

Memorandum to the Work & Pensions Select Committee for a one-off evidence session on 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.

Summary

1. This memorandum focuses on developments since the Committee's last report on Personal Accounts and reiterates the importance of generic financial advice in supporting the new scheme.

- Information alone will not be enough to meet people's advice needs. People will need advice and guidance that enables them 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, an issue currently being considered by the Thoresen Review. This analysis has been endorsed by this Committee and by the Treasury Committee in previous reports.
- Since the Committee last reported on Personal Accounts, a strong consensus has developed on this issue. 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.
- Ministers made clear during the passage of the Pensions Bill that information and communications should be a key priority for the new Delivery Authority; this should therefore be reflected in the legislation extending the Authority's powers which is due to come before Parliament in the next session.
- 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.

We therefore hope that the Committee can once again make a strong recommendation to ensure that people's advice needs are at the heart of the Personal Accounts regime before it is launched in 2012.

Background

2. 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. 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

3. As the Committee has previously stated, 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 pensions 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.
4. 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.
5. As we have illustrated in previous submissions, increased access to financial advice could deliver significant benefits to consumers, the Government and the financial service industry:
 - 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 up 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.³
 - The Foundation's research has also suggested that increased access to financial advice would lead to a more sustainable financial services market in

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

³ See *A national dividend: The economic impact of financial advice*; Resolution Foundation, December 2006, economic modelling undertaken by Deloitte and Touche LLP, to evaluate the impact of providing generic financial advice.

the long term, with people investing more in savings, pensions and life assurance, while reducing their spending on credit card and other unsecured debt products.⁴

Developing consensus

6. Since the Committee's last report was published, there has been a growing consensus that the introduction of a generic financial advice service and Personal Accounts should be closely linked.
7. 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.⁵ 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 advice in the context of wider financial issues, rather than just focusing on pensions. He also stressed DWP's commitment to supporting the work of the Thoresen Review.
8. 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.
9. 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.⁶

The role of the Personal Accounts Delivery Authority

10. Ministers have 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.'

11. 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

⁴ *The advice gain: The impact of generic financial advice on the financial services industry*, Resolution Foundation, 2007

⁵ For a full brief of the seminar please go to:

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

⁶ *Are personal accounts suitable for all?* Pensions Policy Institute, December 2006

*inherent in pension saving and the simplicity that most people want in practice.*⁷

12. During the 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.'

13. 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.'*⁸

- 14. It is therefore vital that forthcoming legislation, which will give further powers to the Delivery Authority, reflects the Government's commitment to linking Personal Accounts with generic financial advice.**

The Delivery Authority and the Thoresen Review

15. The Thoresen Review's terms of reference make specific reference to Personal Accounts:

*'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.'*⁹

16. Lord McKenzie stressed the important link between the Delivery Authority and the Thoresen Review in the debates on the Pensions Bill in the House of Lords:

'A number of noble Lords recognised that Otto Thoresen is conducting an independent review, and we should await its outcome before we discuss in more detail generic financial advice and how it will impact on personal accounts. It is a very important task he has under way.'

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

⁷ Rt Hon John Hutton MP; speech to the National Association of Pensions Funds Annual Conference, 24 May 2007

⁸ 2007: Pre-Budget Report and Comprehensive Spending Review, (HM Stationery Office) Box 5.1, p.84.

⁹ http://www.hm-treasury.gov.uk/independent_reviews/thoresen_review/thoresenreview_index.cfm

An advice framework for Personal Accounts

18. Since the Committee's last report, the Foundation has carried out further work and held a seminar to discuss how generic 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 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.
 - 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, is essential to increase trust in the scheme.
 - 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.
19. The seminar 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.¹⁰ 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.

¹⁰ 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.

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

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