

Pensions Bill: Second Reading in the House of Commons

7th January 2008

Advice & 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.

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1/ Key messages

- Information alone will not be sufficient to ensure people understand how Personal Accounts interact with their personal circumstances. People will need advice and guidance that enables them to understand their pension choices in the context of their wider financial planning. The key to achieving this is to facilitate access to generic financial advice, an issue currently being considered by the Thoresen Review. This analysis has been endorsed by the Work & Pensions Committee and by the Treasury Committee in previous reports.
- The Foundation has also developed a set of 'advice protocols' which we believe could form the basis for the advice and guidance that should be provided alongside Personal Accounts (see below).
- Ministers made clear during the passage of the previous Pensions Bill that information and communications should be a key priority for the new Delivery Authority; this should now be reflected in the current legislation which will extend the Authority's powers.
- The Delivery Authority should liaise with the Thoresen Review as it develops its proposals and, once the Review has reported, should give priority to working with any body established to take forward the Review's recommendations.

2/ Introduction

During the Pensions Bill in the last Parliamentary session the Foundation highlighted the unequivocal need for generic financial advice to be provided alongside Personal Accounts. The Foundation stressed that the Government's pension reforms will only be successful if people understand the options available to them and are able to make the right decisions. 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 Foundation impressed the importance of joint working between the Department of Work and Pensions, the advisory Personal Accounts Delivery Authority and the Thoresen Review in developing proposals to create an advice regime that would fulfil this purpose.

The new Pensions Bill will move from phase one of the Personal Accounts Delivery Authority's remit as an advisor to the government to phase two establishing its powers of implementation. It is therefore crucial that during this next round of legislation the case for a strong link between generic financial advice and Personal Accounts continues to be made so that it remains a key priority for the Delivery Authority at this vital stage.

Currently the Bill refers to the provision of information, but does not specify what this means in practice. The Foundation believes that pure information, such as an employer providing a leaflet, is not sufficient to ensure people understand their pension options and select the appropriate course of action according to their personal circumstances. If Personal Accounts are to succeed, people must be given sufficient advice regarding the risks associated with pensions investments, but also understand the benefits of Personal Accounts and that for the majority of cases remaining opted in will be in their interest. One of the keys to achieving a successful uptake and support for the scheme is by increasing access to generic financial

advice, and by placing it at the heart of the Personal Accounts regime before it is launched in 2012.

3/ Background - Personal Accounts and Generic Financial Advice

Chapter 1 of the Bill sets out an employer's duties on auto-enrolment and the provisions on auto-enrolment. Section 8 includes regulation making powers to provide information to people about auto-enrolment including for a 'prescribed' person to provide this.

Pension decisions are among the most complex and vital financial choices people make during their lifetime. However, understanding of the pensions system is low and many people are currently failing to plan adequately for their retirement. This is particularly true for people on low to moderate incomes which make up the main target group for the Thoresen Review and Personal Accounts. 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 those on higher incomes.¹

It will be essential to ensure that people have access to the advice they will need to understand their options and make the right decisions:

- 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 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 pension assets, with research showing that people can achieve an increase in annuity income of 10 per cent or more by shopping around.² The outcomes from the Open Market Option (OMO) review announced in the 2007 Pre-Budget Report endorses this.

The goal must be to encourage people to make 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. Bridging this 'advice gap' is critical to the success of Personal Accounts, but also to pensions reform more broadly: the Foundation's research demonstrates that improved access to financial advice could deliver significant benefits to consumers and the Government by improving pensions savings:

- People on low to moderate incomes could enjoy an increase in retirement income of up to £1,500 a year as improved financial decision-making during their lifetime

¹ 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

² *Annuities: Bonus or burden*; ABI, 2005

increases their personal wealth and pension savings.

- A subsequent annual saving to the government in expenditure on Pension Credit of up to £100 million within 10 years, rising up to £400 million by 2055 and £800 million by 2084, as increased personal wealth lifts people clear of the threshold for Pension Credit.

4/ Developing consensus

Since the last Pensions Bill there has been growing consensus that the introduction of a generic financial advice service and the development of Personal Accounts should be closely linked.

Speaking at a conference hosted by the Foundation in March, the then Pensions Minister, James Purnell, and the Economic Secretary to the Treasury, Ed Balls, both endorsed this.³ James Purnell suggested that the key challenge would be to find a way to provide advice that is 'generic, yet sufficiently personalised to be helpful to the individual'. He cited the work of the Retirement Commission in New Zealand as evidence that the emphasis should be on giving people pensions advice in the context of wider financial issues, rather than just focusing on retirement. He also stressed DWP's commitment to supporting the work of the Thoresen Review.

