harness the power of technology will outpace their rivals:

> *The good news is that the robo-adviser can be harnessed to work for flesh-and-blood adviser, rather than against it. In fact, used correctly, technology-based solutions can be a valuable tool for segmenting an adviser's customer base and servicing legacy clients. Forward-looking advisers will be able to white-label simplified advice propositions offered by networks, platforms and providers, and will be able to offer customers simplified advice for between £150 and £250.*
>
> *By partnering with an organisation that has already done the due diligence on the algorithms and messages under the bonnet of the system, advisers*

[553] Reported in Carmen Reichman (2015) FinaMetrica launches robo-advice tool for sub £100k investors, Professional Adviser, 21 September.

[554] Mark Loosmore (2015) Robo-advice can't be avoided but it can be assimilated, Professional Adviser, 1 July.

can be comforted they are not exposing themselves to unnecessary regulatory risk.

Not only can robo-advice provide an adviser with a revenue source in itself, but it should also be a way to filter large volumes of individuals – whether direct clients or those engaged with through the workplace – and identify those nuggets that can be turned into valuable full advice clients.

Simplified robo-advice systems will present anyone with complex affairs or large portfolios towards messages telling them need to speak to a financial adviser. The workplace, in particular, could prove to be a rich seam of new business for advisers that adapt to this new technology.[555]

Bruce Moss, strategy director at eValue, believes that robo-advice could help to solve the pensions freedom advice/guidance conundrum:

Robo-advice has frequently been seen as a threat to advisers, or as sub-standard and gimmicky. This is wrong and seriously misses the important point that robo-advice is a complement to traditional advice. Robo-advice not only caters for clients who have traditionally been financially inefficient for advisers to serve, it also allows adviser firms to deal with volumes that are way beyond their existing capacity.

The phase the UK is currently in is similar to that which happened in the US some seven years ago. When robo-advice started in the US, it mostly focused on investing new money without reviewing existing investments. In the main, robo-advice in the US has been targeted at the younger investor as a low cost pre-packaged investment option, but even if advisers use the technology to reach the masses, it is still far from a threat to advisers on either side of the Atlantic.

The robo-advice process is simple and short. A few simple questions and a risk assessment questionnaire, a stochastic forecast to help investors understand what the outcome might be, and a recommendation of a model portfolio of mostly ETFs [exchange traded funds] to keep the costs down.

It is a process that is not exactly rocket science and can be easily applied in the UK….Firstly, it is not very difficult to create an investment robo-advice process which ticks all the regulatory boxes. Secondly, it is only really necessary because the dividing line between information/guidance and advice is unclear. Essentially, the more help given to the consumer, the more likely it is that the line between guidance and advice may be crossed. In spite of the FCA's attempts to clarify the distinction between guidance and advice, it remains a grey area which may ultimately be decided by the

[555] Andrew Storey (2015) Advisers must harness robo-advice and 'make it work for them', Professional Adviser, 15 July.

courts. The distinction between online guidance and robo-advice needs legal clarity as the market develops.

Robo investment advice is undoubtedly useful as a means of resolving an area of regulatory uncertainty and providing a source of income for adviser firms from consumers who it would otherwise be uneconomic to serve…

To understand the real potential of robo-advice, we need to understand what it can do to meet the biggest challenge facing the financial services industry today in the UK – that of pensions freedom. Every year more than 300,000 people retire with defined contribution (DC) pensions. Many have comparatively small funds of circa £50,000. With a typical fee of over £1,200 plus VAT for conventional "at-retirement" advice, the fee aversion of most consumers at present seems very understandable.

Beyond being able to reduce the cost of advice dramatically to around £150, robo-advice has the capability to handle hundreds of thousands of cases a year – a feat which would be impossible by conventional means. The numbers needing robo-advice will grow rapidly because all those retirees who don't buy an annuity at outset will potentially need ongoing advice on how to invest and drawdown their retirement savings over the rest of their lives. This combination of high volume and low cost is the real advantage of robo-advice.

As with almost all innovations, there are some potential downsides, but they can all be managed. Robo-advice cannot handle complex cases, but it can handle the majority. In those complex cases, conventional advice can be offered with a substantial discount as a considerable amount of information captured by the robo-advice process can be made available to a human adviser.

The process must be very well-designed and a good model is vital, for any weaknesses in the model will continue to be replicated. Validation checks and monitoring are essential with borderline cases being identified and reviewed. There is also the risk that consumers may struggle to understand and use robo-advice, but innovative design and gamification techniques[556] *can help to engage consumers.*

Robo-advice is important because it helps address the greatest challenge faced by our industry – helping consumers make wise retirement choices.[557]

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[556] Gamification techniques apply 'game-design elements and game principles in non-game contexts..[and] strive to leverage people's natural desires for socialising, learning, mastery, competition, achievement, status, self-expression, altruism, or closure. [They] use rewards for [those] who accomplish desired tasks' (https://en.wikipedia.org/wiki/Gamification).

[557] Quoted in Bruce Moss (2015) Untapped potential: Understanding the real power of robo-advice, Professional Adviser, 12 October.

Jamie Fiveash, chief operating officer at The People's Pension, believes that there is no reason why pension scheme members could not receive advice for less than £100 per head: 'I am surprised trustees are not thinking around advice….We see no reason why you cannot get advice to your members for less than a £100 each. So we are committed to looking at how we can do that and are looking at digital advice as a solution'. He said that the pensions industry was behind other sections of the financial sector in its use of modern technology and could learn from the US: 'I think we will see a lot emerge from the market into this space and there is a lot of learning from the US where they use robo-advice a lot. We think that you can get the cost of advice down through some digital solutions'.[558]

In November 2015, Vanguard released the results of a survey of 70 UK wealth managers. Around 40% viewed robo-advice as a threat, while a similar 40% viewed it as an opportunity to increase efficiency and attract new clients. The rest said the impact would be minimal. Janine Menasakanian, head of wealth for Vanguard UK, said: 'The advent of the robo-advice age is creating significant hype and so it is not surprising that wealth managers are considering the impact over the long-term. What we do know is that technology is here to stay, so wealth managers will need to consider how to embrace the advantages of technology whilst still emphasising the personal, trust and relationship-based parts of their value proposition'.[559]

Also in November 2015, Finametrica published a report entitled *The Robo Revolution*. The report argued that rob-advice is 'paradigm changing' and 'the most significant development in the delivery of financial advice in the past three decades'. However, it noted that the biggest obstacle facing robo-advisers is the same one facing the entire financial services sector, namely the cost of acquiring new clients. This is estimated to be £200 per client in the UK, a sum which is 'beyond the means' of many advisory firms and explains their slow growth. The way around this, according to the report, lies in the white label market via channels that target communities, such as corporations, community groups, and even bloggers: 'The cost of acquiring a customer within a community is a fraction [of the cost] of going to the wider market. We all know this to be true – it is why financial advisers join the golf club….Imagine, for a moment, the impact of Apple offering financial services through a robo embedded into the operating system of its iPhones and iPads'.

Another big challenge in the UK are the regulatory hurdles. The report states that the automated models that do exist operate at the 'lowest levels' of restricted, focused, or simplified advice and are 'basically transactional machines': 'Robo-advisers aspiring to rise any further up the ladder towards more sophisticated advice which includes a portfolio

[558] Reported in Michael Klimes (2015) People's Pension: Robo-advice can be delivered for less than £100 per head, Professional Pensions, 25 September.

[559] Laura Dew (2015) Almost half UK wealth managers call robo-advice a 'threat', Investment Week, 24 November.

recommendation become caught in a strange clash of regulatory and compliance regimes'. These include not only the FCA and the Financial Ombudsman Service (FOS), but also EU legislation, such as MiFID II which has expanded the extent of its 'appropriateness' test. Nevertheless, the report sees robo-advisers as the solution to the advice gap 'as they have scalability and can service customers at low cost' and can help to 'democratise' financial advice.[560]

Chris Woolard said the FCA, via its Project Innovate, is keen for firms to come to market with robo-advice models, so that firms are able to deliver regulated advice 'more cheaply, efficiently and effectively' by employing a 'mixture of technology and human beings'. However, Mr Woolard did accept that financial services firms were reluctant to introduce new advice models because of 'nervousness' about the boundaries separating advice and information. He said the FCA was seeking to clarify its definitions of 'regulated advice' and 'personal recommendations' to help firms develop new, lower cost, distribution models with confidence.[561]

The FCA hosted a forum on robo-advice at the end of September 2015. The FCA said it wanted the industry to provide more people with access to financial 'help', whether advice or guidance. It was therefore planning future policy work around both simplified advice and simplified regulation to make it easier for firms to develop solutions.

The following issues emerged at the forum: [562]

- The Government is keen to support fintech (financial technology)
    - Harriett Baldwin, the Economic Secretary to the Treasury, said the Government recognises 'fintech is good news for all concerned' and will support innovation in the sector 'in any way we can'. The Government recognises that too many consumers are put off by the cost of advice and hopes to find ways to deliver financial help more cheaply through the use of technology
- Safe haven for product testing
    - The Government and FCA want to create a 'safe haven' for firms to test new products on consumers without the regulatory backlash if something goes wrong. The FCA wants to hear ideas built with the intention to act in the best interest of the consumer and will vet the ideas it allows in

[560] Reported in Scott Sinclair (2015) Robo-advice: Report detects 'elephant in the room', Professional Adviser, 5 November.

[561] Reported in Scott Sinclair (2015) FCA: We're primed for robo-advice, Professional Adviser, 22 May.

[562] Reported in Carmen Reichman (2015) Five lessons on robo-advice from day one of the FCA's forum, Professional Adviser, 1 October; Carmen Reichman (2015) PFS CEO Keith Richards: Time to focus on quantity not just quality, Professional Adviser, 1 October; and Carmen Reichman (2015) Fintech expert calls for urgent reform of '20th century FOS', Professional Adviser, 1 October.

- Do people need advice or guidance?
    - The Government is looking at how guidance providers, such as the Money Advice Service and Pension Wise, can be made more effective for consumers. People who fall into the advice gap may not actually need advice, instead they might need guidance
- Is there a role for pure robo-advice?
    - Delegates agreed robo-advice was needs-based, making it suitable for people with a well-defined need. However, most forms of automated advice currently in the market are a combination of an online process and human interaction. They use hurdle questions to identify clients with complex needs and refer them to a human adviser. Some delegates thought certain areas of advice, such as DB-to-DC transfers, could never be automated as they are too complex
- What type of consumers love robo-advice?
    - According to Charlie Nicholls, managing partner of Money on Toast, there are four types of consumer groups: self-directed, validators, delegaters, and avoiders. Self-directed and avoider types do not need or cannot be helped, respectively. Validators and delegaters are interested in to varying degrees but may be confused about their finances. They want help and as such are the target group for robo-advice. Mr Nicholls said: 'Robo-advice is needs-based. It's suitable for low- and high-value investment. Just because HNWs [high net worth investors] are served well by the traditional financial advice market doesn't mean robo can't go into that market and take a large market share'
- Bridging the affordability and accessibility gap
    - Keith Richards, chief executive of the Personal Finance Society, believes that automated services will form a key part in bridging the affordability and accessibility gap created after advisers moved upmarket following the RDR. He also believes that robo-advice is 'complimentary rather than a threat [to regulated advice]. We have seen a number of regulated firms have integrated robo or automated solutions into their processes. Simplified advice was put into RDR as [a means] to bridge the advice gap. We do have challenges we have to address including perception, affordability and accessibility [for which] we need different mechanisms'
- Role of the FOS
    - Ian McKenna, director of the Finance and Technology Research Centre, argued that the FOS needs to be reformed if robo-advice is to stand a chance of flourishing in the UK. He said it was operating a '20th century mandate in the 21st century' and needs to be reformed to allow low-cost advice solutions to enter the UK market. The only thing preventing the growth of robo-advice in the UK is stringent regulatory standards around consumer

protection, in particular, around 'assessing suitability, pension switching and self-defeating transactions'.

Delegates at an Intelliflo conference in June 2015 were warned that advisers who fail to embrace technology, and do all their business face-to-face and via paper, will lose out to more tech-savvy firms which better serve pensions freedom clients. Jane Hodges, chief operating officer at Alexander House Financial Services, also said that the sheer number of people who will need retirement income advice following the introduction of pensions freedom means advisers need to think differently about how to use their skill set to help the maximum number of clients.[563]

This view was shared by participants at a round table on robo-advice hosted by eValue in November 2015. Jason Chapman, managing director of Willis Owen, argued that robo-advice does not pose a threat to face-to-face. Instead, what could pose a threat is advisers' lack of skills in using technology, particularly around building consumer friendly websites and a creating a better digital experience. He added that advisers could embrace technology better than they do today: 'What we need to worry about is the huge sway of individuals who have no access to any advice or any product solution and create the journeys that will enable them to use technology and have a choice of the way that they purchase'. Samantha Seaton, CEO of eValue, said: 'We are always going to have a tension whereby a traditional adviser is probably going to feel alienated and threatened by robo-advice and I think that's perfectly natural. But I don't think that will stop robo-advice from happening'. Others agreed robo-advice was an opportunity to increase the overall size of the market: 'It seems to be an opportunity to expand the market rather than cap the market you've already got. It's to build a whole new group of consumers, who if they may not pay so much to begin with, they use your pipeline and they are paying something'.[564]

Some, on the other hand, believe robo advice will only have a limited future in the UK. For example, Numis doubts whether consumers will ever truly 'entrust their life savings to a computer'.[565] Sheriar Bradbury, managing director of Bradbury Hamilton, does not believe that robo-advice 'will fully replace skilled, professional advisers. I appreciate that tools offering automated solutions are sought by the DIY investor but, in the main, our clients are discerning and want to be challenged. They actively seek the value of strategically and tactically thought-through advice which only a human can provide…There will be aspects of advice that an algorithm is unlikely to replace. Holistic advice involving financial planning for more complex areas of, for example, inheritance tax, retirement, investment planning and the taxation interplay, is unlikely to be replaced by an algorithm any time soon. The

[563] Reported in Jenna Towler (2015) Tech averse advisers risk 'losing pension freedom market share', Retirement Planner, 23 June.

[564] Reported in Carmen Reichman (2015) Adviser tech real threat not robo-advice, specialist warns, Professional Adviser, 19 November.

[565] Reported in Dan Jones (2015) Will robo-advice take off in the UK?, Investment Week, 14 May.

question is which wealth management firms will be on the right side of that technology? These are the firms which will survive extinction'.[566]

Steve Hagues, founder of Retiring IFA, believes that 'nothing beats comprehensive personal service…The challenges that high net worth individuals face in managing their wealth range from the complexity of investing to working with multiple providers – banks, asset managers, accountants, lawyers, insurance agents and so on – to the complications of estate and tax planning…[There] is a benefit for forward-thinking firms to improve their focus and free up resource which can be achieved through tie-ups with other professional service companies, such as lawyers and accountants… [As] the advice market becomes more intricate, raising the value and scope of the service offered to clients is more than likely going to be key to professional services firms' success in the future'.[567]

Chris Williams, chief executive of Wealth Horizon, argues that robo-advice could well push out generalist advisers: 'A generalist adviser who is just really managing portfolios of funds for people has got a problem because fees are going to come down. Investment management and portfolio management are easy to automate. There's an abundance of information out there. People will question the fees they are paying. But where there is real complexity, where an individual doesn't really understand what's happening people are happy to pay for it in that space. That is where we will see fees increase because there is a real need for advice and for getting it right…Robo can go a very long way towards meeting financial advice. What it can't do is replicate the emotional, the empathetic [element] of having a human work with you. It's simply a choice whether they want that or whether they are happy to do it online'.[568]

The Finametrica report *The Robo Revolution* cited earlier considers 10 ways in which robo-advisers will affect human advisers:[569]

- Robos are big
    - You're going to hear a lot about them and they will impact on your life. We believe that the impact will be overwhelmingly positive! Don't believe the gloom that says robos will replace human advisers. They won't
- Robos will be everywhere

[566] Sheriar Bradbury (2015) Robo-advice: 'Some conversations an algorithm can never replicate', Professional Adviser, 8 October.
[567] Steve Hagues (2015) Client satisfaction: Why professional tie-ups trump robo-advice, Professional Adviser, 13 November.
[568] Carmen Reichman (2015) Wealth Horizon CEO: Robo-advice will push out generalist advisers, Professional Adviser, 10 August.
[569] Reported in Scott Sinclair (2015) Ten ways robo-advisers will impact human advisers, Professional Adviser, 5 November.

    - Everyone in the financial services supply chain will have a robo, either as a direct-to-consumer offering or as a tool for financial advisers to use
- Your client base may be under threat
    - Robos will be everywhere and your clients will be courted by them. Your new competitor might be a club or a community based organisation or affiliate – any organisation with a large membership could soon be in the market for a while-label robo
- There will be many different robos for different purposes
    - You will have a choice of robos, which will not all be the same. If you plan on working with any one you will need to assess it carefully to ensure it will be fit for your purpose
- Early-movers don't necessarily win
    - Better to make a considered decision and use proven technology and processes
- Robos will have to adopt suitability standards
    - To flourish, robos will have to meet the same suitability standards as human advisers. It is unimaginable that an advice business would want the same client getting a different recommendation depending on whether they used robo or human advice. A business built on a multi-factor assessment of risk tolerance, risk capacity and risk needed will, of course, expect those same standards in a robo
- Dealing with non-assigned clients and other relationships
    - Robos are quick and accurate at process work, like collecting data. And they make things fast – an investment recommendation can be on the table moments after the data is collected. It will, of course, be expected that robos must integrate with your business practices
- Low-cost, multi-asset portfolios are here
    - Robos deal in very low-cost investment structures and that is going to challenge current thinking, current practice and profitability. Like ripples in a pond, over time the effect becomes unpredictable even when it started out very structured
- You will have to prove your value proposition
    - Advisers are professionals who add value to their clients' financial lives. Be ready to prove that, because you will have to be able to supply that proof to charge higher fees than a robo
- Fees may come under pressure
    - Just as low-cost airlines lowered airfare costs, robos are likely to bring down the base-cost of advice. But, just as with the airlines, some people will not want to fly with the cheapest; some will be happy to pay full economy and some will want the silver-service that comes with first-class. The more holistic and detailed you are, the more you will win. Robos are not currently good at

> complex matters, such tax or estate planning or insurance. Possibly, we will see traditional advice operating to create the financial plan, with robos dealing with ongoing transactional needs

Finally, UBS predicts direct advice and simplified advice's share of the UK retail savings market will rise from 21% to 29% by 2025, although it does not identify how much of this will be robo-advice. It also predicts workplace advice's share will increase from 19% to 31% by 2025.[570] McKinsey believes the market for virtual wealth management advice has the potential to generate annual revenues of $66 billion.[571]

3.8.3 RetirementSaverService

The RetirementSaverService is a proposal made by Mark Hoban in January 2015 when he was MP for Fareham:[572]

> *The RetirementSaverService (RSS) would facilitate better retirement planning by supporting savers to see how their current savings might translate into income in retirement and what this means for how much they save, how long they plan to work and their appetite for risk. The service would do this by bringing together the multiple strands of information about an individual's assets and sources of income on a user-friendly online service. The RetirementSaverService would also provide tailored guidance to people approaching retirement. It would bridge the gap between the limited guidance currently provided and regulated advice, which remains unaffordable for most people. The service would help them choose suitable approaches and avoid unsuitable products through a narrowing of choices. The service would be independent and provided in the first instance by the Money Advice Service, building on its existing operations in this space….*
>
> *The RetirementSaverService is targeted at meeting [two] needs: guidance to support savers and a focal point of drawing together savings information. It would be a digital service providing guidance for users. It would be a self-directed service; offering tailored guidance driven by answers given by users to a series of questions. Although focused on retirement planning, it will use data about pensions and other assets alongside personal information to produce tailored guidance. It will not produce personal recommendations but will present a series of choices to users with the user making the final decision.*

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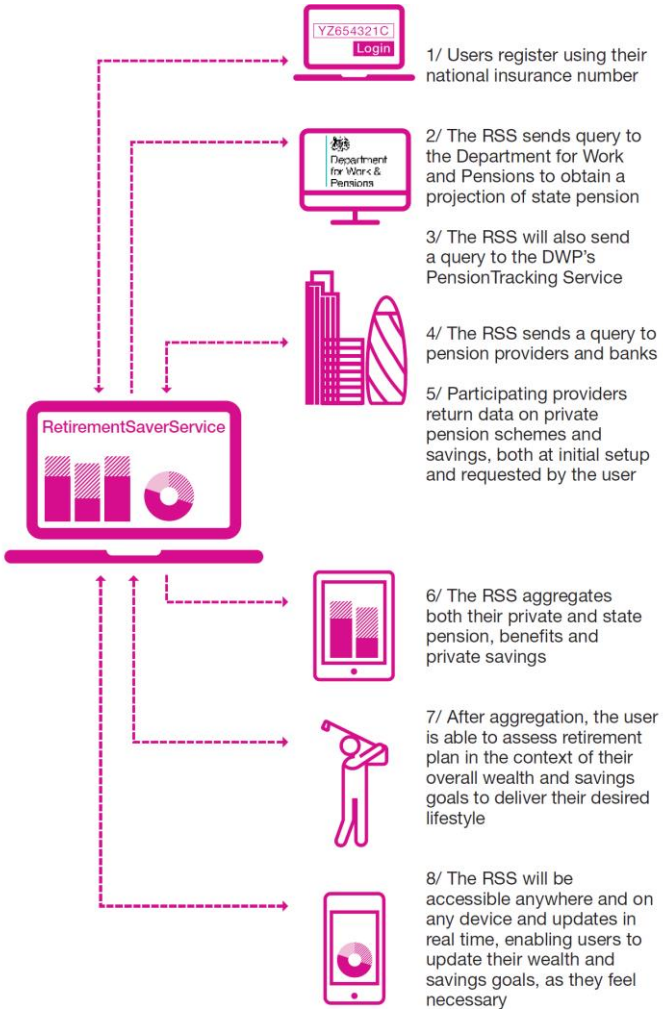
[570] Reported in Dan Jones (2015) Will robo-advice take off in the UK?, Investment Week, 14 May.

[571] Sarah Krouse (2015) Virtual financial advice set to soar, efinancialnews, 1 June.

[572] Mark Hoban (2015) RetirementSaverService, Reform, January; http://www.reform.uk/wp-content/uploads/2015/01/RetirementSaverService.pdf

Figure 3.2 shows a network map which illustrates how data could be shared and aggregated across the RetirementSaverService, while Figure 3.3 shows how users might interact with RSS from joining to retirement.[573]

Figure 3.2: RetirementSaverService network map



[573] Respectively, Figures 6 and 7 in Mark Hoban (2015) *RetirementSaverService*, Reform, January.

Figure 3.3: Lifecycle of the RetirementSaverService

3.9 Is there an advice gap?

3.9.1 A number of advice gaps have emerged

Things do not appear to have gone according to plan. The year between the 2014 Budget and Flexiday, 6 April 2015, was devoted to establishing a system of guidance and advice to meet the needs of those exercising their pension freedoms. The Government would provide the guidance guarantee and, following this, people would be queuing up to seek advice. Now it was not clear at first whether they would be looking at simplified advice or fully regulated advice and there were different views within the advice community about which was more appropriate. It was felt that those with pension pots less than £30,000 would take cash and not seek advice at all. It was also felt that those with pension pots above a certain size (£100,000 or some amount above this) would be likely to – and certainly should be encouraged to – seek full regulated advice. The debate within the advice community was about how many of those with pension wealth between £30,000 and £100,000 would look for simplified advice and how many would take the full regulated route. A new kid on the

block is robo-advice. It is too early to predict what effect this will have on the advice market as a whole, except to say that it could be significant, despite not being able to deal with the 'emotional' needs of customers.

But this is not the way things have worked out. According to Robert Cochran from Scottish Widows: 'The 'guidance guarantee' offered via Pension Wise will offer savers access to information, but early indications suggest this is being sorely under-utilised, with barely 15% of the available appointments being used. For those who do reach the door of the Pension Wise offices, they will find it only gives a certain level of support, and for those who want a recommendation appropriate for their circumstances, they're likely to struggle finding it at a "reasonable" cost. The clincher is that this new segment may not even be aware they need advice. For those who've been saving for a few years and are now approaching retirement with a modest pot, they have a plethora of choice and little understanding of what the options are, or what the tax implications could be. Some may even be confused about the differences between advice and guidance and believe they've already had advice from their providers or Pension Wise, or think the guidance they've had is enough'.

Arguments such as these have led to the view that an advice gap has developed in the UK. Mr Cochran believes 'there's a growing number of people with relatively modest pension savings, and it's becoming apparent that there's a gap in the market for advice aimed at people with smaller drawdown pots. This gap stands to widen as the effects of auto-enrolment start to unfold, and the full potential of the new freedoms truly hit home. … Advice may well be perceived as a luxury for richer clients, but what many consumers won't realise is how much of that fee could be offset as a result of the advice they receive'. He then provided an example to demonstrate the point. The individual has a £45,000 pot which they want to take as cash. Their marginal tax rate is 40%, so will pay £13,500 in tax. But if advised to split the amount taken over two years , the individual could save up to £8,870 in tax, offsetting the £1,500 cost of advice.

Mr Cochran also appeals to providers to help: 'Some providers apply a charge per withdrawal when people take encashment, which eats into the capital which could be used to pay for an adviser. By making products simpler and limiting or removing charges from encashment, it would make it easier to sell into employees with smaller pots, enabling them to seek out paid-for advice without eroding their modest savings'.[574]

Stuart Wilson, managing partner at Later Life Academy, goes further than Mr Cochran and argues that advisers should offer Pension Wise retirees free regulated advice up to a limit. He believes that 'guidance represents an untapped opportunity which, if executed correctly, could deliver a large number of new clients with varying later life advice needs, plus of course, the referrals that naturally come with any satisfied individual…. [This follows

[574] Robert Cochran (2015) What can be done about the advice gap?, Professional Adviser, 23 July.

because Pension Wise] is a long way away from tailored advice which delivers a clear route-map and recommendations for what to do next….[F]or advisers interested in these clients, the important part is developing a proposition which takes these individuals on the next stage of the client journey…By that I mean advisers are probably going to have to offer up some "free" time and advice in order to move the client on – this means taking the information provided by Pension Wise and making it much more specific, it means highlighting options and areas which guidance will not have covered, it will mean a discussion of pension options, but also offering some clear idea of what that may mean for tax burdens and benefit entitlement…And this should be offered free of charge because a client leaving Pension Wise may well recognise their need for financial advice, but they may not yet be in the headspace which means they are willing to pay for it. After this initial session however, the adviser will be able to make clear that any next steps come with a charge'.[575]

Some argue that any controversy over a widening gulf between those who need financial advice and those who can actually afford to pay for it is not actually the advisers' problem. For example, Geoff Mills, founding director of Rayner Spencer Mills Research, says 'The role of the [advice] industry is to educate those who can pay for [advice] about the benefits of it. Yes there is an advice gap but that's not for advisers to solve. That is for the Government to worry about, not businesses'.[576]

The Association of Professional Financial Advisers (APFA) has pressed for advisers' contributions to funding Pension Wise to be reduced because they are not winning sufficient follow-on advice business.[577] Nevertheless, APFA reported that by September 2015, 90% of advisers had received an average of eight new enquiries about getting financial advice on accessing pensions. Around half the advisers surveyed said the request for advice was on how to transfer out of a DB scheme. Although not all enquiries resulted in a transaction, the survey suggests that up to 150,000 people had contacted an IFA. This compares with the 400,000 people who reach retirement age each year. It is recognised that many people fail to take advice because they say that they cannot afford it, resulting in an 'advice affordability gap'. APFA agreed that more needed to be done to lower the price of advice and for Pension Wise to explain the value of regulated financial advice.[578]

It is also becoming clear that a different type of advice gap has emerged – the inability of some segments of the market to find advisers even when they want advice. Whatever the

[575] Reported in Jenna Towler (2015) Why IFAs should offer Pension Wise retirees free regulated advice, Retirement Planner, 14 July.

[576] Reported in Laura Miller (2015) Advice gap branded 'not advisers' problem', Professional Adviser , 31 July.

[577] Reported in Scott Sinclair (2015) Advisers not winning clients via Pension Wise, says APFA, Professional Adviser, 20 May.

[578] Reported in Carmen Reichman (2015) APFA: Almost all advisers see pension freedom enquiries, Professional Adviser, 1 September.

merits of using advisers, some believe that customers with small pension pots will struggle to find advisers who will take them on. According to Graham Bowser, a certified financial planner at QS Financial Planning: 'In practice, most IFAs will not be willing to engage with these "extra" low value retirees who might want to extract funds or use drawdown because the regulatory/compliance risk will be so much higher than is the case when dealing with people in the traditional drawdown market (those with £100,000-plus in pensions and have other savings/investments)'.[579] Chris Smallwood, chief executive of 2plan, said 2plan advisers have been instructed to turn away clients wanting to cash in their pots or move into drawdown when the amount is between £30,000 and £100,000. The firm would only recommend drawdown for pots above £100,000 if it believed it was a suitable product after giving full advice. For many others, an annuity is 'still the right option'.[580]

A related issue is the shortage of advisers following the implementation of RDR which significantly reduced the number of advisers in the market. David Thompson, managing director of business development and proposition at AXA Wealth, has looked at the number of advisers in different countries in relation to population size. Hong Kong, which had an RDR-style reform in 2015, has a one financial adviser for every 156 people. In the US and Australia, there is one adviser for every 1,400 people, while in Canada, there is one adviser for every 1,900 people. By contrast, in the UK, there is one adviser for every 2,700 people.[581] Mr Thompson believes 'we run the risk that people will go looking for advisers and there's going to be no one there to answer the call'.[582]

Steve Hagues of Retiring IFA expects more consolidation of the adviser market via mergers over the next couple of years as a consequence of increased competition from simplified and online advice. He said: 'Advice firms need to be on the ball to make sure they don't lose clients….Do you remember when garages sold fuel and not much else? Most are mini-supermarkets now….Accountants are increasingly interested in investment advice, while financial advisers are beginning to understand the power of doing a client's tax return and probate. The advantage of servicing clients' needs across the board is slowly starting to gain acceptance in the advice industry…As the decade progresses, if you don't ring fence your clients, you will be faced with having to defend them relentlessly from the other professions. Those who move across the professions are likely to succeed at the biggest client land grab wins due to the principle of first mover advantage. As the industry develops, it's clear the lack of a linked up or overarching strategy across different professional service

[579] Quoted in Jenna Towler (2014) Will platforms struggle to cope with pension freedom?, Retirement Planner, 9 December.

[580] Reported in Carmen Reichman (2015) National IFA 2plan won't offer small pot drawdown advice, Professional Adviser, 3 March.

[581] The total number of financial advisers in the UK in 2015 was 22,500 (working in 4,500 firms) down from 26,000 in 2011 (Reported in Carmen Reichman (2015) Adviser numbers up 5%, official figures show, Professional Adviser, 18 November).

[582] David Thompson (2015) Are advisers becoming an endangered species?, Professional Adviser, 23 July.

offerings could be a missed opportunity. At the moment, everyone is doing their job, but no one actually owns the client's overall real outcome'.[583]

The issues of mass access to advice and people being priced out of advice has been an increasing concern of the FCA since RDR. As we mentioned earlier, its solution was simplified advice. But a perceived lack of clarity from the regulator around the rules and liability for simplified advice has meant the concept has not yet taken off.[584]

The FCA is working on a middle-ground category where advice is offered but not a personal recommendation.[585]

> *We have therefore been discussing with our stakeholders the options for low-cost, simpler ways of recommending retail investment products, particularly for customers with relatively modest amounts to invest and relatively straightforward investment needs. It is clear that there has been some reluctance on the part of firms to develop these models and we are keen to understand more about the barriers firms believe they face.*
>
> *We are also aware that firms offering retail investments without personal recommendations want greater clarity on how they can support customers in making informed decisions – increasingly via technology-rich solutions – without stepping over the boundary into providing a personal recommendation.*[586]

3.9.2 The Financial Advice Market Review

In August 2015, the Treasury and FCA launched a major review of the financial advice market. The Financial Advice Market Review (FAMR) has been set up to improve consumers' access to financial advice.

Its terms of reference are to examine:[587]

- the advice gap for those people who want to work hard, do the right thing and get on in life but do not have significant wealth
- the regulatory or other barriers firms may face in giving advice and how to overcome them
- how to give firms the regulatory clarity and create the right environment for them to innovate and grow

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[583] Steve Hagues (2015) Consolidation- The changing shape of adviser mergers, Professional Adviser, 28 May.

[584] Reported in Laura Miller (2015) Advice gap branded 'not advisers' problem', Professional Adviser , 31 July.

[585] Financial Conduct Authority (2014) *Retail Investment Advice: Clarifying the Boundaries and Exploring the Barriers to Market Development*, Guidance consultation GC14/03, July;
https://www.fca.org.uk/static/documents/guidance-consultations/gc14-03.pdf

[586] Note that MiFID II goes further and would class this type of advice as regulated.

[587] https://www.gov.uk/Government/publications/financial-advice-market-review-terms-of-reference

- the opportunities and challenges presented by new and emerging technologies to provide cost effective, efficient and user friendly advice services, and
- how to encourage a healthy demand side for financial advice, including addressing barriers which put consumers off seeking advice.

The review will consider the current regulatory and legal framework governing the provision of financial advice and guidance to consumers and its effectiveness in ensuring that all consumers have access to the information, guidance and advice necessary to empower them to make effective decisions about their finances.

The review will also consider the interplay between the regulatory framework for advice and the role of the FOS and the Financial Services Compensation Scheme (FSCS) in redress. The initial evidence gathering will have a broad scope before narrowing down to consider those areas where the so called advice gap may be most acute. The initial evidence gathering will request examples of problems in obtaining advice in the following markets:

- investments, savings, pensions, and retirement income products (including annuities)
- mortgages (including Help to Buy and equity release) and consumer credit
- general insurance.

The review will also examine evidence from consumers about the barriers they face in seeking advice, the value they place on it and how easy it is to understand where advice can be found and what it means.

While focusing on consumer financial services and products, the review will also look at the provision and effectiveness of advice across retail markets to assess whether differences in regulatory requirements around advice lead to unintended consequences for consumers and firms.

Finally, the review will come forward with:

- a package of reforms to:
    - empower and equip all UK consumers to make effective decisions about their finances
    - facilitate the establishment of a broad-based market for the provision of financial advice to all consumers
    - create a regulatory environment which give firms the clarity they need to compete and innovate to fill the advice gap
- a set of principles to govern the operation of financial advice
- measures to ensure standards of behaviour for firms within all types of financial advice market are in accordance with those principles
- proposals as to whether the regulatory perimeter for financial advice should be amended, taking into account European legislation

- an examination of the role that might be played by regulatory carve-outs, such as a so called safe-harbour
- a consideration of the proportionality of rules and their impact on affordability and availability of financial advice and products
- indications of
    - the resources needed for implementation of these proposals
    - a framework for evaluating how successful reforms have been in closing the advice gap, post implementation.

The FCA said it understood advisers' concerns about their liability for simplified advice that focuses only on specific client needs and dealing with this issue would be a core part of the review. The regulator said it would need to consider clearer and simpler options from both the consumer and adviser point of view. However, it was unlikely the FCA would consider removing liability for 'simple' advice solutions altogether. Speaking at a Work and Pensions Select Committee hearing on 16 September 2015, Christopher Woolard said: 'There is a further jump…to create a safe harbour where if you give someone advice and charge for that in some way and yet not take responsibility for that advice given – that feels like a step too far. But there is a lot we can do listening to those concerns to come up with something to help consumers and the advice community'.[588]

The Treasury (represented by Charles Roxburgh, director general of financial services at the Treasury) and the FCA (represented by Tracey McDermott, acting FCA chief executive) will lead the review with an advisory panel of industry and consumer experts, chaired by Nick Prettejohn, chairman of Scottish Widows. The Treasury said it wanted to make sure people can access high-quality, affordable, tailored guidance and advice to help them make informed financial decisions. Harriett Baldwin said: 'Making sure that our financial services sector supports working people at every stage of their lives is a key part of our long-term plan. That's why we've launched a major new review to explore what more can be done to make sure consumers can access high quality and affordable advice so they can make informed decisions with their hard-earned money'.

Huw Evans, director general of the ABI, said: 'This is a welcome step which comes at a good time. The new pension freedoms have highlighted how important it is that proper advice is accessible to all, not just those that can afford it'.

Chris Hannant, director general of the Association of Professional Financial Advisers (APFA), said: 'We welcome Government recognition of the need to examine the legislative barriers to accessing affordable financial advice. We believe there needs to be a fundamental rethink of the current regulatory environment, particularly around liability' and listed, as examples,

[588] Reported in Carmen Reichman (2015) FCA: We understand advisers' concerns about simplified advice liability, Professional Adviser, 16 September.

the lack of a long-stop [i.e., an open-ended liability] for advisers, the levy approach of the FSCS which penalises regulated advisers for those unregulated investments which go wrong, as well as imposing an unpredictable and seemingly ever-increasing fee burden, and concerns that the Financial Ombudsman Service faces 'systematic problems' in its decision-making. He said: 'Consumers need to understand that investments can never be 100% risk-free. We look forward to continuing to work with HM Treasury and the FCA as part of this review and elsewhere to ensure liability is assigned more fairly and that steps are taken to minimise the cost of regulation for professional financial advisers'.[589] In evidence to a Work and Pensions Select Committee hearing in September 2015, Mr Hannant said: 'There had been incidents where an adviser had, for example, set up a self-invested personal pension, the client had then undertaken their own investments but the adviser had still been held responsible. There is no time limit on which a complaint can be brought to the ombudsman. There are long tail liabilities. The way the FSCS is funded needed a fundamental hard looking at…. [Further], many advisers can foresee problems further down the line as pensions freedom beds in over the coming years. Everyone is saying things have gone reasonably well, they haven't fallen over. But the biggest concern among my members is that they foresee problems further down the track. We won't know until five or ten years down the track [if the reforms have been a success]'.[590]

In October 2015, the FCA announced that it was considering five options for re-introducing a complaints long-stop for advisers:

- Maintaining the current regime – not putting in place a long-stop
- Introducing a single long-stop – for example, a longstop of 15 years (such as that applying to certain causes of action under the Limitation Act 1980), or using a different time period recognising the long life of financial services products
- Introducing varied limitation periods linked to the terms of products – for example, differential time limits which reflect the nature of products or advice, so that liability extends for a longer period when it relates to longer-term products (for example, 25 years for a mortgage)
- Enhanced professional indemnity insurance (PII) – strengthening PII for firms so that it includes cover sufficient to meet claims relating to long-term advice, whether the firm is still in business or not
- A compensation fund – setting up a compensation fund which would pay out in the event of a justified claim older than 15 years against an individual firm, which all

[589] Reported in Jenna Towler (2015) Govt and FCA launch major review of financial advice market, Professional Adviser, 3 August.

