

PENSIONS BILL: SECOND READING DEBATE

Summary

The Government's reforms to the pensions system provide an opportunity to significantly improve retirement income and security for pensioners. However, they will only be successful if people understand the options available to them and are able to make the right decisions. Developing an effective advice regime is therefore essential to support the reforms and, in particular, to meet the Government's goal of promoting personal responsibility. This means going beyond the provision of information to deliver advice that enables people to understand their pension choices alongside their wider financial decisions and circumstances.

The key to achieving this is to increase access to generic financial advice. This analysis is supported by the Treasury and Work and Pensions Select Committees, both of which have made recommendations on the need for generic financial advice to accompany the reforms. The Pensions Policy Institute has also highlighted its importance in relation to the new system of personal accounts. However, although ministers have made some encouraging comments about the need to provide advice and information, this issue has so far been largely overlooked in the reform process.

The Resolution Foundation has developed proposals to deliver generic financial advice to people on low to moderate incomes, the key target group identified by the Government for its reforms. We have also published research highlighting the significant benefits this could deliver to consumers, as better financial decision-making increases their personal wealth and retirement income, and to the Government, in terms of reduced expenditure on welfare benefits as people are lifted above the threshold for receiving Pension Credit.

The Pensions Bill's parliamentary stages provide an important opportunity to debate the role of generic financial advice in supporting pension reform and how it should be delivered. The Bill's introduction to Parliament also coincides with the forthcoming publication of the Government's 10 year strategy on financial capability, presenting a key opportunity to link these two agendas and deliver a step change in the long term financial health of the nation.

Background

Pension decisions are among the most complex and vital financial choices people make during their lifetime. However, as the Pensions Commission noted, understanding of the pensions system is low and many people are currently failing to plan adequately for their retirement. The Financial Services Authority's survey of financial capability showed that, while 81 per cent of people feel that they will not have enough to live on in retirement, only 37 per cent of them have made any additional provision for later life.¹ The Government estimates that approximately 7 million people are currently under-saving for their retirement.²

This is particularly true for people on low to moderate incomes, who often face difficult choices due to their limited resources and the interaction of their income with means-tested benefits. The Foundation's research 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

¹ *Financial capability in the UK: Establishing a baseline*; FSA, March 2006

² *Security in retirement: Towards a new pensions system*; DWP, December 2006

those on higher incomes.³

These problems are exacerbated by the lack of financial advice available to this income group. Their advice 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 critical to the success of pension reform and to promoting financial capability more broadly. 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.

The boundary between 'advice' and 'information' is often contested. However, 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. Evidence from elsewhere, such as the work of the Retirement Commission in New Zealand, underlines the fact that pension issues must be considered within the context of an individual's wider financial decision-making.

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.

Personal accounts

The aim of the new system of personal accounts set out in the White Paper *Security in retirement: towards a new pensions system* is to provide a simple, low cost way of saving for people on low to moderate incomes. The scheme promises to address under-saving for retirement by using 'auto-enrolment' to overcome the inertia associated with pension saving. The Pensions Bill includes provisions to establish a Personal Accounts Delivery Authority to oversee the implementation of the scheme.

One of the principles on which personal accounts will be based is the removal of the requirement to provide the 'regulated' advice that must accompany the sale of personal pension products. This will drive down charges under the scheme, increasing the value of saving for members. The Foundation supports this approach. However, unless they have access to an alternative source of financial advice, this will exacerbate the advice gap currently faced by people on low to moderate incomes.

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

- In deciding whether to participate in or opt out of personal accounts, they will need to consider their wider financial circumstances; those with very high levels of debt, for example, may be better off opting out, at least in the short term.
- When they first come into contact with the scheme, people will need to choose

³ See *Closing the advice gap*; Resolution Foundation, May 2006 – figures based on analysis of the British Household Panel Survey and FSA baseline survey of financial capability

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. For example, research has shown that 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 (although only 40 per cent of people currently exercise their option to do this).⁴

A recent report by the Pensions Policy Institute (PPI) underlined this, finding that, for some people, the decision whether to stay in or opt out of the system will be very complex. The report suggests that people will need to consider a number of factors alongside their income, including their contribution records, eligibility for benefits and tax regimes in later life. It also showed that those on lower incomes, or with broken work records, would be less likely to benefit from participating in personal accounts and would have particularly difficult decisions to make. The PPI therefore recommended that generic financial advice should be provided to enable people to assess the suitability of personal accounts in light of their individual circumstances.⁵

These choices are yet more complex for key groups who are over-represented among people on low to moderate incomes such as women and those working for small employers. In addition to personal accounts, people will need advice on other issues such as their Basic State Pension and State Second Pension entitlements, how their existing pensions will be affected by the move to the new system and the implications of changes to the State Pension Age.

Financial capability

As set out above, the FSA's research indicates that financial capability in the UK is poor, particularly in terms of planning ahead and choosing financial products. This is reflected in low levels of savings, high levels of debt and low take up of protection products. As many commentators have argued, a number of indicators suggest that debt, in particular, is beginning to take a serious toll, with mortgage repossessions, the number of insolvencies and the amount of bad debt being written off by the banks having increased recently.

In addition to supporting pension reform, increasing the supply of generic financial advice has an important role to play in promoting wider financial capability. By providing impartial advice to people on low to moderate incomes, it would play a key part in engaging them in their financial decisions, encouraging them to plan ahead and, as our research has shown, reduce financial stress by enabling them to take preventative action, before they fall into financial crisis.

In March 2006, the FSA published a strategy to improve financial capability. Backed by an annual budget of £10 million, the strategy primarily focuses on initiatives to promote financial education and literacy.⁶ Although increasing the supply of generic financial advice is identified as a key priority, progress in taking this forward has been limited.