The Pensions Policy Institute's (PPI) stakeholder survey in May identified access to generic financial advice as being one of the four further reforms necessary to increase the suitability of Personal Accounts.

This followed a previous report by the PPI which recommended that generic financial advice should be provided to enable people to assess the suitability of Personal Accounts in light of their individual circumstances.⁴

The Foundation believes that it is crucial to build on this developing consensus for Personal Accounts to be supported by generic financial advice.

5/ The role of the Personal Accounts Delivery Authority

Section 61 replaces the provisions in the recent Pensions Act by giving the Personal Accounts Delivery Authority broader powers to establish the scheme.

Ministers have previously made clear that information and advice should be central to the Delivery Authority's remit. The Government's response to the Personal Accounts White Paper consultation stated:

'Clear and high quality information will be critical for individuals to understand the Personal Accounts scheme and the options available to them. The information and communications strategy for Personal Accounts will be a major part of the Delivery Authority's work.'

³ For a full brief of the seminar please go to:

http://www.resolutionfoundation.org/pdfs/news_conferencesummary_14032007.pdf

⁴ *Are personal accounts suitable for all?* Pensions Policy Institute, December 2006

In a speech to the National Association of Pension Funds, the then 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:

*'...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.'*⁵

During the last Pension Bill's passage through Parliament, Lord McKenzie of Luton, Parliamentary Under-Secretary at the Department for Work and Pensions, also stressed this:

'We recognise that individuals will need information to enable them to make decisions regarding their participation in the scheme—for example, on deciding levels of contributions, fund choices and on whether they should opt out—but it will be for the Delivery Authority to determine the information strategy for personal accounts. It is recognised that individuals and employers should have information to enable them to understand their rights and responsibilities. In deciding how this information should be provided, the Delivery Authority will need to take account of the target group.'

The Pre-Budget Report cemented the integral link between Personal Accounts, generic financial advice and the work of the Ministerial Group on Financial Capability, stating that:

*'The group will continue to work, considering plans to embed financial capability...develop the evidence-based information and communications strategy for pensions and personal accounts to support retirement decision-making; and ensure public services can best make use of generic financial advice.'*⁶

During the recent Work & Pensions Select Committee's evidence session on Personal Accounts there were some concerns raised with regards to the detail surrounding the interaction between generic financial advice and Personal Accounts such as the need to keep it simple with the opportunity to access more detailed advice depending on personal circumstances. This however reinforces the importance of joint working, which the Minister of State for Pensions, Mike O'Brien said in his evidence to the Committee:

"Thoresen is looking at the whole issue of generic advice and whether it is possible to get people better educated about financial matters but, more than that, to be able to get access to basic financial advice in a way that is easily accessible, informative, and enables them to make some decisions. The report by Thoresen is going to be very important for DWP and indeed Treasury and wider government but let me just focus for the moment on personal accounts. Thoresen is going to identify the extent to which we need to have generic advice. It is one of the issues that PADA will be advising us on in the future."

...

"In terms of what Thoresen is going to recommend, let us see what he does recommend. I think it is a broader issue that we need to increase the financial capabilities of our population as a whole. Whether it is possible to create a national system of generic advice, I think we

⁵ Rt Hon John Hutton MP; speech to the National Association of Pensions Funds Annual Conference, 24 May 2007

⁶ 2007: Pre-Budget Report and Comprehensive Spending Review, (HM Stationery Office) Box 5.1, p.84.

need to see what Thoresen has to say. That is exactly the point that, in a sense, he is going to report on.”⁷

The Thoresen Review’s terms of reference make specific reference to Personal Accounts⁸ and the recent interim report illustrates how the planned introduction in 2012 of autoenrolment for most employees into an occupational pension scheme could be a significant trigger of demand for advice on retirement planning. It goes on to state that “the Department for Work and Pensions and the Personal Accounts Delivery Authority are considering how best to provide information about the wider pension reform agenda. The Review, and any future GFA delivery body, will remain in close contact with them as our respective work develops.”⁹

It is therefore vital that this legislation, which will give further powers to the Delivery Authority, reflects the government’s overall commitment to link Personal Accounts with generic financial advice and the outcomes of the Thoresen Review.