[590] Reported in Jenna Towler (2015) APFA: Long-stop is missing piece to mass-market advice puzzle, Professional Adviser, 8 September.

firms would contribute to, but which would not require the firm concerned to be insolvent before paying.[591]

The review was also welcomed by advisers. For example, Keith Churchouse of Chapters Financial and Saidso, said: 'There are millions of people who are just not engaged in the financial advice process who should be. There is a mass market, we are talking millions of people, who are totally disenfranchised from financial advice but not through either their own choice or their own knowledge….The reality is that unless people are guided towards taking advice they will carry on probably doing not a lot and missing out on great opportunities to make their money work harder….There are always those who think that everything in life should be free, but I do not think they will get the answers that they want. However, I do think there is a middle market who are prepared to pay a nominal fee for good quality guidance and advice. To say "this is what you should be doing, this is who you should be doing it with". It is those [people] who need to be dealt with. The question is how much is a nominal fee? At Saidso it is £299. I am not saying that is the answer, but it is an answer. I am sure there will be competitors across the market'. Mr Churchouse also believes financial advice aggregator sites will come to the fore over the course of the next ten years. Such sites would compete for business to guide investors towards individual recommendations. This is a different concept from robo-advice which he believed would also become popular: 'Robo-advice might be another low-cost solution, people might be prepared to pay less for that. They are a bit like tracker funds – they are very cheap but run by a computer to keep costs low. Some people might want that, [but] some people might want a bit more of a personal approach'. He does not believe either of these initiatives will be a threat high quality financial advice: 'The reason why this review is going through is that these people are not being serviced at all. Even when internet services come into place, they still won't be a financial adviser's target market'.[592]

Similarly, Wealth Horizon's Chris Williams believes the introduction of safe harbour legislation for financial advisers would be a welcome step towards rebalancing liability between advisers and clients. Safe harbour legislation exists in both the US and Australia. In the US, it means employers cannot be sued if they followed certain steps when arranging employees' pension investments that later underperform; in Australia, it sets out the steps financial planners need to take to ensure they meet a statutory obligation to act in clients' best interests. Mr Williams believes safe harbour legislation could bring about a regulatory environment that recognises caveat emptor, or buyer beware: 'There has to be a view that consumers are able to make their own decisions based on relevant information. Trying to

[591] Reported in Scott Sinclair (2015)A complaints long-stop: Five options on the table, Investment Week, 12 October.

[592] Reported in Jenna Towler (2015) Millions of 'disenfranchised' savers could benefit from advice review, Professional Adviser, 3 August .

instil that level of responsibility and determination for consumers would be really important'.[593]

In October 2015, the FCA reported that it had identified eight main reasons which prevented people from seeking financial advice, and hence created an advice gap. The FCA defines an advice gap as 'any situation where consumers cannot get the form of advice that they want on a need they have, at a price they are prepared to pay'.

The eight reasons are:

1. Price

   Consumers may view the price for advice, particularly for professional, face-to-face advice, to be too high. A survey by unbiased.co.uk found that consumers are paying an average hourly rate of £150 for professional, regulated advice (though this represents a 14% drop compared to 2013). Some consumers may also find it hard to judge the value of advice because the benefits are usually deferred over time and more intangible than for purchases of non-financial products.

2. Lack of trust

   Consumers may not trust firms in the financial services market to act in their best interests, or be able to identify which firms are trustworthy and could provide valuable service.

3. Lack of knowledge

   Consumers might not recognise the need for advice or be aware of it. They also may not understand how to obtain it. As many people engage only infrequently in the market, this is not an area where people can easily gain experience to inform future decisions. In addition, consumers may lack confidence about the process, feel embarrassed about their lack of knowledge or concerned they may be judged for previous decisions – this may cause consumers to make non-advised financial decisions with poor outcomes. For example, a Mintel report showed that there might be a sizeable group of consumers who lack a basic understanding of what professional advice involves and how to obtain it. Of the consumers surveyed, 44% believe it is too complicated to understand how financial services firms can help them manage their finances, and 34% do not believe that professional advice is geared towards them. Moreover, 14% of consumers said they would not know where to begin looking for a financial adviser.

[593] Reported in Scott Sinclair (2015) Call for 'safe harbour' for advisers as rules reviewed, Professional Adviser, 4 August.

4. Engagement

Consumers who are disengaged with financial services generally are unlikely to engage with the process of seeking advice. Others may not recognise the complexity of their financial needs, e.g., longevity, tax, long-term care, benefits and investment returns may be relevant to a decision about retirement planning. Still others may feel they need financial advice but never be prompted sufficiently to seek it.

5. Overconfidence

Some consumers might believe they are as competent as a professional adviser, even though they could benefit from using one. As a result, consumers might not seek professional advice or, if they do, not follow the advice.

6. Access to face-to-face advice

Depending on their location, some consumers may not have easy access to advisers, and others may not wish to make the time to meet with an adviser.

7. Access to the internet and concerns with sharing data online

Where advice is available via the internet (for example, in the form of information, generic advice or an automated online advice service), lack of ability to use such channels and tools may prevent some consumers from getting advice in this way. Consumers may also have concerns about sharing sensitive personal data online.

8. Advice not necessary

Consumers may make a rational and reasonable decision that they do not need advice and are capable of making a decision themselves. This could be the case, for example, where the situation and options are simple and the risk is low, or where the effort or cost of seeking advice is disproportionate to the benefits.[594]

In the same month as FAMR was announced, the results of a survey by comparison website Money showed that the majority of the 669 over-55s with a pension pot who were surveyed neither wanted advice nor were willing to pay for it. The reasons respondents gave for not taking financial advice were: they do not feel they need it (59%), they think advice is a waste of money (28%), they could not afford it (27%), and they want their money quickly without any hassle (15%); further 10% of women said they felt intimated by advisers. Just one in five said they would use Pension Wise and give this as a reason for not going on to pay for advice. Only one in five of the over-55s – and just 13% of men – are willing to pay for

[594] Reported in Laura Miller (2015) Eight reasons people don't seek financial advice, Professional Adviser, 12 October; and Carmen Reichman (2015) FCA advice gap focus turns to income thresholds, Professional Adviser, 12 October.

financial advice. Of those who are planning to pay for advice, 82% said they wanted to get such a major financial decision right. In terms of cost, the average amount the respondents would be willing to pay for advice was £253, with more than half saying they wanted to pay £200 or less; according to Money, the average cost of an initial financial review is double this at around £500. Around 25% of respondents were planning to make a withdrawal from their pot, but only a third of these said they fully understood the tax implications of doing so.[595] The results of this survey indicate another aspect of the advice gap, namely the unwillingness of people to actually seek advice in the first place.

David Brooks, technical director at corporate advice firm Broadstone, explained the results of this survey in terms of the 'Dunning-Kruger effect', described by David Dunning as follows: '...incompetent people do not recognise – scratch that, cannot recognise – just how incompetent they are…What's curious is that, in many cases, incompetence does not leave people disorientated, perplexed or cautious. Instead, the incompetent are often blessed with an inappropriate confidence, buoyed by something that feels to them like knowledge'. While competent individuals tend to underestimate their ability, the opposite is true for incompetent people.[596]

A survey by Aegon, published in November 2015, found that consumers thought they needed a pension pot of around £121,000 before advice was needed, and that they were reluctant to pay for advice with assets below this amount. While some advisers believe that £30,000 is a viable sum to make advice worthwhile, only 6% of potential clients thought paying for advice on a pot of £30,000 would be worth it. The survey also found that customers with £50,000 would, on average, be prepared to pay £191 for advice, while those with £250,000 would pay £314. The benefits perceived by customers from taking advice were the potential to grow their investments (42% of respondents), peace of mind that they have been advised by an expert (34%), and the feeling that they had made the best decision for their circumstances (28%).

Commenting on the findings, Duncan Jarrett, Aegon UK managing director, retail, said: 'There is a significant gap between what consumers believe they need to have saved before they seek advice, and the amount advisers believe is required to make advice worthwhile. The Government's consultation on methods of extending advice needs to look at ways of reframing consumer thinking. Take a household example, as a car gets older many people opt for an annual service which can spot potential problems early. While it involves a regular cost, it could pay you back many times over if it prevents a major expense at a later date.

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[595] Reported in Laura Miller (2015) The reasons over-55s don't want your advice, Professional Adviser, 17 August.

[596] David Brooks (2015) Blog: Understanding why people don't want your advice, Professional Adviser, 18 August; Justin Kruger and David Dunning (1999) Unskilled and Unaware of It: How Difficulties in Recognizing One's Own Incompetence Lead to Inflated Self-Assessments, *Journal of Personality and Social Psychology*, 77(6), 1121–34.

The same is true of advice. When people understand that the cost is potentially securing them a much more comfortable retirement or removing a major worry, then the value becomes apparent'.[597]

In October 2015, Citizens Advice released a report called *The Four Advice Gaps*.[598] The report concludes that more than 5 million people would be willing to seek out and pay for regulated advice, but are not prepared to pay current prices. The report also argues that there is not a single advice gap, affecting those who want advice but cannot afford it. Rather, there are four gaps which lead to a range of people missing out on the benefits of advice and the security that it affords. The results are based on responses from more than 2,000 individuals and 'scaled up' based on the 2011 population total of 48.3 million.

The four advice gaps are:

1. The affordable advice gap affects consumers who are willing to pay for advice, but not at current prices. According to Citizens Advice research, up to 5.4 million additional people would consider paying for advice if it cost less. While 20% of the population would consider paying for advice when making an investment, just 6% would pay £500 or more for simple investment advice.
2. The free advice gap affects people who want advice, but who are unable to pay for it. Citizens Advice said up to 14.5 million people who think they would benefit from free advice haven't taken any in the past two years. This includes some 735,000 people who have apparently tried to access free advice but have been unable to due to a lack of supply.
3. The awareness and referral gap affects people who are not aware that advice exists, or where to get that advice. As many as ten million people who think they would benefit from free advice are not aware of public financial guidance, according to the Citizens Advice report.
4. The preventative advice gap affects those who need financial guidance at key points in their lives, but do not take it because it is not marketed properly, or do not get the required breadth of help they need when they do.

In addressing these advice gaps, the FCA has announced it seeks to explore how access to advice can be 'radically improved'. It has therefore announced, as part of FAMR, an advice consultation which will focus on the following questions:

- What kind of financial advice do consumers want?

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[597] Reported in Jenna Towler (2015) The magic number: Consumers see £121k as advice tipping point, Professional Adviser, 23 November.

[598] Reported in Professional Adviser (2015) Five million more would pay for advice (if it cost less) – report, 15 October.

- Are there gaps between the financial advice that consumers want, and the financial advice that they can access and afford?
- How can these gaps be closed?
- What role could technology, such as robo-advice, play in improving access to financial advice?

There will be a simultaneous guidance consultation which will consider how the Government should structure the provision of free, impartial guidance, including that given by the Money Advice Service (MAS) and Pension Wise, to give consumers the information they need, either to make financial decisions directly or to seek the right additional advice to help them do so. The two reviews will provide a complementary and comprehensive analysis of the advice landscape.[599]

While recognising that the advice gap exists, firms could be opening themselves to risks further down the line if they rush to fill it, according to Simon Laird, a partner at law firm RPC. Addressing an audience of financial advisers at the Wealth Management Association's Investment Conference 2015, he said that 'ordinary people need to make crucial decisions about how to invest their money to last them for 30 years or more….The reality is if firms get tempted into that advice gap [by offering simplified or flat-fee products] without some sort of thought-out structure behind it, then they might only be wanting to help, but if it goes wrong, they're going to be turned on and people are going to lay criticism at their door later down the line… If people do start taking shortcuts to keep costs down, they could fall foul of the regulator'.[600]

The FAMR consultation drew the following responses:

- Thomas Miller Investment has called on the Government to extend a tax exemption for employers who arrange financial advice for employees. The HMRC exemption from an employee benefits tax charge for regulated advice costing an employer up to £150 per person per year should be increased to as much as £1,000 per individual. This would confront the 'inconvenient truth' that 'the only way to ensure people make good decisions is to ensure they get good, sound advice from highly-qualified, highly-regulated advisers'. Matthew Phillips, managing director, said that the Government must face up to 'where the country finds itself. The reality is that retirees' choices are varied, older pension schemes are complex and a 45-minute guidance session will offer nowhere near the level of assistance that most people need to make an informed decision. Sorting out the regulatory befuddlement between advice and guidance is welcome, as is anything that reduces the jargon of

[599] Reported in Carmen Reichman (2015) FCA and Treasury launch 'advice gap' consultations, Investment Week, 12 October.
[600] Reported in Sara Benwell (2015) Firms should be wary of filling the advice gap, Pensions Insight, 5 October.

the financial services industry, but here is the catch: it rather misses the point. The only way to help people is for them to receive advice, and the reality is that with advice there are no half measures. If you have a regulated advice community, it is binary - it either gives advice, for which it is liable, based on an individual's full position, or it does not. It is a tailored solution and tailored solutions come at a price…An increase in the HMRC tax exemption is the best and most practical solution, actively encouraging the use of professional regulated advisers'.[601]

- The Financial Inclusion Centre has called for the establishment of a funded national advice network to help bridge the advice gap, with the funding provided either by industry or the Government. The network would 'provide advice, guidance, and information to consumers who are not commercially viable for the for-profit financial services industry. This must involve some form of cross-subsidy either from the public purse or from the industry. Closing the advice gap means focusing on making the financial services industry more efficient, so it can extend its reach to more consumers and providing alternative provision for consumers who are not commercially viable for the for-profit advice sector'.[602]
- The ILC-UK has called for a new type of advice for older retirees that would sit between the non-advised and advised categories and be cheaper to deliver than full regulated advice. In a report published in December 2015 and entitled *Understanding Retirement Journeys: Expectations vs Reality*, the ILC-UK said: 'Bringing financial advice to the mass market – whether face to face, over the phone or on the internet – is long overdue and we call on the Financial Advice Market Review to facilitate real change in this area'. Using data from the Living Costs and Food Survey and the English Longitudinal Study of Ageing, the report found evidence of under-consumption among the older population who hold the majority of their savings in low interest current accounts. Further, people typically started reducing their consumption around the age of 70, so their saving levels start to rise, thereby creating a drag on economic growth. Much of the decline in consumption came from reduced spending on non-essential items, such as holidays and eating out, whereas spending on essential items such as food remained flat. Some of the reduced spending could be explained by consumers becoming more uncertain about their income. To circumvent this, consumers should be actively re-engaged in the planning process at this point by being offered regular full financial health checks, through

[601] Reported in Professional Adviser (2015) Call for £1k pensions advice tax exemption for employers, 20 October.

[602] Reported in Carmen Reichman (2015) Think tank calls for state-funded national advice network, Professional Adviser, 21 October.

both Pension Wise and the proposed new type of advice. That advice would mention the importance of buying a lifetime annuity to provide security of income.[603]

- The Pensions and Lifetime Savings Association (PLSA) called on the Government to replace the environment where savers are left largely in the dark about the specific options open to them to one where they are signposted to quality-assured retirement income solutions: 'While leaving savers with the right to decide how to use their own retirement pot, this would ensure that the path of least resistance is much more conducive to good outcomes than today's effective default of taking cash'. Although wider access to advice would help ('but only for the few not the many'), the reality is that most people are not inclined to seek advice and are reluctant to pay for it. The PLSA's own research showed that, among those who have already accessed their pension, only 39% sought out financial advice and only 21% had used Pension Wise (mostly using the website only).[604]

3.10 Adviser charging

It is clear from the previous Section that RDR, which required advisers IFAs to move to a fee-based and away from a commission-based charging model, has made the cost of regulated advice more explicit to the consumer. To illustrate, prior to RDR, a typical annual management charge (AMC) of 1% was split 50/50 between the provider (e.g., an insurance company) and the adviser. The insurer provided the administration, premium collection and the investment funds, while the adviser provided advice to both the employer and the scheme members.[605] Following RDR, the adviser has to charge the customer directly for advice. Furthermore, from April 2016, the FCA also banned trail commission on products sold after 31 December 2012, although it still allows trail commission on legacy products that were sold before 2013. This could make the advice business unsustainable for between 20-40% of current advisers, according to some estimates.[606] To reduce adviser costs, in particular regulatory costs, the advisers' trade body, the Personal Finance Society (PFS) has called for the introduction of a product levy – an explicit fee on investments and policies – to be paid for by the client. [607]

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[603] Reported in Carmen Reichman (2015) New category of advice needed to get over 70s spending – report, Professional Adviser, 2 December.

[604] Reported in Stephanie Baxter (2015) Industry urges new approach to freedoms as advice is 'not enough', Professional Pensions, 22 December.

[605] Reported Laura Miller (2015) Point, counterpoint: Henry Tapper responds to pension adviser's charge cap gripe, Professional Adviser, 20 August.

[606] Heath Report, February 2015. Reported in Carmen Reichman (2015) New adviser body backs commission-like charges, Professional Adviser, 18 May.

[607] Carmen Reichman (2015) PFS joins calls for policy levy to combat 'unsustainable' adviser fees, Professional Adviser, 3 June.

In the lead-up to the new pensions regime, there was a debate amongst advisers, conducted in Professional Adviser, concerning the most appropriate charging model going forward. The main choice is between a fixed fee (based on an hourly rate) and a percentage-of-assets (or ad valorem) model.[608] The debate was inititated by Alan Smith, who argued that fixed fees was the 'modern, professional way' to charge, and Clive Waller, who supports a tiered percentage-of-assets model (e.g. 1% to 250,000, 0.75% to £500,000 etc...), with only specific pieces of work, such as an inheritance tax report, charged on a fixed-price basis.[609]

Keith Robertson, managing director at Armstrong Financial, said that the debate exposed a worrying element of conflict: advisers appeared uncertain whether their profits or their clients' outcomes should be the main focus. He added: 'As always, it pays to look through the clients' eyes… The only time ad valorem charging is rational (and therefore likely to be considered reasonable in principle by clients) is if the practitioner is providing genuine investment management advice. If this amounts to no more than passing the client to a discretionary investment manager (DIM), a client could, and should, question what additional skill you add for receiving a kick back on the fees; the DIM does all the work'. Instead, Mr Robertson recommends performance-related fees: 'according to research, it turns out that investors would pay reasonably generous performance-related fees - perhaps 20-25% of all gains above an agreed benchmark. However, this is only the case if the investment manager also participated in the bad years by giving something back. So perhaps this sort of remuneration would have to be on some sort of rolling basis, with a portion of fees held in escrow against possible future negative returns'. His specific suggestion was as follows: 'Say one set a target annual return of an inflation benchmark plus, maybe, 4%. If that return was achieved, an ad valorem fee of, say, a standard 1% would be payable. If the return was higher, the adviser/manager would receive 25% of the excess and the investor 75%. The problem is what happens if the target return is not achieved. Perhaps a sliding scale from 1% at the target down to close-to-zero if no return were generated and, if the return went negative, the adviser to give back some proportion of previously paid fees. Making adviser-managers liable for losses (to a limited extent), as well as gains, would change their behaviour and investment strategies; an interesting thought indeed. Non-investment work is obviously a matter of fixed or time-charged fee, negotiated with the client prior to starting the work, exactly as prescribed by the Retail Distribution Review'.[610]

Simplified advice firm Wealth Horizon argues that advisers should set charges according to the service their client wants, rather than offering a full service that charges 'for everything rather than what is required'. The firm argues that 'significant changes' are required to

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[608] In February 2014, *Which? Magazine* published the results of a survey of fees charged by independent financial advisers (IFAs). It found that 81% charged an upfront fee of 3% on assets. For others who charge on an hourly basis, the average hourly rate was £164.

[609] Scott Sinclair (2015) Percentage charging is 'relic of bygone era', Professional Adviser, 27 April.

[610] Reported in Professional Adviser (2015) The charging model one IFA says will petrify advisers, 6 May.

make the industry more accessible for consumers in the light of the new pension flexibilities. Advisers need to avoid expensive packaged bank account-style add-ons that are designed for 'pandering to the wealthy'. CEO Chris Williams said that customers with less than £100,000 in the bank 'simply don't know where to turn'.[611]

In May 2015, a new association of directly authorised advisers called Libertatem was established with the aim of introducing a type of service for which commission-like payments will be payable. Libertatem would also set fixed fees for certain work, which would allow people currently unable to access advice to get that advice. The new organisation is led by Garry Heath, former IFA Association director general.[612]

The May 2015 survey published by Intelliflo discussed earlier also asked respondents how they would be prepared to pay for advice: 35% preferred a fixed pre-agreed hourly rate, while 12% preferred a fee based on a percentage of assets, with 10% preferring a combination of the two. In terms of what was considered to be a reasonable hourly rate for a fully qualified IFA, a third said less than £50 per hour, a third said between £50 and £100, 18% said between £100 and £150, 10% between £150 and £200, and 4% said between £200 and £300 per hour.[613]

A survey by APFA found that around 60% of advisers had turned away clients seeking pension advice in 2014 because they were concerned that the advice was too expensive, given the clients' needs and circumstances. Chris Hannant called on the FCA to relax regulation to allow advisers to come up with simpler, cheaper processes.[614]

In December 2015, the Schroders Adviser Survey was published. The survey of 575 financial advisers showed that financial advisers' fees had increased during 2015 as advisers have increasingly segmented their client bases by asset size. The average fee was 75bps, compared with 50bps prior to RDR. Robin Stoakley head of UK intermediary at Schroders, said: 'There has been an increase in fees by financial advisers, with 75bps becoming the new norm. Now, clients are paying different amounts as IFAs are cutting deals with bigger clients. Some 87% of respondents offer different levels of service based on a client's asset

[611] Reported in Carmen Reichman (2015) Call to end 'pandering to the wealthy' one-size fits all adviser charging, Professional Adviser, 27 April.

[612] Reported in Carmen Reichman (2015) New adviser body backs commission-like charges, Professional Adviser, 18 May.

[613] Reported in Professional Adviser (2015) Retirees set advice threshold at £100k savings, Professional Adviser, 22 May.

[614] Reported in Carmen Reichman (2015) APFA: Cost top reason two thirds of advisers reject clients, Professional Adviser, 4 March.

size or revenue generated, with 61% of those clients being formally asked to leave having under £50k. Most advisers have no place for smaller clients, usually under £150k'.[615]

According to a study by Which? in January 2014, more than half of the advisers surveyed did not reveal their charges until they had met with customers to see what they wanted.[616] In June 2015, only five of the 50 largest financial advice firms published their fees on their websites, according to research by low-cost adviser Candid Financial Advice. These are Hargreaves Lansdown, ranked second largest with gross sales of £6.6bn 2014, Brewin Dolphin, ranked third with sales of £2.5bn, Investec Wealth & Investment, ranked tenth with sales of £1.3bn, Saunderson House, ranked 23rd with sales of £620m, and Vestra Wealth, ranked 37th with sales of £370m. Most advisers refuse to be transparent about their fees because they say it is too difficult to assess how much their advice will cost without fully knowing a potential client's circumstances. However, this is making life difficult for customers, according to Justin Modray, founder of Candid Financial Advice, who said: 'While the commission ban forces advisers to tell clients how much they charge, it seems the vast majority will only do so when you agree to speak to or meet with an adviser. This makes shopping around for a fair deal very tiresome and in my experience too many clients feel compelled to use an adviser after meeting them, even if their fees are high… I would be very wary of financial advisers who do not publicly disclose their fees, as in my experience it's often because they are expensive'.[617]

In October 2015, Which? renewed its call for advisers to display their fees and charges online. But, it now wants the FCA to act and make displays mandatory. Again, there were mixed views amongst advisers about the issue of greater disclosure, but there was little support for making this mandatory.

Supporters of greater disclosure argue that the move would promote transparency, clarity, and certainty. For example, Al Rush, founder of Echelon Wealthcare and online adviser Fiver-a-Day, said that showing prospective clients how much a service will cost gives clients what they want: greater transparency. To illustrate, the website 'will tell clients that, if they want XYZ, in 85% of cases it will cost you x. This will only increase if the work gets too complicated or there is more work involved'. He did not accept the argument that it is impossible to display generic charges due to the 'bespoke nature' of their service: 'Some of our clients might be bespoke with old pensions and trusts all over the place, but for most people, if they want to consolidate a pension, start investing, re-investing, we know straight away how much it's going to cost. I know within half an hour. The reality is lots of our clients

[615] Reported in Anna Fedorova (2015) Schroders adviser survey: 75bps 'new norm' as smaller investors lose out, Investment Week, 4 December.

[616] Reported in Carmen Reichman (2014) Advice needs to be 'commoditised' to attract consumers – Unbiased, Professional Adviser, 16 December. When it analysed the websites of 500 adviser firms, Which? found 349 did not publish their fees online, while few others 'clearly' displayed their fees or used illustrative examples.

[617] Laura Miller (2015) Five advice giants break away from rivals on fees, Professional Adviser, 3 June.

are not bespoke; they've got pretty similar needs and circumstances. We are not tying ourselves to anything. We give an estimate, which is subject to change'. But while 'it makes good business sense to do it', Mr Rush did not want to see charges disclosure become mandatory.

Those against greater disclosure argue that the focus on cost is 'misleading'. According to Chris Budd, managing director of Ovation Finance, clients should be focusing on services, not fees, and leading them to think otherwise is misguided: 'I don't think Which? calling for the FCA to make it mandatory is helping anybody. Clients need to get the right type of service for them, not focus on costs. A list of possible fees is not going to tell anybody what type of service they will receive. Which? should be telling people to focus on shopping around for the service that's right for them. Cost is secondary. People focus on the wrong thing because they are being misguided by Which?'.[618]

The fee charged by advisers also covers the cost of regulation, which includes fees levied by the FCA and the FSCS. APFA surveyed its member firms in 2014 and found that regulatory costs – which included 'indirect' costs such as case-checking and general compliance – could be as high as 12% of turnover. The FCA and FSCS levies comprise around 0.5% and 4% of turnover, respectively. Sam Caunt, director of Future Life FP, says: 'The real cost of regulation is covering your backside. The fees and levies are just headline noise. The real cost is sitting down with the client, finding out their needs and objectives, doing the research and, on the back of that, the compliance it demands. We spend three times as much on IT and compliance as we do on FSCS. Most of our cost is labour: doing the job, documenting it all and doing the IT'.[619]

A study by consultancy Investment Trends of the Australian advisory market showed that profit margins have narrowed following the introduction of regulatory reforms in 2013 similar to the RDR which banned commission on products. The average profit margin has fallen to 1.2% for upfront advice (defined as 'the total cost of providing full advice to the typical client') and 3.2% for ongoing annual advice (defined as 'maintaining a client file, including periodic reviews'), compared with corresponding UK margins of 4% for both upfront and ongoing advice.

The two markets responded in different ways to the reforms. The UK switched mainly to percentage-of-assets charging (or 'explicit commission') and focused on high net worth clients. This allowed UK advisers to earn higher fees per client, although the client base was smaller. In contrast, Australian advisers moved more to fixed fees, because clients told advisers 'we don't want to pay asset-based fees'.

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[618] Reported in Carmen Reichman (2015) For and against: Should adviser fees be displayed online?, Professional Adviser, 26 October.

[619] Reported in Carmen Reichman (2015) Talking Heads: Should advisers include 'cost of regulation' in fees breakdown?, Professional Adviser, 21 August.

Investment Trends' research shows the average Australian adviser earned 21% of its income from fixed fees in 2011, compared with 22% from asset-based fees and 54% from commission. This grew to 33% via fixed fees in 2014 and is projected to grow further, to 42% by 2017. In the UK, the average firm earned 14% from fixed fees, 20% from percentage fees and 65% from commissions in 2011. This changed to 21% fixed fees and 52% asset-based fees in 2014 and is projected to change to 25% fixed fees and 56% asset-based fees in 2017.

Australian advisers also started to compete more directly with each other – there are 70,000 advisers in Australia, more than thrice the number in the UK – while product providers also started offering low-cost advice and the result was to drive down prices. Investment Trends believes the UK could come under similar pricing pressure as cheaper forms of advice – such as simplified advice from providers such as Standard Life and robo-advice – enter the market to fill the 'advice gap' created by RDR.

3.11 The implications for a default pathway

To be feasible, any default pathway using a decision tree would need to be aligned with the guidance guarantee process in a way that it is not classified as regulated advice or a personal recommendation. To meet this requirement, the decision tree would, according to the FCA, need to 'avoid making any judgement or assessment that would result in a single product or a list of products being identified as suitable'.[620] Under the current regulatory framework, this is clearly a challenge, but it suggests we should be looking at the simplified advice route.

3.11.1 A default pathway with simplified advice

If the objective is a well-designed default pathway based on simplified advice, there are six important hurdles to cross.

The first relates to suitability: over what wealth range will simplified advice be suitable? The industry consensus seems to be up to £100,000 (the exception being those who believe almost everyone needs bespoke regulated advice). According to Rachel Vahey, independent pensions consultant: 'At the moment, it is clear drawdown is only suitable for those with large funds and who understand the risks and take them on comfortably'. A particular issue was the cost of guarantees in the new range of drawdown products being offered: 'Guarantees serve a useful purpose, but can be expensive. It is important people understand

[620] Financial Conduct Authority (2014) *Developments in the Distribution of Retail Investments: Purchasing Investments without a Personal Recommendation or with Simplified Advice*, Thematic Review TR14/10, July. http://www.fca.org.uk/static/documents/thematic-reviews/tr14-10.pdf

what the costs are, what the implications are for their money management, and importantly what the alternatives are'.[621]

Joel Adams, adviser with LIFT Financial, argues that, while drawdown will become more mainstream, it will not be viable for people with smaller pots: 'Complete flexibility is a very dangerous thing, especially for those without an adviser. I anticipate that there will be a cut-off level where it is not profitable for advisers to be involved and I think it will be at about £100,000. You have to look at it realistically as to whether it is worth getting involved with small pots. There is a cut-off line where the benefit of advice will be outweighed. That is exactly why we need to see innovation from product providers to make sure advisers can offer simple solutions to clients'.[622]

The second relates to cost. The process needs to be sufficiently commoditised that the cost of the advice (or at least a typical rate) is transparent to the customer at the outset. This allows customers to shop around to get the best deal. This is particularly important, since less than a tenth of the population has complex enough needs to warrant the fees they would pay for full advice, and would be better served by guidance, according to a study by IFA Prydis in December 2014.[623]

The third relates to the quality of and trust in the advice. As mentioned above, research commissioned by the FCA suggests that customers are put off seeking financial advice because they are unable to trust the advice they receive or judge its quality. The research was conducted by consultant Ignition House as part of the FCA's Interim Report for its Retirement Income Market Study.[624] The main findings from the research are:[625]

- cost is seen as a 'barrier to advice' rather than a sign of quality, leading to a 'tendency for consumers to revert to a DIY approach'
- providers were not communicating with clients effectively about their retirement options, and were ignoring the code of practice produced by the Association of British Insurers
- a 'strong mistrust' towards IFAs by those yet to retire and those not currently with an adviser, due to a combination of 'poor past experiences' and a belief that IFAs 'might not always work in their best interests'. Respondents were 'surprised to hear

[621] Reported in Jenna Towler (2014) 'Will the masses be hooked on non-advised drawdown?', Retirement Planner, 22 October.

[622] Reported in Jenna Towler (2014) 'Will the masses be hooked on non-advised drawdown?', Retirement Planner, 22 October.

[623] Reported in Carmen Reichman (2014) Advice needs to be 'commoditised' to attract consumers – Unbiased, Professional Adviser, 16 December.

[624] Financial Conduct Authority (2014) *Retirement Income Market Study: Interim Report*, Market Study MS14/3.2, December, http://www.fca.org.uk/static/documents/market-studies/ms14-03-2.pdf

[625] Reported in Carmen Reichman (2014) Public wants quality-of-advice benchmark, report suggests, Professional Adviser, 11 December.

that pension advice in the post-RDR environment would be paid for through an explicit fee, and that this could cost them in excess of £1,000'. This put some customers off using an IFA, especially those with small pension pots

- pre-retired advised customers were content with how much they paid their adviser and would be happy to continue the relationship post retirement.
- there were mixed views from those already retired about the value of advice, with some respondents reporting that they had sufficient information available for them to confidently make decisions on their own, while others saying that they would seek advice if they did not understand the options facing them
- many retirees using advice reported that they had no way of telling whether the service they had received was good.

The fourth hurdle relates to a potential confusion by customers about the difference between information and advice. Providers are concerned that that customers will wrongly assume that any information and guidance that they receive is in fact advice.[626] According to Fiona Karlin, director at Momentum Partners, FCA guidelines suggest that firms should treat simplified and focused advice in the same way as full advice and this would include risk profilings. Advice firms need to protect themselves and hence should include hurdle questions to assess client suitability in online advice.[627]

The fifth relates to the 'model investment portfolio' which the FCA defines as a 'service which provides access to a pre-constructed collection of designated investments that meet a specific risk profile sometimes offered with a periodic rebalancing of investments to maintain a consistent asset allocation'. A model investment portfolio is used by advisers to illustrate to clients the outcome of different investment and drawdown strategies. However, when a model investment portfolio is re-balanced, an adviser will be acting 'with discretion', according to the FCA. This means advisers must ensure each re-balancing is suitable for the client.

The final hurdle relates to how the FOS treats complaints. The FOS's view is that if suitability has been appropriately assessed or some effort made to 'know the customer', the case would be assessed as if regulated advice had been given. Otherwise FOS will 'expect customers to be responsible for their own choice'.[628]

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[626] Carmen Reichman (2015), Pension provider fears 'advice' risk in FCA's retiree rules, Professional Adviser, 28 January.

[627] Quoted in Carmen Reichman (2015) Simplified advice should include 'hurdle questions', says IFA, Professional Adviser, 25 February.

[628] Reported in Carmen Reichman and Scott Sinclair (2015) FCA tweaks guidance on what constitutes 'advice', Professional Adviser , 22 January.

3.11.2 Can simplified advice work in a default framework?

There are strongly differing views as to whether a default framework with simplified advice can work. Interestingly, opinion splits according to whether those giving a view work for a provider or an adviser/wealth manager.

Barry O'Dwyer, managing director at provider Standard Life, believes that the financial services industry 'ought to take [simplified advice models] very seriously'. Similarly, Tom McPhail, from Hargreaves Lansdown which has been providing non-advised drawdown for eight years, is confident that guidance alone can work: 'Our own experience of dealing with non-advised drawdown – and we know more about it than any other business in the UK – is that you have to engage with the customer, walk them through the relevant information and ensure that they understand what they are doing. If the pension provider fails to take responsibility for these simple steps, then it is not unreasonable for them to be called to account for their failings. One of the biggest risk areas will be trust-based schemes offering drawdown. It can be done, but doing it safely requires care and robust processes'.

Chris Daems, director of Principal Financial Solutions, believes that the guidance guarantee can work, but customers need a clear route to more specialist advice. He uses the analogy of the NHS: 'so, where the NHS has a flow like this:

> *NHS Direct (or NHS 111) > Paramedic > Doctor > Specialist (with referrals going to the next stage if the 'patient' needs more help than the current level can provide)*

...the guidance guarantee version might look like this:

> *Web site > Phone > Unqualified face-to-face support > Qualified face-to-face support > Specialist qualified face-to-face support (this also needs to be within a clear framework so when certain information is disclosed or questions asked, it can be passed on to the next level)'.*[629]

Those working for advisers or wealth managers tend to disagree that simplified advice can work in a default framework. The following views are typical.

Kay Ingram, divisional director of individual savings and investments at LEBC, said: 'There is a whole lot to take into account [when planning for retirement]. [It includes] everything from drawdown to deferring pensions and looking at clients' other sources of income. The point is, to [deliver guidance] that people can follow and take action on, it is going to take

[629] Chris Daems (2014) Making the guidance guarantee the go-to retirement service, Retirement Planner, 17 September.

more than a decision tree. The only way really to get an idea is to consult an IFA. It is something that has got to last the test of time and that's what's difficult'.[630]

Austin Broad, technical director at AFH Wealth Management, goes further:[631]

> *Retirement options remain one of the most complex areas of financial planning, driven in part by the fact that, when an individual enters the decumulation phase of their life, it is rarely a simple matter of considering their pension plans in isolation. Most retirement planning requires the retirees' whole financial situation to be considered in formulating the best outcome for them.*
>
> *Clearly this is most acute where the retiree has sufficient assets to consider drawing their future income directly from their retirement funds, avoiding the purchase of an annuity. Known as drawdown, the options and variations available are significant and careful consideration and professional advice is essential.*
>
> *This is completely at odds with the guidance guarantee and more importantly, non-regulated individuals delivering guidance in a strategic area that requires professional understanding of the retiree's tax position, their total assets, their income and their expenditure.*
>
> *The new rules in many ways further compound matters as there are likely to be more complex solutions and greater alternate options for the retiree to consider.*
>
> *This is not about whether to use a particular insurance product or independent option, this is about the strategy adopted, which according to Treasury, does not need a regulated individual to deliver.*
>
> *The delivery of strategic drawdown solutions in the new world will require advisers to consider the holistic financial position of the retiree, together with their objectives and needs. It will require an understanding of life expectancy and tax in order to promote the concept of retirees taking seriously the need for their plan to be sustainable for life and yet meet their other income objectives in the most tax efficient way.*
>
> *Trying to guide somebody through this maze, with what could amount to limited information, is an accident waiting to happen and therefore the emphasis of any guidance, where drawdown is a likely outcome, is to refer to a professional adviser.*
>
> *I am sure that insurance companies will be very interested in the potential for retirees to take on drawdown themselves. Again, for many retirees, following this course of action is likely to present challenges which would*

[630] Quoted in Carmen Reichman (2014) Guidance guarantee plans not good enough, LEBC warns, Professional Adviser, 30 July.

[631] Austin Broad (2014) 'An accident waiting to happen': Why drawdown retirees need more than guidance, Professional Adviser, 2 October.

benefit from professional advice input. In some of the cases where a retiree goes direct, the problems that are created could take many years to surface and could potentially prove very costly.

In conclusion, retirement options, in all but the smallest of pension funds, will benefit from professional advice.

The provision of guidance on drawdown, outside of delivering an education is dangerous and should be referred to a regulated source.

The decisions made at retirement are by definition long term decisions that need to take account of the whole, not just a part, of the story.

Therefore, a fee-based, preferably independent advice approach should be recommended. This would allow the adviser to manage any conflicts they may have, within the agreed fee structure they adopt for the work to be done.

Jamie Smith-Thompson, managing director at Portal Financial, is concerned about people cutting out advice to reduce costs: 'Who is going to direct the investments and why are they selecting those investments? To be able to do that as an IFA, you need a few years' worth of exam taking and knowledge before you can recommend that to the client. Do you think these DIY people have got that extent of investment knowledge? That is a real concern'.

Rachel Vahey argues: 'There is a worry that those going into unadvised drawdown will not understand the risks involved or how to manage them. Guidance will have a role in explaining this, but professional advice will obviously be the best route to those considering drawdown'.[632] She was concerned about people ending up in their existing provider's poor value drawdown fund: 'So we might have the unappealing situation where instead of failing to shop around for an annuity (as is the case now), people fail to shop around for a drawdown fund and just go for the one with their current provider'.[633]

David Thompson, managing director of business development and proposition at AXA Wealth, said: 'Few would argue that the pensions reforms….are not to be welcomed. Having greater choice and greater flexibility over pension arrangements is surely a good thing. However, we believe that, with greater choice and flexibility, there is also a greater risk that, without professional financial advice, a lot of people will not achieve their financial expectations in retirement…. Less scrupulous providers may be lured by a quick buck and

[632] Reported in Jenna Towler (2014) 'Will the masses be hooked on non-advised drawdown?', Retirement Planner, 22 October.

