

MEMORANDUM TO THE WORK AND PENSIONS SELECT COMMITTEE INQUIRY INTO THE GOVERNMENT'S PROPOSALS FOR PERSONAL ACCOUNTS

1. The Resolution Foundation is an independent research and policy organisation, currently focusing on the financial advice and support needs of people on low to moderate incomes.

Summary

2. This memorandum focuses on the advice needs of this income group in light of the Government's proposals to introduce a new system of personal accounts. In summary:
 - The introduction of personal accounts offers an opportunity to significantly improve retirement income and security for people on low to moderate incomes. However, the new scheme 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 personal accounts, as well as the Government's wider reforms to the pensions system.
 - 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 has been endorsed by this Committee and by the Treasury Committee in previous reports on pension reform. However, although the White Paper on personal accounts flags up the need to develop an information strategy, 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 personal accounts. We have also published research highlighting the significant benefits this could deliver in terms of increased retirement income and reduced expenditure on Pension Credit.
 - This inquiry provides an important opportunity to place the delivery of generic financial advice at the heart of the debate about the design of personal accounts, and to link the pension reform and financial capability agendas with the aim of achieving a step change in the long term financial health of the nation.

Background

3. 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

4. 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 those on higher incomes.³
5. Personal accounts offer an opportunity to address this. However, it will be essential to ensure that people have access to the financial advice they will need to understand their options and make the right decisions. People on low to moderate incomes currently lack access to this advice. This group's 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.
6. Bridging this 'advice gap' is critical to the success of personal accounts and pension reform 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.
7. 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 should be considered within the context of an individual's wider financial decision-making.
8. 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 financial products or providers, which would be subject to the regulatory regime that applies to advice linked to product sales.

Personal accounts

9. 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

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

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

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

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.

10. 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 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
11. 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
12. 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. Alongside personal accounts, people will also 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.

Delivering generic financial advice

13. 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

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

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

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.⁶

14. 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 Committee in its recent report into financial inclusion.⁷
15. We have also published research, based on economic modelling undertaken by Deloitte and Touche LLP, to evaluate the impact of providing generic financial advice.⁸ 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 experiencing financial stress as debt and other financial problems are reduced.

Financial capability

16. 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.
17. On 15 January 2007, the Government published a new long term strategy on financial capability.⁹ This set out the Government's aspiration to ensure that everyone has access to high quality generic financial advice. An independent feasibility study, led by Otto Thoresen, Chief Executive of Aegon UK, will be established to develop plans to implement a 'national approach' to delivering this.
18. The timing of the strategy, alongside the parliamentary debate on the

⁶ See *Closing the advice gap: Analysis of consultation responses*; Resolution Foundation, December 2006

⁷ *Financial inclusion: Credit, savings, advice and insurance*; Treasury Committee, Twelfth report of Session 2005/06, HC 848-I

⁸ See *A national dividend: The economic impact of financial advice*; Resolution Foundation, December 2006

⁹ See *Financial capability: The Government's long term approach*; HM Treasury, January 2007

Pensions Bill and consultation on the White Paper, presents an important opportunity to link the pensions and financial capability agendas. The strategy states that:

‘.... the Government recognises the importance of generic advice, especially in this context, to ensure that people have the information and advice to make informed decisions about personal accounts and wider retirement planning.’

19. The Foundation believes that the development of a national resource to provide generic financial advice should be taken forward as a priority, once Otto Thoreson’s feasibility study is complete. This should be closely co-ordinated with the Government’s plans for providing advice and information on personal accounts and pensions more broadly, including the specialist advice provided by The Pensions Advisory Service (TPAS).

Conclusion

20. The need to increase access to generic financial advice to support reform of the pension system was strongly endorsed by this Committee in its report on pension reform in July 2006, and by the Treasury Committee in its report on the design of the National Pension Savings Scheme in May 2006.
21. The Government has acknowledged that high quality information will be needed to support personal accounts. Ministers have also indicated that generic financial advice is part of their thinking. However, these issues have so far been largely overlooked in the reform process. The White Paper simply states that the Government will work closely with the Personal Accounts Delivery Authority and will develop an evidence-based information strategy over the next year, in consultation with stakeholders.
22. This inquiry provides an opportunity to place the need for generic financial advice at the heart of the debate about the design of personal accounts. 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, by linking the pension reform agenda with the development of the financial capability strategy, to deliver nothing less than a step-change in the financial health of the nation.