6/ An advice framework for Personal Accounts

In the Foundation’s response to the Thoresen Review’s interim report we highlighted that there has been much debate as to the suitability of Personal Accounts for different individuals. Self employed, those with broken work records and those over 50 in 2012 when Personal Accounts are introduced are all commonly cited groups of people who may not see a return on a Personal Account.¹⁰ Nevertheless, for the majority of people, personal accounts may still be suitable and whilst may not be an optimal investment, may still provide a good return. In addition, it is clear that any pension saving is better than no pension at all – which may be the alternative for many in the target group for Personal Accounts.

As Mike O’Brien raised in his recent evidence to the Work & Pensions Select Committee, it is therefore not possible to make a definitive recommendation as to whether staying in or opting out of a Personal Account is the best course of action for any given individual. It is for this reason that personalised advice is so crucial – a generic financial adviser can explain to a consumer the benefits and broad advisability of remaining opted in to a Personal Account, but this can be caveated by an understanding that certain personal circumstances may reduce the return on this form of pension. This iterative process will be extremely valuable for a consumer who needs to come to an understanding of the suitability of a Personal Account in the context of their other financial circumstances – something which is not easily achieved with the provision of information alone.

The Delivery Authority should liaise with the Thoresen Review as it develops its proposals and, once the Review has finally reported, give priority to working with any body established to take forward the Review’s recommendations.

The Foundation held a seminar earlier this year along these lines to discuss how generic

⁷ UNCORRECTED TRANSCRIPT OF ORAL EVIDENCE To be published as HC 1069-i
House of COMMONS, 17th November 2007,

<http://www.publications.parliament.uk/pa/cm200607/cmselect/cmworpen/uc1069-i/uc106902.htm>

⁸ ‘To determine a range of models for achieving greater access to generic financial advice on a national scale, taking account of future developments in financial services markets and, in particular, personal accounts’, Thoresen Review Interim Report Executive Summary, p.14

⁹ *ibid*, P.83

¹⁰ *Are Personal Accounts suitable for all?*, PPI 2006

financial advice can best meet the needs of the users of Personal Accounts. A series of protocols were suggested:

- 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 pensions decision and the options available to them.
- Advice should be founded on a the basis that it is likely to be in people’s interests 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.
- Unmanageable debts should be paid off in preference to remaining opted in, but in less severe cases, consumers should be given guidance that it is likely to be in their interests to stay opted in and to pay off debt at the same time.
- Those at high risk of low returns due to a subsequent loss of means-tested benefits in retirement should be advised that remaining opted in may be unsuitable for them, while a cautious approach should be adopted for those likely to end up with medium returns.
- Advice should be given in the context of an individual’s wider financial circumstances including their potential need for insurance and savings products.
- 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 this should be reflected in the advice offered.
- 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.

The seminar, which was attended by a range of stakeholders from the government, third and commercial sectors, highlighted a high level of support for the protocols, although it was also acknowledged that there would be a trade off between giving people in-depth advice on the detail of their situation and simple advice to help them grasp the essentials of their position.¹¹ The boundary between ‘generic’ and ‘regulated’ advice, and the extent to which the advice could guide people towards particular outcomes as opposed to simply setting out their options, was also raised. This is an issue that is currently being considered by the Thoresen Review.

The Foundation believes that the protocols provide a sound basis from which to begin developing the generic advice that should accompany Personal Accounts.

¹¹ The Foundation suggests that the national service being developed by the Thoresen Review should provide a basic level of advice on Personal Accounts and pensions, referring more complex issues to The Pensions Advisory Service which currently provides high quality generic advice across a full range of pensions -related issues.

7/ Conclusion

Personal Accounts offer an important means to encourage those on low to moderate incomes, who do not often have pensions provision, to save towards later life. However, for Personal Accounts to be sustainable in terms of uptake and public support, people will need advice and guidance that renders the new system and its associated risks and benefits clear and transparent, and which enables consumers to understand their pension choices alongside their wider financial decisions and circumstances. Personal Accounts need to therefore be considered, as the Pre-Budget Report highlighted, alongside the Thoresen Review and the wider financial capability agenda. This would also help consolidate the contrasting government approaches of auto-enrolment (a passive activity requiring little understanding or knowledge on the part of the consumer) and the promotion of financial capability (which seeks to encourage consumer engagement, informed decision-making). In this way, the coordination of the Government's pension reform and a new advice service will ensure that people *actively* make the right choices in securing their retirement incomes, and in the longer term help deliver a step-change in the financial health of the nation.