[633] This is a real possibility according a recent Retirement Planner Inquiry. The main explanations were related to behavioural barriers preventing customers shopping around and staying with their existing provider. According to respondents to the Inquiry, 37% put inertia as the main reason, followed by lack of advice (32%). Other explanations were lack of knowledge, lack of understanding and taking the 'easy option'. Three-quarters of respondents believed that OMO should be made compulsory ahead of annuity purchase. See Jenna Towler (2015) Annuity sales - When will retirees get a better deal?, Professional Adviser, 29 January.

exploit the opportunities to get assets under management… We need to find a way forward that allows people to access professional financial advice which is detailed enough to give confidence in the expected outcome, yet at the same time affordable for individuals – or their employers – with smaller pension pots'.[634]

Despite Tom McPhail's views that guidance alone can work, Hargreaves Lansdown launched a low-cost retirement planning service in June 2015 aimed at filling the advice gap between Pension Wise and regulated financial advice. The HL Retirement Planning Service, which charges a flat fee of £395 plus VAT, 'is an advisory service but stops short of providing specific, personal recommendations'. Mr McPhail said: 'The Pension Wise service provides investors with an invaluable introduction to the key issues they need to think about. The HL Retirement Planning Service takes investors a stage further than Pension Wise, walking them through the issues they need to consider when setting up their retirement income'. The service would help people understand:

- their retirement income options and the tax position of each
- how much secure income they might need
- the risks of drawdown and provides guidance on sustainable income
- the need for contingencies, protecting dependants and factoring in potential care costs
- provides a sense check to their current thinking
- where to go and how to convert their pension into income.

If clients who use the service want to progress to full advice the £395 fee will be knocked off future bills. Mr McPhail noted that HL's service costs 'only around a quarter of a typical full advisory service'.[635]

3.12 Consumer vulnerability and regulatory responses

The purpose of regulation is to protect the consumer. But the nature and effectiveness of the regulation will depend on which model of consumer behaviour – econ or human – comes closest to describing real world consumers. In the case of econs, the role of the regulator is to ensure that the customer has the information needed to make well-informed decisions, sure in the knowledge that econs are perfectly capable of assessing value for money and protecting themselves against fraud. In the case of humans with their limited understanding and interest in pension matters, the question becomes whether any amount of information, however well presented, will be sufficient for consumers to make well-

[634] David Thompson (2014) Mind the trap: The unintended consequences of pensions flexibility, Professional Adviser, 27 October. The potential conflict between providers and advisers was also noted in Chapter 2.

[635] Reported in Jenna Towler (2015) Hargreaves Lansdown aims to 'fill advice gap' with low-cost pension planning service, Professional Adviser, 23 June.

informed decisions. What does the regulator do in the case of such potentially vulnerable consumers?

Our research reveals a conflict in the regulatory response to the new pension flexibilities. This can be illustrated by the statement made by Christopher Woolard in his forward to the FCA's discussion paper *Smarter Consumer Communications*, published in June 2015:[636]

> *A well-functioning market needs informed and engaged consumers. It requires consumers to have access to high quality, appropriate information to help them understand the product or service they have or plan to buy. This is especially true in the financial services sector, where it is important that the information helps empower consumers to make informed decisions about their finances.*

This statement is much more consistent with the econ model than the human model of behaviour and econs are typically not classified as vulnerable consumers.

3.12.1 Governance of pension schemes in the new pension environment

The Government has introduced new governance requirements for both trust- and contract-based pension schemes from April 2015 in response to the new pension environment.[637]

Governance in trust-based schemes – which are regulated by TPR – require the setting of minimum quality standards from April 2015 which ensure:

- default investment strategies are designed in members' interests and regularly reviewed
- core scheme financial transactions are processed promptly and accurately
- scheme rules do not restrict the trustees' appointment of advisors and administrators
- trustees assess the levels of charges borne by members and the investment costs, with a charge cap of 0.75% on default funds
- trustees have, or have access to, all of the knowledge and competencies necessary to properly run their scheme
- the scheme has a chair of trustees with responsibility for preparing an annual governance statement setting out how the scheme has complied with these governance requirements.

Deloitte has produced a seven-point checklist for trustees:

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[636] Financial Conduct Authority (2015) *Smarter Consumer Communications*, Discussion Paper DP15/5, June.
[637] Introduced by the Pensions Act 2014.

1. Consult with employers on issues such as the cost to set up and administer new pension options, to determine the amount of flexibility to be granted to scheme members, and what defined benefit de-risking strategies the employer may wish to implement.
2. Communications to members should cover the latest changes and the degree of flexibility their pension scheme will offer. Frequent communications will be required throughout the implementation phase.
3. Scheme administration should be reviewed, particularly around new minimum requirements to signpost members to the guidance guarantee during their retirement process. Similarly, another requirement seeks to ensure members are properly instructed to find independent financial advice at the appropriate time. New pension flexibilities may have additional administrative complexities and costs.
4. Seek legal advice on issues arising from the 'freedom and choice' changes. Conduct a review of the trust deed and rules which may unearth amendment requirements, and consider the implications of the statutory overrides.
5. Get actuarial advice. Changes will be applicable for DB schemes specifically, and centre on cash equivalent transfer values (CETV) calculations. The basis of these should be reviewed and its consistency with cash commutation factors within the scheme considered. Seek advice on whether CETVs should be reduced, by what level, and whether the employer is willing to support payment of full CETVs. Other considerations include the Code of Practice on DB-to-DC transfers and conversions, as well as the impact on scheme funding.
6. Benefit options
    a. DC schemes: A final decision should be made as to the flexibilities offered within the scheme, including a review of annual benefit illustrations to reflect the new freedoms. The process of notifying and recording should also be considered when the money purchase annual allowance is triggered.
    b. DB schemes: As a minimum regulatory requirement, receipt of independent financial advice must be confirmed and recorded before CETV completion. Additional, and optional, considerations include whether CETVs should be provided as part of the retirement process, or whether individuals may take a non-statutory CETV at normal retirement as part of their standard scheme options.
7. Investment strategy
    a. DC schemes: A review should be taken of the default investment strategy, as well as the lifestyle strategy and switching period, to assess their appropriateness. The range of investment funds available to members should also be a consideration both pre and post 'retirement' age.
    b. DB schemes: The investment strategy here should take into consideration the membership profile of the scheme which could change rapidly, and DB CETV requirements in response to possible liquidity and disinvestment issues.

> Ongoing trends should be monitored in this regard for future investment strategy reviews. [638]

Some believe that the new pension regime combined with the terminal decline of DB schemes is likely to reinforce the move away from individual trusts as the vehicle for operating pension schemes. Instead, employers are likely to switch to contract-based DC schemes or enter into master trusts. According to Alan Morahan, head of DC consulting at Punter Southall, 'we are going to see a move away from individual trusts. Many trustees and sponsoring employers are going to struggle to open up the full range of freedoms that are available. So with that flexibility readily available elsewhere, it will mean that those trusts will get wound up and there will be further reduction in the number of trustees that are operating in the market'. Penny Cogher, head of pensions at Charles Russell Speechlys, believes: 'The move to contract-based frees [companies] and their employee trustees from the heavy burden of running a scheme. Classic trusteeship will fade away as business owners follow the example set by large companies in establishing ... a pension committee. These will make sure that their pension provider is delivering a scheme that is fit for purpose'.[639]

From April 2015, governance in contract-based schemes – which are regulated by the FCA – will be based around independent governance committees. IGCs must have at least 5 members, the majority of whom (including the chair) will need to be independent of the firm. Their role is as follows:

- act in the interests of active and deferred members
- assess the value for money of the scheme (comparing the cost with the benefits and services it provides)
- where the IGC finds problems with value for money, to raise concerns (as it sees fit) with the firm's board
- raise concerns to the FCA, alert relevant scheme members and employers, and make its concerns public, and
- produce an annual report of its findings.

Schemes in small companies can appoint an independent third party (known as 'a governance advisory arrangement' (GAA)) to take on their IGC responsibilities.

Questions have been raised about the real powers of IGCs. For example, Jacqui Reid, pensions lawyer at Linklaters, said: 'The jury's out on the extent to which IGCs will bridge the gap between contract-based schemes and trust-based schemes. IGCs can make recommendations to contract-based providers, but they have little power in practice. They

[638] Reported in Retirement flexibilities - a seven-point trustee checklist, Professional Pensions Online, 1 April 2015 .
[639] Quoted in Marek Handzel (2015) Taking flight, Pensions Age, May.

cannot make changes to improve value for money where they find that value for money does not exist [e.g., if the member is in an old-style high charge fund]. Even where it is clear that a fund is underperforming, neither IGCs nor providers can vary existing members' contractual arrangements by moving their members from that fund without the members' express consent'. Richard Wilson, policy lead for DC at the NAPF, said IGCs didn't 'have any actual powers' and were 'essentially advisers'.[640] An insider told us: 'The Government considers IGCs and trustee boards to be essentially equivalent. This is not remotely true. IGCs were set up as a way defending the failure to impose a fiduciary duty (i.e., trustees) on insurance companies. IGCs are neither independent nor governing. Insurance companies appoint the members of the IGC, half of whom can be employees and the other half can be representatives of companies which supply the insurance company. The IGC can only make recommendations. The conflicts of interest are extreme'. However, Steve Webb, the then Pensions Minister, said that providers that ignore their IGC would face huge reputational damage.[641]

There is third governance model – the master trust – which has been around since the 1950s, but has been given a new lease of life with the introduction of auto-enrolment. A master trust is a multi-employer occupational pension scheme where each employer has its own, effectively ring-fenced, division within the master arrangement.[642] They can benefit from economies of scale and hence have lower charges. NEST, The People's Pension and NOW: Pensions are set up as master trusts. These schemes have also joined the master trust assurance framework (MAF).[643]

Specific benefits of the master trust model include:

- the ability for members to benefit from the ongoing management and oversight of investments
- the ability to drive down operating costs through bulk purchasing
- the need to appoint just one group of professional advisers for the whole scheme rather than a group for each division
- one board of trustees for the whole scheme, rather than a board for each section, thereby coming under TPR rather than the more onerous governance rules of the FCA

[640] Reported in Stephanie Baxter (2015) IGCs will have 'little power' to improve value for money, Professional Pensions, 9 February.
[641] Reported in Michael Klimes (2015) Webb rejects 'toothless' IGCs claim, Professional Pensions, 22 January.
[642] TPR's definition of a master trust is 'an occupational trust-based pension scheme established by declaration of trust which is or has been promoted to provide benefits to employers which are not connected and where each employer group is not included in a separate section with its own trustees. For this purpose, employers are connected if they are part of the same group of companies (including partially owned subsidiaries and joint ventures)'.
[643] Introduced in April 2015, MAF was developed by the Institute of Chartered Accountants of England and Wales in association with TPR; http://www.thepensionsregulator.gov.uk/trustees/master-trust-assurance.aspx

- consolidated accounting and governance requirement.

A potential disadvantage is that the trustees are typically appointed by the provider of the master trust, which can lead to employer disengagement with the pension arrangement. On the other hand, some, especially small employers, might welcome this.[644]

Both trustees and IGCs will have to define and assess 'value for money' in their DC schemes. In the case of trustees of an occupational DC scheme, this means assessing whether scheme charges and transaction costs represent 'good value'. In the case of IGCs, this means assessing the 'ongoing value for money' of a provider's contract-based workplace DC pension schemes.

Table 3.6: Factors to be taken into account by trustees and IGCs in the new pensions environment

Factor	Trustees	IGCs
Objective	Calculate the charges and (in so far as they can) transaction costs borne by members Consider investment return Compare to others in the market, where possible	Consider the level of charges borne by members and the direct and indirect costs (including transaction costs) incurred in managing and investing Consider the design of default investment strategies and the net performance of all investment strategies Compare to others in the market, where possible
Subjective	Weigh up benefits and services received by members against what members value in: • Governance • Communications • Administration (This includes a statutory requirement to consider whether core financial transactions are processed promptly and accurately)	Weigh up benefits and services received by members against what members value in: • Governance • Communications • Administration (This includes a FCA requirement to consider whether core financial transactions are processed promptly and accurately)

[644] This is drawn from Graham English (2011) Master Trusts - Making a comeback, Pensions World, November.

There is no statutory definition of value for money, so according to Helen Ball, head of DC, Sackers, both trustees and IGCs will need to develop their own assessment process which will involve comparing costs against the benefits provided.[645] A well-run scheme in terms of, say, good administration and clear communication might cost more, but could result in better member outcomes and hence be of 'good value'. Table 3.6 shows the factors that need to be taken into account.In assessing value for money, trustees/IGCs will need to establish what factors members value most and then decide how to weight the different factors.[646]

Some information will nevertheless be hard to gather. An important example of this is the disclosure of the full costs of fund management, including transactions costs.[647] This is a needed for assessing value for money and the AMC, total expense ratio (TER) or even the ongoing charges figure (OCF) are inadequate and incomplete measures of fund management costs. From April 2015, trustees and IGCs will have to report transaction costs for the first time.[648]

The DWP-FCA Call for Evidence on this issue in March 2015 stated:[649]

> *Work to increase transparency of transaction costs in the workplace pensions market should be viewed in the wider context of efforts to ensure other consumers are fully informed about all costs and charges associated with other retail investments. Efforts at European Union level are already moving towards including transaction costs in any pre-contractual cost figure disclosed to the end consumer for retail investment products. This is being developed through the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation and the recast Markets in Financial Instruments Directive (MiFID II). Neither PRIIPs nor MiFID apply to workplace pensions, whether occupational pensions or workplace personal pensions, but it is important to work towards achieving consistency across the information consumers will receive in relation to these other retail investments. Negotiations also continue on European Commission governance and transparency proposals within a recast directive on Institutions for Occupational Retirement Provision (IORP II).*

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[645] Helen Ball (2015) Assessing 'value for money' in DC arrangements, Pensions Insight, 1 April.

[646] The Pensions Regulator (2015) *Regulatory Guidance for Defined Contribution Schemes*, April (http://www.thepensionsregulator.gov.uk/docs/guidance-dc-schemes.pdf)

[647] Transactions costs are just the visible costs. There are also the hidden costs of investment management which reduce the net returns to savers and these can be larger than the visible costs. See David Blake (2014) *On the Disclosure of the Costs of Investment Management*, Pensions Institute Discussion Paper PI-1407, May 2014. (http://www.pensions-institute.org/workingpapers/wp1407.pdf). See also the response by the Investment Association (2015) *Meaningful Disclosure of Costs and Charges*, February.

[648] Pensions Act 2014.

[649] DWP-FCA (2015) *Transaction Costs Disclosure: Improving Transparency in Workplace Pensions – Call for Evidence*, March; https://www.gov.uk/Government/consultations/improving-transparency-in-workplace-pensions-transaction-costs-disclosure

Disclosure of fund management costs will be particularly important in the decumulation phase, since retirees may find it difficult to return to work if their pension pot is depleted too quickly by excessive withdrawals, poor investment performance or high fund management charges, particularly for offering guarantees. However, 'any cost information disclosed to members should be understandable and relevant, and presented in a format that contains sufficient, yet succinct, information to inform the member'.[650]

3.12.2 Vulnerable consumers

Notwithstanding Mr Woolard's statement at the beginning of this Section, the FCA is certainly aware of potential consumer vulnerability and has introduced a number of regulatory initiatives in relation to concerns raised by the new pension flexibilities.

In February 2015, the FCA published an Occasional Paper which identified up to half the UK adult population as being 'vulnerable' consumers.[651] The paper found 'problems at every stage' in the way firms deal with vulnerable consumers from high-level policy, through system design, to the products that are available and ways that staff implement policies and sell products. Vulnerable consumers are those with poor literacy skills, those who have caring responsibilities, people with disabilities, dementia or the elderly.

The paper gave the following examples:

- Policy
    - Many firms lack an overarching strategy or policy on consumer vulnerability
    - Policies designed to prevent financial abuse and fraud can inhibit staff empowerment to use discretion, particularly regarding legitimate access by third parties (e.g., those with power of attorney)
- Systems
    - Failure of internal systems, where firms fail to communicate and connect information internally. For example, this can lead to customers having to tell firms multiple times about bereavement, resulting in numerous duplicate letters from different areas of the business being sent
    - Interfaces or channels of communication that are not inclusive
    - Increasing automation and use of call centres may create challenges in spotting potential vulnerability and ensuring customers are referred on to specialist teams where necessary

[650] Page 48 of DWP-FCA (2015) *Transaction Costs Disclosure: Improving Transparency in Workplace Pensions – Call for Evidence*, March.

[651] Martin Coppack, Yasmin Raza, Simon Sarkar, Kate Scribbins (2015) *Consumer Vulnerability*, Financial Conduct Authority Occasional Paper No.8, February; http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-8.pdf

- Products
    - Inflexible products and services that are designed for a standardised perfect customer and do not factor real-life events into their design. Some customers who face a change in circumstances are therefore not able to receive a flexible, tailored response
    - Product and information complexity and confusing communications
    - Lack of suitable affordable products for people in some non-standard situations
    - Lack of solutions for temporary delegation (enabling a family member or carer to manage your affairs for a short time) which retain privacy and safety
- Implementation
    - Policy/practice gap at firms, where frontline staff are not aware of or do not implement head office policies. Frontline staff may not refer people on to specialist teams
    - Consumer time is not valued highly and many people give up if the process is too time consuming, especially if they are in a stressful situation with other demands on their time
    - Inconsistent approach around flexible temporary forbearance
    - Arrangements around temporary delegation (enabling a family member or carer to manage your affairs for a short time) and accompaniment (sitting in or helping with a phone call or interview) not sufficiently developed and flexible to enable family and carers to help
    - Inappropriate selling and sales practices which exploit behavioural biases
    - Issues around disclosure of a vulnerability and data protection – inaccurate or overzealous application creates unnecessary problems

The paper then goes on to describe what 'good' looks like to consumers, based on research that the FCA conducted:

- Having financial products that are clear and easy to understand
- A choice of ways of communicating to be available whenever you need to make contact and for these to be designed in an inclusive way so that they are clear, easy to understand and meet your needs. This could relate to the method of communication (e.g., audio/braille/face-to-face) or the service delivery (e.g., agreement to talk at a particular time of day depending on carers and medication)
- Feeling that firms will treat you as an individual and you won't face the 'computer says no' response just because your personal circumstances do not fit the standard mould
- Knowing that, should you experience a sudden change in circumstances, you will be offered a flexible and tailored response from your financial services provider

- Being able to talk to someone who will take the time to listen, who is flexible enough to let the conversation take its natural course, and who is sufficiently trained to spot signs of vulnerability and refer on to specialists where necessary
- Being referred on to someone who has the authority and discretion to take a tailored approach to your situation and offer flexible solutions, including use of specialist sources of help and advice if necessary
- Feeling confident that your firm encourages disclosure, that they will work with you in your best interests
- Knowing that if you do disclose information about your needs, that information will be recorded properly, so that you do not have to repeat it every time you make contact with all departments of a particular firm
- Knowing firms will proactively contact you if they suspect you may be having financial difficulties
- Knowing appropriate action will be taken if a firm spots suspicious activity that may signal abuse or fraud
- If you are trying to speak to a firm in a caring capacity, finding that the firm listens and makes a note of your concerns even though it may not be able to divulge any information to you
- If you are recently bereaved, have a power of attorney or a third party mandate, receiving consistent advice and treatment.

The paper concludes by describing what can firms do to deliver good customer outcomes:

- To ensure a consistent approach that is embedded across all operations, it is important to have a high-level policy on consumer vulnerability in place
- It is important that all relevant staff are aware of the policy
- Firms could begin by auditing current practice
- Ongoing evaluation of the effectiveness of a vulnerability strategy plays a significant role
- Research demonstrates that it is important for staff on the front line to have sufficient training to facilitate a proper conversation and that they know where internal expertise lies
- Flexibility in the application of terms and conditions of products and services plays a significant role in ensuring the needs of consumers in vulnerable circumstances are met
- An efficient process for referring consumers on to specialist teams who have authority to make flexible decisions is important
- Good policies and practice in handling disclosure or communication needs of consumers and recording of that information effectively play a key role for consumers and are helpful to staff. Actively encouraging disclosure, by staff able to have proper conversations, has been shown to be helpful here

- Clear, simple information and explanation throughout the product life cycle is important to all consumers
- Policies around data protection in particular, but also safeguarding and affordability, need to be implemented based on a correct understanding. If staff are well trained, they are less likely to apply such policies in an overzealous manner which can create problems for customers. For example, proper affordability is vital to the wider protection of consumers, but firms should have systems in place to allow for appropriate discretion.

3.12.2.1 Vulnerable DC consumers

In November 2014, the FCA announced in a Policy Statement that it would protect vulnerable consumers and review requirements where money is taken directly from pensions.[652] The regulator noted that (p. 23): 'Drawdown itself may be used quite differently in the new environment. As we assess the impact on the requirements that relate to drawdown, we will consider how to ensure consistent protection for consumers and review requirements on firms where money is taken directly from the pension. One particular area we will explore is non-advised sales of income drawdown and uncrystallised pension fund lump sums. A number of respondents raised concerns here as currently most drawdown products are sold with regulated advice'. The FCA also stated it would modify its rules on projections in drawdown products which currently assume a regular income is being taken over time. If retirees access their pension pots more flexibly, the current rules may produce 'confusing or irrelevant information'.

On 26 January 2015, the FCA announced a new layer of consumer protection called 'additional protection' or a 'second line of defence'. It did this in a 'Dear CEO' letter.[653] Prior to allowing a pension pot to be cashed in, providers will be required to find out clients' health and their comprehension of issues such as tax, impact on means-tested state benefits and pension scams before giving them personalised risk warnings. In particular, providers must do the following:

- Ask retirees a set of questions about 'key aspects of their circumstances that relate to the choice they are making' such as their 'health and lifestyle choices or marital status' in order to protect them from making the wrong choices[654]
- Issue 'relevant risk warnings' such as the tax consequences of a decision to take cash

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[652] Financial Conduct Authority (2014) *Retirement Reforms and the Guidance Guarantee*, Policy Statement PS14/17, November, http://www.fca.org.uk/static/documents/policy-statements/ps14-17.pdf

[653] http://www.fca.org.uk/static/documents/dear-ceo-letters/dear-ceo-letter-retirement-reforms-guidance-guarantee.pdf

[654] The people most likely to benefit from transferring out of a DB scheme will be single people, who do not need the partner's benefit in a DB scheme, and those in poor health who have impaired life expectancy.

- Make a recommendation, in customer communications about retirement options, that consumers consult Pension Wise or take regulated advice.

The 'Dear CEO' letter was followed up by a FCA Policy Statement in February 2015 which formally set out the new rules to come into force on 6 April 2015.[655] They will apply to providers operating personal pensions, stakeholder pensions, selling pension decumulation products or facilitating the access of pension savings on an execution-only basis. The FCA also announced that it plans to consult in summer 2015 on whether to retain, modify or add to these rules, as part of a wider consultation on the rules around consumers' interaction with providers as they approach retirement. It also stated that TPR will be publishing complementary guidance for trustees of trust-based schemes.

The introduction of additional protection or second line of defence followed criticism of the FCA at a hearing of the Work and Pensions Select Committee on 17 December 2014 at which Christopher Woolard stated: 'What we can never do, in any area we regulate, is stop fools behaving like fools'. The committee felt that this attitude was a dereliction of the FCA's responsibilities. Mike Thornton MP, a member of the committee said: 'You are the Financial Conduct Authority. How providers act towards their customers is at the centre of your responsibilities'.[656] The effect of the criticism was to raise the level of concern within the FCA about the possibility of not only mis-selling but also theft via scamming.

Some welcomed the changes on the ground that they challenged the inertia of the existing system. Tom McPhail said: 'This second line of defence….is exactly what we have been calling for. Without this, it would have been far too easy for pension providers to carry on rolling their customers over into poor value or inappropriate retirement income products. However it will also raise the bar, making it more challenging for pension companies to deal with their customers; some may decide it just isn't worth the effort'.[657]

Some were concerned that consumers, overwhelmed by the array of new pension options, could easily become confused or misinterpet the new questions about their personal circumstances as advice. For example, Claire Trott, head of technical support at Talbot and Muir, said: 'I am concerned that some retirees who have opted to avoid the use of Pension Wise will also opt not to answer the prescribed questions [put by the provider] fully or honestly and therefore won't receive the most appropriate risk warnings'.[658] Similarly, Paul

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[655] Financial Conduct Authority (2015) *Retirement Reforms and the Guidance Guarantee: Retirement Risk Warnings*, Policy Statement PS15/4, February; http://www.fca.org.uk/your-fca/documents/policy-statements/ps15-04

[656] House of Commons Work and Pensions Committee (2014) *Oral Evidence: Progress with Automatic Enrolment and Pension Reforms*, HC 668, Wednesday 17 December.

[657] Reported in Natasha Browne (2015) FCA introduces emergency rules to prevent mis-selling from April, Professional Pensions, 26 January.

[658] Quoted in Jenna Towler (2015) Providers back FCA's 'second line of defence' for retirees, Professional Adviser, 26 January.

Evans, pensions technical manager at Suffolk Life, said: 'There will be a lot of providers who are concerned they will be seen as giving advice in asking the "relevant" questions. It is essential clients understand the questions they are being asked. There's clarification needed on what the regulator wants and what providers can do in order to make it work'.[659]

Ms Trott believes that if the second line of defence is insufficiently robust, there could be future mis-selling scandals:

> *The second line of defence is actually an important stage when trying to combat pensions liberation, the time it takes to complete the forms and sign the disclaimers should hopefully give just enough time for people to stop and realise what they are being asked to do, even if they don't read the carefully crafted risk warning letter presented to them. The fact they have to complete a questionnaire in order to access the benefits might be enough for them to reconsider their options.*
>
> *I don't believe conducting the second line of defence over the phone is sufficient enough to ensure that clients who haven't taken advice are suitably warned about the implications of what they are doing, having to sign something to say you want to proceed is much more significant to people than listening to someone and agreeing…*
>
> *Anything we as providers can do to protect clients without infringing their right to access their benefits is great, but it still goes back to full personal advice from an FCA regulated financial adviser is clearly best.*
>
> *The fact that the FCA require providers to give risk warnings to clients who have used the Pensions Wise service is a clear indication that they also consider this guidance to be inadequate.*
>
> *I would like to see all clients taking advice, but it is wholly unacceptable to limit their retirement options just because they've chosen not to. For years, annuities have received a poor press. Many people view annuity purchase as inflexible and representing poor value. If clients' options are curtailed in this way, it could be a real disincentive for the next generation of pension savers. I don't believe that an annuity is a better non-advised option than drawdown and taking the whole fund as cash is a significantly more risky course of action for a non-advised client.*
>
> *I can see a new mis-selling scandal here by creating new default options for clients and this could all be prevented with robust second line of defence practices.*[660]

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[659] Quoted in Carmen Reichman (2015) Pension provider fears 'advice' risk in FCA's retiree rules, Professional Adviser, 28 January.

[660] Quoted in Claire Trott (2015) Providers pushing pensions freedom advice demands 'too far', Professional Adviser, 21 September.

Even where they do take advice, many members might not like the advice they receive and disregard it. In this case, they are classified as 'insistent clients', although this is not a recognised regulatory term and, from a regulatory point of view, they fall into the non-advised category. Advisers took different views on 'insistent clients'. Some believed that they have a 'moral obligation' and a 'duty of care' towards their clients and would not implement anything they regarded as unsuitable, irrespective of whether the client insists, even if it means they would lose the client's business. Others said they have no moral obligation as long as the client is sufficiently informed and would not want to 'browbeat clients', although they remained concerned about risks to their business.[661]

In September 2015, the ABI's Huw Evans told a Work and Pensions Select Committee hearing: 'We must resolve the tension that came to light when the reforms were implemented around safeguards that have been put in place. Some customers deeply resent those safeguards and want to find a way round them. A decision has to taken by policymakers to find a way forward. A resolution to that has to be sorted. As a part of that we absolutely need to clarify what the advice requirements are. Some providers were still unclear when they had to ensure customers take regulated financial advice'.[662]

In January 2016, the FCA announced that 42% of customers taking drawdown were doing so on a non-advised basis.[663]

3.12.2.2 Vulnerable DB-to-DC consumers and others with safeguarded benefits

In February 2015, TPR issued guidance for trustees of DB schemes on dealing with member requests for DB-to-DC transfers.[664] The guidance aims to:

- help trustees ensure they have appropriate processes in place to manage transfer requests
- prompt trustees to consider the impact of transfer values as part of an integrated approach to the risk management of their scheme
- require trustees to provide clear information for members so that they can get independent advice on the best option for them.

The guidance recognises that 'it is likely to be in the best financial interests of the majority of members to remain in their DB scheme'.[665] If a member's CETV is over £30,000, the

[661] Reported in Carmen Reichman (2015) I don't think that's a good idea: How to deal with insistent clients, Professional Adviser, 19 March.
[662] Reported in Jenna Towler (2015) Comparing pensions to bank accounts 'irresponsible', ABI chief warns, Professional Adviser, 8 September.
[663] Financial Conduct Authority (2016) *Retirement Income Market Data: July – September 2015*, January.
[664] The Pensions Regulator (2015) *DB to DC Transfers and Conversions*, Consultation Document, February; http://www.thepensionsregulator.gov.uk/docs/db-dc-transfers-conversions-consultation.pdf

member must take independent financial advice from a D60 qualified specialist pension adviser before transferring.[666] The member must pay for this advice (unless the transfer is initiated by the employer). The adviser will send a questionnaire to the scheme to establish the benefits in the scheme and then perform a full benefit comparison with the DC pension arrangement the member wishes to switch to. The member is required to provide written evidence to the trustees that the advice has been given. However, trustees are not 'responsible for checking what advice was given, what recommendation was made or to confirm whether the member is following that recommendation'. Further, it is not 'the trustee's role to second-guess the member's individual circumstances and choice to transfer [DB] benefits. Nor is it their role to prevent a member from making decisions which the trustees might consider to be inappropriate to the member's circumstances'. The trustees are required to ensure that the receiving scheme is a legitimate arrangement and not a pension liberation scam.

In March, 2015, the FCA announced new rules on pension transfer advice. In particular, it would change its Regulated Activities Order, amend the definition of 'pension transfer' to reflect the new pension environment, and introduce a requirement for firms to appoint a pension transfer specialist (PTS):[667]

- New Regulated Activities Order
    - Advice on transfers from a DB occupational scheme to a DC occupational scheme will require the firm to be FCA-authorised for pension transfer permission
    - Advice on conversion of safeguarded benefits within a DC occupational scheme to access flexible benefits will require the firm to be FCA-authorised for pension transfer permission
    - Advice on transfer of safeguarded benefits within a DC occupational scheme to access flexible benefits will require the firm to be FCA-authorised for pension transfer permission
    - Pension trustees/managers of occupational schemes must check a scheme member has received advice before a transfer of safeguarded benefits to flexible benefits is carried out. Pension trustees/managers will not be

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[665] The FCA's own analysis predicted that up to 40 per cent of people transferring out of a DB scheme would be 'irreversibly' worse off with some being 'left destitute' in old age. Reported in Dan Hyde (2015) Savers who cash in final salary pensions are 'irrational', says watchdog, Daily Telegraph, 4 March.

[666] Pension Schemes Act 2015. The advice will be regulated by the FCA. *Financial Conduct Authority (2015) Proposed Changes to Our Pension Transfer Rules,* Consultation Paper CP15/7, March; http://www.fca.org.uk/static/documents/consultation-papers/cp15-07.pdf

[667] Reported in Aileen Lynch (2015) Safety first - How to operate in the new pension transfer world, Professional Adviser, 1 May.

required to check advice has been received where the fund is less than £30,000, or where an annuity is being purchased.

- Definition of pension transfers
    - A transfer of deferred benefits (regardless of when these are to be crystallised) from:
        - an occupational pension scheme
        - an individual arrangement providing fixed or guaranteed benefits that replace similar benefits under a DB scheme
        - an arrangement that contains safeguarded benefits (for example, guaranteed annuity rates and guaranteed minimum pensions)
    - To:
        - an occupational pension scheme
        - an individual pension plan (personal pension/stakeholder)
    - Or:
        - to transfer safeguarded benefits to obtain a right to flexible benefits
    - These proposals mean firms not authorised for pension transfers must consider pension advice with extra precaution to ensure they do not carry out activities beyond their scope of permissions.
- Appointment of a pension transfer specialist
    - Firms that wish to continue to advise clients on some/all of the above areas will be required to apply for a variation of permission. This process will necessitate the appointment of a pension transfer specialist (a person holding an appropriate qualification and who can demonstrate knowledge and experience in this area). Firms that currently hold pension transfer authority need take no action as their permissions will automatically be updated to reflect the proposed definition of this activity.

In June 2015, the FCA issued an amended Policy Statement (PS15/12) on pension transfer rules. It creates a new regulated activity of 'advising on conversion or transfer of pension benefits'. It also clarifies the meaning of safeguarded benefits, a term introduced by the Pensions Schemes Act 2015 and defined in the negative as all benefits that are not a money purchase benefits or cash balance arrangements.

It was not clear at the time whether benefits offering a guaranteed annuity rate (GAR) would be included in the definition. In principle, they are money purchase benefits, but the guarantee could imply that they are safeguarded benefits. The FCA has now decided to exclude GARs from the new regulated actively to avoid possible confusion. It argues that the transfer of a GAR to flexible benefits is less complex than a transfer of a final salary scheme and therefore a PTS is not required, although advice will still be required if the benefit being given up is valued at more than £30,000.

In May 2015, the Daily Mail reported the case of a 65-year old customer with a valuable GAR on his £67,000 DC pension pot, but who wanted to cash it and spend it on a holiday and home renovations. His provider insisted he had to take professional advice. But due to the GAR, he could not find an adviser willing to sign the form authorising the release. The customer says: 'I thought this would be easy. Some of the companies I've spoken to have said it's just not worth the risk of being hit with a future compensation claim.' The same thing has happened to a 60-year old customer who had a pension pot currently worth £21,501, but due to the GAR it will be worth more than £30,000 when he reaches 65. His provider insisted he get advice before cashing in the pension, but eight adviser firms have turned him down. The provider says: 'Mr [customer's name]'s policy has an attractive guaranteed annuity rate, which is available at age 65. This could be worth over double what he could find in the open market with immediate annuity rates. We don't feel we have been overzealous. These rules protect the customer and ensure they do not lose very valuable guarantees without being fully aware of what they might be giving up.' However, the FCA says the provider was wrong to interpret the rules like this. It says firms should look at the size of someone's pension pot today – not what it may pay out in future.[668]

In November 2015, the DWP announced it was looking to establish a simpler method of valuing pensions with GARs to help consumers gauge whether they need to take financial advice. It accepted that both providers and consumers were struggling to determine when the £30,000 threshold is breached because of the 'considerable variety' of 'safeguarded' pensions and the challenges presented by the potential value of a GAR when the 'promise' element is taken into account.[669] In January 2016, the FCA announced that 68% of GARs were not being utilised by pension freedom clients, although this was concentrated amongst those with small pots who had GARs: 79% of those with pots below £30,000 and 90% of those with pots below £10,000 did not take up their GARS. However, 59% of those with pots over £30,000 did take up their GARs.[670]

The FCA requires, as a further protection for consumers, that all other transfers in excess of £30,000 from safeguarded benefits to flexible benefits be checked by a PTS where advice is given, whether the benefits are deferred or for immediate vesting (crystallisation). A transfer value analysis will still be required for these cases where the transfer and immediate vesting is not at the final salary scheme's normal retirement date. A transfer from an occupational scheme with safeguarded benefits to another occupational scheme with flexible benefits will now need PTS involvement, whereas previously this was not required. Even a move from one part of a scheme that has safeguarded benefits to a part

[668] Reported in Ruth Lythe (2015) Thousands of savers are locked out of the pensions freedom revolution - because they're better off than they think they are, Daily Mail, 6 May.

[669] Reported in Scott Sinclair (2015) DWP may simplify GAR valuations for £30k advice threshold, Retirement Planner, 23 November.

[670] Financial Conduct Authority (2016) *Retirement Income Market Data: July – September 2015*, January.

that has flexible benefits will require a PTS to be involved in the advice. One the other hand, a transfer from an occupational scheme with no safeguarded benefits to a personal scheme with flexible benefits will now not need a PTS, whereas previously it would have. The Pensions Scheme Act does not require advice for members whose benefits are worth less than £30,000. However, if advice is given, the same rules above apply: there is no exemption from the FCA rules based in fund size.[671]

Despite the new freedom to do so, it is likely to be the case that many if not most DB scheme members would not benefit in the long run from moving from a DB scheme to a DC scheme, as the FCA has itself acknowledged. Even in a well-funded DB scheme, members who transfer might get only 80-90% of the value of their benefits,[672] but for a scheme in deficit it could be as low as 60%.[673] Someone who switches from a DB scheme to a DC scheme and uses the transfer value to purchase an index-linked annuity (the same type of pension as in their DB scheme) at current rates will get little more than half their initial pension.

DB scheme members appear to be frustrated by the requirement to take regulated advice before transferring out if calls to Fidelity Worldwide Investment's pensions hotline are anything to go by. Around 10% of calls are from DB clients who just want to take their cash.[674]

Furthermore, not only will many members be reluctant to seek and pay for this advice, they might actually find it hard to find advisers willing to offer it.[675] Henry Denne, head of private clients at Punter Southall, argues: 'Much of the advice process will start on the presumption that remaining in DB is in the best interests of the individual. ..[P]roviding this advice could cost a few thousand pounds and this will need to be paid to the adviser regardless of the outcome of the discussion. They may advise against the transfer. I think the individual will find it difficult to access advice at reasonable cost. Advisers may be reluctant to advise on this area once they understand the full impact of the decision. When advisers read through the guidance on enhanced transfer value exercises, they will realise how much care needs to go into advising in this area'.[676]

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[671] Reported in Claire Trott (2015) Pension transfer rules - Everything advisers need to know, Professional Adviser, 15 June.

[672] Natasha Browne (2015) Regulator to update guidance on DB transfers, Professional Pensions, 19 January.

[673] Katie Morley (2014) Is it worth ditching a final-salary pension for cash?, Daily Telegraph, 15 November.

[674] Reported in Professional Adviser (2015) Advice rule irritates DB savers as pension freedom trends emerge, 19 May.

[675] This is in addition to the problem that people with small pots finding a willing adviser.

[676] Helen Morrissey (2014) DB members will struggle to access advice for DC transfers, Professional Pensions, 22 July.

The FCA's review of enhanced transfer values[677] published in July 2014 found that 59% of members who took an ETV from a DB scheme did so as an insistent client. The FCA wants advisers to ensure they have recorded the client's reasons for wanting to transfer out of the scheme and have discussed the risks involved as well as alternative options.

The June 2015 Policy Statement cited above also clarified the FCA's position on how advisers can avoid liability when dealing with insistent clients. They need to satisfy the following three regulatory requirements:

1. You must provide advice that is suitable for the individual client, and this advice must be clear to the client. This is the normal advice process
2. It should be clear to the client that their actions are against your advice
3. You should be clear with the client what the risks of the alternative course of action are.

Where the advice includes a pension transfer, conversion or opt-out, there will be additional requirements, such as ensuring the advice is provided by or checked by a PTS in the case of transfers over £30,000, comparing the DB scheme with the DC scheme and starting by assuming the transfer is not suitable.

