Resolution Foundation

PENSIONS BILL: COMMITTEE STAGE IN THE HOUSE OF LORDS
GENERIC FINANCIAL ADVICE AND PERSONAL ACCOUNTS

The Resolution Foundation is an independent research and policy organisation, established in October 2005. Our first project has explored how people on low to moderate incomes access financial services, focusing in particular on their financial advice needs. This work has included a series of research reports and a number of seminars that have highlighted the need for increased access to financial advice to support pension reform.

The Foundation held a seminar on 23 May 2007 to discuss generic financial advice and personal accounts. The seminar, which was attended by a wide range of key stakeholders, discussed a framework of 'advice protocols' on which the advice that should accompany personal accounts could be based. This briefing draws on the conclusions from that seminar, as well as the Foundation's wider work on this issue.

Summary

The need for an effective advice regime to accompany personal accounts was raised by a number of peers during the second reading debate on the Bill. In winding up the debate, the Minister stated:

> 'The Government believe that everyone has the right to get advice they can understand and trust on the options available to them .... I understand that this is an issue we will wish to discuss in considerable depth in Committee.'[1]

Two amendments have so far been tabled in relation to this issue:

- Amendment 111, tabled by Lord Oakeshott of Seagrove Bay and Lord Addington, would require the Personal Accounts Delivery Authority to publish a report before the end of 2007 setting out how generic financial advice will be delivered to people liable to be enrolled into personal accounts.

- Amendment 115, tabled by Baroness Hollis of Heigham and Lord Oakeshott of Seagrove Bay, would require the Delivery Authority to publish a report on the advice needs of women and men within a year of being established.

The Foundation hopes that the debate on these two amendments will provide an opportunity for the Minister to set out the Government's thinking on this issue. In particular, we hope that he can provide assurances that developing an effective advice regime to support personal accounts will be a priority for the Personal Accounts Delivery Authority, once established, and that definitive proposals will be brought forward in time for the next phase of the pension reform process and the report of the Thoresen Review.[2]

[1] Official Report; 14 May 2007, col. 89
[2] The Thoresen Review, which is being led by the Chief Executive of AEGON UK, Otto Thoresen, has been established to develop a national approach to generic financial advice. As part of its terms of reference, it has been asked to take particular account of the development of personal accounts.

Background

The second reading debate reflected a growing consensus about the importance of developing an effective advice regime to support personal accounts. The key to this is to increase the supply of generic financial advice - impartial information, advice and guidance, given in light of people's personal circumstances, that enables them to understand their financial needs and take appropriate action as a result. This goes further than providing information but stops short of making recommendations about specific products or providers, which would be subject to the regulatory regime that applies to advice linked to product sales.

Three separate select committee reports have endorsed the need for generic financial advice to support personal accounts.[3] In his recent speech to the National Association of Pension Funds, the Secretary of State for Work and Pensions, Rt Hon John Hutton MP, identified the 'quality of information and guidance' as one of the three key challenges in taking forward the next stage of pension reform and embedding a stronger savings culture. He went on to say:

> '……. we need to consider carefully the relationship between any generic advice service and the Personal Accounts Board ……. and how any generic advice service could get the balance right between communicating the uncertainties inherent in pension saving and the simplicity that most people want in practice.'[4]

Access to high quality advice is particularly important for the 'target group' for personal accounts – those on low to moderate incomes. The Resolution Foundation's research has showed that only 53 per cent of people in this income group are members of an available employer's pension scheme, compared to 81 per cent of higher earners. The research also found that only 17 per cent of this group are members of a personal pension scheme, in comparison to 27 per cent of those on higher incomes.[5] This group includes a disproportionate number of people from key groups for whom pension decisions are particularly complex, including women and those working for small employers.

It is clear that providing information alone will not be sufficient to meet people's needs. They require advice that is personalised enough to enable them to understand their pension choices in light of their individual circumstances. However, this income group currently has very limited access to financial advice. Their needs are not met by the financial services industry, which 'packages' advice with product sales or provides it via independent financial advisers at rates they are unlikely to be able to afford. Their needs are also unlikely to be met by voluntary sector services which tend to focus on the poorest and most vulnerable and on delivering remedial debt advice.

Bridging this 'advice gap' is therefore critical; the goal must be to encourage people to make active, informed decisions by increasing their knowledge of the pensions system, improving their understanding of the choices available to them and encouraging them to take action.