The initiatives being taken forward under the FSA's strategy are very important. However, they will not on their own be enough to deliver the step change needed. In

⁴ *Annuities: Bonus or burden*; ABI, 2005

⁵ *Are personal accounts suitable for all?* Pensions Policy Institute, December 2006

⁶ *Financial capability in the UK: Delivering change*; FSA, March 2006

July 2006, the Government announced its intention to publish a 10 year strategy on financial capability. The Economic Secretary to the Treasury, Ed Balls MP, has indicated that increasing access to generic financial advice will be a key theme:

'I believe there is a growing consensus that there is a gap here and that we should be aiming for a more comprehensive and preventative approach to advice The 10 year strategy must move this debate forward and identify clear options that would allow all players to make the right contributions to filling the advice gap.'⁷

The timing of the strategy, which is due to be published shortly, alongside the parliamentary debate on the Pensions Bill and consultation on the personal accounts White Paper, presents an opportunity to link the pensions and financial capability agendas.

Delivering generic financial advice

The Resolution Foundation recently consulted on proposals to establish a national resource to deliver generic financial advice, targeted at people on low to moderate incomes. The advice would be provided by a combination of the telephone, internet and face-to-face advisers. We believe a new national organisation should be established to oversee the advice resource, working closely with existing providers such as citizens advice bureaux, and that funding should be provided by a public-private partnership between the Government and the financial services industry.⁸

These proposals were strongly supported by a wide range of representative bodies, consumer and voluntary organisations, financial services companies and others with an interest in the field. The need to increase the supply of generic financial advice was also strongly endorsed by the Treasury Select Committee in its recent report into financial inclusion:

'The desirability of developing generic financial advice services is not in doubt We recommend that the Treasury assumes lead responsibility for taking forward discussions on the provision of generic financial advice and brokering an agreement between the FSA, the financial services industry and other interested parties on the way forward'⁹

We have also published research, based on economic modelling undertaken by Deloitte and Touche LLP, to evaluate the impact of providing generic financial advice.¹⁰ This identified significant potential benefits including:

- An increase in retirement income of up to £1,500 a year among people on low to moderate incomes, as improved financial decision-making during their lifetime increases their personal wealth and pension savings.
- Annual savings in expenditure on Pension Credit of up to £100 million within 10 years, rising to £400 million by 2055 and £800 million by 2084, as increased personal wealth lifts people clear of the threshold for Pension Credit.
- A reduction of up to two-thirds in the number of people in this income group

⁷ Quoted from a speech by Ed Balls MP to the joint Treasury/FSA financial capability conference on 18 October 2006

⁸ See *Closing the advice gap: Analysis of consultation responses*; Resolution Foundation, December 2006

⁹ *Financial inclusion: Credit, savings, advice and insurance*; Treasury Committee, Twelfth report of Session 2005/06, HC 848-I

¹⁰ See *A national dividend: The economic impact of financial advice*; Resolution Foundation, December 2006

experiencing financial stress as debt and other financial problems are reduced.

The Foundation believes that proposals to develop a national resource to provide generic financial advice should now be taken forward as a priority. This should be closely co-ordinated with the Government's plans for providing advice and information on pensions including individual pension forecasts and the more specialist advice provided by The Pensions Advisory Service (TPAS).

Conclusion

The need for generic financial advice to support pension reform has been strongly endorsed by both the Treasury and Work and Pensions Select Committees. In its report on the design of the proposed National Pensions Savings Scheme, published in May 2006, the Treasury Committee concluded:

'We recommend that the Government give consideration at an early stage in implementation of an NPSS or any comparable measure to the design and availability of generic advice to those considering participation in the scheme as well as to scheme members.'¹¹

In its wide-ranging report on pension reform published in July 2006, the Work and Pensions Committee stated:

'We conclude that a strong case has been made for the provision of free generic advice to those on below median incomes and recommend that DWP, DTI and the Treasury continue to work with organisations such as Citizens Advice and the Resolution Foundation to develop a model to meet the needs of this group and make the necessary resources available.'¹²

The Government has acknowledged that high quality information will be critical to the success of its reforms and ministers have indicated that generic financial advice is part of their thinking. In a recent speech, the Pensions Minister, James Purnell MP, said:

'It will be up to the individual to decide whether they remain in a personal account. The test for us in this will be whether we can give simple generic advice to people about whether they should do so. And we think that will be possible.'¹³

The Secretary of State, Rt Hon John Hutton MP, has also called on the financial services industry to help the Personal Accounts Delivery Authority in designing generic advice to support personal accounts.¹⁴ However, the Government has not, as yet, been any more specific. The White Paper simply states that it will work closely with the Delivery Authority on this and will develop an evidence-based information strategy over the next year, in consultation with stakeholders.

The parliamentary stages of the Pension Bill provide an opportunity to place the need for generic financial advice at the forefront of the pensions debate and to link the pension reform and financial capability agendas. The goal must be to ensure that people on low to moderate incomes are able make the right choices in securing their retirement incomes and wider financial well-being, and to deliver nothing less than a step-change in the financial health of the nation.

¹¹ *The design of the National Pensions Savings Scheme and the role of financial services regulation*; Treasury Committee, fifth report of Session 2005/06, HC 1074-I

¹² *Pension reform*; Work and Pensions Committee, Fourth report of Session 2005/06, HC 1068-I

¹³ Quoted from a speech by James Purnell MP to the Social Market Foundation on 30 October 2006

¹⁴ Quoted from remarks made by Rt Hon John Hutton MP at the ABI Savers Summit on 23 November 2006