This was the first time the FCA had issued rules on how advisers should deal with insistent clients – even though it still did not technically recognise the term. Nevertheless, it said: 'There is no rule to prevent advisers from transacting business against their advice if the client insists. In practice, there may be occasions where the client wishes to take a different course of action from the one you recommend and wants you to facilitate the transaction against your advice'. In such circumstances, advisers should ensure they have followed the 'normal advice rules', including doing a thorough fact find and suitability report and advising in the client's best interest.[678]

In November 2015, Aileen Lynch, head of technical services at Compliance First, expanded on the FCA's three steps: [679]

- Step 1

  Conduct the business as an advised sale, following all the processes and procedures carried out for all clients. For confirmation, this will include the following:
    - providing the client agreement (disclosure of costs and services)

[677] Financial Conduct Authority (2014) *Enhanced Transfer Value Pension Transfers*, Thematic Review TR14/12, July.

[678] Financial Conduct Authority (2015) *Proposed Changes to Our Pension Transfer Rules*, Policy Statement PS15/12, June; http://www.fca.org.uk/static/fca/documents/policy-statements/ps15-12.pdf

[679] Quoted in Aileen Lynch (2015) Handle with care: Dealing with insistent clients safely, Retirement Planner, 18 November.

- completing a fact-find
- assessing attitude to investment risk
- preparing research
- delivering a recommendation based on the client(s) needs, circumstances and objectives
- produce a suitability report to confirm this position.

- Step 2

  On receipt of the recommendation, should the client(s) decline/reject the advice, a request should be made for the client(s) to prepare, in their own words, the reason for the rejection, awareness of the risks associated in this course of action and then confirmation of the action they wish to take.

  The risks associated with the action they wish to take could include:
  - penalties on encashment/transfer/switch
  - reduction of future benefits
  - loss of existing/future benefits (death benefits, guarantees, bonuses, etc)
  - depletion of retirement funds/income

  It is also recommended, for the future protection of the firm, that the spouse or dependants/beneficiaries countersign this declaration as they can be considered an interested party in the transaction.[680]

- Step 3

  You should prepare a final letter to clarify that you are acting on the client's insistence and confirming the product, provider, fund choices, etc., or drawdown of funds if in a pension scheme.

  This should also confirm the risks associated with the instruction and, if it relates to the drawdown of a pension fund, it should make specific reference to:
  - taxation
  - sustainability of income
  - impact on state benefits (welfare and social care support)
  - state benefit means-testing – deprivation of capital.

  You should then include a disclaimer to highlight the client's potential loss of regulatory protection, with wording similar to: 'You have chosen not to accept our original recommendation and you should be aware that, by proceeding on your

[680] The FOS has previously commented that a 'breathing space' of a week would be expected in such cases.

specific instructions, you may not benefit from the protection of the rules of the Financial Conduct Authority on assessing suitability or from the Financial Ombudsman Service'.

The FCA's technical specialist, Rory Percival, has provided examples of bad practice discovered by the FCA during its 2014 investigation of ETV pension transfer advice. To illustrate, he said the regulator had come across cases of advisers apparently conducting business on an 'insistent client' basis in order to bypass its suitability requirements. He said that dealing with insistent clients is a 'high risk' practice that requires firms to implement additional controls: 'We found, of the cases that advised on ETV transfers, 59% were on an insistent client basis and, within those, there were a lot of problems, [one of which was advisers] not really providing their own advice'. Some advisers were apparently conducting business based on their clients' wishes rather than determining whether those wishes were suitable for them. Another example was 'papering', where 'it's manifestly not an insistent client case, but that's what the paperwork demonstrated it to be,… [with such cases] presumably undertaken to avoid some of our rules, particularly those around suitability'. There were also specific issues around suitability, such as when an adviser agreed to a transfer on an insistent client basis but then gave advice on which product to switch into: 'Just because one element of the insistent client process is insistent doesn't mean that the bit where you are giving advice, and the client is taking that advice, [doesn't need] to be suitable'. Some organisations, such as the Personal Finance Society, have advised members not to transact against their advice under any circumstances, but Mr Percival concluded: 'That's not our position. You can transact against the advice if you take the (above) three steps. But we understand the rationale for that point of view and it's up to firms to decide what services they provide'.[681]

Despite this reassurance, some advisers still feel exposed. For example, Katherine Dandy, partner in Sackers, has warned that confusion over the pension reforms combined with poor understanding of the potential risks would result in a high level of mis-selling, which, in turn, would trigger mis-selling claims worth billions of pounds. Most at risk will be long-serving members of final-salary schemes who might be tempted to transfer to a DC scheme. She warned of a repeat of the mis-selling scandal in the 1980s and 1990s when members of final salary schemes 'were often mistaken by the belief that they can do better themselves by investing the money elsewhere. This proved not to be the case, and resulted in huge claims'.[682]

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[681] Reported in Carmen Reichman (2015) Insistent clients - FCA's Percival flags historic poor advice examples, Professional Adviser, 17 June.

[682] Reported in Stephanie Baxter (2015) Budget freedoms could trigger mis-selling claims 'worth billions', Professional Pensions, 15 January. For a summary of the 1990s mis-selling scandal, see David Blake (2003, p.311) *Pension Scehemes and Pension Funds in the United Kingdom*, Oxford University Press, Oxford.

Aileen Lynch, writing in the same article cited above, was also concerned that the issues surrounding insistent clients will only continue to grow over the coming months: 'There's an unsettling dichotomy between the messages of the mainstream media ("This is your money and you are entitled to do with it whatever you want, whenever you please") and the more considered, long-term approach which is generally prevalent in financial services press and among advisers and providers. The difference in perspective is understandable but is almost certain to lead to continued misunderstandings between clients and advisers. Recent decisions from FOS indicate that erring on the side of caution is always the right path for advisers and I would urge you to continue to refuse to undertake business that you believe would be detrimental to the financial wellbeing of the client'.[683]

Richard Nuttall, a compliance officer at support services provider SimplyBiz, believes that clients insisting on going against their adviser's commendations should be asked to put their instructions in writing to show they are aware of the risks. Merely asking a client to sign a typed statement offers inadequate protection as it may not prove the customer understands their actions: 'Something as [important] as this really needs to be in their own handwriting, otherwise it's just another letter they sign [and don't properly understand]'. He warned that 'there could be a raft of complaints as clients who have transacted against their adviser's wishes later run out of money' and added 'the [FCA] don't know how to build the rules around insistent clients. What we have had has been very light touch'.[684,685]

Sheriar Bradbury believes some companies might start to offer a signing off service on business that other advisers turn down in the expectation of making a 'quick income'. If things go wrong, the cost will will fall on the FSCS which is paid for by advisers. Mr Bradbury continued: 'Any adviser who agrees to sign off such a transfer either against their advice or without giving proper advice is "really stupid", even if they ask the client to sign caveats explaining they did not advise the transfer. A lot of IFAs got into trouble over various things in the past because they took risks they shouldn't have taken and they convince themselves it's OK and they want the money. People like me will end up paying for it through the FSCS'. He refuses to allow his advisers to do DB-to-DC transfers on an insistent client basis and argues the FCA should publish further guidance and 'tell people "we don't like this and watch out"'.[686]

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[683] Quoted in Aileen Lynch (2015) Handle with care: Dealing with insistent clients safely, Retirement Planner, 18 November.

[684] Reported in Carmen Reichman (2015) Ask insistent clients to put it in writing, advisers urged, Professional Adviser, 6 August.

[685] In March 2015, SimplyBiz launched a pension transfer bureau for advisers in partnership with adviser Selectapension (reported in Carmen Reichman (2015) Intelligent Pensions launches DB transfer advice service, Retirement Planner, 23 April).

[686] Reported in Carmen Reichman (2015) Insistent clients easy prey without FCA guidance, warns adviser, Professional Adviser, 5 May.

In April 2015, Intelligent Pensions (IP) launched a DB transfer advice service for financial advisers who want to assist clients planning to transfer their DB pension to a DC scheme. The service allows advisers who do not have the necessary pension transfer specialist qualification to outsource the transfers. Clients can choose a drawdown plan of their choice or stay within IP's own self-invested personal pension wrapper. Advisers can then choose either to remain with the client in their new scheme or transfer responsibility for ongoing advice to IP. The company charges the client an initial advice fee and then a set-up charge to carry out the transfer if the client decides to go ahead. IP launched a flexi-access drawdown plan in March 2015 with ongoing advice at an annual charge of 0.75%.

A survey sponsored by the APFA found that more than 50% of advisers are refusing to implement pension transfers out of DB schemes due to concerns that the regulator could later hold them to account; only 25% are prepared to undertake the transfers. Chris Hannant said: 'This highlights the uncertainty for advisers and the need for the FCA and FOS to clarify the position on advisers' liability when they undertake a pension transfer'.[687]

The Personal Finance Society has also called on the FCA to introduce additional safeguards for advisers dealing with insistent DB transfer clients. It wants clear rules stating that such clients cannot later claim redress from the FSCS. Additional independent warnings should be given by the scheme trustee to those insisting on transferring against the recommendation of their adviser. The PFS has identified a 'problem already emerging' of clients who are 'not really looking for advice', but just want the adviser to facilitate the transfer to satisfy the new rules. It is concerned that many who transfer out of their DB pensions could later regret the decision and 'look for someone to blame'. Keith Richards, chief executive of the PFS, said: 'If the Government expects advisers to facilitate transfers, irrespective of their advice to the contrary, there must be a change of process to further protect the client and guarantee that advisers will not be held liable if a poor outcome subsequently materialises'.[688]

The FCA has found that 70% of providers (and 77% of the 15 largest providers) are willing to accept pension transfer requests from insistent clients, except where the ceding scheme has safeguarded benefits or where the transfer is not facilitated by a financial adviser. However, if a customer is able to find an adviser willing to act on their behalf, it is likely the provider

[687] Reported in Carmen Reichman (2015) Half of advisers shun pension transfers amid FCA backlash fears, Professional Adviser, 7 May. Similar results were found in a survey by Zurich published in October 2015, reported in Carmen Reichman (2015) Half of advisers avoiding pension freedoms advice over liability fears-research, Professional Adviser, 9 October 2015.

[688] Reported in Carmen Reichman (2015) PFS pushes FCA for extra DB pension transfer safeguards, Retirement Planner, 14 April.

will accept the transfer. It therefore seems that advisers are more concerned about insistent clients than providers.[689]

There are a range of reasons why DB scheme members might want to transfer. At one extreme, some people could feel pressured by other family members to use their pension pot to support them rather than provide for their own retirements. A study by the Centre for the Modern Family (which is sponsored by Scottish Widows) published in January 2015 indicated that, of the 2,082 people surveyed, 23% expected to use their pension pot to fund care costs for elderly relatives, while 22% reported that they would use it to fund a deposit for children buying a home. Carolyn Fairbairn, chair of the centre, said: 'Although, for many, the reforms announced in the 2014 Budget will represent greater autonomy over how to use their savings in later life, it is important to consider the knock-on effects on families. Many may feel pressure to access their pensions to support struggling family members and, while it is reassuring that family members are seeing the importance of pulling together in this way, it is vital people are aware of all the short- and long-term implications for retirement pots'.[690]

At the other extreme, according to James Baxter, managing partner of Tideway Investment Partners LLP: 'Members value control of the capital and flexible access to funds above guaranteed lifetime income. They will also be thinking: "I can't believe how big my transfer offer is and I can't afford not to take it"'. Mr Baxter believes that 'capitalising on a DB benefit and getting flexible access to those funds from age 55 can be transformational for many members….The ability to split cash withdrawals from taxable income withdrawals, limit taxable withdrawals to lower income tax bands, save in a tax-exempt fund and pass on funds to children and create higher levels of temporary income when required are all options that don't exist for DB pensioners. These come on top of an offer which is likely to be well beyond what most members believe their pensions are worth. Members are weighing these benefits versus a loss of income security in their eighties, often recognising that life beyond 80 is likely to be quite different, with significantly different financial demands, than life in their fifties, sixties and seventies'.[691]

Some financial advisers believe that the new pension flexibilities could change attitudes to transfers out of final salary schemes. For example, Kim Bendall, director at The Paraplanners, says: 'History tells us advisers would be crazy to recommend a transfer out of a final-salary pension but that's all in the past... I've had the opportunity recently to review

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[689] FCA *Pension Freedoms Data Collection Exercise: Analysis and Findings*. The average pension transfer time was 16 days (reported in Scott Sinclair (2015) Providers confused on pension transfer advice rules, rofessional Adviser, 16 September 2015).

[690] Forever Young: The New Landscape of Later-Life Planning; http://reference.scottishwidows.co.uk/docs/cmf_report_jan_2015.pdf. See also Dan Hyde (2015) Older savers pressured to give pension cash to children, Daily Telegraph, 14 January.

[691] Quoted in James Baxter (2015) DB to DC transfers: the member's perspective, Engaged Investor, 15 June.

some final-salary pensions in order to determine whether a transfer out may be suitable.…In nearly all cases, the critical yield still suggests that the client would be "worse off" if they transfer out; however we believe this is becoming a flawed and unrealistic way of determining the suitability or a potential transfer….Ultimately, the critical yield has to be balanced with the client's non-financial objectives – such as providing options for their spouse when they die, or the ability to pass on some of the pension fund to their children'. [692] Similarly, James Baxter believes DB scheme members 'must overcome perceived wisdom and historic prejudice that it's simply never a good idea to transfer out of a DB benefit. We have absolutely no doubts that if schemes were to start communicating transfer offers to members, with balanced guidance on the pros and cons of the transfer option and some help as to how to get through the advice maze, then the level of transfers would be significantly higher'. [693]

Despite the potential risks, employers and their consultants might well actively encourage DB members to move. The Association of Consulting Actuaries (ACA) was very supportive of the pension freedoms when they were first announced: 'Banning private sector DB-to-DC transfers... would have put UK plc at a huge commercial disadvantage with Europe as it would effectively have locked companies into funding for buy-out'. [694] Employers certainly benefit when members leave the DB scheme. This is because the CETV that the member takes when they leave a scheme reflects the best estimate cost of providing the benefits in the new scheme and does not include the prudence margin that funding on an ongoing basis requires. This margin covers future longevity and inflation risk for example. Further, if the scheme is in deficit, this is reflected in a reduced transfer value. The ACA anticipated that many companies will initiate transfer value exercises after April 2015.

Steve Johnson reports that: 'Transfer value exercises can be popular with companies that want to de-risk by reducing the size of legacy DB pension schemes. They have often been criticised for encouraging people to give up valuable "gold-plated" benefits in return for moving to a riskier personal pension. In 2012, the Financial Services Authority, the financial regulator at the time, said it had found instances where advisers had recommended a transfer but where the FSA could find "little or no justification to do so", potentially leaving people short-changed in retirement'. [695]

Despite this, a number of practitioners support members transferring out of DB:

- Simon Taylor, a partner at Barnett Waddingham, said: 'The new pension freedoms may lead to an increase in members looking to transfer out of defined benefit schemes into defined contribution, which may ultimately help schemes de-risk'.

[692] Kim Bendall (2015) Why the world of pension transfers has changed forever, Professional Adviser, 2 April.
[693] Quoted in James Baxter (2015) DB to DC transfers: the member's perspective, Engaged Investor, 15 June.
[694] Association of Consulting Actuaries Press Release, 21 July 2014.
[695] Steve Johnson (2014) Employees to be lured out of DB pensions, FTfm, 27 July.

- Martyn Phillips, head of buyouts at JLT Employee Benefits, believes that paying a generous transfer value may be cheaper than buying a member out with an insurance company: 'That's a gain from a sponsor objective and from a trustee objective, and it's obviously a more generous offer than the trustees would normally be offering those members'.[696]
- Ian Gutteridge of Premier Pensions Management believes that ETV exercises to encourage DB members to switch to a DC scheme might be an attractive way for employers to reduce their DB liabilities in the new pensions environment. Another option is for the employer to offer a pension increase exchange (PIE): the member receives an increase in the pension but then foregoes annual pension increases on non-statutory pension benefits. The employer could pay for the member to have advice so that 'only appropriate individuals accept a PIE or transfer value'. Mr Gutteridge adds: 'It's a dangerous strategy from the trustees' point of view if they say 'no; we don't want to get involved in this'. Providers have been criticised [in the past] by regulators for failing to give policyholders the full range of options available. Trustees are [also] open to be criticised'.[697]
- Tom Ground, head of bulk annuities and longevity insurance at Legal & General, argues that member option exercises have an important role to play in DB pension scheme de-risking exercises. He says that: 'Transfer value exercises, pension increase exchanges and other member option exercises can provide valued flexibility to scheme members, while potentially increasing the affordability of an insurance de-risking solution, such as a buyout or buy-in. For example, with certain member option exercises, insurers may take the view that there is the potential for "selection risk" and will charge a higher premium to cover this risk. This may have an impact, where a transfer value exercise has been carried out already and the insurer then subsequently assesses the average life expectancy of the remaining members as part of a buyout, buy-in or longevity insurance quote. If the insurer believes that only those members in poor health had taken up the offer, then the average life expectancy of the remaining members will be higher. So the insurance premium would then be higher to reflect the increased longevity of the members. This could, in some circumstances, put the scheme in a position where it may have been better for all parties, if the exercise had been conducted on a wider basis initially. By engaging with an insurance provider at an early stage, ahead of the point of carrying out member option exercises, a scheme can ensure that the initiatives contribute towards achieving the scheme's long term de-risking objectives'.[698]

[696] Reported in Sara Benwell (2015) Rewriting the rules of de-risking, Engaged Investor, 6 February.
[697] Reported in Luisa Porritt (2015) Are transfer exercises back in fashion?, Engaged Investor, 5 May.
[698] Tom Ground (2015) A holistic approach to insurance de-risking, Engaged Investor, 28 April.

A survey of 322 DB schemes conducted by KPMG in May 2015 found that 75% of DB schemes intended to offer transfer quotes to members as part of their standard retirement process, while a third of schemes planned to offer partial transfers. Around 25% of schemes reported that they would offer free or subsidised advice to members, while 30% planned to provide online modelling tools. Only 14% of schemes polled said they had no plans to change retirement processes in the new pension regime. Two thirds of those polled accepted that responsibility for dealing with the impact of the new legislation rested with employers (31%) or trustees (34%), rather than with individuals, providers or the Government.

Stewart Hastie, pensions partner at KPMG, said: 'It is encouraging to see that most employers and trustees are waking-up to the fact that they need to respond to the recent changes to pensions flexibility. The decisions facing pension scheme members at retirement are irreversible. This shows that employers and trustees have recognised that doing nothing is not a risk-free strategy…Both employers and trustees must stay on top of the recent changes and ensure they are engaging with their members. We see a need for education, not just the provision of information. By educating members, employers and trustees can help them plan for their retirement based on their individual needs. Members can also benefit from the full range of flexibility options open to them, in turn, increasing staff morale and the firm's reputation'.[699]

The potential size of the DB-to-DC transfer market could be huge. Some sources estimate that about 500,000 members of private sector DB pension schemes will give up their index-linked final-salary pensions and instead take a cash lump sum.[700] Others put the numbers at 2m or 50% of those over 55. Research by industry analysts for Channel 4's Dispatches programme estimated that withdrawals could be as high as £6bn, which is three times more than HM Treasury estimates. Alan Higham, then retirement director of Fidelity Worldwide Investment, told the programme: 'About 20 per cent of the calls we've had are from people who have made very quick plans to spend money on house improvements, buy a new car, go on holiday . . . and are looking to access their pension funds quickly for that purpose'.[701]

A Close Brothers Asset Management survey in April 2015 asked 400 employers about the response by scheme members to the new pension regime. Around 44% of respondents with a DB scheme reported they had been contacted by members considering transferring out, while 11% said they had been approached by a 'significant number' of members. For those with DC schemes, 57% of employers were planning to offer employees help to allow them to make more informed decisions. Around 23% said they thought employees would turn to

[699] Reported in Jack Jones (2015) Most schemes plan to give transfer quotes to retiring DB members, Professional Pensions, 6 May.

[700] Katie Morley (2014) Is it worth ditching a final-salary pension for cash?, Daily Telegraph, 15 November; Nicola Brittain (2015) DB transfer advice – Is it worth the reputational risk?, Professional Adviser, 27 February.

[701] Reported in Jane Croft (2015) Pension withdrawals set to rise by £6bn, Financial Times, 12 January.

the Government's Pension Wise service, 27% expected their staff to ask them for help, while 28% thought employees would seek specialised advice from a financial adviser.[702]

In August 2015, Selectapension released the results of a survey which showed that pension transfer requests from DB schemes doubled in the three months following Flexiday compared with the three months from April 2014. The top providers chosen to receive the transfers were: Royal London, Scottish Widows, Prudential, and LV=. Andy McCabe, managing director at Selectapension, said: 'Pension freedoms have started to make a considerable impact on consumers and have acted as a catalyst for many to reassess whether remaining in a DB scheme is the best option. However, it is important to recognise that transferring from a DB scheme is not suitable for everyone and a decision as complex as this should not be made hastily but with comprehensive financial advice'.[703]

TPR is concerned that a large volume of transfers could destabilise the DB scheme by crystallising liabilities. It has therefore provided guidance to DB pension scheme trustees on reducing a member's transfer value and how to apply for more time to carry out a transfer.[704]

3.12.2.3 Vulnerable consumers in the annuity market

We distinguish between the primary and secondary annuity market. The primary market is the market where annuities are first sold. The secondary market is where someone who has bought an annuity can subsequently sell it for cash; this market does not currently exist in the UK, but the Government is planning to set one up in April 2017.[705]

The primary annuity market

In August 2014, the Daily Telegraph reported that the FCA had begun an investigation into the sale of annuities sold since 2008 to check if they were unsuitable for customers. The paper said that more than 600,000 pensioners could have been sold annuities that did not take account of their health status. People with diabetes or high blood pressure could have had their pensions increased by around 20% if they had been sold an enhanced annuity instead of a standard one. It is estimated that as many as 60% of retirees have a medical

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[702] Reported in Owain Thomas (2015) One in ten employers seeing 'significant number' of DB transfer enquiries, Professional Pensions, 21 April.

[703] Reported in Carmen Reichman (2015) Defined benefit pension transfer requests 'double', Professional Adviser, 25 August.

[704] Reported Laura MacPhee (2015) Regulator warns trustees to prepare for an increase in DB to DC transfers, Engaged Investor, 2 June.

[705] HM Treasury and DWP (2015) *Creating a Secondary Annuity Market*, Cm 9046 March;https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/413764/Creating_a_secondary_annuity_market__web_file_.pdf

condition or make lifestyle choices (e.g., smoke) which reduce their life expectancy and qualify them for an enhanced annuity. They may now be due compensation if they were sold a standard annuity. The difference between the worst standard annuity rate and best enhanced rate could be as great as 30%. Telephone conversations will be examined, as will paperwork sent to customers before they retired. Compensation orders could be issued where failures are identified.

Observers believe the level of compensation could be significant. For example, John Perks, managing director of retirement solutions at LV=, said 'Any element of compensation will be costly because it means rectifying an annuity income for the long term plus the cost of doing that, so there is potentially quite a scary compensation element here'.[706]

The secondary annuity market

The Government's consultation on its plans to create a secondary annuity market in 2017 closed in June 2015.

Many respondents generally welcomed the Government's proposals, but there were also many critics. For example, Mark Polson, founder and principal of the lang cat, said:[707]

> *I'm on record as loving the other freedoms that have been opened up, and encouraging the industry to trust savers with their own money. So why buck and kick against these freedoms being extended to current annuitants?*
>
> *There are two reasons.*
>
> *Firstly, on a micro level, it's going to be terrible value for those who participate. If we accept the mighty Ned Cazalet's recent figures that up to 20% of the purchase price of an annuity is snaffled in charges, then annuitants have already borne significant pain.*
>
> *Do we really believe those that purchase second-hand annuities will be doing so pro bono? Of course not. We don't know how the figures might look, but the purchase has to be profitable for those putting up the capital, and that's just another way of saying that the annuitant will receive what we like to call a 'secondary screwing'.*
>
> *For sure, we won't be multiplying monthly payments left to the actuarial cohort's expected age of death and paying that to the individual. And you can expect medical underwriting and postcoding to work in reverse.*

[706] Quoted in Ollie Smith (2015) Why the FCA annuity mis-selling probe is good politics, Citywire, 8 September 2015.

[707] Mark Polson (2015) The freedom to sell your annuity (read: The freedom to get screwed), Professional Adviser, 6 January.

As Cazalet's 129-page blockbuster proves, annuities are anything but simple, and unwinding them will be even worse – think Ginger Rogers' famous quote that she did everything Fred Astaire did, except backwards and in heels.

Can we expect the industry to behave itself and not give annuitants looking to flee a worse-than-usual screwing? No, we can't. And it is for this reason – the supply side, not the demand side – that at an individual level this proposal shouldn't go ahead.

Freedom to get re-screwed by an industry hell-bent on loading the decks against you is no freedom at all.

At a macro level it gets even worse. Purchasers of second-hand annuities will only make it work by pooling – that is, by buying lots and lots of them to spread mortality risk. Once we're in that world, we'll start profiling those pools.

We might have 'A' pools, with healthy folk in good postcodes, 'D' pools for people who didn't listen to their wives about the bottle of whisky and all that.

Once that's happening, it's only a matter of time before we have second-hand annuity funds in the life settlement/second-hand endowment fund style, and we know how well those went. And am I the only one who can see packages of annuities being bundled up, collateralised and sold on on what I suppose would be a tertiary market?

….this omni-screwing proposal should be put down humanely before it has a chance to breed.

Similarly, Richard Parkin, head of retirement at Fidelity International, said: 'With these benefits come significant risks for consumers who are giving up guarantees in return for cash. In essence, this market combines the complexity of defined benefit transfers with the risks of pension freedom. We would therefore expect to see similar levels of consumer protection and requirements for advice that we have for these transactions. We cannot afford to skimp on protecting customers in pursuit of making transactions easy'.[708]

Even amongst those who welcomed the Government's proposals, there was widespread support for the idea that annuitants wanting to sell their annuities for cash should be required to take independent financial advice to reduce the risk that they end up getting a raw deal, although some warned that it could hinder competition and choice.

For example, Aegon warned that people cashing in their contracts could be left below the means-tested benefits threshold without entitlement to claim a government top-up. It also pointed out that fraudsters would look to exploit any weaknesses in the market place and that beneficiaries could be hit if their partners decided to sell the policy. Similarly, the NAPF

[708] Quoted in Sara Benwell (2015) The dangers of second-hand annuities, Pensions Insight, 15 December.

proposed that there should be mandatory advice if the annuity was valued at £10,000 or more. It also pointed out that customers could face a significant tax bill estimated to raise for the Treasury an estimated £1bn in the first two years. Under the current tax regime, someone wanting to sell their annuity would face a 55% tax charge; however, the Government has said it would remove this charge, so people will be taxed only at their marginal rate.

By contrast, LV= Retirement Solutions supported the idea of mandatory advice but only for those who 'need' it. John Perks, managing director, said: 'Given the potential detrimental risks involved for consumers, we fully advocate that consumers are obliged to take advice before making a decision as to whether they proceed. However, we think the requirement needs to be assessed to avoid the cost of advice damaging the value of smaller annuities'. Similarly, JLT Employee Benefits accepted that consumers must be protected from scams, but did not believe that the advice should be mandatory. TISA wanted consumers to have access to 'tailored guidance' rather than advice which could be viewed by consumers as an 'unnecessary barrier and expense'. The guidance would be carried out under the existing guidance guarantee, Pension Wise, together with an extension of the second-line-of-defence rules – the requirement on providers to highlight warnings about their clients' choices – to apply to all secondary annuity transactions.

APFA has asked for more clarity around adviser liability when advising on annuity sales: 'We would strongly recommend the provision of further guidance to financial advisers and other intermediaries around what constitutes a suitable reason for assigning annuity income rights. The continuing regulatory uncertainty on adviser liability both generally and around the new pension freedoms has meant many advisers are unwilling to engage in the DB-to-DC pension transfers. We hope this will be looked at by the Government and the regulator elsewhere'. Further, it said that existing annuities should only be allowed to be sold to regulated firms, not retail investors, since 'secondary market income streams can be complex and consumers must be protected as far as possible from making financial decisions which are to their detriment'.

There was also concern about reliably quantifying the extent of longevity risk. Hymans Robertson recommended the creation of standardised health underwriting, an auction-style market place, and a robust audit trail to document the seller's reasons for cashing in their contract.

There was also a difference of view about whether the original provider should be allowed to buy back a client's annuity (i.e., provider buy-back). The Government had initially said it did not like the idea. However, TISA'stechnical director, Jeffrey Mushens, said existing annuity providers should be allowed to buy back annuities 'in order to encourage competition and consumer choice'. Mr Perks agreed: 'We believe that individuals should have the right to sell their annuity to their existing annuity provider should the provider be willing to do so, and where the provider can demonstrate that a fair offer has been made.

We do not believe that it is in the spirit of the reforms to restrict individuals' 'freedom and choice' as to how they take their retirement income. We support the proposed approach to allow a wide range of corporate entities to purchase the annuity as this will lead to greater competition and ultimately better value pricing'.[709]

In December 2015, the Government announced that the secondary annuity market would start on 6 April 2017. The Government said it saw 'no reason to prevent retirees who have already purchased an annuity from selling their right to future income streams for an upfront cash sum if it is right for them'. Five million people with an annuity would be able to sell it for a cash lump sum and be taxed at their marginal rate. The annuity can be sold back to the original provider or to another institutional investor. Those taking advantage will be able to spend the money received as they see fit. The Treasury has also said it wants to make 'appropriate financial advice' mandatory for those considering selling their annuity and said that it will make an amendment to the Bank of England and Financial Services Bill to achieve this. It also seems that anyone will be able to sell their annuity. It had previously been thought that those on means-tested benefits would be excluded. Now, the Government intends to rely on existing deliberate deprivation rules which state that anyone on or likely to become eligible for means-tested benefits who gives up income or capital with the deliberate intention of gaining additional support or benefits can be treated as still possessing it.[710] It is also not currently clear whether the proceeds from selling an annuity would remain within a pension tax wrapper.

Harriett Baldwin said the reforms would include:

- Setting out that pension annuities belonging to an individual and held in their own name will be eligible for the new freedoms
- Requiring that all UK-based annuity purchasers and intermediaries are regulated by the FCA
- Allowing annuity providers the choice to buy back an annuity, subject to robust safeguards
- Introducing a comprehensive consumer protection package to ensure people make informed decisions about their savings, including:
    - extending the free and impartial Pension Wise service to cover the secondary annuity market
    - requiring individuals to seek independent financial advice for annuities worth above a certain threshold

[709] Reported in Natasha Browne (2015) Mandatory advice crucial for secondary annuity market, Professional Pensions, 18 June; and Carmen Reichman (2015) Industry split on mandatory advice for annuity trade-ins, Professional Adviser, 19 June.

[710] See Chapter 1.

- Asking the FCA to put in place a consumer protection framework which could include consulting on a range of extra consumer protections, such as risk warnings and ways for consumers to understand the fair value of their annuities
- The Government has also responded to consultation feedback and will work with the industry and the FCA to create a simple online tool to help consumers work out an estimated value of their annuity.

Ms Baldwin continued: 'For most people, sticking with an annuity is the right thing to do. But there will be some who would welcome being able to draw on that money as they choose – the same freedom we gave people approaching retirement in April [2015]. That's why I'm delighted that we're extending our landmark pension freedoms to over five million people with annuities from April 2017. People who've worked hard and saved hard all their lives should be trusted to make the right decision for them and with the help of the regulator, we will ensure these people have the right information to do that'.

Ros Altmann, the Pensions Minister, added: 'The new pension freedom reforms are crucial in allowing people to make the most of their hard-earned savings. Keeping an annuity will still be the right decision for the majority of people. But some were forced to buy annuities in the past that may not have been suitable for them – and I am delighted that this reform will allow more people greater choice and the opportunity of a more flexible income stream. …Individuals may want to sell an annuity for instance to provide a lump sum for relatives or dependants; in response to a change in circumstances; or to purchase a more flexible pension income product instead'.[711]

Tom McPhail said the Treasury's latest amendment was consistent with current rules around pension transfers, which require regulated advice for pots over £30,000. He believes that having a similar safeguard in place should help prevent investors from selling their guaranteed incomes for rock-bottom prices, but the size of the threshold is important: 'There is already some concern that the current £30,000 threshold is causing problems, with some investors unable to obtain the advisory services they need. Any increase to the threshold would have to be accompanied by other suitable protections to ensure investors could make an informed choice'.[712]

[711] Reported in Jenna Towler (2015) Government to launch secondary annuity market in April 2017, Professional Pensions, 15 December.

[712] Quoted in Carmen Reichman (2015) Treasury backs mandatory advice for annuity re-sales, Professional Pensions, 10 December.

Others warned that the change 'opens the door to millions making a financial mistake by flogging a guaranteed income in return for an immediate lump sum that will be much less than they would end up with by sticking with their annuity':[713]

- Steve Webb, former Pensions Minister and now director of policy at Royal London, said: 'There is a real risk of poor outcomes if people on low incomes sell their annuity only to discover that the DWP treats them as if they were still drawing that income'.
- Alan Higham of Pensionschamp.com said the Government was prioritising 'political ideology over people's real needs in retirement. [The change would] 'benefit few consumers while exposing many to significant risks'. He has estimated that someone aged 75 who bought an annuity 10 years ago with £100,000 would be receiving on average £7,000 a year from it. If they were to sell it and were in good health, they would get around £56,000. They would be worse off if they lived for another nine years, yet official estimates indicate that an average healthy 75-year old will live for another 12 years. Mr Higham added: 'Some healthy 75-year olds could easily live to 100, given increased life expectancy, and giving up 25 years' worth of money for eight years looks a very bad deal by anyone's measure'.
- Sarah Pennells of SavvyWoman.co.uk warned that the freedom to cash-in an annuity will be welcomed by 'rogues and fraudsters [who] have already taken millions from people' since the wider pensions freedoms came into force in April.

The Government announced that advisers in the secondary annuity market could be required to undergo further training and take examinations: 'Intermediaries are likely to have new opportunities in this market, including facilitating the purchase of annuities and providing a range of services for the consumer. These new opportunities are likely to improve the profitability of firms. However, there may be a requirement for advisers to take part in additional training or earn new qualifications to work with customers looking to sell their annuity'.[714]

3.12.3 The FCA's proposed new rules and guidance following the 'freedom and choice' reforms

In October 2015, the FCA issued a consultation paper on the 'freedom and choice' reforms.[715] This was a follow on from its Retirement Income Market Study, conducted prior

[713] Reported in Simon Read (2015) The Government will let you cash-in your annuity: but it could cost you, Independent, 16 December.

[714] Reported in Jenna Towler (2015) Advisers face second-hand annuity training and exams, Retirement Planner, 15 December.

[715] Financial Conduct Authority (2015) *Pension Reforms – Proposed Changes to Our Rules and Guidance*, Consultation Paper CP15/30, October; http://www.fca.org.uk/static/documents/consultation-papers/cp15-30.pdf.

to the introduction of the pension reforms, which focused on the risks facing consumers and how they could make poor choices at retirement.

The FCA has reviewed its rules and guidance and made proposals for future rule changes to protect the interests of retirees. The proposals include additional rules and guidance for firms on how they should communicate with customers, a review of the retirement risk warnings, which were introduced in February without consultation, and new rules for pension freedoms communications. The key proposals are:

- Rules and guidance to ensure that consumers receive timely, relevant and adequate information to both encourage consumers to explore the full range of options for accessing their pension savings and enable informed decision-making
- New rules on the methodology for providing illustrations to members wishing to access their pensions flexibly, including guidance to set out the type of ongoing information that consumers are provided, once they start accessing their pension savings and remain invested
- To retain the rules on retirement risk warnings, but to remove the requirement for a firm to go through the question and answer process of the rules when a consumer has a pension pot of £10,000 or less and where there are no safeguarded benefits
- To add guidance to make explicit the application of existing rules in the context of pension reforms, particularly in relation to debt collection and debt advice
- Restrictions on the promotion and distribution of high risk investments and amendments to the FCA's definition of certified high net worth investor and restricted investor.

Christopher Woolard said: ‘Pensions are of fundamental importance and it is vital that the market works well for consumers. Our proposals today are designed to ensure that consumers have access to products and services that are well governed and deliver value for money following the Government's pension reforms. We will continue to monitor the market as it evolves following the introduction of the Government's pension reforms to ensure that firms are helping consumers get the best outcome in retirement’.

To ensure consumers are able to make informed decisions about an appropriate retirement solution, the FCA proposes to change the information in the pre-retirement wake-up pack. In addition to information about Pension Wise and regulated financial advice, the FCA proposes to:

- Reduce and simplify the information provided
- Ensure information is presented on all retirement options
- Make it easier to obtain annuity comparisons, which would mean the need to provide more focus on enhanced annuities
- Make it easier to shop around after carrying out these comparisons

- Ensure all information is balanced, so it does not promote one solution over another. This would mean where an illustration is provided, for, say, an annuity, illustrations would also have to be provided for all other available options
- To reduce consumer inertia, restrict the annuity application form being enclosed within the pack. This has the effect of ensuring consumers make a positive election from the options available
- As flexibility allows consumers to access the fund at different stages throughout their retirement, information should be provided at each time, i.e., pre and post retirement.

In cases where the advice is to use income withdrawal, a suitability report needs to be prepared. The current rules apply to flexible access drawdown, but not to uncrystallised fund pension lump sums, and the rules will be updated to make specific reference to the latter.

Non-advised annuity sales could be subject to a commission cap or an outright ban. This is because consumers were at risk of not getting value for money from non-advised annuity sales, and that, in some circumstances, commission payments were so high they exceeded the cost of regulated financial advice. Currently, most annuities are bought without advice – either direct from the annuity provider (typically the accumulation-stage pension provider) or via a third-party distributor. Many third-party distributors were paid a commission by the pension provider for arranging the sale. Commission rates were 1% - 1.5% for a standard annuity and 2.5% - 3% for enhanced annuities. This contrasts with taking regulated advice, which involves consumers themselves agreeing to the service they want to receive and the fee to be paid to the adviser.

However, the FCA is aware of the potential consequences of an outright ban: ‘Other options, such as drawdown, would still carry commission. Therefore limiting any ban to annuities could distort competition between these potentially substitutable products. Firms might, as a consequence, be incentivised to promote drawdown over annuities with potential harmful impacts on consumers in the long term. This would mean that, to avoid distorting competition, we would need to consider banning commission on a wider range of investment solutions’.

The FCA also wants to exclude pension wealth from the definition of a high net worth investor (HNWI) in order to prevent retirees losing their pension pot in high-risk investments. It proposes an amendment to its ‘certified high net worth investor' and ‘restricted investor' (RI) certification criteria, so that lump sum pension withdrawals are excluded from the HNWI income criteria. It also wants money released from pensions as cash to be excluded from the definition of net investable assets for the purposes of HNWI and RI certification, in addition to the current exclusion of money held in pensions. It said: ‘We are concerned some consumers' perception of their overall financial wealth following withdrawal of up to 100% cash from their pension savings may lead consumers to certify

themselves as HNWI. [It could also lead them to] invest more money than is appropriate under the RI category, and for firms to distribute potentially inappropriate investments to these consumers'.