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[3] *The design of the National Pensions Savings Scheme and the role of financial services regulation*; Fifth report of the Treasury Committee, May 2006; *Pension reform* ; Fourth report of the Work and Pensions Committee, July 2006; and *Personal Accounts*; Fifth report of the Work and Pensions Committee, March 2007

[4] Rt Hon John Hutton MP; speech to the National Association of Pensions Funds Annual Conference, 24 May 2007

[5] Figures based on analysis of the British Household Panel Survey and FSA baseline survey of financial capability: see *Closing the advice gap*; Resolution Foundation, May 2006

An advice framework for personal accounts

The introduction of personal accounts will leave people with a number of important decisions to make over their pensions lifecycle including:

- Having been auto-enrolled, they will need to consider whether to continue to participate in or opt out of personal accounts, in the context of their wider financial circumstances
- If they decide to stay in the scheme, they will need to choose between different options, for example in deciding their contribution levels and investment choices
- They may also wish to reassess their options over time; for example if their circumstances change, they reconsider their retirement aspirations or the system itself changes
- When they reach retirement age, people will need to make decisions about how to realise their pensions assets alongside other issues such as their long term care needs[6]

The seminar held recently by the Foundation was a useful exercise in beginning to map out how to provide generic financial advice in relation to personal accounts. While it highlighted a number of challenges that would need to be overcome in designing the advice, it did not reveal any disagreement of principle about either the necessity or the feasibility of providing this advice.

Most of the main challenges in providing generic financial advice in connection with personal accounts will relate to the decision about whether to remain in or opt out, especially where people may be entitled to means-tested benefits in retirement. Research by the Pensions Policy Institute has highlighted that some groups may be at risk of losing out by saving in personal accounts. While young people would not be at risk, those it identifies for whom personal accounts may be unsuitable would include:

- Single people in their 40s and 50s likely to rent in retirement (due to the interaction with Housing Benefit)
- Low earners in their 40s and 50s without savings
- Self-employed people (as they would not be eligible for employer contributions)

Another key challenge will be to strike the right balance between, on the one hand, presenting people with information and explaining their options and, on the other, encouraging them to either remain opted in or to opt out. This goes to the heart of the issues being considered by the Thoresen Review and the boundary between 'generic' and 'regulated' advice.

Advice protocols

The Foundation has commissioned work on a framework of 'advice protocols' to guide the development of the advice that should accompany personal accounts. The protocols are based on providing 'good advice', rather than the degree of prescription that could be

[6] For example, although people can achieve an increase in annuity income of 10 per cent or more by shopping around rather than simply taking the rate offered by their pension provider, only 40 per cent of people currently exercise their option to do this: see *Annuities: Bonus or burden*; ABI, 2005

expected of an independent financial adviser, and on ‘coaching’ people to give them confidence and help them reach a decision.

(1) The advice should be based on a simple ‘ready reckoner’ approach to explain the individual’s current position, the key future variables that would affect their decision and the options available to them.

(2) The advice should also be founded on a ‘bias’ to remain opted in to personal accounts, unless there is a clear reason not to, in order to encourage people to save for their retirement.

(3) Unmanageable debts should be paid off in preference to remaining opted in, but in less severe cases, consumers should be encouraged to stay opted in and to pay off debt at the same time.

(4) Those at high risk of losing out due to a subsequent loss of means-tested benefits in retirement should be advised that remaining opted in is likely to be unsuitable for them, while a cautious approach should be adopted for those with a medium risk of losing out. However, if in doubt, the bias to join should apply.

(5) Advice should be given in the context of an individual’s wider financial circumstances including their potential need for insurance and savings products.

(6) Based on indications from the Government so far, the default fund is likely to be the appropriate choice for the majority of people remaining opted in to personal accounts and they should be advised accordingly.

(7) Advice should provide consumers with clear expectations of the retirement income likely to be delivered by making the minimum contribution, and encourage them to save more if possible.

A number of issues were raised in discussion during the seminar, especially about the practical application of the concept of ‘good advice’ and the ‘bias to join’. However, there was general consensus that the protocols provide a sound basis from which to move forward. In developing the protocols further, we suggest that a number of issues will require additional work, in particular:

- Clarifying the extent to which advice should guide people towards particular outcomes as opposed to simply setting out their options; this should include a definitive assessment of the boundary between generic and regulated advice, an issue which is being considered by the Thoresen Review.

- Following on from this point, developing a concept of ‘good advice’ that can be clearly understood by both consumers and advisers, and which minimises the risk of potential ‘mis-selling’ charges.[7]

- Developing detailed protocols in relation to debt and entitlement to means-tested benefits that strike the right balance between the ‘bias to join’ and providing clear

[7] Some participants at the seminar were concerned that there could be a potential risk of ‘mis-selling’ if people end up losing out from remaining opted in to personal accounts

guidance in circumstances where it may not be in an individual's best interests to remain opted in to personal accounts.

- Ensuring that the advice in these circumstances also strikes the right balance between explaining the variables affecting the decision about whether to remain opted in and ensuring that advice is clearly communicated, can be easily understood and prompts appropriate action.

Conclusion

There is now an emerging consensus that developing effective generic financial advice to accompany personal accounts should be a priority for the next phase of the pension reform process. We hope that the level of concern among peers about this issue during the second reading debate and the amendments tabled in Committee will encourage the Minister to make a definitive statement setting out the Government's thinking on this issue. This should include a clear statement that developing an effective advice regime to support personal accounts will be a priority for the Personal Accounts Delivery Authority, once established.