The criteria for certifying HNWIs are based on either net income (£100,000) or net investable assets (£250,000). As a result of the pension reforms, more retirees could find themselves falling within these criteria which, in turn, could leave them exposed to pension scammers or being targeted for high-risk investments. Anyone certified as a HNWI does not receive the regulatory protection of the suitability rules and it also means there are no restrictions on the type of promotions they receive. To reduce the potential risks, the FCA wants to exclude cash from a pension from the definition of net investable assets, in the same way that money held in a pension fund is already excluded.[716]

In September 2015, Mark Neale, the chief executive of the FSCS, called for the Government to extend the level of financial protection to cover the total value of peoples' retirement savings. Currently, the FSCS protects up to £50,000 of people's retirement and investment savings. But this is only for those who invest in regulated products or received regulated financial advice and where the firm has defaulted. The FSCS already covers 100% of the policy value of an annuity. Mr Neale wants the protection increased to 100% of the value of pension pots. He highlighted examples of failures in the self-invested personal pension market, relating to high pressure sales tactics to invest in unsuitable alternative assets, which created a case for improved protection. The FSCS assesses whether a firm is liable for its clients' losses by applying a 'civil liability test', i.e., whether, looking at the evidence, the case would have been won in a civil court.

Mr Neale said: 'In recent years, the bulk of investor compensation we have paid out because of negligent advice has concerned investments in risky and exotic assets, such as overseas property schemes. The recent spate of claims to FSCS arising from investments in SIPPs have fallen into exactly this category. These are exactly the sort of investors who should have FSCS protection. Such investors have seen all or the bulk of modest retirement savings put at risk because they did the right thing and sought professional advice about how best to invest those funds. They received very bad advice which the great majority of responsible financial advisers would not have contemplated. This raises the question of whether - following the Government's reforms – we should take a fresh look at the scope of FSCS protection for retirement savings'.[717]

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[716] Reported in Reported in Jenna Towler (2015) FCA overhauls at-retirement rules after major pension reforms, Professional Adviser, 1 October; Jenna Towler (2015) Commission on non-advised annuity sales could be banned,Professional Adviser, 1 October; Laura Miller (2015) FCA wants pension rich excluded from sophisticated investor loophole, Professional Adviser, 1 October; Aileen Lynch (2015) Consumer danger: Assessing the FCA's new pensions freedom rulebook, Professional Adviser, 16 October.

[717] Reported in Carmen Reichman (2015) FSCS chief renews calls for full protection of retirement savings, Professional Adviser, 28 September.

3.13 Media and Government reactions to regulatory and provider concerns about consumer vulnerability: The issues of access and exit charges

Despite the large sums of money that were withdrawn in the first few months following Flexiday, it soon became clear that many customers were actually finding it difficult to access their pension pots or were being made to pay significant exit charges by their providers.

3.13.1 Access

While the measures put in place by regulators and providers were there to protect vulnerable consumers, some of them at the prompting of MPs on the Work and Pensions Select Committee hearing in December 2014 with the FCA, the media – led by the Daily Mail and the Daily Telegraph – saw them as unnecessary and costly barriers to people accessing their money and this view was immediately taken up by Government ministers.

Typical of media reaction is this article in the Daily Mail:[718]

> *George Osborne's pensions revolution was in crisis last night with thousands of savers unable to spend their nest eggs as they want.*
>
> *Just 65 days into the new regime, financial giants are under siege from furious customers.*
>
> *The Chancellor had promised savers easy access to their cash. But today a Money Mail investigation can reveal a string of disastrous failings:*
>
> - *Firms refusing withdrawals for fear of being sued for negligence in years to come;*
> - *Savers being forced to pay up to £1,000 for financial advice if they want their money;*
> - *Customers turned away because they have only small pensions;*
> - *Delays of up to 90 days in paying out cash;*
> - *Sky-high charges for withdrawals or for switching to rival firms;*
> - *Insurers knocking thousands off the value of pensions [that] customers want to access.*
>
> *....Since April 5 this year anyone over 55 should in practice be allowed to take all their savings out in cash, or dip in and out of it as they want – just like a bank account.*
>
> *But in reality savers are finding that they cannot get their hands on their money.*

[718] James Coney (2015) What a pensions shambles! Revolution in crisis as savers are barred from taking out cash and charged £1,000 just for advice... and scandal could be worse than PPI, Daily Mail, 9 June.

Some firms such as NEST, Friends Life and Phoenix will not allow savers to use their pension like a bank account.

Others charge hefty fees of up to £240 for each withdrawal, or place restrictions on how much someone can take out.

Money Mail has been bombarded with letters from pensioners who have been told they cannot have their savings unless they first see a financial adviser. This typically costs about £1,000. And even if they do consult an adviser they may still may not be able to get at their cash if the adviser does not think taking the pension is a good idea and refuses to help.

Some savers had found that the specific type of pension they have does not qualify. And many have faced lengthy delays because insurers have been forced to dig out pension contracts that are three decades old.

Customers of firms such as Clerical Medical, Phoenix Life and Aegon have experienced huge delays in getting hold of their cash.

…Dr Yvonne Braun, of the Association of British Insurers, said: 'Providers have and are continuing to work round the clock to ensure these reforms are implemented as smoothly as possible.

'In the first month alone, the industry handled over one million telephone enquiries – up 80 per cent on normal. 'While the vast majority of customers have been able to access their funds in full, some may be required to take advice as a result of the Government's rules because they have valuable guarantees.'

In June 2015, the Daily Telegraph, launched a 'Make Pension Freedoms Work' campaign with five demands:[719]

1. All pension providers must offer savers 'bank account' type access to their money. Where providers won't do this, they must allow their customers to switch to rival providers for free
2. Charges for making use of the new pension freedoms – per cash withdrawal, for example – should be reasonable and capped
3. The Government's default work pension provider, NEST, should offer its own range of bank account features that will be suitable, and affordable, even for modest savers
4. Exit penalties for all pension savers, even where these penalties have been written into old-style pension plans should be scrapped for every saver beyond the age of 55
5. Savers wanting to move their pension cash from one provider to another should be offered a safe, standardised process where all the associated risks and costs are clear.

[719] http://www.telegraph.co.uk/finance/personalfinance/pensions/11653726/Pension-freedoms-This-is-how-to-make-them-work.html

Even the Consumers' Association stepped into the debate. Richard Lloyd, executive director of Which?, said: 'The recent pension reforms are a golden opportunity to make the pensions market work in the best interest of consumers. So it is disappointing to see one of the biggest providers not stepping up and implementing the changes'.[720]

In the same issue of the Daily Mail cited above, Ros Altmann, as Pensions Minister, and Harriett Baldwin, as Economic Secretary to the Treasury, wrote (under the heading 'Insurers shouldn't have any excuses'):

> *Earlier this year, George Osborne introduced the most significant reforms to the pensions system in a century.*
>
> *Gone is the effective requirement to buy an annuity. If you're over the age of 55, you now have the freedom to access your defined contribution pension pot in the way you want — in flexible payments, by taking some out and leaving the rest for later, as a regular income, or as cash.*
>
> *As the Prime Minister said this week, we want to give people more control over the money they saved hard for over their working lives.*
>
> *It's great that many pension providers and schemes have risen to the challenge and are offering their customers flexibility.*
>
> *However, it is disappointing that some firms are lagging behind, and some providers have chosen to focus their efforts on far too narrow a range of options.*
>
> *No matter which pension provider you saved with, you should be able to use your pension how you want to.*
>
> *The industry should be embracing this exciting opportunity and developing innovative and competitive products that work for you — and we will work closely with them to help them achieve this.*
>
> *We have to recognise that some companies have met practical difficulties along the way, including creaking IT systems that can't 'speak' to each other.*
>
> *That is why we've allowed insurance companies flexibility over how and when they introduce these reforms. But we are determined that customers should in no way be disadvantaged by that.*
>
> *So, we have made sure that if you can't access your pension flexibly, or feel you are being charged too much, you can transfer your savings to another provider.*
>
> *We are monitoring these issues closely and will continue to ensure that there is a system in place that works for you. We have also legislated to*

[720] Quoted in Dan Hyde (2015) Pension companies 'failing to move with times', says minister, Daily Telegraph, 4 June.

allow pension schemes to override their previous narrow scheme rules, so they can offer the flexibilities if they want to.

This means that there is no excuse for firms to claim that their rules mean you can't access your money.

There are some circumstances where you will be asked to seek independent financial advice from a regulated professional adviser — that's simply because your pension has special, valuable features which you need to understand before you make a decision.

Ask your pension provider to explain why they're asking you to take financial advice.

The Government will be watching this issue closely and working with the industry and regulators to address any problems.

If you're considering accessing your pension, make sure you take the time to find out what the options are, get help and support, and make the decision that is right for you and your family.

After all, this could well be a once-in-a-lifetime decision that will affect what you have to live on for the rest of your life.

To help you make that decision, the Government has set up Pension Wise, which offers free, impartial guidance on your options and will help you to understand the tax that you might pay, what charges to look out for and other important information.

These have been major changes, underpinned by a very simple philosophy: it's your money, you have earned it, you have saved it and we want you — not the Government or pensions companies — to choose what you do with it.

Our focus now will be to make sure that the new system works in practice — and that the industry helps you get the most out of these historic reforms.

Despite this, there were mixed messages from the Government about when it would intervene to oblige providers to offer full pension flexibility. Writing in the Daily Telegraph, Iain Duncan Smith, the Work and Pensions Secretary, said the Government was ready to 'name and shame' providers who were not giving their customers pensions freedom. He also said the Government was talking to regulators to ensure that people have the flexibility they deserve and will 'not hesitate to take action'. In contrast, Ros Altmann said the Government would not intervene immediately to 'give the reforms a chance' first to 'see how they work'. A DWP spokesman said: 'It is early days and no-one is proposing an immediate intervention, but both ministers are clear that the situation needs to be carefully monitored. We are prepared to "name and shame" those companies who are putting barriers in the way of people getting access to their money if such action becomes necessary to encourage the industry to make changes. If, as the market develops, it becomes apparent

that Government action is necessary to ensure consumers get a good deal, then action will be taken'.[721]

The ABI immediately hit back at proposals that providers – most of which are insurance companies – would be 'named and shamed' for not offering the full range of pension freedoms. Huw Evans, director general, said: 'We warned in February that not enough had been done to ensure a completely smooth implementation of these major reforms. The priority now is for the Government, regulators and providers to work through these teething problems together. The reforms are proving successful so far for the majority of customers and we have to build on that rather than get into a blame game'. In the meantime, Friends Life – one of the life offices criticised – has refused partial withdrawals to its customers, although it says it plans to offer this in 'due course', while NEST and Phoenix – two of the other providers criticised – have confirmed they will not be providing the full freedoms in-house.[722]

The ABI also went on to propose a series of measures to help resolve the 'implementation challenges' that 'freedom and choice' raised for insurance companies. In particular, it suggested that mandatory advice on pension freedom cases with guaranteed annuity rates worth more than £30,000 should be scrapped and replaced with a 'customer control' mechanism, giving people access to their pension pot without having to pay for advice. It said the mechanism should be delivered through a specific guidance session by Pension Wise, and enshrined in a protocol agreed with the FCA and the FOS.

The ABI also published an action plan to facilitate pensions freedom implementation:

- Establish a joint taskforce between the Government, the regulators, providers and advisers to deal decisively with the remaining issues
- The FCA to conduct a broader review of the balance of responsibility between customers and providers in light of pension flexibility
- The FCA to set out clearly those products and circumstances where advice should be taken
- The Treasury to work with the FCA and DWP to clarify the definition and valuation of safeguarded benefits, by a change in the law
- Providers to work with the FCA and DWP to clarify the definition and valuation of safeguarded benefits, by a change in the law
- The Government to publish Pension Wise data and restart marketing to ensure maximum take up of this valuable service

[721] Reported in Carmen Reichman (2015) Mixed messages from govt on pensions freedom intervention, Professional Adviser, 15 June.

[722] Reported in Natasha Browne (2015) ABI warns against 'blame game' on access to pension freedoms, Professional Pensions, 15 June.

- The ABI and its members to start work on developing a standardised language on products and charges to help customers consider their options
- The ABI and its members to ensure clear, consistent communications to customers on the products and services available.

The ABI said: 'While the vast majority of customers so far have successfully exercised their choices without complaint, it is clear that implementing the law and regulatory requirements as they currently stand is not enough to ensure the benefits of the reforms can be universally felt. This action plan proposes a solution to the problem of customers unable or unwilling to access advice in the circumstances set out in the law….We also request the urgent establishment of a joint taskforce between the Government, regulators, providers and advisors to work through the outstanding issues and deal decisively with them. The ABI and its members remain completely committed to making the pension reforms a success so customers can make the most of the pension freedoms. But it is clear this cannot happen fully without a decisive and joined up approach to the implementation challenges that have arisen. If the proposals in this action plan are taken forward, we are confident customers will be able to enjoy the freedoms in a suitably regulated environment'.[723]

3.13.2 Early exit charges

Another issue that soon became apparent was that not only were people facing difficulties transferring their pension pots, those that were able to do so were being charged significant exit charges. A report in the Financial Times showed that exit charges could typically lie between 5% and 15% of the value of the pension pot, although in a few cases the charge could be as high as 20% or even 50%. The Chancellor, George Osborne, said that deductions of this size were 'unjustifiable'.[724] In June 2015, the ABI said nearly 90% of customers eligible for the pension freedoms will not face early exit charges.[725] However, the FCA reported that while 84% of customers will not face an early exit charge, 670,000 consumers aged 55 or over faced an early exit charge (16% of the total). Of these, 358,000 faced charges between 0-2%, 165,000 faced charges between 2-5%, 81,000 faced charges between 5-10%, and 66,000 faced charges above 10%.[726]

[723] Reported in Professional Adviser (2015) ABI urges govt to scrap mandatory pensions freedom GAR advice, 19 June.

[724] Quoted in Dan Hyde (2015) Pension 'exit' penalties cut so over-55s can withdraw cash, Daily Telegraph, 17 June.

[725] Reported in Professional Adviser (2015) Govt to scrutinise early exit charges under pensions freedom, Professional Adviser, 17 June.

[726] Reported in Jack Jones (2015) One in 30 retirees facing exit charges above 5%, Professional Pensions, 16 September.

Insurers impose exit charges on policies that are cashed in before their maturity date, which typically coincides with the retirement date of the policy holder, e.g., age 65. This mostly affects policies sold in the 1980s and 1990s.[727] Such policies were sold by sales staff who received up-front commission from the insurer. The insurer recoups the commission over the remaining life of the policy in its annual charge and imposes an exit charge if the policy is cashed in early.

Claire Trott, from Talbot and Muir, believes the exit charges are really market value adjustments (MVAs): 'To me the majority of "high exit fees" are actually MVAs. People see it as an exit fee, because they are penalised for taking [their money] early, [but] you are breaking your contract and [the company] is recouping the cost [of selling the policy]'. She also pointed out that those breaking their contracts early could also miss out on terminal bonuses that would significantly enhance their pension pot: 'The pension pot could be reduced by a hefty amount if you take your pension 10 years before the contract ends, for example, at 55 rather than 65…You need to look at the contract and take account of anything in it that could reduce your fund value'.

Neil Lovatt, from Scottish Friendly, said policyholders should also be aware of 'enhanced allocation rates' which would be lost if policyholders withdraw early. The purpose of the enhancements was to provide an incentive to remain with the insurer. However, the enhanced rates were linked to the ongoing payment of commissions, so if the policy was cashed in early, the enhancement would be wiped out: 'Some people have extra charges built in to their contracts. People who have a contract 15 years ago…would have got an allocation value of more than 100% and that extra has been in there from day one and because you are [breaking the contract early], the [extra] is taken back….Contracts were built until retirement age and if you leave early there will be a clawback'.[728]

3.13.3 Official responses

The official responses to the criticisms raised over the issues of access and exit charges were swift in coming – from the FCA, TPR, HM Treasury and the Work and Pensions Select Committee.

3.13.3.1 Financial Conduct Authority

On 1 July 2015, the FCA announced that it had written to all pension providers requesting data on how customers were accessing their pension pots following Flexiday. The request

[727] Policies sold since 2000 tend not to include exit charges, since they unfairly restrict people to stay with a particular insurer, irrespective of the insurer's investment performance.

[728] Reported in Michelle McGagh (2015) Pensions: the savers left in the lurch by exit fee clampdown, Citywire, 30 July.

for data includes a questionnaire seeking information on exit charges; transfer procedures; treatment of insistent clients; financial advice requirements; and the options they offer consumers seeking access to their pots. The announcement followed a request from Harriett Baldwin to Martin Wheatley, then FCA chief executive, to take action on the implementation of 'freedom and choice'.[729]

The move was widely welcomed in the press. Typical are these views from the Daily Mail:

> *The pensions industry has been given one month to clean up its act over the treatment of older savers.*
>
> *Following a Daily Mail campaign, regulators have written to the chief executive of every pension provider to demand they hand over details of the fees they are charging customers to withdraw their savings.*
>
> *They have also been told to come clean about any other barriers customers face when they try to get hold of their money under the new pension freedoms.*
>
> *The Financial Conduct Authority has given companies until August 7 to declare the exit fees charged if people over 55 try to move to a more flexible scheme or a rival firm.*
>
> *They will also have to present evidence of what options they have been offering customers.*
>
> *If they fail to disclose the information, regulators could impose sanctions, which might include fines in the most serious cases.*
>
> *The demand by regulators follows concerns that millions of savers are being blocked from using the pension reforms.*
>
> *Since April, the over-55s have been able to cash in their pension for the first time rather than being forced to buy an annuity, a fixed monthly income for life.*
>
> *But the Mail discovered that excessive fees and other restrictions meant many were unable to use the full freedoms.*
>
> *While most were able to withdraw all their money in one go, many could not use their pension 'like a bank account' by taking it in chunks and keeping the rest invested.*
>
> *Some insurers refused to offer this flexibility, and then charged huge fees to move to a rival firm that did.*

[729] Reported in Professional Pensions Online (2015) FCA writes to all pension providers over 'freedoms' access, 1 July.

Last month the Mail launched its Play Fair On Pensions campaign, which called for providers and regulators to lift rules preventing people accessing their hard-earned savings.[730]

3.13.3.2 The Pensions Regulator

On 2 July 2015, TPR announced it had launched an investigation into exit charges and the DC scheme transfer process to complement the FCA's investigation announced the previous day. It said it will survey a sample of schemes and the results will be used in a discussion of the broader 'operational readiness, governance and member communications' of schemes looking to provide flexible decumulation options. It also said that a similar investigation was taking place to understand the impact of pension freedoms on DB schemes, any subsequent risks and the application of its regulatory guidance. TPR said: 'We remain committed to making pension flexibilities work in the interests of retirement savers and expect to conduct further research on decumulation, to include costs and charges, in the autumn. We will consider with Government and the FCA what further action may be required to promote good outcomes for members'. It said it was considering creating more prescriptive guidance for trustees communicating the pension freedoms to members of large schemes.[731]

3.13.3.3 HM Treasury

On 30 July 2015, the Treasury released a consultation document called *Pension Transfers and Early Exit Charges*.

The consultation will: [732]

- consider the issues around early exit charges, to ensure that people are not facing unjustifiable charges when moving scheme or accessing their pension savings flexibly within their scheme as part of the new freedoms
- seek views on how the process for transferring pensions from one scheme to another could be made quicker and smoother, and
- explore issues and concerns in relation to the provision and need for financial advice when making certain transfers.

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[730] Louise Eccles and Ruth Lythe (2015) Crackdown on punitive fees to free pension cash: Victory for Mail campaign as industry is given one month to clean up its act , Daily Mail, 3 July.

[731] Reported in Natasha Browne (2015) TPR to probe schemes on DC transfer procedures, Professional Pensions, 2 July.

[732] HM Treasury (2015) *Pension Transfers and Early Exit Charges*: *Consultation*, July; https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/449861/PU1847_Pensions_transfers_v4.pdf

In particular, the Treasury wishes to consult on whether to place a cap on exit charges that may represent an 'unreasonable barrier' to accessing the pension pot. It has set out three proposals:

1. A cap on all early exit fees – a blanket cap that would allow pension schemes to charge a fixed percentage of the value of the funds being transferred or a capped fixed amount. However, there is concern that a fixed amount would deter those with small pots from exiting
2. A flexible cap – this would try and address the small pot issue, so pension providers would only be forced to use a cap over a 'de minimis' amount or tailor the fees to take into account small pots
3. A voluntary fee – this would allow the pension industry to set exit fees and even waive fees in cases where they see fit.

The Treasury's concern is that '[w]here an individual wishes to access their pension under the new freedoms, they should be able to do so quickly and smoothly and the Government is concerned that exit charges may represent an unreasonable barrier to their doing so. For example, an exit charge might prevent an individual from accessing freedoms where the level of the charge represents a significant proportion of the funds being accessed, or where it is so high that even those with larger pots regard the level of the charge as prohibitive. In these circumstances, the level of the charge might be considered disproportionate and, therefore, unfair and excessive'.

The consultation paper said: 'Although many of these individuals will face charges that represent fair and reasonable charges to cover costs, the Government believes there is a high degree of overlap between transfer fees and exit charges and, in the case of the latter, would like to understand, in particular, whether and why some charges may be significantly higher than others', adding that as many as one in ten savers in workplace schemes could be affected by charges when transferring their pension.

The Treasury said there were 'particular issues' concerning certain pension products sold in the 1980s and 1990s: 'In some cases, policyholders are reported to have been paying high annual management charges, with high exit penalties for switching to another provider. Although the majority of these schemes are now closed to new members, a significant number of these plans continue to operate for existing customers'. However, the consultation excludes pensions that have a 'market value adjustment' or 'terminal bonus' written into the contract.

Claire Trott of Talbot and Muir said: 'A consultation on high early exit penalties should be welcomed. There will be many people trapped in poor performing historic pensions that won't be in a position to access their income in a flexible way without incurring excessive fees to do so. [However], the consultation should not miss the point that many of the historic charging structures were low in the early years because of these built-in exit

penalties and some companies will be out of pocket if they are forced to reduce the penalties. This doesn't mean that it shouldn't be looked into though. The constant changing of pensions legislation can be very costly for pension providers with large historic books and bringing in the changes expected by the Government in the short timescales given has been a challenge for many. The consultation needs to take into account the cost of providing the retirement options and how these differ between different retirement products. Running drawdown in a self-invested personal pension with a wide range of assets, such as commercial property and various other assets, will be significantly more time consuming than drawdown run in a basic personal pension with a range of mutual funds also run by the same provider. The consultation should look at value rather than outright cost'. Nevertheless, she felt that the exclusion of MVAs meant that there was 'little need for the Government to legislate'.[733]

Stephen Scholefield, pensions partner at Pinsent Masons, said, while tackling exit fees makes the Chancellor an 'unlikely consumer champion', it will not be enough to ensure the freedoms are successful: 'To have real success, he'll need to create a safe-harbour environment in which providers can process transfers efficiently, whilst savers don't live to regret their decisions. Otherwise, ambulance chasers will be joining car retailers in looking to profit from those who cash out their pension savings'.[734]

Some argued that there was a case for some form of exit charge. For example, Jamie Smith-Thompson of Portal Financial agreed that exit fees up to 20% were punitive and excessive and therefore a cap would help to protect consumers. However, he was concerned that this could turn into a 'witch-hunt on fees in their entirety' and argued that exit fees could actually help protect savers: 'It is not a requirement for all consumers to seek financial advice before emptying their fund or transferring away, which means many people will be able to make that decision by themselves without necessarily knowing about certain implications, such as tax or how it may affect their benefits. A sensible charge can encourage people to think twice and be really sure they are doing the right thing, and hopefully even prompt them to seek advice so they don't have any surprises'.[735]

The Daily Telegraph reported that key pension providers had already held meetings with the FCA to lobby against a draconian cap being imposed on charges. The providers also wanted a coordinated approach so all firms reduce their fees at the same time to ensure that no

[733] Reported in Jenna Towler (2015) Govt vows to cap 'excessive' pension exit fees, Retirement Planner, 30 July.
[734] Reported in Stephanie Baxter (2015) Cap on pension exit charges 'could turn into witch-hunt', Professional Pensions, 18 June.
[735] Reported in Stephanie Baxter (2015) Cap on pension exit charges 'could turn into witch-hunt', Professional Pensions, 18 June.

provider faced a sudden exodus of customers to rival companies, although it was recognised that this might breach competition law, since it could be classed as price fixing.[736]

In January 2016, the Treasury announced that it will legislate to cap excessive early exit charges.[737] The following month, it said that the cap would come into effect in March 2017. implementation target. The FCA will be responsible for setting the level of the cap and will consult fully on this in due course.[738]

3.13.3.4 The Work and Pensions Select Committee

On 17 July 2015, the Work and Pensions Select Committee announced it would launch an inquiry into the new advice and guidance regime. The committee wanted to hear evidence on the take-up, suitability, affordability and independence of the advice, guidance and information available to those approaching retirement. It also wanted to hear recommendations for improvement. Committee chairman, Frank Field MP, said: 'Many constituents were ripped off in the process of putting their earnings into pension savings. We have a duty to ensure they are not ripped off again if they wish to take their money out and spend some lump sums'.

Richard Graham MP, a member of the committee as well as chairman of the All-Party Parliamentary Group (APPG) on pensions, said: 'Taking away the requirement to buy an annuity and introducing much greater flexibility in how and when individuals can access their pension savings should be a positive change for many. However getting the right guidance is key, and this inquiry will look at the guidance and advice being given, and how effective the system is in helping people make informed choices'.[739]

In September 2015, the ABI's Huw Evans told a Work and Pensions Select Committee inquiry hearing that likening pensions to bank accounts is the 'most irresponsible' thing anyone can say in relation to pensions freedom: 'If I could rub a lamp "Aladdin-style" and have a few wishes, certainly one of them would be to stop people referring to pensions as a "bank account". It is the most irresponsible thing anyone can say. You cannot attract a tax liability when you withdraw money from a bank account or set up a direct debit. You can if you

[736] Reported in Dan Hyde (2015) Hope of amnesty on pension exit penalties, Daily Telegraph, 30 July.

[737] Reported in Jenna Towler (2016) Treasury to cap 'prohibitive' pension exit penalties, Professional Adviser, 19 January.

[738] Reported in Jenna Towler (2016) Pension exit charge cap set for March 2017, Professional Adviser, 10 February.

[739] Reported in Jenna Towler (2015) MPs launch pensions freedom advice and guidance inquiry, Professional Pensions, 17 July.

access pension liabilities. There is a piece [of work to be done] around customer expectations and we have to use the right language'.[740]

The Work and Pensions Select Committee reported the results of its inquiry in October 2015.[741] It found that the Pension Wise website, which provides information and guidance on options at retirement, but not advice, was 'not fit for purpose'. It also found a lack of regulatory clarity over the difference between 'advice' and 'guidance' which is putting savers at risk of poor decisions, 'particularly in the affordable middle ground between free general guidance and expensive independent advice'. The report said that 'Good quality, co-ordinated and accessible guidance and advice will be the best tools to ensure people make the best, informed decisions about their retirement savings, and protect them from scammers…We call for clarification of the distinction between guidance and advice; the definitions of safeguarded benefits; and protections in providing advice to insistent clients. We also expect to see a reduction in the use of jargon and complex pricing structures'.

3.14 Pension fraud and investment scams

Red flags for spotting pension fraud

- Any unsolicited approach: phone, email, text messages or in person
- Free pension reviews, particularly from unregulated companies marketing early access to cash or guaranteed investments
- Pushy advisers that encourage members to speed up signing paperwork, as well as the use of couriers to collect/sign paperwork
- Any mention of loopholes, overseas or strange/creative/unique investments – unregulated investments, such as hotel rooms, car parking spaces, forestry, renewable energy, storage pods
- Any mention of loans or bonuses provided by Government
- An offer to help you access your pension savings before age 55
- A recommendation to take a large amount of money, or your whole pension pot, in a lump sum and invest it.
- Warnings that the deal is limited and you must act now
- An encouragement not to get professional financial advice or talk to Pension Wise
- Contact by somebody who is not on the FCA register

Source: Retirement Advantage, reported in Jenna Towler (2015) Pension scam alert, Professional Adviser, 1 July.

[740] Reported in Jenna Towler (2015) Comparing pensions to bank accounts 'irresponsible', ABI chief warns, Professional Adviser, 8 September.

[741] House of Commons Work and Pensions Committee (2015) *Pension Freedom: Guidance and Advice*, HC 371, 19 October; http://www.publications.parliament.uk/pa/cm201516/cmselect/cmworpen/371/371.pdf

Even with safeguards in place, many pension scheme members, especially those with large DB pension pots, have attracted the attention of scammers and con artists.[742] Tom McPhail believes that cold-calling scammers are 'going to take advantage of the Government-sanctioned freedoms to persuade people that they can do better than investing in "traditional" pensions. In reality, many of these schemes will be nothing but a rip off. They will use seductive offers of generous guaranteed returns. The two risks from this will be unexpected tax charges when they take money out of the pensions and then in some cases the loss of the rest of their money when the unregulated investments fail to live up to expectations'.[743] Even the Pensions Minister at the time, Steve Webb, received a text message from a con artist on his mobile phone: 'if you have a frozen pension prior to 55 you are entitled to a free review. Please call back'.[744]

In October 2015, a survey commissioned by Portus Consulting, found that one in seven savers over the age of 55 has been targeted by a pensions scam since Flexiday. It also showed that 69% of those targeted said they were offered a free pension review. Over 27% said the suspected scam involved an exotic investment scheme, promising attractive levels of return. The most common method used by potential scammers to contact over-55s is by email (cited by 36% of the people interviewed), followed by the telephone (33%).[745]

Con artists can be pushy and charming. Each year, they steal £1.2bn from investors, including pension liberation, an average loss of £20,000. They are drawn to the most vulnerable: those in debt and desperate for cash, or who are confused about the rules surrounding their pension. Margaret Snowdon, head of the Pension Liberation Industry Group (PLIG), says fraudsters are very difficult to identify: 'They do tend to mimic legitimate schemes and providers. They are fairly clever or they would be easily found out. It is probably the patterns of behaviour that help identify them – cold calling for example, or pushy and threatening to sue on delays'. They have a background in either financial services, including ex-IFAs, accountants, solicitors, or in wealth or debt management. They invest in expensive marketing material and websites. [746]

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[742] The fees that the scammers charge can be as high as 30% and in addition there could be a tax charge of up to 55%, see Sarah O'Grady (2014) Warning as fraudsters target elderly in scam to get pension savings, Daily Express, 11 December; see also Jenny Towler (2015) Pensions freedom 'absolutely made' for cunning fraudsters – Phoenix Group. Professional Adviser, 29 January.

[743] Quoted in Andrew Oxlade (2015) Pensions freedom: how we can help you make the most of it, Daily Telegraph, 16 February.

[744] Reported in Daily Mail, 12 February 2015

[745] Reported in Rebecca Shahoud (2015) One in seven targeted by pension fraudsters, Professional Pensions, 27 October.

[746] Natasha Browne (2015) A portrait of a con artist, Professional Pensions, 2 February.

Jack Doyle and Sam Dunn provide this warning:[747]

> *How crooks will target you*
>
> *Promised pension freedoms herald a bright new dawn for millions of savers. Unfortunately, they will also act as a clarion call for crooks to target millions of pounds about to be unlocked by the trusting and the unwary.*
>
> *The danger lies in scammers' ability to contact you by phone, text or email – and their persistence to wear you down.*
>
> *Their first approach is usually the most enticing. A text might typically offer a 'free pension review', 'one-off investment opportunity' or promise of 'upfront cash'.*
>
> *But the minute you respond to the cold-caller, they'll begin to crank up the pressure. Their prize is your pension pot – and they need you to agree to sign a funds transfer form to get their hands on it.*
>
> *So the promises will come thick and fast. They might suggest juicy returns of 8 per cent or more, talk authoritatively about locking away cash in overseas investments or dangle cashback payments.*
>
> *To soothe fears, they may also claim to be a Government adviser or say they've been endorsed by officials. And while there will be talk of you, at 55, having plenty of time to lock your money away, there will be no mention of the imminent tax bill you'll need to pay. The fee they'll charge, perhaps as high as 30 per cent, will be glossed over.*
>
> *It might take a dozen or so emails and phone calls – or even ten times that – but once you're hooked, they'll then push you to sign a transfer form as soon as possible.*
>
> *This may be sent to you by email as a form to fill in online or even couriered over to your front door. You'll be convinced it's a simple final matter of filling in the details of your existing pension scheme – usually its name and number.*
>
> *Legally, your original pension provider – usually an insurer – can only agree to transfer the money on the condition it will go straight to another registered pension plan. However, the scammers – acting as the broker – do no such thing. They'll take the money and then release only a chunk of it to you as a loan or cash sum.*
>
> *And once your funds are released from your insurer and into a new account – often overseas and outside UK jurisdiction or the arm of the regulator – then your chances of ever seeing the cash again will vanish.*

[747] Jack Doyle and Sam Dunn (2015) Beware of the pension sharks: Flood of spam texts and cold calls 'could create the next PPI scandal', Daily Mail, 16 March.

You may find the scammer picks up the phone the first time you call to check up on your investment – but they won't be there the next time.

As well as the hefty fee, HMRC will then slap you with a tax charge of up to 55% because you've taken out an 'unauthorised payment' from your pension.

Always check the credentials of the company and any advisers, who should be registered with the Financial Conduct Authority at fca.org.uk.

If you think a company is trying to get you to liberate your pension, report the company to Action Fraud or call it on 0300 123 2040. It can prosecute companies found breaking the law.

In April 2015, Citizens Advice warned that sophisticated fraudsters were targeting 'cash rich' retirees. It released a report *Consumer Experience of Pension and Pensioner Scams before April 2015* which analysed 150 case reports from consumers made in the run up to the new pensions regime.[748] It has identified five key types of pension scam:

- Moving savings to a new pension
- Fake investment opportunities
- Offering free 'advice' or services
- Charging for 'dodgy' services
- Getting personal information from people.

The report also identified cold calling as the most common means of initial contact (covering two-thirds of cases), although text messages, post, visiting in person and internet contact were also methods used by scammers. In some cases, multiple approaches were used: for example, phoning and then sending someone to their house, texting then phoning, or calling and then following up with letters.

It said scammers used either a 'carrot and stick' approach or employed high-pressure tactics: 'We've heard from many consumers who have been offered the chance to take advantage of a "tax loophole" or a "special investment rate", while others have been told they've won lotteries despite never entering one. Pressure is often applied by saying that special offers are time limited, or by bombarding people with correspondence to catch them at a weak moment. To appear authentic, some scammers claim to be acting on behalf of a client's pension provider. In other cases they use official sounding names like 'the Pensions Office' or say they are a Citizens Advice "pensions officer"'.

In terms of human cost, the report said one person had lost £200,000 as a direct result of pension scams and added: 'The money lost in a scam can mean the difference between a

748

https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/other-issues-policy-research/consumer-experience-of-pension-and-pensioner-scams-before-april-2015/

comfortable retirement and a life on the breadline…. One consumer spoke for many when they said: "I feel really stupid to have given away my pension money to a crook on the phone"…. As well as direct losses, people can also lose through unexpected tax or benefit consequences'.

In a follow-up report, Citizens Advice said that there is increasing evidence that fraudsters are using investment scams to target people's pension pots. Scams include:

- Unspecified financial products which see fraudsters offering to invest pension money in other products without explaining what those products are
- Free pension 'reviews'. People are texted or cold-called with offers of free pension reviews. Citizens Advice has had reports of fake-IFAs – who could not describe investments – visiting homes
- Investment schemes where victims are persuaded to invest money in property, or in fine wine.

Gillian Guy, chief executive of Citizens Advice, said: 'Pension scams threaten people's financial security. People are being targeted again and again with bogus investment offers or fraudulent pension opportunities. Opportunistic fraudsters are finding new ways to go after people's pension pots including offering free pension reviews and promising to invest in funds that don't necessarily exist. Pension and investment scams are particularly dangerous, as they can destroy people's entire pension pot, leaving them with little or no savings for retirement. We will be monitoring pension scams closely in order to track how they are evolving, and warn consumers what to look out for. If you've had an offer or signed up to a scheme you're unsure about, contact Citizens Advice for support'.[749]

In March 2015, the Information Commissioner's Office (ICO) reported that it was investigating claims made by the Daily Mail that its reporters, posing as a cold-calling company, had bought a database containing information on the pensions, salaries and investments of 15,000 people for 5p a record. The ICO said it was making enquiries to establish whether there have been any breaches of the Data Protection Act or Privacy and Electronic Communications Regulations. It was also in contact with the police. The information was sold without consent, leaving these people vulnerable to fraudsters. The ICO also reported that it had received more than 1,000 complaints about pension-related spam texts, automated calls and cold-calling relating to pensions in the second half of 2014. According to the Pensions Regulator, pension scheme members have so far lost £500m via 'pension liberation' scams, where companies illegally encourage people before the age of 55 to transfer money from their pension fund into investments offering implausibly high

[749] Reported in Jenna Towler (2015) Pension fraud 'increasingly linked' to investment scams, Professional Adviser, 7 August.

returns. These people end up not only losing their investment, they also have to repay the tax relief they receive.[750]

In July 2014, TPR relaunched its 'Scorpion' campaign which warns consumers not to be 'stung' by cold calls, text message spam or website offers claiming to be able to help them cash in their pension. The regulator is urging pension trustees and providers to include its leaflet in the next annual statement sent to members, and anyone who requests a transfer in the meantime. The campaign highlights cases where victims have lost thousands of pounds by being scammed into moving their retirement savings into unregulated high-risk or bogus investments. One woman, whose 40-year-old son took his own life after never receiving a promised £17,000 lump sum following the transfer of his £42,000 work pension, said: 'I don't want other mothers to suffer what I've been through, and what my family has been through. No matter how desperate things get, don't be tempted to cash in your pension. Don't do it – the people behind these scams are rogues who exploit people's vulnerabilities'. Another 49-year-old scam victim, who is potentially facing an £18,000 tax bill and risks losing her home after falling victim to a 'pension loan' scam said: 'These scams target vulnerable people. I feel very angry that I have been misled. Ignore the sales patter, ignore the glossy websites, ignore the cold calls and text messages. Go to an independent financial adviser – speak to an expert'.[751,752]

In October 2014, the FCA launched ScamSmart, a campaign to alert people to the dangers of 'scammers offering opportunities that are too good to be true'. The Treasury has made it a criminal offence for anyone to pretend to offer Pension Wise guaranteed guidance. In July 2015, the FCA provided updated figures on ScamSmart. Around 100,000 people had visited the ScamSmart website since October last year. Around 20% had checked an investment through the warning list.[753]

In March 2015, the Pension Liberation Industry Group introduced a code of good practice for combating pension scams:[754] 'The Code of Good Practice is voluntary and sets an industry standard for dealing with requests by members for transfers from a UK registered

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[750] Claer Barrett and Josephine Cumbo (2015) Watchdog probes sale of financial data, Financial Times, 30 March.

[751] The Pensions Regulator (2014) Pension scams – a lifetime's savings lost in a moment, 24 July; http://www.thepensionsregulator.gov.uk/press/pn1423.aspx. The campaign is being led by the Department for Work and Pensions, The Pensions Regulator, The Pensions Advisory Service, Money Advice Service, Financial Conduct Authority, Serious Fraud Office, HMRC, Action Fraud, National Crime Agency and City of London Police.Visit www.pension-scams.co.uk for more information. If you fall victim of a pensions scam please report it to Action Fraud on 0300 123 2040; www.actionfraud.police.uk.

[752] See also Professional Adviser (2015) Pension scams push savers to take their own lives, 5 May.

[753] Reported in Professional Pensions Online (2015) FCA writes to all pension providers over 'freedoms' access, 1 July.

[754] *Combating Pension Scams: A Code of Good Practice*, March 2015; http://www.combatingpensionscams.org.uk/

pension scheme to another registered pension scheme or Qualifying Recognised Overseas Pension Scheme.

The Code is aimed at trustees, administrators and providers and sets out industry standard due diligence to follow when considering a transfer request. The legislation relating to transfers is not prescriptive as to due diligence that trustees/providers should carry out on transfer applications'.

The Code operates according to the following three principles:

1. Trustees, providers and administrators should raise awareness of pension scams for members and beneficiaries of their scheme.
2. Trustees, providers and administrators should have robust, but proportionate, processes for assessing whether a receiving scheme may be operating as part of a pension scam, and for responding to that risk.
3. Trustees, providers and administrators should generally be aware of the known current strategies of the perpetrators of pension scams in order to inform the due diligence they need to undertake and refer to the warning flags as indicated in the Regulator's Guidance, FCA alerts and Action Fraud.

In May 2015, the FCA issued a warning announcing that fraudsters were using the details of the firms it authorises, such as their 'firm reference number' (FRN), in an attempt to convince customers that they work for a genuine, authorised firm. This followed a similar announcement in April about a scam firm which used the details of investment manager BlackRock to defraud investors. The regulator pointed out that investors who give money to unauthorised firms have no recourse to the FSCS or the FOS if they lose their money.[755] There is even a case of a fraudster, who goes by the name William Howarth, pretending to be calling from the FCA.[756] There are fraudsters pretending to be from National Savings & Investments who are cold calling pensioners and trying to sell them 'pensioner bonds'.[757]

In July 2015, the BBC reported that fraudsters had built a database of around 200,000 people – with an average age of 74 – on so-called 'suckers lists'. Almost 11,000 of them had already lost an average of £1,184 each.[758] Also in July 2015, provider Retirement Advantage reported the results of a YouGov survey that it commissioned which showed that 17% of over 50s and 20% of over 55s had been approached by a company offering to 'help' them access their pension savings early, typically via a legal loopholes or a one-off investment

[755] Reported in Laura Miller (2015) Fraudster alert - FCA warns on four investment firm clones, Professional Adviser, 5 May.

[756] Reported in Laura Miller (2015) FCA warns of cold calling fake regulator fraudster, Professional Adviser, 19 May.

[757] Professional Adviser (2015) NS&I warns on 'pensioner bond' fraud as application deadline looms, 14 May.

[758] Reported in Professional Adviser (2015)Thousands of pensioners found on fraudsters' 'suckers list', Professional Adviser, 24 July.

opportunity. Andrew Tully, pensions technical director at Retirement Advantage, said: 'It is clear that there are already scammers preying on people who might like the idea of using the new pension freedoms to take large amounts of cash from their pension schemes. The scammers may be offering get-rich-quick schemes or even early access before age 55 to trick people out of their hard-earned savings. Retirees need to be on their guard: if an opportunity sounds too good to be true, it almost certainly is. It is vital that the Government and financial industry work together to ensure all practical measures possible are in place to protect people from these scams. We need to make people aware that there are fraudsters hoping to trick them out of their money. Hopefully Pension Wise will help educate people around the risks, but professional financial advice will be crucial to ensure people understand the options available to them and make the right decision for their personal circumstances. The Government also needs to make life difficult for the scammers, and punish those found guilty of preying on innocent victims'. The ABI's campaign Your Retirement, Your Choice also aims to prevent people avoid pension scams by helping them understand their options better.[759]

There is also evidence of an increased number of frauds using prominent financial addresses in the heart of the City of London. The City of London police force said it was struggling to cope with the increased number of cases being reported and it now concerned about the City's own reputation. It said that it has already investigated dozens of individuals, and has identified at least 14 different criminal groups.[760]

Even if the investment opportunities being offered are not scams, they can be unregulated which can be equally risky. An example of this is the case of Capital Alternatives and the schemes it promoted – Capital Carbon Credits (later renamed Reforestation Projects) and African Land – which the FCA claimed were deliberately structured to avoid regulation. Most investment funds are collective investment schemes (CIS), where investors pool their assets and have these managed by an independent fund manager, and most are regulated. The promotion and operation of a CIS is a regulated activity and cannot be lawfully carried out by anyone who is not authorised by the FCA. Capital Alternatives is not authorised by the FCA. In June 2013, the FCA banned the promotion and sale of unregulated collective investment schemes (UCIS) to most retail investors in the UK, the exceptions being certified high net worth individuals, certified sophisticated investors, and self-certified sophisticated investors. Capital Alternatives denied that its schemes were CIS or UCIS and took the FCA to court. In March 2015, the Court of Appeal agreed with the FCA that the Capital Alternatives schemes met the definition of CIS, namely that investors' monies was pooled and the investments were managed centrally. Capital Alternatives appealed to the Supreme Court which in August 2015 confirmed that Capital Alternatives' schemes were in fact UCIS and

[759] Jenna Towler (2015) Pension scam alert - Five tips to share with clients, Professional Adviser, 1 July.

[760] Reported in Investment Week (2015) Investment scams spike as fraudsters use City firms' addresses, 20 August.

hence cannot be sold to unsophisticated UK investors. Tobias Haynes of Regulatory Legal said: 'The decision of the Supreme Court is a welcome one, and one which is a true consumer victory. The decision opens up the doorway to many vulnerable investors who otherwise would have no recourse. This is particularly the case where SIPP providers have allowed retail investors to invest directly into UCIS without having first been satisfied that the consumer was properly certified as a high-net-worth or sophisticated investor'.[761]

The Personal Finance Society has warned about the dangers of consumers becoming confused about the difference between regulated and non-regulated financial advice as a result of the 'inevitable wave of non-regulated scammers' capitalising on 'freedom and choice'. It called for greater oversight of non-regulated advice. Keith Richards, chief executive, said: 'The public generally do not understand the difference between regulated and unregulated activities and, in fairness, should not be expected to. They are, therefore, more exposed to scammers, fraudsters and opportunists who often look like regulated firms or processes….The increasing danger of consumers finding their way into unregulated activity is worrying. It is now time for all activity to come under the same umbrella, to provide consistency of standards and consumer protection'.[762]

In August 2015, Portal Financial published the results of a survey which appear to show that consumer education campaigns around spotting financial scams and finding financial advice were not working. The results of the survey of 1,000 people over the age of 55 in four regions across the UK are shown in Table 3.7. Jamie Smith Thompson said: 'The result raises questions over the effectiveness of the MAS and Pension Wise awareness campaigns, but it also highlights the problem that, at the moment, you can't simply use the message "go to a regulated company and you will be protected" for every financial product. MAS and Pension Wise's job would be easier if that were the case. Until legislation is changed to bring all financial product sales under the regulatory umbrella it is going to be hard for the man in the street to tell a sophisticated scam from a genuine service. The current system of identifying and shutting down scam companies can take a very long time, which in turn means more people can be affected'.[763]

[761] Reported in Laura Miller (2015) Supreme Court backs FCA's tough stance on collectives in landmark case, Investment Week, 5 August.

[762] Jenna Towler (2015) PFS chief warns on 'increasing danger' of unregulated activity, Professional Pensions, 26 May.

[763] Reported in Carmen Reichman (2015) Pension scam awareness campaigns 'failing to reach' retirees, Professional Adviser, 25 August.

Table 3.7: Portal Financial survey concerning financial scams and financial advice				
Question	Midlands and Wales	North & Scotland	Northern Ireland	South
Have you ever been contacted by a company that you felt could be running a financial scam?	Yes: 50% No: 50%	Yes: 51% No: 49%	Yes: 69% No: 31%	Yes: 55% No: 45%
Are you confident that you could tell the difference between a scam and a genuine offer from a regulated company?	Yes: 59% No: 41%	Yes: 58% No: 42%	Yes: 46% No: 54%	Yes: 63% No: 37%
Have you noticed an increase in the volume of pension-related sales calls in the last month or so?	Yes: 40% No: 60%	Yes: 43% No: 57%	Yes: 77% No: 23%	Yes: 33% No: 67%
If you wanted accurate financial advice on the pension reforms, would you know where to go?	Yes: 73% No: 27%	Yes: 80% No: 20%	Yes: 54% No: 46%	Yes: 77% No: 23%
Source: Portal Financial				

As a consequence of investment scams, compensation payouts from the FSCS jumped 156% in 2015 compared with the previous year to £183.1m. The average payout rose from £5,136 to £8,855. Mark Neale, chief executive at FSCS, said: 'Many savers had been poorly advised to move pension savings from safe workplace schemes to risky investments'.[764]

The Pensions Ombudsman (PO) deals with member objections to transfer requests that have been blocked by providers who suspect members could become a victim of fraud. The PO's rulings have been consistent in stating that scheme administrators cannot block a member's request where there is a statutory right to transfer and that right will only exist where it has been established that the receiving scheme is a properly established and registered arrangement. Geoff Egerton, associate at Linklaters, said: 'You do your due diligence. And you do your work to make sure that you've flagged the warnings from The Pensions Regulator's guidance, which says you should satisfy yourselves that this isn't a

[764] Reported in Holly Black (2015) Alert over rise in failed pensions with thousands feared to have lost money in high risk schemes, Daily Mail, 21 July.

pensions liberation vehicle. But once you've done all that, if the right exists, there has to be a transfer'.[765]

There are also concerns about pensioners cashing in their annuities, and the introduction of the secondary annuity market was pushed back from 2016 to 2017 as a consequence of these concerns. Providers have warned about the 'terrible consequences for elderly policyholders if the changes are pushed through before the right safeguards are in place….[M]any people would be offered a very low value for their annuity and could face rip-off charges to cash it in'. The ABI recognised the plan for a secondary annuity market 'poses a risk'. Dr Yvonne Braun, of the ABI, said: 'Naturally there are considerable challenges in establishing a functioning market, [with] many unresolved complex legal, regulatory and prudential questions. We urge the Government not to rush these proposals through for 2016'. The ABI said more clarity was needed around how a partner would be protected if someone sold a joint life annuity. Also those selling their annuities would include vulnerable older people with 'reduced mental capacity'. In addition, the ABI was concerned about how the Government would 'protect people from scams and fraud'.[766]

3.15 Customer engagement, customer communications and customer responsibility

3.15.1 Customer engagement

One key problem with auto-enrolment is that it does not require any customer engagement. However, the new pension regime will not work well without engagement. This could be a serious problem, since as Nigel Aston, head of DC at State Street Global Adviser, says: '"Freedom and choice" legislation hasn't suddenly created a population of self-empowered, interested, financially savvy people….[However], all the research points to the fact that they can make really good decisions…but they can only do it when they've been given some sort of guidance and better products'.

A survey of trustees and pension managers at nine trust- and contract-based DC schemes was carried out by Spence Johnson on behalf of the Defined Contribution Investment Forum (DCIF) in March 2015. This confirmed that their biggest challenge is improving engagement with members to ensure people understood what they wanted. The schemes agreed that engagement was much more difficult than choosing an investment solution which one respondent said was 'quite simple'. The schemes had developed straightforward

[765] Reported in Natasha Browne (2015) Liberation fraud - Where do trustees stand after the latest ombudsman decisions?, Professional Pensions, 29 April.

[766] Reported in Louise Eccles (2015) Fears grow that pensioners cashing their annuities will be 'at the mercy of fraudsters' if reforms are rushed through next April, Daily Mail, 26 June.

communications on the impact of the pension freedoms, but are looking for tools that can help them improve longer term engagement.[767]

We know that in other areas of economic activity, particularly those involving immediate gratification, people can become engaged and put the necessary effort in. An example put to us was holiday planning. The more effort put in, the better the holiday. We need to find a comparable way of engaging people in retirement planning, so that more effort gets better outcomes.

There is also an important question about the best time to begin the engagement process. According to a survey by Mercer, 52% of employers and trustees believed the guidance guarantee should be offered 5-7 years before retirement, 32% when the member chooses, 15% when they take their first pension and only 1% at retirement. The following are typical of the majority view: 'It's too late at retirement. It needs to be considerably earlier to ensure adequate money is going in, and the correct investment strategy is being applied to the potential decumulation option to be used' (John Chilman, First Group) and 'We believe that pension guidance should start a lot earlier than a year or two prior to retirement and needs to be part of an integrated approach to improve financial awareness and understanding in the workforce' (Chartered Institute of Personnel and Development).[768]

For the plan to be effective, there needs to be a set of key decision dates both before and after the plan begins:

- 10 years prior to the nominated implementation date to confirm whether a de-risking glidepath is required and, if so, when it needs to begin
- 1 year prior to the nominated implementation date to re-confirm commencement date
- Age 74 to review death benefits
- Ages 80 and 85 to confirm implementation of longevity insurance (i.e., switch to annuitisation if drawdown was used at the implementation date).

3.15.2 Customer communications

The FCA believes that customer engagement can be increased by better communications with customers. In June 2015, it issued a discussion paper called *Smarter Consumer Communications*.[769] The DP begins by arguing that information, while important, is not

[767] Reported in Stephanie Baxter (2015) DC schemes want more tools for 'biggest challenge' of member engagement, Professional Pensions, 1 May.
[768] Reported in PLANSPONSOR UK, June 2014.
[769] Financial Conduct Authority (2015) *Smarter Consumer Communications*, Discussion Paper DP15/5, June; https://www.fca.org.uk/news/dp15-05-smarter-consumer-communications

enough: there needs to be better communications with customers. In the introduction to the DP, Christopher Woolard said:

> *Like many other regulators, we have relied heavily on information to help ensure greater consumer protection and make competition work. In some cases, we specify the type of information firms should disclose to customers and the format it should take. We will continue to do this where we feel it is necessary to improve outcomes for consumers.*
>
> *We recognise, however, that information itself does not necessarily empower the consumer. Our work on behavioural economics has clearly shown it can overwhelm, confuse, distract or even deter people from making effective choices if presented in a way people struggle to engage with. We can begin to understand why consumers often fail to make good decisions about financial products and services, when we take into account that:*
>
> - *behavioural biases, low levels of financial literacy and the complexity of some financial services and products can limit people's ability to take appropriate action*
> - *firms tend to use financial and legal jargon, which can make the materials they produce lengthy and impenetrable for the consumer*
> - *in some firms, marketing material is much more consumer focused than other consumer communications.*
>
> *Communications play a fundamental role in helping consumers to make informed decisions. Effective, engaging information can be a key tool in promoting effective competition to supply products and services that consumers want. Greater transparency in firms' communications with consumers can also lead to greater efficiency for the industry, with less time spent handling complaints.*
>
> *Effective, engaging information is also already integral to our regulatory approach: we require firms to have due regard to the information needs of their customers, and to communicate information in a way that is clear, fair and not misleading. While some firms may feel they already do this, from what we have seen in our research, thematic reviews and market studies, it is evident most firms need to do more to communicate with consumers in a way that truly empowers them to make effective decisions.*
>
> *We expect all firms to embed an organisation-wide culture where the importance of communicating effectively with consumers is recognised and prioritised. The information needs of potential customers need to be fully considered when developing a product or service and throughout the lifecycle of that product or service.*
>
> *We are committed to driving improvements in the effectiveness of the information consumers receive about the financial products and services they have or want to buy. This DP is intended to kick start a debate around how the FCA, industry, consumer groups and other stakeholders can work*

together to deliver information to consumers in smarter and more effective ways, including adopting innovative techniques as we move away from the paper-based mindset.

In the DP, the FCA reiterates its expectation that firms:

- understand and recognise the importance of communicating effectively with consumers
- create product and service information for consumers with at least as much behaviourally informed creativity as is applied to business development, marketing and financial promotions
- create communications as an integral part of the product or service design process.

It acknowledges that many firms are doing this and it signals its support and encouragement for firms that are:

- writing for the consumer first and then ensuring communications are compliant, rather than the other way round
- moving away from a box-ticking approach to communication design, or the perception that communications driven by regulation are the responsibility of compliance and legal staff
- building a wider understanding of their customers' information needs and objectively considering not only what consumers actively demand to know, but also:
    - what the consumer needs to know
    - how much they need to know
    - when they need to know it
- prioritising efforts to ensure that information is effective for the intended audience and testing communications among real consumers
- adopting innovative techniques to improve how key information about products is conveyed and delivered to consumers.

The FCA said it was pleased with the good practices and innovative approaches to communicating effectively with consumers that it saw emerging in some firms. This included firms that:

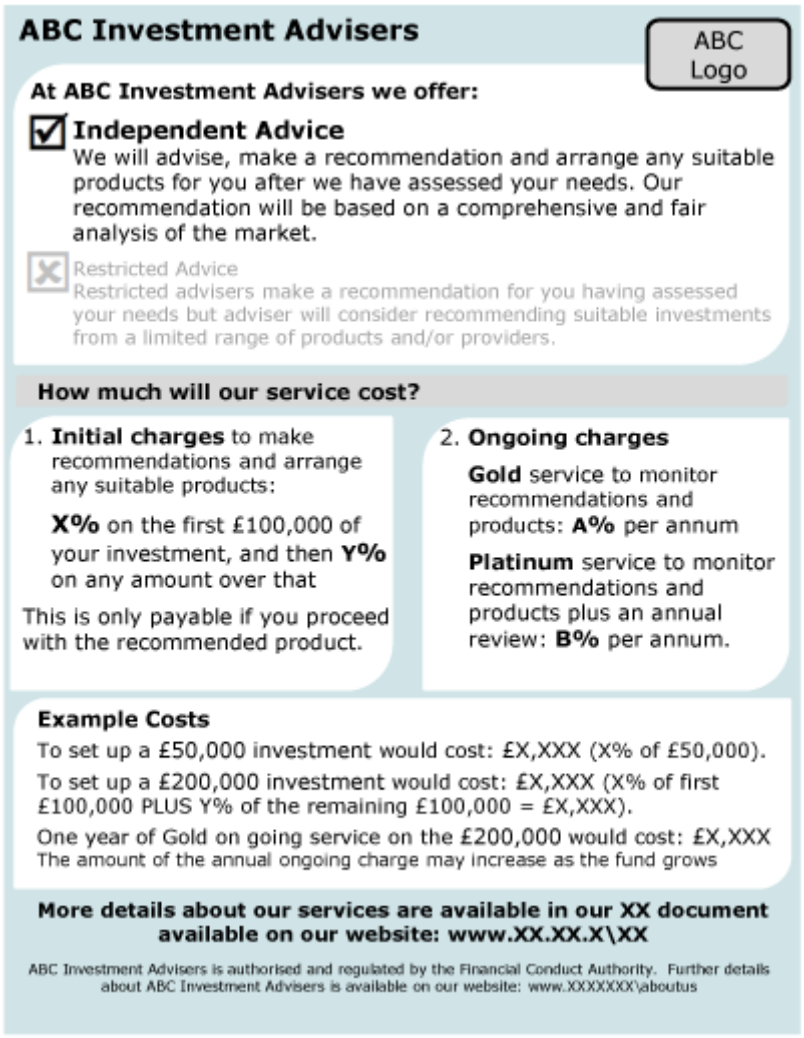
- designed communications to meet the needs of the product or service's target market
- ensured their communications effectively delivered the key information to consumers by, for example, using plain language, a clear and short format, bullet points and clear graphics
- provided information at a time consumers need it and in an engaging format

- developed interactive communications, harnessing technology such as mobile devices, tablets, apps, social media, YouTube and online tools to ensure key information was more accessible to consumers.

One problem area that the FCA identified was communication about charges to consumers. It noted that the compounding impact which charges have on investment returns over the long term 'can be a difficult concept for some consumers to understand'. It identified Nutmeg as an example for other firms to follow in terms of 'presenting this [impact] graphically, with a clear explanation'.

Figure 3.4: FCA-proposed label for the services offered by firms derived from the US Environmental Protection Agency's 'fuel economy' label'

Figure 3.5: FCA-proposed label for firms' charges schedule derived from the US Environmental Protection Agency's 'fuel economy' label'



The FCA said it also liked the idea of disclosure 'labels' to outline firms' charges and the type of advice they offer to consumers. It pointed to the 'fuel economy label' designed by the US Environmental Protection Agency which has been on display on all new cars in the US since 2008 and which it adapted in Figures 3.4 and 3.5.

3.15.3 How responsible is the consumer?

The regulatory tension between the econ and human view of the customer was clearly demonstrated by Martin Wheatley, then chief executive of the FCA, speaking at the NAPF investment conference in Edinburgh on 11 March 2015.[770]

He said consumers will be liable for their decisions in retirement as long as the industry complies with conduct rules and standards which involve informing customers about the Pension Wise guidance service and about regulated advisers, and giving personalised risk warnings to people wishing to access their pension pots. He added:

> *Certainly, under the system as it will be, there will be no ability to prevent all of the people, all of the time from making "sub-optimal" decisions. Some savers, come 55, will invariably head to Las Vegas, buy fast cars or otherwise calculate how to run down their pension pots in days and months, rather than years. Optimists will be inclined to believe that these numbers will be fractional. Pessimists that they may be more significant. But the reality is that this is all simply part of the process that flows from the benefit of freedom. Some responsibility, by definition, has to bump across from industry to customers otherwise you simply return to difficult conversations around why policy makers should, in effect, decide how savers draw their money.*
>
> *Come April 6, what you will have is a structure under which customers will, on seeking access to their pensions, immediately be recommended to seek guidance – via Pension Wise or financial advice. After which, when a decision has been made, the system will effectively have a further check, if necessary triggering a personalised risk warning. Allowing a final opportunity for people to assess the wisdom of their choice. [With all this in place, customers] will be in a position to make what are, clearly, life-influencing decisions on future income, with some confidence that the structure behind their choice is sound.*

Yet Mr Wheatley left open some doubt about where responsibility ultimately lies:

> *It is perfectly reasonable for firms to question where accountability eventually lies if you end up in a situation where X percentage of consumers refuse to listen to any guidance or risk warnings given. Who, ultimately, is to blame if – 10 to 15 years on from now – those people regret whatever choice they've made, or complain they weren't properly guided? And actually at that point, it becomes difficult to sensibly argue that individual consumers shouldn't accept responsibility. Nor, I think, would wider society expect otherwise. [Under the new system, there will be*

[770] Reported in Carmen Reichman (2015) Wheatley: Consumers liable for 'Las Vegas' retirement decisions, Professional Adviser, 11 March; Tessa Norman (2015) Wheatley: 'Pension reforms are Y2K moment for industry', Money Marketing, 11 March.

a] division of responsibility [between consumers, firms and policy makers that is] a long way from today's annuity-based system.

3.16 Monitoring outcomes

Monitoring outcomes under the 'freedom and choice' pension reforms will be a crucial part of assessing the success of the reforms.

Yet, as pointed out in a briefing note released by Just Retirement in June 2015, the Government has put no monitoring mechanism in place.[771] The briefing note states: 'Our primary concern is the lack of a co-ordinated and comprehensive forward plan for monitoring the impact of the reforms on consumer outcomes, both in the early stages and over the longer term. This is important because of known problems with consumers' engagement with pensions and retirement planning decisions which have led to negative outcomes for consumers…The Government accepts it cannot predict the outcome of the reforms and has made clear that individuals are responsible for their decisions. Nonetheless, it will be important to monitor the available data in order to understand developing norms, and to help prevent consumer detriment likely to result from poor financial capability, disengagement and the impact of financial scams'.

The briefing note identifies the following information sources that will be crucial inputs into any evaluation of the success of the reforms:

- Take-up rates for Pension Wise; the characteristics of the consumers using the service; details of what people do next after exiting the service; and the outcomes for those who do not choose to use Pension Wise
- Data collected by the ABI and FCA will be crucial indicators of early trends. The ABI collects sales data from its members, though this does not cover the full range of providers across the wider financial services industry and so is limited. By contrast the FCA (and before that the Financial Services Authority) has been receiving product sales data from all regulated firms since 2005, providing a basic but complete data set from which to analyse product purchase outcomes.

However, the data collected by the FCA does not currently capture certain information, such as the rate of cash withdrawals from DC pension savings, type of annuity (e.g., joint or single life, enhanced or standard, level or escalating/inflation-linked), or details of the risk profile or funds invested through income drawdown contracts at the time of purchase. The briefing note states that: 'These data points are important in the context of the pension reforms due to known shortcomings in financial engagement and capability, especially in relation to

[771] Just Retirement (2015) Briefing note on the need for adequate monitoring of pension reform outcomes, June.

retirement choices. Consumer analysis, including the FCA's own thematic work on the retirement market, has shown that consumers are often ill informed or make decisions without being aware of better options, with the outcome often irreversible. Common examples include individuals failing to consider their dependant's needs and opting for a single life annuity instead of a joint-life policy, or buying a standard annuity without realising the significantly higher income provided by enhanced annuities. The potential risk of mis-selling and mis-buying has increased with the new options available since April 6 [2015], and new risks, such as the potential for individuals to unknowingly trigger a large tax charge on lump sum withdrawals'.

The briefing note identifies the monitoring gaps that need to be closed in order to fully assess the success of the pension reforms:

> *The concerns outlined above emphasise the need for substantive data on a range of key measures without which regulators and the Government will be unable to monitor outcomes in the new pensions environment. Compared to the depth of information required for non-retirement products such as mortgages, the FCA's present retirement product data collection is minimal and will not be sufficient to monitor consumer outcomes in the new environment.*
>
> *Similarly, the Treasury has yet to set out any plans for the collection and publication of data on the feedback from Pension Wise users. This will be an important measure, providing basic user feedback on the service itself, its quality and whether it is succeeding in helping individuals navigate the new pension freedoms.*
>
> *In addition to collecting this feedback on Pension Wise, data on the wider outcomes for all retirees must be captured to understand the longer-term impact of the reforms. This must also include proper assessment of the impact of at-retirement processes for consumers including product provider behaviour and the adequacy of regulatory protections including the second line of defence or 'retirement risk warnings'.*

The briefing note ends by arguing: 'The need to collect and then aggregate a range of inputs including Pension Wise user data, FCA sales data and intelligence from regulators' thematic and supervisory work, points to the wider need to coordinate these various activities. Addressing these intelligence gaps will allow policymakers to identify and address potential consumer detriment at an early stage, enabling the Treasury, FCA and TPR to refine the regulatory and policy framework, and by so doing ensure the reforms benefit consumers'.

The *Aon DC Survey*, published in November 2015, indicated that achieving better member outcomes was a top priority for DC schemes (suggested by 57% of respondents). This was followed by communications (46%) and increased member engagement (45%). Nevertheless, Sophia Singleton, head of DC Consulting at Aon Hewitt, said that schemes needed to put practical steps in place if they are to meet these objectives: 'Now is the time

to re-set the DC agenda. If schemes are serious about the ambition to achieve better member outcomes, then they need to start setting clear targets and putting plans in place to achieve them. They must also set and measure themselves against clear key performance indicators to ensure their intentions become reality'.[772]

In October 2015, the Work and Pensions Select Committee also reported[773] that it was concerned about the lack of Government data on 'freedom and choice'. It said that the available statistics were 'unacceptable' and asked the Government to do more to shed light on the impact of the reforms. Specifically, the committee wants regulators to collect information on: customer characteristics of those using freedoms from pot size to sources of retirement income; take-up of each channel of guidance; reasons for not taking up guidance and advice; and subsequent decisions made and reasons for those decisions.

Apparently, the Government is relying on incomplete HMRC data to assess the reforms. Tom McPhail said there is 'considerable disquiet' about Government vigilance over the policy and a lack of early warning systems about unintended consequences: 'HMRC has published some very superficial data, which was underwhelming. Either they are not getting much data or they are not sharing it. Either way, it doesn't look good. The Treasury appears to have been surprisingly blasé about the consequences of reform, which are approached from an ideological standpoint….There are longstanding divisions in the system [such as, the division of pension policy between DWP and the Treasury] which exacerbate the data problem. Why has no one sought to mitigate the divisions and bring all data sources into one helicopter view for what is going in UK retirement savings?'.[774]

Frank Field MP, chair of the Select Committee, said: 'Reluctance to provide information about how a reform or service is working is rarely a good sign. It is very difficult for the Government to support its claims that all is well, or for us to make any assessment of progress, when no data are forthcoming despite repeated requests. The scarcity of information regarding Pension Wise, in particular, is not conducive to effective scrutiny. The committee repeats its call for Government to address these omissions urgently, and particularly to introduce a research programme tracking consumer outcomes…. We have seen all too clearly, too many times, what happens when financial information is not properly provided and regulated'. The committee also said the Pension Wise website was 'not fit for purpose' and that the lack of regulatory clarity over what is 'advice' and

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[772] Reported in Helen Morrissey (2015) Schemes must be able to measure member outcomes, Professional Pensions, 24 November.

[773] House of Commons Work and Pensions Committee (2015) *Pension Freedom Guidance And Advice: First Report of Session 2015–16*, HC 371, 19 October;
http://www.publications.parliament.uk/pa/cm201516/cmselect/cmworpen/371/371.pdf

[774] Reported in Sam Dale (2015) Freedom and choice in a governance vaccuum, Pensions Insight, 30 October.

'guidance' is putting savers at risk of poor decisions. Nick Thomas-Symonds, shadow Pensions Minister, said the report showed the Government was failing to protect and inform consumers: 'Since pension freedoms have been introduced, money lost through scam activity has increased. Labour is urging the Government to look very closely at this report and act now in order to avert the next great mis-selling scandal'.[775]

However, Martin Tilley, director of technical services at Dentons Pensions Management, has described the claims by the Select Committee that pensions freedom could be the next 'mis-selling scandal' in financial services as a misplaced attack on providers and advisers. He said: 'The industry wasn't consulted about the changes before they were announced, didn't ask for them and has been criticised at every turn for not adopting the changes more quickly and charging too much to implement them: the latter sometimes in campaigns by national journals who are happy to print popular opinion without understanding the facts. By using the phrase 'mis-selling', I'd suggest this is a similarly ill-addressed attack'. Mr Tilley added that customers are now able to do things that might not be in their best interest 'not because the industry is selling it, simply because legislation now allows it'.[776]

3.17 The self-employed and non-eligible job holders for auto-enrolment

There are two groups not eligible for auto-enrolment: the self-employed and non-eligible job holders for the purpose of auto-enrolment.

There are around 4.5m (i.e., 17% of the 26.3m employed population, up from 8% in 1980) who are self-employed[777] and around 6.2m (24%) non-eligible job holders.[778] This means that around 11m people working in the UK will not be auto-enrolled onto any pension scheme. There are, however, a number of problems with interpreting these figures which should be noted. For example, the definitions used by ONS for employment categories are different from those applied by TPR for auto-enrolment, which include 'eligible jobholders', 'non-eligible jobholders' and 'entitled workers'. In addition, permanent employment, contract employment in the workplace and self-employment are not mutually exclusive categories. On average, people change jobs 10 or 11 times during their working lives. This can include periods of permanent employment (where the individual is eligible for auto-

[775] Reported in Josephine Cumbo (2015) MPs warn of pension changes 'endangering savers', Financial Times, 19 October.

[776] Reported in Jenna Towler (2015) MPs' pensions freedom mis-selling warning is 'ill-addressed' attack, Professional Adviser, 19 October.

[777] Source: ONS, https://www.nomisweb.co.uk/reports/lmp/gor/2092957698/report.aspx,

[778] The Pensions Regulator (2015) *Automatic Enrolment: Declaration of Compliance Report*, April; http://www.thepensionsregulator.gov.uk/docs/automatic-enrolment-declaration-of-compliance-monthly-report.pdf

enrolment), periods of non-eligible employment (where the employment contract renders them ineligible for auto-enrolment), and periods of self-employment.

The Royal Society of Arts (RSA) recently published two reports on the self-employed.[779] Between the 2008 recession and 2014, more than 500,000 people have become self-employed, accounting for more than half of all jobs created during this period.[780] Five key trends are discernible in this boom in self-employment:

- The rise of one-person businesses – 95% of new micro-businesses (which employ between 0 and 9 employees) started since 2000 have no employees; one-person businesses now account for 75% of all businesses in the UK
- The growth of part-time self-employment – the number of self-employed people working less than 30 hours a week has increased by 60% since 2000, compared with a 20% increase in full-time self-employment over the same period
- The increasing importance of self-employment outside of London – for instance, 92% of all new jobs in the North West since 2000 have been in self-employment
- The changing demographic of the self-employed – the biggest growth areas in self-employment have been among women, the under 25s and older people. The number of self-employed people over 65 has increased by 140% since 2000.
- The uniqueness of the boom to the UK – the UK is an outlier amongst developed countries: self-employment has fallen in Germany, Canada and the US since 2008.

In terms of the self-employed's pension arrangements, there is some information contained in these RSA studies, as well as two other reports from the Resolution Foundation[781] and from Scottish Widows.[782]

The RSA studies found that the self-employed are half as likely as employees to contribute to a private pension. They also typically have a pension pot that is half the size at the point of retirement: according to the Wealth and Assets Survey, 55–64 year-olds in self-employment have a median private pension pot of £50,000, compared with £98,700 for those in a typical job. One key reason for this difference is the self-employed people do not benefit from employer contributions: according to Prudential, those who choose to work for

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[779] Benedict Dellot (2014) *Salvation in a Start-up? The Origins and Nature of the Self-employment Boom*, Royal Society of Arts, May (https://www.thersa.org/discover/publications-and-articles/reports/salvation-in-a-start-up); Benedict Dellot and Howard Reed (2015) *Boosting the Living Standards of the Self-employed*, Royal Society of Arts, March (https://www.thersa.org/discover/publications-and-articles/reports/boosting-the-living-standards-of-the-self-employed)

[780] RSA analysis of the Labour Force Survey, September-November 2014.

[781] Conor D'Arcy (2015) *The Self-employed and Pensions*, Resolution Foundation, May; http://www.resolutionfoundation.org/wp-content/uploads/2015/05/Self-employment-and-pensions.pdf

[782] *The Scottish Widows Retirement Report*, June 2015; http://www.scottishwidows.co.uk/extranet/working/about/reports/pension-report

themselves forego an average of £91,500 in employer contributions over their lifetime. The self-employed also tend to start saving at a relatively late age, with less than 15% of self-employed 25–34 year-olds contributing to a private pension.

The latter two reports found that pension membership for the self-employed has fallen significantly behind that of employees, but only since 1998. Scottish Widows, for example, found that 39% of self-employed people (as well as 30% of employees working in a small business) were saving nothing for retirement in 2015, up from 23% the previous year. The Resolution Foundation report found that the self-employed who run businesses with employees (17% of the total) are much better prepared for retirement than those who work for themselves without additional support. The former can either sell their business or keep it and draw an income. In many cases, the self-employed were previously employees and can therefore expect some occupational or personal pension income when they retire.

The RSA studies also found that many self-employed people have made an active decision not to contribute to a personal pension. Instead, they will use ISAs to provide for their retirement. Data from the Wealth and Assets Survey shows that 55% of households with a self-employed worker have savings in an ISA (averaging £17,000, compared with £8,000 for employee-only households). These studies point out that, although ISAs give people more flexibility, large ISA savings may adversely affect their benefit entitlements under Universal Credit.

In September 2015, the PPI published a briefing note on those who were ineligible for auto-enrolment.[783] There are three main reasons why 6.2m people are ineligible for auto-enrolment:

- 3.5m (57% of the total) earn below the £10,000 Earnings Threshold because they work part-time.[784]
- 1.8m (29%) are below age 22.
- 843,000 (14%) are above state pension age.

Most (2.7m) of the 3.5m people earning below £10,000 are women. Some of the 3.5m will have a number of part-time jobs and may have a combined annual income above £10,000. However, the qualification for auto-enrolment is assessed on a 'per job' basis. Two other groups that that fail the eligibility criteria are the disabled and carers. Around 30% of disabled workers (649,000 people) earn less than £10,000. Similarly, around 81% of employed carers are ineligible, including 35,000 who earn below £10,000.

[783] Pensions Policy Institute (2015) *Who is Ineligible for Automatic Enrolment?*, Briefing Note Number 75, September.

[784] Someone on the minimum wage and working 40 hours a week would earn £13,520 p.a.

Both the self-employed and non-eligible job holders will benefit in due course from the single-tier state pension. Similarly, members of both groups could join NEST which has a public service obligation to take on anyone who applies, but only around 800 self-employed people have done so to date. However, it is more likely that, if they do make any pension arrangements, this will be through the retail market. But we could find no accurate data on the combined number of the self-employed or non-eligible job holders with individual DC policies. Similarly, when it comes to decumulation, it is likely that these groups will fail to benefit from institutional value-for-money solutions and instead will have to rely on the high-cost retail market.

The Resolution Foundation report argues: 'Taken together, the evidence suggests there is a case for greater intervention to ensure the self-employed are adequately prepared for their later years'. A similar case could be made for non-eligible job holders. The PPI briefing note finds that 'if the income from both first and second jobs was taken into account when assessing eligibility for automatic enrolment, then a further 80,000 people (60,000 women and 20,000 men) would earn enough to meet the qualifying criteria'.

The RSA reports do not, however, believe that auto-enrolment into NEST or another of the larger master trust schemes is a sensible solution due to the administrative challenges of dealing with the irregular and volatile incomes the self-employed tend to have, but also because of the clear preference amongst many of them to have flexible access to their savings. Instead, the RSA proposes the following two options:

- Present a 'compulsory question' for enrolment onto a pension or ISA scheme
    - The Government should present the self-employed with a compulsory question asking them whether they wish to join a workplace pension scheme and/or a Government-backed ISA, for example, one provided by National Savings & Investments (NS&I). To increase the likelihood of take-up, this should be done at a moment of financial reflection, such as when people complete their tax return or Universal Credit application.
- Establish automated saving schemes for the self-employed on low incomes
    - The Government should provide an option within the Universal Credit system that allows claimants to automatically channel a percentage of their benefits into a savings account. Banks should consider following suit by creating a 'Save When Paid' initiative for their self-employed clients, which would take a small amount off the value of every invoice and immediately transfer this into savings.

3.18 Experience from abroad

In April 2015, the Pensions Policy Institute released a report that compared the new UK pension system with those developing in Australia, Ireland, New Zealand and the US.[785] It noted that the UK was moving in the opposite direction to these countries in terms of risk pooling. Whereas the new UK pensions regime completely individualises risk bearing, countries, such as Australia, have seen the benefits of greater pooling of risks, and, in particular, longevity risk. Chris Curry, said: 'The findings from the research are encouraging in that the UK pensions industry as a whole has an understanding of various types of risk and a sophisticated market has developed here for, in particular, underwritten annuities. The challenge for the industry will be around the identification of effective default glide-paths where it can no longer be assumed that individuals purchase an annuity. So far, the focus of regulation in the UK has been the introduction of a standards regime to ensure the quality and consistency of guidance. This contrasts with countries, such as Australia, which are now considering the introduction of rules to ensure defaults that manage longevity risk. It is possible that further steps will be considered in the UK that 'nudge' individuals towards decisions that ensure they have a regular income stream over the course of their retirement'.

We will examine the experience in Australia, Switzerland, Chile and the US.

3.18.1 Australia

Australia has been put forward as a success story for a 'freedom and choice' regime might look life. Many of those familiar with the Australian experience take a different view.

Many people in Australia – a country with no requirement to annuitise the pension pot – actually pre-spend their pension fund: they spend more than their disposable income in the lead up to retirement, knowing that they will use their pension fund to pay off their debts.[786] Paul Leandro, partner at Barnett Waddingham, said: 'We went out there looking for the silver bullet and we just did not find it…The Australian model is still relatively immature and it will be some 40 years before we see people retiring after having contributed 9.5% to their pension and there has also been little focus on what happens at decumulation. What is also important is that people don't view this money in terms of a

[785] Pensions Policy Institute (2015) *Transitions to Retirement: How Might the UK Pensions Landscape Evolve to Support More Flexible Retirements?*, April;
http://www.pensionspolicyinstitute.org.uk/publications/reports/transitions-to-retirement---how-might-the-uk-pensions-landscape-evolve-to-support-more-flexible-retirements

[786] Mark Wood (2015) Australians got pension freedom and they are running out of money, Daily Telegraph, 14 April.

retirement income. Around 27% spend the money on a holiday, while only about 4% purchase an annuity'.[787]

The Australian Financial System Inquiry discussed earlier discovered that a lack of risk sharing and over-reliance on drawdown products had left Australians with inadequate incomes in old age. The FSI had estimated that moving to a system that managed longevity risk reduced the level of assets needed for adequate retirement incomes by around 15%. It was for this reason that the FSI recommended that Australian pension schemes introduce a default comprehensive income product for retirement, the CIPR.

Kevin Davis[788] in an article for Reform[789] entitled *Retirement Incomes Policy Reform in Australia*,[790] wrote:

> *A number of shortcomings [in the Australian retirement income system] were highlighted by the recent Financial System Inquiry. The main focus of the FSI in the areas of superannuation and retirement income was on improving efficiency in the accumulation phase and increasing risk-pooling in the retirement phase. These have the potential to increase retirement incomes substantially, and reduce age pension related Government budgetary pressures. The recommendations of the FSI, together with other recent reforms, should enhance sustainability and adequacy.*
>
> *One fundamental problem, identified by the FSI, is a lack of member-driven competitive pressure to induce lower fees and costs and improve efficiency in institutional funds, particularly for default funds….Absent significant improvements, consideration should be given to introducing a formal competitive process (such as a tender or auction) for allocating new employees into default funds. (Those recent reforms sought to introduce a cost effective, simple default fund product, improve transparency and governance and streamline administrative arrangements.)*
>
> *Another major concern is that superannuation assets are not being efficiently converted into retirement incomes due to a lack of longevity risk pooling and overreliance on account-based pensions. Evidence suggests that the major worry among retirees and pre-retirees is exhausting their assets in retirement. An individual with an account-based pension can reduce the risk of outliving their wealth by living more frugally in*

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[787] Reported in Helen Morrissey (2015) UK should beware of following Australian pension example, Professional Pensions, 27 April.

[788] Professor Kevin Davis, Professor of Finance, University of Melbourne; Research Director, Australian Centre of Financial Studies; and Professor, Monash University; and Member of Australian Financial System Inquiry Panel (the Murray Inquiry).

[789] Reform (2015) *Beyond April 2015: The Long View on UK Pension Reform*, February; http://www.reform.uk/wp-content/uploads/2015/02/Beyond-April-2015_V3-FINAL.pdf

[790] Reform (2015) Beyond April 2015: the long view on UK pension reform, February; http://www.reform.uk/wp-content/uploads/2015/02/Beyond-April-2015_V3-FINAL.pdf

retirement and drawing down benefits at the minimum allowable rates (which a majority of retirees do).

The Inquiry also noted that many retirees find it challenging to navigate the transition to the retirement phase of superannuation. The task of managing multiple financial objectives and risks in retirement is complex and the quality of financial advice can vary significantly.

Accordingly, the Inquiry recommended that institutional super funds be required to offer their members a 'pre-selected' comprehensive retirement income product which, where appropriate, includes a regular and stable income stream, longevity risk management and some flexibility. A product involving some mix of an account-based pension and deferred annuity is one such example, and the longevity risk pooling provides an opportunity for higher consumption streams for participating retirees. There is, of course, no free lunch, as beneficiaries receive lower inheritances from residual super balances. This is consistent with another of the Inquiry's recommendations to shift the focus of the system from tax-preferred wealth accumulation and estate planning to provision of retirement income by setting clear objectives for the system.

Offering a 'pre-selected' product was preferred to a system where individuals are 'defaulted' or mandated into a specified product. This maintains consumer sovereignty, while positively influencing retiree choice towards taking up products that include some longevity insurance. A default solution also faces practical complications given retiree diversity.

The concerns about Australia were reinforced by a study published by the Social Market Foundation published in November 2015.[791] The study identifies two types of Australian consumer:

- 'Cautious Australians' who preserve their capital by reducing it by less than 1 per cent a year. They face a very low risk of running out of savings, even if they live longer than average. But this comes at the cost of reduced incomes and lower living standards throughout retirement.
- 'Quick-spending Australians' who consume pension funds quickly with four-in-10 running out by age 75 – long before they reached average life expectancy. Their incomes risk sinking towards poverty levels.

The study argues that lessons should be drawn by the UK Government. In particular, it should create a two-tier 'Early Warning System' to understand what retirees are doing with

[791] Nigel Keohane, Ben Richards and Katie Evans (2015) *Golden Years? What Freedom and Choice will mean for UK Pensioners*, Social Market Foundation, November; http://www.smf.co.uk/wp-content/uploads/2015/11/Social-Market-Foundation-Publication-Golden-Years-What-Freedom-And-Choice-Will-Mean-For-UK-Pensioners.pdf

their pension savings and to identify emerging long-term risks both to consumers and the taxpayer. It recommends:

- A 'Retirement Risk Dashboard' – to help the Government monitor retirement decisions and provide a view on long-term outcomes for consumers and the state. This would be based on a range of statistics such as pension balances, pension cash withdrawal, insurance take-up, levels of investment risks and take-up of guidance and advice.
- 'Personal Pension Alerts' – to help policymakers intervene where appropriate with the sub-groups it has identified as at particularly high risk. Potential interventions could include: targeted support and advice; initiatives to make retirees think twice before taking one-off decisions such as withdrawing all their pension savings; and, a 'Mid-Retirement Financial Health Check' to encourage older people to reconsider their financial position for their later years.

Nicholas Morris is writing a book with the working title *When Markets Don't Work: Lessons from Australia's Superannuation Fiasco* which focuses on investment issues. He summarised the situation as follows:

> *Today, Australia has a complex and expensive [investment fund] industry which manages these very large [superannuation] funds. Most funds are predominately actively managed, with substantial associated costs. On average, administrative and investment management costs exceed 3% of managed funds, or over $50 billion, per annum. As risk-free investments struggle to earn much more than this in today's markets, the result is that returns after expenses are very modest. Compared to funds in Canada, the US and Europe, Australia's funds perform badly….*
>
> *Why did this outcome emerge and what can other countries learn from it? The answer is that principal-agent and conflict of interest problems combined with lack of effective competition and light-handed regulation allowed rent extraction by private sector managers on a massive scale. The prevailing regulatory ethos in Australia followed that adopted in many other countries in believing that disclosure and competitive pressures would prevent excessive rent extraction from occurring. Inattentive trustees, and contractual eclipse of trust law arrangements, led to weak representation of members….*
>
> *[I]nefficiency [in the fund management industry] results from the development of a complex, multi-layered, industry, with extensive delegation of both functions and responsibilities, and from extensive use of active funds management with excessive focus on short-term results. Additionally, although in principle there should have been economies of scale as the funds administered grew, most of this has not been passed on to scheme members. Rent extraction has been facilitated and permitted by a laissez-faire and unfocused regulatory system, including a disclosure*

regime which permits the majority of costs to remain hidden, and limited effective competition.

The evidence from Australia illustrates how a large degree of separation between fund managers and members, created by extensive outsourcing and delegation of responsibility, creates a poor outcome for scheme members. The result is a sorry tale of costly complexity, poor representation of member's interests, limited disclosure and extensive unresolved conflicts of interest.[792]

3.18.2 Switzerland, Chile and the US

Chris Curry in an article for Reform entitled *The UK Retirement Market: Lessons from Abroad*,[793] wrote:

[C]ountries, such as Switzerland and Chile, have high levels of annuitisation. Despite Swiss savers being permitted unlimited access to their private pension savings (though some schemes restrict access), around 80 per cent of DC assets are put into lifetime annuities. This is attributed to cultural attitudes; Swiss workers are described as being 'financially conservative' and 'preferring guaranteed incomes for life' over taking lump sums.

However, Swiss annuities are funded by hosting pension schemes and their rates (which are regulated by the Government) are considered to be very generous, given the current low interest rates in the Swiss market and low mortality rates amongst annuitants.

Chileans who wish to access their DC pension savings must opt either for a lifetime (deferred or immediate), index-linked annuity or for phased withdrawals from a pension fund. The number of DC savers purchasing an annuity in Chile has risen from 3 per cent of pensioners in 1985 to just under 70 per cent of DC savers for whom annuities were an option in 2007. This equates to around 70 per cent of DC assets.

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[792] Some of the problems the book will highlight have been discussed in Australia, though the full extent of the problems is not widely understood even there. See for example, Alan Kohler, 'Australia's super system is a national disgrace', ABC, 31 Oct 2012 and Mike Steketee, 'Unfair, inefficient and expensive: what went wrong with Australia's superannuation system', Inside Story, 18 February 2013. The 2010 Cooper Review concluded that that disclosure to members had failed to achieve its objectives, that there were inadequate accounting and financial reporting standards, and that fees were too high. A recent Grattan Institute Report also points out the high charges in Australian pension schemes: see Jim Minifie (2014*), Super Sting: How to Stop Australians Paying Too Much for Superannuat*ion, Grattan Institute Report No. 2014-6, April 2014. The recent Financial System Inquiry (2014) has also concluded that 'there is little evidence of strong fee-based competition in the superannuation sector, and operating costs and fees appear high by international standards'.

[793] Reform (2015) *Beyond April 2015: The Long View on UK Pension Reform*, February; http://www.reform.uk/wp-content/uploads/2015/02/Beyond-April-2015_V3-FINAL.pdf

The high demand for lifetime annuities in Chile is attributed to the restrictions on accessing savings and on the lack of a sufficient universal state pension to fall back on. In addition, fund providers must guarantee a minimum rate of return, which is backed by the Government.

Both Switzerland and Chile offer higher annuity rates than would have been expected given market conditions.

Annuities are perceived as a 'good deal' for annuitants in these countries.

….The purchase of lifetime annuities is minimal in the USA, estimated to account for less than 2 per cent of pensioner income in 2009. Savers in the USA are permitted to access their DC savings from retirement age without restriction and the lack of interest from consumers in annuitisation is attributed to the lack of bequest options, large fund sizes, 'adverse selection' and consumer concerns about developing health problems in later life.

Finally, it is interesting to note that the UK is not the only country concerned about pension advice. In the US, President Barack Obama has introduced a fiduciary standard for financial advisers who recommend retirement-account investments which requires them to act solely in their clients' interests. Currently, advisers' recommendations must be 'suitable' for a client, but they do not have to be in the client's best interest, which would be a fiduciary standard. The absence of a fiduciary standard has allowed advisers to recommend products which earn the advisers higher commissions of around 1%. This is particularly the case when 401(k) accounts (the US equivalent of the accumulation phase of personal pension schemes) are rolled over into independent retrement accounts (IRAs) (the US equivalent of a retail drawdown product) when someone retires. In 2013, about $353 billion was rolled from 401(k) accounts into IRAs. However, advisers claim that anyone with less than $50,000 would no longer be able to find an adviser willing to deal with them.[794]

3.19 Feedback from our interviews and responses to the consultation paper

3.19.1 Feedback from our interviews[795]

3.19.1.1 Consultants

What will members with DC schemes do?

There was considerable uncertainty about what scheme members would actually do, although the most common view is that many will follow 'the path of least resistance' and just accept their existing provider's decumulation product.

[794] Andrew Ackerman and Karen Damato (2015) Obama Backs New Rules for Brokers on Retirement Accounts, Wall Street Journal, 23 February.

[795] The interviews took place in late 2014 and early 2015.

Nobody yet has a clue as to how many people will want to take all their cash immediately or over a very short period (to mitigate a high tax bill in a single year). They will need to consider a range of complex decisions depending on what they've got in DB, DC, state pension, and other sources of capital.

They need advice, but regulated advice will not make financial sense for most people. There was widespread criticism of the FCA's role when it comes to the issue of advice:

- 'The FCA doesn't consider the profit motives of advisers. In effect it has stopped employers and trustees from helping members, because they have to tread on eggshells around the advice/guidance mess. It's a case of "whatever you do, under no circumstances must you give members useful information"'.
- 'The FCA is in denial – if the right people to advise members are not permitted to do so, we will have another scandal of similar proportions to the personal pension mis-selling scandal [in the 1980s and 1990s]'.

3.19.1.2 Providers and investment managers

What are your views on defaults?

In one sense, there is always a default in decumulation which is 'doing nothing'. So, the default might be to stay in the final stage of accumulation default fund, unless an active decision is made. What subsequently happens depends on the scheme rules:

- In a contract-based scheme, it is not possible to force annuitisation (due to unfair contract terms legislation), although it might be possible, depending on the contract, to require the member to take a surrender value at some age (e.g., 75)
- In a trust-based scheme, trustees have the power to say to a member 'if you don't tell us otherwise, after one year we will buy you an annuity' (i.e., they can force annuitisation as a default). Trustees do want a process for moving people from accumulation to decumulation, but are concerned about having a specific default, since retrospectively, a member could claim they would have been better off with a different solution. So trustees still need to give choices (which conflicts with the idea of a single default).

It was also recognised that many people will take 'the path of least resistance', whereby the individual accepts the decumulation product of the pension provider. This used to be the provider's annuity (rather than the open market option). Now, this will be cash or some form of drawdown product.

Some insurance company participants questioned whether there was even a need for a separate default decumulation fund. It could simply be a continuation of the accumulation fund, but used to deliver a certain percentage of the fund as income each year until, say,

age 75. Others pointed out that this could lead to a similar consumer detriment as previously existed with rollover/internal annuities.

There was support for the idea of default pathways using decision trees, with a small number of branches in the decision tree, dealing with health, dependants, other assets and liabilities, tax, etc. However, others thought that narrowing down to a single universally suitably default will be difficult if not impossible, even though they recognised that defaults may be useful.

It was agreed that an appropriate default should recognise and give appropriate weighting to the need for a secure retirement income as the basis upon which to build other access options, accepting that there is both a demand for a secure income (guaranteed income for life) and a demand for flexibility. However, the first aim should be to secure basic lifelong income to meet the needs of 'heating and eating'. You can then add a platform for drawdown.

Two defaults were proposed (both meet the needs of a good scheme):

- Drawdown plus a deferred annuity
- Layering – first secure essential life-long expenditure ('heating and eating'), then allow for luxuries (e.g., a SPEEDOMETER plan).

However, there are challenges with the first of these proposals. Individuals do not really want to manage investment risk. In the US, for the small number those who choose to take out longevity insurance, around 10-15% of the fund at retirement is used to buy a deferred life annuity. In the UK, a key problem with a deferred annuity is cost and this will be made worse by the introduction of Solvency II in 2016. People might decide to wait until, say, age 85 and buy an immediate annuity, but these might not appear to be good value due to selection factors.

We were told that there is potentially a problem with having a default that arises from MiFID.[796] MiFID says you cannot put people into a commercial contract without their consent. However, we were informed that it is possible to get around this by getting a Letter of Comfort from the EU. This was the mechanism used to get around a similar problem in the case of auto-enrolment in the UK.

What are your views on guidance and advice?

We first asked about the distinction between guidance and advice in relation to a decision tree for a default decumulation strategy. We were told by Huw Evans, CEO of the ABI, that there is an important difference between 'advisory' and 'advice' in English law. A decision tree would be advisory, but is not really advice. However, there is no distinction between

[796] https://www.fca.org.uk/firms/markets/international-markets/mifid-ii/mifid-review

'advisory' and 'advice' in the current regulatory framework. If a decision tree is classified as advice, then it means that it is regulated. This is not at all useful and would need to change for a decision tree to work in the manner intended.

We were also told that schemes using a decision tree would need to make sure customers have used the Government's new guidance service, Pension Wise, even though this just takes stock of people's assets and liabilities and explains the options available.

If these two hurdles can be crossed, then we were told that it might be possible to follow up Pension Wise with a standardised decision tree (possibly with statutory approval) which would be suitable for those above the new trivial commutation level (£30,000) and below those classified as high net worth, i.e., middle income households with assets below £100,000.

It would be better if the decision tree had a standardised set of questions across all providers. These might be aligned with the questions asked under advanced protection (or the second line of defence) which gives the FCA comfort that a provider is not selling a standard product to someone with a health problem, is not selling a single life product to a married man, is not selling a fixed-income product to someone who makes clear that he wants an inflation-protected income, etc. However, we were told that this would cause a problem if the provider does not offer a product covered by a particular question.

Turning to the question of advice more generally, the nature of 'advice' will vary in terms of how it is regarded under FCA regulations. It could be fully regulated fee-based advice (where the firm makes a clear recommendation and therefore is responsible/liable) or some other form of 'non-advice' (where the firm provides decision trees, explains options etc, but the individual makes the final choice – in which case the individual is responsible and the firm has little or no liability).

All participants were agreed that the FCA's various definitions of advice is a major problem and out of step with what the DC decumulation market needs. This has to change. One participant told us that the FCA's attitude is that only the best will do, which implies that we have a zero-failure regime. But the 'best is enemy of the good' – it results in advice costs of at least £1,500 which no one wants to pay. However, it was believed that the FCA will say its hands are tied by EU law.

The concept of advice has to change to make it more useful to customers. Advice should help people understand the difference between 'want' and 'need' and help people clarify the decisions they need to make. At present, people are presented with a whole range of complex questions and choices and then told 'you're on your own'. Even guidance or a steer towards a single solution or even two solutions constitutes 'advice' under current rules. The implication is that most customers are overwhelmed by choice, but have nowhere to turn without paying £1,500 for advice.

What is the solution to this problem? We were told that the simplest solution involves only three routes:

- Execution-only – the customer makes all the decisions
- 'Filtered choice' – the customer is steered towards tailored options (e.g., low-risk funds); but this is still currently classified as advice
- Personal recommendation (i.e., full regulated advice)

It would then be necessary to find a way to nudge the mass population towards a soft default or a set of default pathways. Three types of nudging were suggested to us:

- Guidance
- What do 'people like me' do?[797]
- Advice (needs to be simplified, targeted)

However, participants told us that the industry is still a long way from this ideal. For example, one provider told us they had built a simplified advice website but acknowledged that it does not really serve customers' needs. The FCA has reviewed existing simplified advice models, but says that they are not clear enough. No life office has yet brought a simplified advice model to the market, which is regarded as very telling.

All agreed that guidance/advice is where there is a need for real innovation – far more than in product design. The use of web-enabled technology is already producing good results. Consumer education is another key factor and the industry needs to rise to the challenge.

It was also agreed that guidance and advice could not be a single event, but had to be a process. There needed to be periodic financial health checks, with at a minimum of one leading up to retirement, and another before age 75.

There was common agreement amongst interviewees that the FCA's advice and guidance regime is little short of catastrophic and does virtually nothing to prevent customers 'self harming'. There was also common agreement that the two regulators, the FCA and TPR, should merge.

3.19.1.3 Trade unions

What are your views on advice to members?

A participant opened with the comment: 'What you can have is a default to financial advice. The scheme or employer can say we will pay for you to have a session with a regulated financial adviser who will take responsibility for that advice (and the individual therefore has recourse if wrong advice is given). Guidance is great because it takes you through your

[797] See for example, https://www.fidelity.co.uk/investor/getting-started/tools-info/people-like-me.page

options. But if the best thing for you is drawdown or an annuity, that is buying a regulated financial product. But the way the industry is at the moment, it is difficult to get financial advice for pots less than £30,000'.

We pointed out that 75% of people currently have pots less than £30,000 and regulated advice can cost £1,000 or more, which prompted the discussion:

- 'If schemes are paying for this, may be they are able to bring costs down'
- 'If it is the case of an employer having to pay, I cannot see them leaping at that'
- 'To my mind, the only way you would get employers to take on the real responsibility and cost is if the state said "we are going to subsidise advice through tax relief or some other mechanism"'
- 'There is no incentive for an employer to do it'
- 'Low and middle-income savers lack the trust and experience of dealing with financial advisers. This is why attention should be focused on default options not advice'
- 'Some unions (e.g., Unison with Lighthouse, Unite) and have directories of financial advisers'
- 'Advisers have an interest in (maintaining) complexity. With good defaults you can take a lot of the complexity out of it. People do not really want regulated advice. They want to be directed'
- 'Advisers just try to sell you stuff'.

3.19.2 Responses to the consultation paper

We summarise the responses to Questions 22-31 in the consultation paper here.

22. *It is now recognised that many people face a number of behavioural barriers which prevent them behaving optimally. When it comes to decumulation, what are the key barriers?*

A wide range of behavioural barriers were mentioned by the different respondents. The barrier to optimal behaviour that was most commonly mentioned was the lack of financial literacy. Other behavioural barriers included poor understanding of longevity risk, lack of engagement, short termism, framing effects, procrastination and over/under confidence.

23. *We need to recognise that retirees: have different expenditure needs during different phases of their retirement; need to pace their spending throughout retirement in order to optimise the use of their lifetime assets and income and their ability to make intended bequests; and need a choice architecture that reflects the market segment to which they belong. (a) What is your understanding of the regulatory consumer market segmentation and is this appropriate in relation to the needs of DC retirees? (b) What nudges and choice*

architecture do people need to deal with these issues and overcome the behavioural barriers they face?

There was general agreement on the characterisation of market segmentation into mass market, mass-affluent market and high net worth. A substantial minority of responses were enthusiastic about nudges, but more thought that it was more important to provide better information.

24. *(a) What lessons from auto-enrolment in the accumulation phase can be brought to the decumulation phase?*

Responses to this were very mixed. Respondents agreed that inertia had provided benefits in the accumulation phase of pension saving, but not all thought that this could be used in the decumulation phase: one reason for this was the greater diversity of needs in the decumulation phase, which makes it much harder to provide appropriate defaults. There were also differing views on whether defaults were needed to address the issue of inertia or whether they discouraged engagement with the process and made matters worse. Several responses suggested having a menu with a limited number of default choices.

24. *(b) Given the importance of income security for the elderly and the existence of longevity risk, is there a case for defaulting people into buying longevity insurance via auto-enrolment (i.e., drawdown with longevity insurance becomes the default retirement strategy)? Consider the advantages and disadvantages of such a strategy.*

Responses were equally divided on whether or not there should be defaults into longevity insurance. Opponents said that such a policy was inconsistent with 'freedom and choice' and that it would be hard to select an appropriate range of options for heterogeneous pensioners with different needs. The most enthusiastic supporters said that people could always opt out.

24. *(c) What would be the likely annualised cost of such products for individuals?*

Responses suggested that the cost of default longevity products depends on too many factors to provide a simple answer.

24. *(d) How could the default principle, upon which the success of auto-enrolment is predicated, be best reconciled with the individual freedoms for DC decumulation introduced in the 2014 Budget?*

Responses were very divided on whether or how defaults into longevity products could be reconciled with choice and there was no agreed position. Supporters of defaults thought there was no real problem of reconciliation: defaults were useful in eliminating confusion and helped those who wanted to be told what to do, while everyone was free to opt out. Opponents said individuals needed advice to take full advantage of the individual freedoms.

25. *What are the implications of the Chancellor's announcement in September 2014 effectively ending the 55% tax rate on inherited pension pots?*

A third of respondents thought that ending the 55 per cent tax rate on inherited pension pots would encourage more pension savings. Others thought people might feel obliged to use their pension pot for inheritance, rather than spend it during their own retirement. Most recognised that the issue was irrelevant for people with small pension pots.

26. *What are your views on the guidance guarantee and how effective it will be?*

Many responses thought that it was too soon to tell whether the guidance guarantee would be effective and many had concerns that it would be insufficient, especially for those who wanted to be told what to do.

27. *(a) Will other forms of guidance and advice be needed?*

There was a very strong view that more support would be needed than the guidance guarantee alone. A quarter of responses thought that there needed to be a level of support between guidance and advice.

27. *(b) For DC savers who prefer to make their own decisions, what is the best way to build on the guidance guarantee to help individuals avoid buying retail products that are inappropriate (e.g., in relation to risk) and/or poor value (e.g., in relation to price)?*

Most responses thought that better information needed to be provided to build on the guidance guarantee, possibly via online resources. Only a minority referred to advice or nudges.

28. *(a) What specific risks should regulatory safeguards aim to address in relation to financial decisions made at retirement?*

Respondents identified three main risks of decision-making at retirement that need to be addressed by regulation: the risk that individuals purchased inappropriate products (e.g., a married person buying a single life annuity); the investment risks faced by individuals; and the risk of scams and mis-selling.

28. *(b) At what point does individual choice cease to be a regulatory concern/responsibility?*

Responses disagreed on when individual choice ceases to be a regulatory concern. On balance, responses suggested that it was when (or if) an individual secured an income for life. A significant minority (42 per cent) said that the point of the recent reforms was to provide choice and that this would inevitably mean that at some point consumers should be free to make mistakes and hence not the concern of the regulator.

29. *Some DC customers might draw down all their pots in the early years of retirement, a decision they might subsequently regret. What is the most effective way of assisting DC customers to act in their best long-term interests?*

Respondents were divided on how to assist DC customers to act in their best long-term interests and not make decisions that they subsequently regret. Some responses noted that the point of 'freedom and choice' is to allow choice and that the possibility of bad choices must be accepted as part of that. The responses to this question on how to avoid bad choices were varied and included defaults, better education and incentives to secure an income (at varying points in retirement).

30. *(a) What is the best way of ensuring that any DB-to-DC transferees only undertake such a transfer when it is in their best interests?*

The large majority of respondents thought that transfers from DB to DC should only be allowed after taking advice (with an exception for small pots). Many accepted that the advice could be ignored, although one suggested that transfers should be banned if the advice was negative. One response suggested that if individuals wanted to transfer out they should take advice at their own expense.

30. *(b) What are your estimates of the number of DB-to-DC transferees (deferred and also active) and size of assets involved?*

Very few responses provided estimates of the number of DB-to-DC transferees. Those that did thought that about ten per cent would transfer.

30. *(c) Is the requirement for regulated independent advice for such transferees adequate?*

The few responses to this question believed that the requirement for regulated independent advice for DB-to-DC transferees was adequate.

30. *(d) Can/will the guidance guarantee process cope with DB active/deferred members who seek help in considering their options?*

Respondents thought that the guidance guarantee for DB members was inadequate.

31. *Are there other ways of supporting pension savers to make the right choice at retirement for them and their family?*

Respondents suggested that a combination of approaches (including advice, nudges, incentives and information) would be needed to support pensioners to make the right choice at retirement. Some believed that better education and improved financial literacy were required in the longer term.

3.20 Analysis and recommendations

3.20.1 Analysis

This Chapter is called 'Supporting savers to make the right choice at retirement for them and their family and how to build on the lessons of auto-enrolment'. In order to meet this aim, we need to examine, in turn, each of the players involved in or commenting on pension provision: savers, the national media, advisers, the wider financial services industry, and the FCA. We also consider pension fraudsters and investment scammers, and the self-employed and non-eligible job holders. We begin with savers (i.e., the pension scheme members).

3.20.1.1 Savers

The model of economic behaviour underlying the pension flexibilities introduced in the 2014 Budget is the exact opposite of the model underlying auto-enrolment.

The model used by the Chancellor George Osborne on 19 March 2014 was that of an 'econ', a rational lifetime financial planner:

> *People who have worked hard and saved hard all their lives, and done the right thing, should be trusted with their own finances.*
>
> *And that's precisely what we will now do. Trust the people….*
>
> *I am announcing today that we will legislate to remove all remaining tax restrictions on how pensioners have access to their pension pots.*
>
> *Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want.*
>
> *No caps. No drawdown limits.*
>
> *Let me be clear. No one will have to buy an annuity.*

However, the model used in auto-enrolment (AE) to get people to save more for their retirement is that of a 'human' in which inertia and other behavioural biases drive behaviour. With AE, individuals make no active choice to join a pension scheme, are enrolled at a default contribution rate, and do not need to choose the fund into which their contributions are invested.

So the Government has relied on the model of 'humans' to get people to do something relatively simple – namely get them to save a bit more – and is now relying on the model of 'econs' to get people to negotiate the highly complex process of decumulation.

As Sara Benwell points out: 'Auto-enrolment largely exists because we believe that people are either incapable or unwilling to save for their future. At the same time, "freedom and choice" makes the assumption that people are capable of making good decisions about retirement. It doesn't take a behavioural economist to tell you something's not right here, but what behavioural science can tell you is the two policies aren't just contradictory; they

are underpinned by diametrically opposed assumptions about the way people work'.[798] As the FCA itself recognised in its June 2015 discussion paper *Smarter Consumer Communications*: 'We can begin to understand why consumers often fail to make good decisions about financial products and services, when we take into account that behavioural biases, low levels of financial literacy and the complexity of some financial services and products can limit people's ability to take appropriate action'. Either that or the Government believes that 'humans' have somehow transformed into 'econs' over the course of their working lives.

Greg Davies, head of the Barclays behavioural finance team, compared AE with 'freedom and choice':[799]

> *It's not necessarily enough to ensure that everyone is in the right situation for them.*
>
> *Essentially, nudging people to make pensions contributions creates better outcomes, but to ensure optimum outcomes, we also need to educate people to ensure they save more and in the right way.*
>
> *That engagement has long-term benefits as well because it's only by having engagement over time that we do actually build up the confidence and the knowledge for people to start approaching the decisions when they're decumulating with any degree of confidence.*
>
> *[With the new pensions freedoms], we now have a raft of behavioural issues that are going to be there that weren't there before.*
>
> *This is largely because the assumptions behind auto-enrolment are right. If we can learn anything from the past it is that when left to their own devices, people make sub-optimal decisions.*
>
> *By shifting to an opposing behaviour assumption at the finish line of the pensions process, we are assuming people will act in a different way. When we look at the poor choices people made when choosing an annuity, it's clear that this isn't the case.*
>
> *When left to their own devices, people make sub-optimal decisions.*
>
> *The assumption seems to be that in the intervening decades between when we nudged people into savings when they wouldn't do it themselves, we now seem to believe that they have magically become able to assimilate large quantities of information in a short period of time and make optimal decisions for their future.*

[798] Sara Benwell (2015) 'Freedom and choice' could be the undoing of the pensions industry, Pensions Insight, 30 January.

[799] Quoted in Sara Benwell (2015) 'Freedom and choice' could be the undoing of the pensions industry, Pensions Insight, 30 January.

> *Giving people choice on its own doesn't seem to be that well grounded in our behavioural knowledge, because we know that if you give people complex choices, in an area that they're not experts in, particularly one which involves trade-offs over time between actions now and outcomes in the future, these are all features that make people deeply uncomfortable.*

Complexity is indeed a key problem. Many of the risks in Table 1.2 are very hard to understand – even for pension professionals. Pensions must be made simpler to appeal to ordinary savers, according to Lesley Williams, the first chair of the Pensions and Lifetime Savings Association (PLSA),[800] as well as group pensions director at Whitbread. In her first speech as chair, she said that 'we're kidding ourselves if we think education will fix' the problem of people not understanding pensions or being engaged in them and that it will only treat the symptoms. Savers should not be regarded as the problem – rather the industry and policy-makers are collectively to blame for creating complexity in pensions. Ms Williams said that, while she is a 'real believer' in default pathways, she believed that the industry could make pensions simpler and less technical for the end customer.[801] Speaking at the same event as Ms Williams, Andy Harrison, chief executive of Whitbread, said: 'Pensions have always been hard for people to understand, but the trust in pensions is probably the lowest it has been in my lifetime. Government really has not helped, but we need to do the best with what we have… The lesson from AE's success was simplicity and solid communication worked and this could be applied to other problems in pension'.[802]

Of course, if the 'econ' model is right, we do not need to worry about any of this – econs are not troubled by complexity. If, instead, the 'human' model better describes most people's behaviour – which appears to be the case – then we should be looking for a framework for nudging people to behave in what is in their best long-term interests. Running out of money before they die and living in poverty in very old age is clearly in no one's long-term interests. It was to avoid this possibility that pension schemes providing lifetime incomes – rather than lump sums – first started in this country.

Given the complexities of decumulation and the risks in Table 1.2, the challenge is to design a simple and effective default decumulation strategy that deals with the key risks in the Table, yet allows for the flexibilities made possible by the 2014 Budget. At the very minimum, we believe that an effective quasi-default decumulation strategy – initiated by the scheme members, but which they can always opt out of – can be designed which allows for:

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[800] This is the new name, from October 2015, of the National Association of Pension Funds (NAPF).

[801] Reported in Stephanie Baxter (2015) NAPF 2015: Incoming chair blames industry and policymakers for complexity in pensions, Professional Pensions, 16 October.

[802] Reported in Michael Klimes (2015) NAPF 2015: Whitbread chief says trust in pensions 'lowest in my lifetime', Professional Pensions, 14 October.

- access
- investment performance to beat inflation during retirement and
- longevity insurance.

This could be determined using a standardised decision tree (possibly with statutory approval) which will be suitable for those above the new trivial commutation level (£30,000) and below those classified as high net worth, i.e., middle income households.

Those opposing a default employ a 'one size does not fit all' argument. While this is a reasonable point to make – although much less so if the member can opt out of the default – we do not believe that most people's circumstances are so complex that they cannot use a decision tree with a small number of pathways that lead them to a set of suitable retirement income products that will meet their life-long expenditure needs – especially if the alternative is 350,000-400,000 different bespoke solutions per year, one for each retiree whatever the size of their pension pot. We should always bear in mind the statement 'the best is the enemy of the good'. If the default is 'good', then that should be 'good enough' for most members with relatively small pension pots – especially if the alternative is a huge set of expensive, highly engineered, over-complex solutions designed by providers and advisers.

An important aspect of the success of such a quasi-default will be consumer engagement. The value of any product or service depends on the time and effort that goes into planning it. Consumers understand this with products and services which give immediate gratification, such as holidays. Can we get them to understand that the same applies to products and services involving deferred gratification, such as retirement income solutions?

Related to this is the number of product and solution choices. While competition can be good and lead to product innovation, it also leads to a proliferation of essentially identical products which are marketed as being different. This leads to customer confusion. Consumer engagement will improve if there are only a small number of well-designed products and solutions being offered to customers.

We expect – and certainly hope – that, whether nudged, guided or advised, the majority of decumulation strategies after April 2015 will take the form of either (a) layering (e.g., SPEEDOMETER plans), or (b) cash and income drawdown, with longevity insurance in the form of annuity purchase deferred until later life. Retirees in poor health without dependants might well choose to access their funds in full at the date of retirement. Nevertheless, we would find it very hard to understand if savers in good health at retirement were not advised to purchase longevity insurance as part of their retirement expenditure plan. Careful tax planning will also be a feature of such strategies in order to avoid people paying too much tax in the early years of the plan. However, this can be quite straightforward for most people, if they have access to a simple table that allows them to

calculate how much they can withdraw from their fund in one year in relation to their current income before they move into a higher tax bracket.

Another important aspect will be realism. Clearly, consumers value flexibility, but it can be expensive to provide. The new flexibilities have placed product providers in a similar position to an airline pilot who believes her passengers want to fly from London to Sydney, but, as she is about to land, is told that the passengers have changed their mind and want to fly to Shanghai instead. It can, of course, be done, but only at a price. Consumers also value guarantees, but they are also expensive. For example, guaranteed drawdown which gives complete flexibility of withdrawal can result in the income that can be withdrawn being up to 30% less than an equivalent annuity.

Related to this is consumer vulnerability. Humans can be particularly vulnerable when it comes to financial services and the FCA has estimated that up to 50% of UK consumers are potentially vulnerable. Humans are also prone to overconfidence, bordering on arrogance. There is nothing potentially more toxic in financial services than consumers who are not aware of their own vulnerability and are dismissive when this is pointed out to them. This is particularly true when it comes to investment and longevity risks, the two key risks in retirement. Both risks are likely to be dismissed as unimportant by many humans.

3.20.1.2 The national media

The situation has not been helped by national media reports that emphasise the immediate problems that people have accessing their pension pots, but which do not mention longer-term risks, such as investment and longevity risks, or the importance of the additional protection/second line of defence that was designed to protect consumers.

Typical are these extracts from Daily Mail articles:[803]

> *More than 100,000 savers have already discovered they face a fee if they take advantage of the new pension freedoms.*
>
> *Radical reforms introduced two months ago promised that the over-55s could cash in their pots rather than being forced to use the money to buy an annuity, or income for life.*
>
> *But a Money Mail investigation found some savers are being charged huge fees if they withdraw their funds or seek financial advice, while others are being allowed no access at all to their cash.*

[803] Louise Eccles and Ruth Lythe (2015) 100,000 are hit by huge fees to join pension revolution: One in ten over-55s eligible to take advantage of new freedoms are forced to pay to get their hands on savings, Daily Mail, 10 June; Sam Dunn and Ruth Lythe (2015) Delays, sky high fees and firms refusing to hand over savings: Six fatal flaws strangling the pensions revolution, Daily Mail, 9 June.

Now, industry analysts have revealed one in ten over-55s eligible to take advantage of the pension freedoms will have to pay if they want to get their hands on their hard-earned savings…..

Many pensioners have been told they cannot withdraw their money until they have seen a financial adviser.

But if the adviser believes it would be a bad idea to cash in their pot, some pension firms have then refused to let people do so. Advisers and pension firms are worried they will face fines for mis-selling if customers later blow their cash and end up penniless in retirement.

But critics said savers must be allowed to spend their money as they wish, even if it contradicts professional advice. Paul Green, of over-50s specialist firm Saga, said: 'People should be trusted with their own money.'….

We have identified six major failures of the reforms:

1: Firms refusing to hand over savings

Before the reforms, most pension providers promised they would take part. They admitted there were challenges, but that things would be ready on time. In practice, many savers are finding this is not the case.

Research from actuary firm Barnett Waddingham found that none of the major pension firms offer full access to all the freedoms.

Some have publicly admitted they won't allow savers to use their pension as a bank account.

2: £1,000 for advice you don't want

Some big insurers are so scared of being accused of mis-selling that they refuse to help customers unless they have had formal financial advice.

There are specific circumstances where savers have to take guidance for their own protection. These include anyone who wants to take all their cash at once from a pension of more than £30,000, and those with guaranteed payout rates written into their contracts.

But many firms are telling customers they have to see an adviser regardless of circumstances. A session with a financial adviser will typically cost £500 to £1,000.

3: Savers stuck in limbo with no help

Money Mail has been bombarded with letters from savers stuck in limbo after their insurer and financial adviser refused to help them.

Some have been turned away by dozens of firms who just don't want their business. In many cases, savers have visited advisers for help withdrawing all their cash from a pension.

The adviser has recommended that they don't do this, but when the customer insists they still want to press ahead, the adviser refuses to assist.

4: Delays of up to 90 days

Time and time again, Money Mail has come across savers being forced to jump through hoops before they can access their own savings.

It's leaving many facing substantial delays in getting their cash.

Often, savers are being made to move their money to a different type of pension and, though the official industry figures show this should be completed within ten days, readers and independent experts say it can take as many as 90.

5: Sky-high fees and crippling red tape

Even when they are allowed to get their hands on their pension savings, many retirees are being confronted with sky-high charges.

There is also a dazzling array of terms and conditions that stop them using their pot as they would wish. Savers can be hit with a set-up fee of £184 and then charges to manage their pension fund on top of that. They can also be asked to pay from £20 to £90 – and in some cases up to £240 – every time they make a withdrawal.

Some firms only allow wealthy savers access to the freedoms. According to Barnett Waddingham, you can only have flexible drawdown at Legal & General if you have £30,000 saved, £20,000 at Royal London, or £50,000 at Zurich.

At the Government's approved low-cost pension provider NEST, you can only have access to the freedoms if you are prepared to take all your savings in one go – potentially exposing yourself to a massive tax bill.

6: Insurers who cut value of your pot

Money Mail has also heard from savers who have been told they cannot enjoy the freedoms unless they move to a new type of pension – at a steep cost.

When they switch the money to the newer scheme they are hit with a charge.

A typical problem occurs when someone wants to take their pension over the age of 55, but then discovers their contract prevents them from doing so without penalty before the age of 60 or 65.

Articles such as these give the impression that the pension fund is held in cash and people are being charged high fees for accessing it. If the pension fund were held in cash, the return on the pension fund would be very low. Instead the pension fund is invested in growth assets that aim to generate higher average long-term returns, but which are hard to liquidate at short notice. If the pension fund had to hold more assets in cash-like instruments, just in case someone wants to withdraw money without notice, this will bring down the return on the overall pension fund – which would lead to a different complaint from the national media. Even more important is that there is no mention of longevity risk.

Pension assets have to last a lifetime – complaining that it takes 90 days to access a pension pot really is the wrong issue to be discussing at the start of someone's retirement.

3.20.1.3 Advisers

The evidence we have gathered in the earlier Sections of this Chapter suggests that advisers need to address five key issues.

First, advisers do not appear to be sufficiently focused on the consumer's real needs. Most consumers (as many as 90% according to one study) have very simple needs. They also have very modest resources in retirement. Such consumers need something very straightforward, namely financial help.

There is insufficient clarity amongst advisers about the appropriate way to segment the market and about the level of assets below which financial help in the form of a purely advisory default pathway will be adequate. We believe the market should be segmented by behavioural type, by spending type, and by resources and needs – and suitable integrated solutions offered to each segment. This would assist in determining the appropriate level of guidance, help and advice more effectively. The evidence we have gathered suggests that, as a rough rule of thumb, those below £30,000 need only guidance (provided it deals effectively with the impact on entitlement to welfare benefits or unless they actively choose something different), those with £30,000-£100,000 need help via a default pathway (unless they to actively choose something different), and those with more than £100,000 would benefit from full advice (unless they also choose something different).

Anyone who strongly believes that full advice is needed as a default by those with smaller amounts should bear in mind that the new single-tier state pension has a capital value of around £200,000 and no one is setting up a business to advise people how to spend their state pension. Also when drawdown was first introduced, it was deemed to be a suitable product for people with a pension fund above £250,000.

There has to be a middle way between guidance and regulated advice. Many people's pots are just not big enough and their financial circumstances are just not complicated enough to warrant full regulated advice. If we do not end up with a simple set of default pathways which the middle market can use with confidence, then there are two dangers. The first is that many people will not take advice at all, in which case, we need to answer the question raised by Ian Price, divisional director of pensions at St James's Place: 'Liberating pensions will be the new windfall and the new boost to consumption, but what happens when that money is all spent and people still have 10 to 15 left in retirement?'[804] The second is that many of the 350,000-400,000 people who retire each year will be persuaded by advisers and providers that they need a personally designed bespoke retirement income solution that

[804] Quoted in Professional Adviser, 13 August 2014.

has been exclusively prepared for them. It would, of course, be nice if we could all afford our own interior designer when we redecorated our homes, but most people do not need one. Peter Bernstein coined the phrase 'interior decorator fallacy' for the argument that most people's investment portfolios should reflect investor characteristics such as attitude to risk in the same way that interior decorators attempt to reflect the personal taste of their clients.[805] There is a hint of the interior decorator fallacy about the argument that every retiree needs full regulated advice.

There is, of course, an important role for advice for those prepared to pay for it, but it should be highly focused at its cost should reflect this. As John Porteous, head of client proposition at Towry, says: 'As a general observation, there seem to be three primary challenges that the industry faces in delivering both effective and valued client outcomes for a rapidly growing market:

- Advice policy around the relative merits of the options available
- Investment strategy to support a sustainable standard of living
- Ongoing communication and client engagement over time'.[806]

Second, advisers appear to be too focused on their own revenue generation, rather than providing the right type of advice for the right type of client. We were told that the advisers were 'pushing for decumulation to be a retail market for obvious reasons: it's payback time, as they have lost out when auto-enrolment was introduced – with no need for advice'.

It is also somewhat surprising that advisers had not sorted out whether they should have a fee-based or percent-of-assets charging structure by the time that the pension freedoms began. Steve Lewis, head of distribution – retirement solutions at LV=, believes a fixed fee can work for smaller pots: 'The challenge is doing that in an efficient way which clearly explains the risk and balances to the client without creating an excessive burden of fee….A lot of people below £100,000 will come into the drawdown space. I suspect we will see adviser firms doing it on a fixed-fee basis; so perhaps fixed initial fees, and pre-determined fees for "advice events"'.[807]

It is significant to note that very few professional services firms – lawyers, accountants, etc – now charge on an ad valorem basis. Instead they charge on the basis of the amount of work done, typically expressed as an hourly rate. One of the reasons for this change was the loss of professional indemnity cover in cases where clients successfully sued a professional services firm and the firm could not justify the size of the fee charged against the amount of

[805] Peter Bernstein (1992) *Capital Ideas*, Free Press, New York.

[806] John Porteous (2015) The death of the 'once and done' pension plan, Professional Adviser, 16 April.

[807] Reported in Jenna Towler (2014) 'Will the masses be hooked on non-advised drawdown?', Retirement Planner, 22 October.

work done, typically expressed in terms of hours worked.[808] Many in the financial services industry, in particular advisers and investment managers, along with estate agents, still charge on an ad valorem basis and we wonder why that is the case.

The new pensions regime is an opportunity for financial advisers – and other financial services firms such as investment managers – to put themselves on the same footing as most of the rest of the professional services industry. We accept advisers need to be adequately rewarded, but there also needs to be much clearer evidence that the charging method used provides customer value for money. If advisers want to be compared with estate agents, then estate agents have smart high street offices, embrace the latest technology and have enthusiastic sales staff selling your property.

Third, and equally remarkable, is the lack of clear charge disclosure on advisers' websites. The argument that exact fees can only be established after a conversation to gauge the work involved does not prevent fees for typical scenarios being published. With estate agents, lawyers, and accountants, for example, it is also easy to find out the sales commission or fees that will be charged without feeling committed to using a particular agent. We recognise that people want to sell their house, for example, whereas most people do not 'want' investment advice, but we should also ask why that is the case, given that many people have pension pots and houses of similar value.

Fourth, the advice industry also has to redesign its business model to deal with new technologies such as online advice and the competitive challenges this will bring for both the revenue and cost side of the model. Similarly, simplified advice will be suitable for many people and that has to be delivered at low cost, another challenge for the advisers' business model. There is a very clear role for low-cost, fixed-fee robo-advice for people with pension pots between £30,000 and £100,000 – with fees of around £100 p.a. per client.

Finally, there is the issue of the professional standards of advisers. Advisers have certainly become more professional in recent years. For example, the Financial Adviser School was launched in 2011 and offers vocational and academic training for financial advisers. It was established by the Sesame Bankhall Group and sold to Intrinsic in October 2015.[809] Similarly, the Society of Later Life Advisers (SOLLA) has created an industry standard for retirement advisers called the SOLLA Retirement Advice Standard (RAS).[810] To satisfy the standard, SOLLA accredited advisers need to hold a QCF level 4 financial planning qualification, a statement of professional standing (SPS), and the minimum qualifications in equity release

[808] Of course, the hourly rate provides an incentive to 'over-service' the client in order to build up the fee.

[809] Reported in Carmen Reichman (2015) Intrinsic and OMW to launch national advice business, Professional Adviser, 2 October.

[810] http://retirementstandard.co.uk/for-advisers/

and long-term care.[811] In November 2015, the Chartered Insurance Institute (CII) announced that it would launch a new Life and Pensions Foundations examination unit (LF1) to support professional standards in the life and pensions sector. It is targeted at new entrants as well as those already working in customer-facing jobs. People who pass will get a CII Level 2 Award in Life and Pensions Foundations. The exam is designed to enhance public confidence in life and pensions.[812]

Despite this, advisers are not a recognised profession, unlike accountants, and this is affecting recruitment into the industry. The average age of advisers is rising and could be as high as 50, according to recent surveys, implying that not enough younger people are looking at financial advice as a career choice. A debate on LinkedIn suggested reasons why this was happening and put it down to the absence of a recognised career path in financial advice. According to Lawrence Gosling: 'The cost of training is too high, not enough people are taking up some of the excellent financial services degrees which are available at universities, and the generally negative image of the profession outside the industry. One participant perceptively made the comparison with accountancy, pointing out trainee accountants have a clear career path – pass the two Chartered accountancy exams and you can practice. Then, after a couple of years, you can become a fellow of the Institute of Chartered Accountants. There is no such clear equivalent in the advice sector, which could read "take the exams, then a few more, be subject to a couple of FCA audits, realise the cost of professional indemnity insurance is high, network like crazy, and you might get a few clients". But even after all of this, you do not have a career, unless you can find a firm to take you on, or get lucky and find a couple of good clients and set up on your own'.[813]

3.20.1.4 The wider financial services industry

There is always going to be a tension between competition and cooperation, but the evidence we have gathered in this and the previous Chapter suggests that there is currently too much tension between (a) advisers and providers (who are fighting a turf war over access to clients), and between (b) investment managers and insurance companies (who are fighting a turf war over control of client pension assets) to the detriment of consumers.

On the one hand, we have customers, many of whom do not understand the risks they face in retirement, are not interested in finding out more about these risks, and even when told about them, do not care. Yet, they still need to use their pension pot to provide them with a 'good' life-long retirement income journey.

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[811] Reported in Carmen Reichman (2015) SOLLA launches retirement advice standard, Professional Adviser, 9 September.

[812] Reported in Professional Adviser (2015) CII to launch life and pensions qualification for front line staff, 5 November.

[813] Lawrence Gosling (2015) Does the advice industry really need new talent?, Professional Adviser, 28 August .

On the other hand, we have suppliers – advisers, providers, investment managers and insurance companies – which should be offering integrated effective value-for-money solutions to these customers, but which appear to be more concerned about protecting their own patch and their own revenues. This means that instead of an integrated approach in which each supplier contributes an appropriately designed component that fits well in an overall 'good' solution, we are seeing a fragmented approach in which each supplier offers what they consider to be the 'best' solution, without taking into account the full retirement journey that the member needs to make. So, for example, we are seeing investment managers recommending equity income funds as the 'best' solution for providing retirement income, without any acknowledgement of the importance of dealing with longevity risk. Or we have advisers who see full regulated advice as the 'best' solution for everyone, irrespective of the size of their pension pot. Just as bad, we have advisers more concerned with inheritance tax planning than with managing longevity risk. All this is actually worse than the customer getting a 'flat pack furniture unit'. At least with a 'flat pack furniture unit', you know what you are going to get, once you have put the pieces together correctly. What the customer is being offered now is a range of incomplete 'flat pack furniture units', with no clear way of putting them together and no obvious piece of furniture that is recognisable at the end of the exercise.

There are other examples of bad practice. For example, we see providers and insurance companies relying on customer inertia to retain accumulation-stage customers, once they enter the decumulation stage. As Janette Weir, founder of Ignition House, said: 'We are in danger in the drawdown market [that] we will make the same mistakes as in the annuity market. In the annuity market, inertia was key and people just went with their providers. It caused all sorts of problems. The FCA got involved and drawdown is compounding that, because, if the providers don't offer drawdown solutions and have appropriate funds to go with that, then people will find it impossible to shop around. It is really difficult for them'.[814]

Another example is client poaching. Advisers have recently accused providers of inappropriate contact with clients that the advisers have 'introduced' to them, e.g., Aegon was accused of poaching dozens of an adviser's clients for its direct-to-consumer (D2C) platform, although the FCA said the provider had broken no rules. A Professional Adviser survey of 76 advisers found that half had experienced at least one incidence of a provider contacting their clients in a way they felt was inappropriate. Some respondents thought that some providers were deliberately trying to undermine the relationship between the adviser and the client: 'One provider wrote to a client without copying to me, stating: "As your adviser has not made any changes to your investment in the last three years, we have removed them as the adviser for this plan". But we had been reviewing the plan annually. So this led to hours of work, needless contact and annoyance for the client'. Others said the

[814] Reported in Michael Klimes (2015) Industry in danger of disappointing by not giving choice, Professional Pensions, 25 September.

problem could be resolved if the adviser was always notified of any contact: 'The relationship between client, adviser and provider should be seen as a partnership in its loosest form. As such, I am quite comfortable with providers contacting clients direct but with the proviso that a copy is sent to the adviser'. Nevertheless, most respondents wanted the FCA to intervene and limit the amount of freedom providers have to contact their clients.[815]

Providers would certainly like to be able to give advice to their clients, as Paul Bucksey, head of DC at BlackRock, points out: 'My sense is that there is a reluctance among members of pension schemes to pay for advice. [Providers can, and should, step in to fill the gap.] From an advisory point of view, anything we can do as a provider which is more than listing out a range of funds is good. From our perspective, we certainly welcome a bit more clarity around firstly acknowledging that people need some help, most people want to be told what to do…. Providers, like BlackRock, can do more without getting into personal recommendations. This concept of simplified advice, rules of thumb, being able to tell people they should be aiming to contribute about 15%, for example, is not 'advice'. It is giving people some guidance, some rules of the road. If you go into drawdown, if you take an income of no more than 5%, that would be quite sustainable, but at the moment, people get there and ask: "how much should I take?"; "how much is too much?"'. Mr Bucksey's colleague Tony Stenning, head of UK retail at BlackRock, added: 'We should able to say this stuff without thinking it is advice. Or that it would not be construed as advice if it came from TPAS or MAS, but it would be if it came from BlackRock'.[816] Clearly a number of providers feel that they should be able to offer this sort of financial help to their clients without having to bother about advisers.

We believe that there should be a much more focused narrative based on an appropriate segmentation of the market and providing good integrated solutions for each market segment. There needs to be a much greater spirit of co-operation amongst the four main players involved in pension decumulation – at least in the early stages of the development of the new market. Even so, there will be winners and losers. The winners are likely to be providers benefiting from the inertia of their clients and investment managers offering decumulation products with flexibility and guarantees. The losers will be insurance companies selling annuities and advisers trying to get people with less than £100,000 to pay very much for advice. Advisers offering simplified or robo-advice might have better luck in this market segment, but still might find it hard to get customers to pay much more than £100 per year for it. Advisers offering full regulated advice might find their client pool

[815] Reported in Retirement Planner (2015) Advisers urge FCA to regulate provider/client contact, 14 September.

[816] Reported in Jenna Towler (2015) Walk the line: Where does guidance stop and advice start?, Professional Adviser, 1 October.

restricted to those will assets above £100,000 – although it is also clear that many will be comfortable with only this type of cleint.

3.20.1.5 The Financial Conduct Authority

The current regulatory process is not working well either for customers or their advisers. The main reason for this is that the key regulator, the FCA, appears to be confused about whether the 'human' model of the customer is more appropriate than the 'econ' model. On the one hand, it talks of vulnerable consumers. On the other hand, its chief executive speaking at the NAPF investment conference in Edinburgh on 11 March 2015 says the consumers must take responsibility. Something that is really rather straightforward – the delivery of a pension, something we have been doing for hundreds of years – has become fiendishly complicated, not least because of endless regulatory interventions.

Taking first the customer. In terms of products, there are no safe harbour products that the FCA is currently prepared to recognise. In terms of advice, the regulator distinguishes between half a dozen definitions of advice, while the average customer is unable to differentiate between advice and guidance. There are just too many different types of advice.

Turning to advisers, they have become fearful of offering common sense solutions to clients. We are currently in the extraordinary position of having, on the one hand, people being given a whole new set of flexibilities, yet, on the other hand, it is apparently not possible for the industry to design a sensible default that helps manage the risks in Table 1.2 without coming up against the barrier of regulated advice. As Tony Stenning from BlackRock has said: 'It is a minefield. People do need help and we have our hands tied behind our back. Clearly, one of the unintended consequences of RDR was the advice gap. Individuals now have much more flexibility and choice which is great, but that also increases their anxiety. When you ask people, they really want guidance and to be helped. [But] there is a very thin line between advising them and guiding them'.[817]

There needs to be greater clarity on suitability and appropriateness. As Rachel Vahey has said: 'Obviously, [the FCA] will need to develop new guidance on suitability. At the moment, it is clear drawdown is only suitable for those with large funds and who understand the risks and take them on comfortably'.

Does a decision tree constitute advice? If so, is it regulated? If so, this needs to change. As mentioned previously, there is an important difference between 'advisory' and 'advice' in English law. The decision tree is advisory but not advice. However, there is no distinction

[817] Reported in Jenna Towler (2015) Walk the line: Where does guidance stop and advice start?, Professional Adviser, 1 October.

between ‘advisory’ and ‘advice’ in the current legislative framework. This too needs to change.

One way out of the impasse is for the FCA to recognise safe harbour retirement income plans. These involve the use of key safe harbour products and a decision tree. Any adviser or provider who uses the decision tree and assesses the suitability of the safe harbour products for their customers would not subsequently face problems with the FOS. It is important that the FCA approves both the decision tree and the default options at the end of the decision tree, even if these can only be classified as options that are ‘good enough’, rather than the ‘best’ possible options for member’s circumstances.

In Chapter 2, we provided a list of potential safe harbour products:

- In the annuities class:
    - Lifetime annuities (with/without capital protection) – fixed and inflation-linked
    - Investment-linked annuities (with a minimum income underpin and with/without capital protection)
    - Enhanced annuities
- In the drawdown class:
    - Capped drawdown (with a minimum income underpin)
- In the hybrid class:
    - Variable annuities (with a minimum income underpin)
    - Guaranteed drawdown (with a minimum income underpin).

It is important that there is full transparency over the product design and over charges for each of the above products – and that the charges are demonstrably not excessive.

Retirement income solutions which do not offer longevity insurance that (together with the state and any defined benefit pensions) covers at least essential expenditure should not be given a safe harbour status. Products not granted safe harbour status should not be sold without regulated advice. Anyone selling them should be open to future claims for mis-selling.

As Derek Bradley, CEO of Panacea Adviser, also argues, simplified advice cannot work without simplified regulation: ‘Simplicity of financial advice delivery, it seems, is difficult to define. There is considerable uncertainty and fear of regulatory retro-retribution for getting it wrong, a lesson well and truly learned by advisers. Now here's a simple thought. What if the regulator were to define and approve what products could be safely placed in this simplified space, along with a simple set of tick-box questions and processes to confirm client understanding of product, purpose and suitability in any application. We know that would require responsibility from the FCA,….[but] even if FCA clarity was possible, the FOS does not do ‘clarity' to the extent it can be relied upon. It is the simplified advice killer. To

prove this a number of major firms have concluded that simplified advice is not "currently commercially viable"'.[818]

Finally, the FCA needs to sort out the question of customer safeguards. As Huw Evans told a Work and Pensions Committee hearing in September 2015: 'We must resolve the tension that came to light when the reforms were implemented around safeguards that have been put in place. Some customers deeply resent those safeguards and want to find a way round them. A decisions has to taken by policymakers to find a way forward. A resolution to that has to be sorted. As a part of that, we absolutely need to clarify what the advice requirements are. Some providers were still unclear when they had to ensure customers take regulated financial advice'.[819]

3.20.1.6 Pension fraudsters and investment scammers

When it introduced pension freedoms, the Government completely underestimated the extent to which pension fraudsters and investment scammers would also seek to enjoy these pension freedoms. A great deal of belated effort has gone in to trying to rectify this problem, but with limited success to date. It is a potentially bigger risk to pension scheme investors than, say, investment risk.

3.20.1.7 The self-employed and non-eligible job holders

There are around 4.5m who are self employed and around 6.2m non-eligible job holders. This means that around 10.7m people working in the UK will not be auto-enrolled onto any pension scheme. Very little is known about their pension arrangements, although it is almost certainly the case that their pension arrangements need improving.

The RSA did not believe that auto-enrolment of these groups into NEST or another of the larger master trust schemes was appropriate due to the administrative challenges, and also because of the clear preference amongst many of them to have flexible access to their savings. Instead, the RSA proposed a Government-backed ISA to encourage these groups to save more, together with a nudge in the form of a 'Save When Paid' option to pay into the ISA when an invoice is received or a tax form has to be filled.

3.20.2 Recommendations

Our analysis in this Chapter leads us to make the following 12 recommendations.

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[818] Derek Bradley (2014) Simplified advice can't work without simplified regulation, Professional Adviser, 30 July.

[819] Reported in Jenna Towler (2015) Comparing pensions to bank accounts 'irresponsible', ABI chief warns, Professional Adviser, 8 September.

Recommendation 3.1: Safe harbour retirement income plans

We recommend that a quasi-default retirement income plan is designed and used by providers and advisers. This will involve a simple decision tree and a limited set of default pathways. The plan would be self-started following a guidance or advice surgery, and the plan member has the right to opt out until the point at which the longevity insurance kicks in.

The guidance or advice surgery needs to collect information on:

- **pension pot size**
- **other sources of lifelong income (especially any state and defined benefit pensions)**
- **other sources of wealth (such as housing equity)**
- **liabilities (e.g., mortgage, credit card debts)**
- **health status**
- **family circumstances, including bequest intentions**
- **given other income sources, health status and family circumstances, decide the levels of expenditure that are considered essential, adequate and desired**
- **tax position**
- **risk attitude**
- **risk capacity.**

The plan could be operated by a provider or an adviser. Two forms of the plan would be acceptable:

- **drawdown plus a deferred annuity, or**
- **layering – first secure essential life-long expenditure ('heating and eating'), then allow for luxuries.**

The plan must allow for:

- **access – the flexibility to withdraw funds on an ad hoc basis**
- **inflation protection (either directly or via investment performance), and**
- **longevity insurance.**

The customer will choose from a set of safe harbour products approved by the regulator. The purpose of the decision tree is to identify the products that are most suitable for meeting the customer's needs. To be feasible, any default pathway using a decision tree would need to be aligned with the guidance guarantee process in a way that it is not classified as regulated advice or a personal recommendation. This is because a decision tree is advisory – not advice – and so would be granted safe harbour status. Any adviser or provider making use of such a retirement income plan would be protected against future mis-selling claims.

A whole range of problems that emerged during the early months of 'freedom and choice' can be overcome by using such a default, e.g., lack of financial engagement and capability by members, ineffective communications, and scammers.

Recommendation 3.2: Simplifying the definitions of information, guidance and advice

We recommend that the Financial Conduct Authority:

- **reviews its multiple definitions of information, guidance and advice with a view to replacing them with just two categories: 'personal recommendation' and 'financial help', with the latter replacing everything that is not full regulated fee-based advice where the adviser takes responsibility for the personal recommendation**
- **recognises that a quasi-default decumulation strategy is 'advisory' rather than 'advice' and that advisers and providers should be able to explain the quasi-default decumulation strategy and assess suitability without this being classified as regulated advice.**

The simplest solution involves only three routes:

- execution-only – the customer makes all the decisions ('I want to do it myself')
- 'financial help' – the customer is helped or steered towards tailored options using a decision tree; but this is currently classified as advice ('Help me do it')
- personal recommendation or full regulated advice ('Do it for me'[820])

It is also important to recognise that guidance and advice cannot be a single event, but has to be a process. There needs to be periodic financial health checks or just simple reminders:

- 10 years prior to the nominated retirement date to confirm whether a de-risking glidepath is required and, if so, when it needs to begin
- 1 year prior to the nominated retirement date to re-confirm commencement date
- at age 74 to review death benefits
- at ages 80 and 85 to confirm implementation of longevity insurance (i.e., the switch to annuitisation if drawdown was used at the beginning of retirement).

Recommendation 3.3: Appropriate segmentation of the advice market

We recommend that:

- **an attempt is made to segment the advice market in a way that would be helpful to consumers. There are a number of ways of doing this, e.g.:**

[820] Terms used by the Universities Superannuation Scheme.

    - **by level of assets – Is there a level of a ssets below which 'financial help' alone will be adequate (for most people) and above which full regulated advice is recommended?**
    - **by spending type – Are there spending types for whom 'financial help' alone will be adequate and are there spending types for whom full regulated advice is recommended?**
    - **by behavioural type, e.g., 'econ' or 'human'. Econs only need information in order to make informed decisions. Humans face behavioural barriers and biases which need to be identified early on (e.g., low levels of financial literacy, overconfidence, and self-control and hyperbolic discounting problems). Are there simple nudges that would improve effective decision making by humans, such as:**
        - **help**
        - **What do 'people like me' do?**
        - **advice (simple and targeted)?**
- **an attempt is made to agree on:**
    - **the appropriate level of help or advice for each market segment**
    - **the appropriate role of technology (e.g., robo-advice) for each market segment.**

The service in economy class is broadly similar across different commercial airlines and the same is true for business class and first class. Millions of people are content with this simple classification. Why can't the financial advice market be segmented in a similar way?

Recommendation 3.4: Turning financial advisers into a recognised profession

We recommend that financial advisers undertake a review of their industry with a view to transforming themselves into a recognised profession. The following issues would be covered in the review:

- **formalising and improving the professional (including training) standards of advisers**
- **introducing a fiduciary standard for financial advisers who provide full regulated advice**
- **the appropriate charging model for the service offered (fixed fee or percentage of assets), with the charges demonstrably delivering value for money to the customer and with full transparency over charges.**

Financial advisers are not a recognised profession, yet they wish to provide advice on billions of pounds of UK retirement savings. Further, research by the FCA shows that customers are put off seeking financial advice because they are unable to trust the advice

they receive or judge its quality. The obvious solution is to transform themselves into a recognised profession. They should continue to improve their professional standards, accepting that the advice market might be smaller, although more profitable as a result. In particular, the professional training of advisers should be improved, with a much greater emphasis on understanding the risks involved in delivering retirement income solutions and how those risks can be measured, monitored and managed.[821]

Advisers should also consider introducing a fiduciary standard for those who provide full regulated advice, as in starting in the US. This requires advisers to act solely in their clients' best interests.[822]

The current disparate views expressed by the industry on both the nature of the service offered (ranging from 'everyone needs bespoke advice' to 'advice is only necessary for the very well off') and the charging model (fixed hourly rate vs percent-of-assets) is not helpful to consumers or in the long-term interests of advisers. We need a common national narrative on both these issues, bearing in mind that surveys show that most consumers are not currently prepared to pay very much for advice, because they do not place much value on it.

In terms of adviser fees, there needs to be much greater justification of ad valorem fees where the fee is unrelated to the amount of work done. Such fees are now very uncommon in most other types of professional services organisations. Charges also need to be transparent and easy to understand. It is not acceptable in this day and age that a potential client needs to have a long face-to-face meeting with an adviser before they are told what the charge will be, and then feel under some moral pressure to accept this charge.

Recommendation 3.5: Review of the unresolved implementation challenges of the pension reforms

We recommend that the Financial Conduct Authority:

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[821] The actuarial profession was required to do this following the Equitable Life debacle and the resulting Morris Review of the Actuarial Profession in 2005. Further, there are only around 5,000 actuaries in the UK, less than 25% of the number of financial advisers;
http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/morris_final.pdf

[822] Following the Morris Review, the actuarial profession adopted five core ethical principles which should underpin the conduct of all members when related to their professional lives (see *The Actuary Magazine*, August 2009):

- Integrity
- Competence and care
- Impartiality
- Compliance
- Openness.

- **reviews the circumstances where mandatory advice is necessary**
- **clarifies the legal consequences for customers, advisers and providers when 'insistent clients' act against advice.**

We support proposals, made by the ABI and others, to deal with the remaining implementation challenges of the pension reforms.

Recommendation 3.6: Review of the powers of independent governance committees

We recommend that the Government reviews the powers of independent governance committees (IGCs) in contract-based schemes with a view to making them equivalent to the powers of trustees in trust-based schemes.

This essentially means giving IGCs a fiduciary duty to act in the best interests of scheme members. For example, IGCs should be given the power to fire an underperforming fund manager without requiring the members' express consent.

Recommendation 3.7: Dealing with pension fraud and investment scams

We recommend the following measures are taken to deal with the problems of pension fraud and investment scams:

- **all financial product sales (covering both regulated and unregulated products) should be brought under a common regulatory umbrella**
- **telemarketing (cold-calling) should be made illegal**
- **penalties for pension fraud and investment scams should be greatly increased.**

There can be no hiding place for pension fraudsters and investment scammers.

Recommendation 3.8: Customer responsibility

We recommend that the Government initiates a national debate amongst relevant stakeholders on the appropriate degree of customer responsibility and what industry and regulators need to do before consumers can reasonably become liable for their decisions in retirement.

Associated with this should be attempts to improve customer engagement via better customer communications.

Recommendation 3.9: Introduction of an 'early warning system' to help retirees

We recommend that the Government introduces the following measures to support consumers as soon as possible:

- **a 'pensions dashboard'**
- **'personal pension alerts' to help policymakers intervene where appropriate with the sub-groups it has identified as at particularly high risk.**

We support the various proposals that have been made to develop a 'pensions dashboard' that would enable consumers to view all their lifetime pension savings (including their state pension) in one place. In the past, this idea has been dismissed as too much of a technological challenge, given the multiple data bases that this information is held on, but we understand that the technology is now available to do this.[823]

We also support the proposal for introducing 'personal pension alerts', developed by the Social Market Foundation, which would enable potential interventions, such as 'targeted support and advice; initiatives to make retirees think twice before taking one-off decisions such as withdrawing all their pension savings; and, a "mid-retirement financial health check" to encourage older people to reconsider their financial position for their later years'.

Recommendation 3.10: Monitoring outcomes

We recommend that the Government puts in place a monitoring mechanism to assess the success of the 'freedom and choice' pension reforms. This should be benchmarked against the criteria for a good pension scheme listed in Recommendation 1.1 and Table 1.1.

Data should be collected from sources such as Pension Wise, the ABI, the FCA and HMRC. Focus groups should be established to discuss their experience. We support the Work and Pensions Select Committee's request for better information on: 'customer characteristics of those using freedoms from pot size to sources of retirement income; take-up of each channel of guidance; reasons for not taking up guidance and advice; subsequent decisions made and reasons for those decisions'.

[823] In January 2016, it was reported that the FCA and TPR were working on designing a 'pensions dashboard'. Michael Roe, development manager at Origo, said that the technical architecture was available to support this initiative (reported in Sara Benwell (2016) FCA and TPR working together on pensions dashboard, Pensions Insight, 22 January).

Recommendation 3.11: The annuities market

We recommend:

- **The sale of immediate annuities should be via an auction**
- **The Government should facilitate and encourage the development of a market in deferred annuities.**

The first point deals with the problem identified by the FCA in 2014, namely 'consumers' tendency to buy from their existing pension provider [which] weakens competitive discipline. Not only do incumbent providers feel less pressure to offer competitive vesting rates, but challengers find it difficult to attract a critical mass of consumers. As a result, there has been limited new entry into the decumulation market in recent years'. It is also likely that these annuities will be medically underwritten, i.e., applicants have to fill in a medical questionnaire which asks health and lifestyle questions.

The second point attempts to address the problem that an open market in deferred annuities does not exist in the UK, yet is essential to provide the longevity insurance needed for the decumulation default to work (see **Recommendation 3.1**). The various reasons why a deferred annuity market does not exist (e.g., onerous regulatory capital requirements under Solvency II) need to be addressed.

Recommendation 3.12: The self-employed and non-eligible job holders for auto-enrolment

We recommend that the Government:

- **considers revising the qualification for auto-enrolment from a 'per job' basis to an 'combined jobs' basis**
- **begins to collect more reliable information on the pension arrangements of the self-employed and non-eligible job holders for auto-enrolment**
- **investigates the possibility of establishing a Government-backed arrangement (like an ISA) to help these groups save for their retirement**
- **considers how to help these groups draw a retirement income in a cost-effective manner.**

The combined size of these two groups is significant: 4.5m self-employed people (17% of the employed population) and 6.2m non-eligible job holders (24% of the employed population), implying that around 11m people working in the UK will not be auto-enrolled onto any pension scheme.

The qualification for auto-enrolment is assessed on a 'per job' basis, which implies that individuals with a number of low-paid jobs will be excluded from auto-enrolment onto a

pension scheme. The PPI estimates that 'if the income from both first and second jobs was taken into account when assessing eligibility for automatic enrolment, then a further 80,000 people (60,000 women and 20,000 men) would earn enough to meet the qualifying criteria'. We fully recognise the practical difficulties of implementing this recommendation. Further, the recommendation might not actually be desirable if it results in workers falling into a benefit trap. Indeed, it might be the case that the only feasible way of dealing with this group of workers is through the state pension system.

We could find no accurate data on the combined number of the self-employed or non-eligible job holders with individual DC policies. Similarly, when it comes to decumulation, it is likely that these groups will fail to benefit from institutional value for money solutions and instead will have to rely on the high-cost retail market, unless NEST establishes a decumulation scheme which they could join.

We support the call of the Resolution Foundation 'for greater intervention to ensure the self-employed [and and non-eligible job holders for auto-enrolment] are adequately prepared for their later years'. These groups should be encouraged to save more for their retirement, but in a way that allows them flexible access to their savings and has low charges. We therefore support the recommendation of the RSA for the introduction of a Government-backed ISA (e.g., provided by National Savings & Investments) to facilitate this. In addition, the groups could be encouraged to join NEST. We also support the RSA's 'Save When Paid' proposal which automatically diverts a percentage of every pay cheque to a savings account.

When it comes to drawing an income in retirement, both groups should be allowed access to a national decumulation scheme like NEST (once its decumulation blueprint has been implemented).

Appendix: Information services for customers and advisers

Services for customers

In September 2015, the Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA) launched a Financial Services Register of firms and individual and collective investment schemes. The register will include the names of unauthorised firms as well as firms knowingly running a scam.[824]

The Money Advice Service's (MAS) retirement adviser directory was launched in April 2015. It contains a list of 5,000 financial advisers – both independent and restricted – specialising in retirement planning for those wanting to access regulated paid-for advice following the introduction of the new pensions regime. The directory asks people a number of filtering

[824] Reported in Laura Miller (2015) FCA to include scam firms in relaunch of official register, Professional Adviser, 4 September.

questions, such as why they want advice and what size of pot they have, to ensure they are guided to the most suitable advisers. The MAS is also working on a charges display to its directory so people can compare costs before they seek advice. A total of 6,000 people accessed the directory in its first month of operation, although MAS is not currently able to say how many people went on to receive advice.[825]

In April 2015, the Personal Finance Society launched a consumer financial education website called Yourmoney to help consumers make better informed decisions about their personal finances.[826] It contains a fully-searchable directory of more than 22,000 accredited financial advisers, all of whom are members of the PFS and must abide by the society's code of professional ethics. The directory contains information on the costs of professional advice. It also contains links to financial planning tools from the Money Advice Service, Which? and Moneyfacts. It can be accessed at: www.thepfs.org/yourmoney.[827]

In March 2015, the Association of British Insurers launched Your Retirement, Your Choice, a campaign to help customers understand their choices in retirement in the new pensions environment. Its aim is to prevent people from rushing into decisions, while pointing them to the Government's guidance guarantee. It will also make people aware of pension scams and how to avoid becoming a victim.[828]

In October 2015, the Money Advice Service launched a 10-year strategy to enhance financial capability in the UK.[829] The aim is to improve people's ability to manage money well day to day, prepare for and manage life events, and deal with financial difficulties. It will also educate people about the difference between financial guidance and advice, help them understand when they need advice and how to get it. The work will cover consumers of all ages – from education in schools to at-retirement. Progress will be monitored through a 'financial capability survey' and formal reviews will be published in 2020 and 2025, alongside updates on the strategy's website. Advisers will be able to contribute to the strategy by joining a number of steering groups, which will each have their set of specific targets and success measurements.

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[825] Reported in Carmen Reichman (2015) Thousands flock to MAS adviser directory in first month, Professional Adviser, 6 May.

[826] The Personal Finance Society is one of a number of associations in the UK to which financial advisers are affiliated. Two others are the Institute of Financial Planning (IFP) and the Chartered Institute of Securities and Investment (CISI). In August 2015, it was announced that the IFP would merge with the CISI in November 2015.

[827] Reported in Laura Miller (2015) PFS launches consumer education website with 22,000 strong adviser database, Professional Adviser, 24 April.

[828] Reported in Carmen Reichman (2015) ABI launches pension freedom awareness campaign, Professional Adviser, 17 March.

[829] Reported in Carmen Reichman (2015) Consumer education strategy looking at guidance and advice launched, Professional Adviser, 28 October.

The strategy will be governed by MAS's Financial Capability Board, whose members at the time of launch were:

- Andy Briscoe, chair, the Money Advice Service (chair of the Board)
- Jasper Berens, head of UK Funds, JP Morgan
- Sherard Cowper-Coles, senior advisor, HSBC and chair of the Financial Inclusion Commission
- Benny Higgins, chief executive, Tesco Bank
- Elaine Kempson, emeritus professor, University of Bristol
- Lily Lapenna, founder & co-chief executive, MyBnk
- Phil Loney, group chief executive, Royal London
- Eleanor Marks, deputy director communities division, Welsh Government
- Louise Macdonald, chief executive, Young Scot
- Gwyneth Nurse, director of financial services, HM Treasury
- Steve Pateman, executive director, head of UK banking, Santander
- Caroline Rookes, chief executive, the Money Advice Service
- Roger Sanders, managing director, Lighthouse Group
- Hector Sants, chair Archbishop of Canterbury's Task Group and StepChange Debt Charity
- Otto Thoresen, chair, National Employment Savings Trust
- Sian Williams, head of national services, Toynbee Hall
- Chris Woolard, director of strategy and competition, Financial Conduct Authority
- Tom Wright, group chief executive, Age UK

Services for financial advisers

Defaqto has launched a pension ratings service for financial advisers in May 2015 which measures the quality of the service from pension providers. Pension Service Ratings uses advisers' satisfaction scores on 41 aspects of service to set the provider ratings. The data was collected using a survey of 500 financial advisers who advise on personal pension products. Defaqto then allocates providers to the following classes: gold, silver or bronze, or not rated.[830]

F&TRC launched a similar service in July 2015.[831] Pension providers are awarded a gold, silver or bronze rating depending on their proposition in eight sub-categories:

- Product offering and administration
- Investment and fund options
- Record keeping and governance

[830] Reported in Professional Adviser (2015) Defaqto launches pension ratings service, 1 May.
[831] Reported in Retirement Planner (2015) F&TRC launches ratings service for workplace pensions, 14 July.

- Scheme setup
- Joiners and leavers process
- Education
- At-retirement options
- Auto-enrolment process.