

**Consumers in the retirement  
income market – an ABI  
consultation: response by the  
National Association of Pension  
Funds**

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## About the NAPF

The NAPF is the leading voice of workplace pension provision in the UK. We represent some 1,200 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. Ten million working people currently belong to NAPF member schemes, while around 5 million pensioners are receiving valuable retirement income from those schemes. NAPF member schemes hold assets of some £800 billion, and account for over one sixth of investment in the UK stock market. Our main objective is to ensure the security and sustainability of UK pensions.

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## Executive Summary

### Summary

The next few years will see great change in the UK's pension system. The introduction of automatic enrolment in October 2012 will get millions more people into pension saving. But the continuing shift from Defined Benefit (DB) pensions to Defined Contribution (DC) pensions means new savers will be auto-enrolled into DC pensions. It is therefore vital that the DC pensions market can deliver the outcomes people need and want in retirement.

The NAPF welcomes the ABI's Code of Conduct on at-retirement communications. We support any effort to improve the way people make choices at the point of retirement. However, we believe there are a number of ways the Code of Conduct could be improved to address the underlying barriers to shopping around and to securing better annuity outcomes.

### **NAPF's main recommendations:**

- 1. The Code of Conduct should encourage pension providers to publically disclose some simple information about retention rates and pricing practices. This will help to monitor compliance with the Code of Conduct and improve the operation of the Open Market Option.**
- 2. The Code of Conduct should, at a minimum, require scheme providers to give members a list of specialist annuity brokers when providing information on how to shop around, so that members are directed straight to the best sources of support, including those that can service smaller pots.**
- 3. To truly drive a default OMO the Code of Conduct should go further and actively encourage providers, as best practice, to route their members straight to a specialist annuity advice and brokerage service, so that members are contacted by an organisation that can provide support and advice on a full range of products. We are aware of some scheme providers that already do this.**
- 4. Where the scheme provider does not use a specialist annuity service, the Code of Conduct should encourage providers (and employers and pension managers setting up contract-based DC schemes) to put in place service agreements about data sharing so that information about scheme members can be passed to the employer and their own appointed annuity broker.**
- 5. The ABI should monitor and publish analysis of the impact of the Code of Conduct on member behaviour and shopping around, with a clearer understanding of what 'shopping around' means – in terms of actual levels of engagement and whether members have considered their annuity options and secured themselves a good outcome. The ABI statistics on shopping around should separate out workplace pension scheme members and personal pension members, as current improvements in shopping around statistics may be driven by personal pensions only.**

## Treating DC members fairly at retirement

1. The next few years will see great change in the UK pensions landscape. With the introduction of automatic enrolment scheduled for later this year, millions more people will be saving in a pension for the first time. The NAPF is strongly supportive of automatic enrolment which has been designed to address the UK's pensions crisis and to widen access to workplace pensions.
2. With the continuing shift from Defined Benefit (DB) pensions to Defined Contribution (DC) pensions, the vast majority of new savers will be automatically enrolled into DC pensions. It is therefore vitally important that the DC pensions market is able to deliver the outcomes individuals need and want in retirement.
3. The decisions (or lack of decisions) people make as they approach retirement can have a significant impact on their income, for better or for worse. In a DC world, individuals must make a decision for themselves on how to turn their pension pot into the most suitable type of income. But throughout most of their retirement savings journey, decisions have been made for them. The introduction of automatic enrolment and the widespread use of default funds will depend on savings inertia and lack of engagement. It should come as no surprise that people exhibit the same inertia when it comes to making decisions about retirement income.
4. Why is inertia such a problem at retirement? By making the right choices when purchasing an annuity, people can often improve their income in retirement by 20%-30%, though for some individuals who may be eligible for an enhanced or impaired annuity the increase could be much greater. Unlike decisions made in the accumulation phase, decisions made at retirement tend to be one off and irreversible. Whilst there can be some complacency in the industry about the impact of modest increases in income, with millions of pensioners already relying on means tested benefits in retirement and millions more set to begin saving in a pension for the first time, continuing with the status quo risks consigning millions of people to poverty in old age, reducing tax revenues, and increasing burdens on the state.
5. In an effort to improve the way people make retirement income choices, the DWP and HM Treasury tasked the longstanding OMO Review Group with finding a way to improve the Open Market Option (OMO). The OMO is supposed to encourage people to shop around for a better deal, but there is a general agreement that more needs to be done to improve the way the OMO works and make it truly the default. Many savers do not take the opportunity under the OMO to shop around for their annuity. The ABI statistics suggest that only 70% of people 'shop around' for their annuity, with only a subsequent 44% purchasing an annuity from a provider other than the one that provided their pension scheme. Furthermore, the definition of 'shopping around' used only asks whether another provider was considered, it doesn't measure whether there was any real engagement in shopping around, whether other products and rates were investigated, or whether or not changing provider was the best outcome for the member. The presentation of the statistics also tends to imply that shopping around and not changing provider is evidence that it would not have been in the member's best interests to switch. Preliminary analysis that the NAPF has commissioned from the IFS is producing evidence that shopping around is less prevalent

amongst women, as well as those with lower income, lower wealth, lower education and lower numeracy. Worryingly, it also tends to be slightly lower amongst smokers than non-smokers, who are a group likely to benefit from shopping around due to eligibility for enhanced rates.

6. In September 2011, the Association of British Insurers (ABI) announced that it would require its members to remove the annuity application form from the communications they send to customers as they approach retirement. This was a small step, but nevertheless a step in the right direction. The ABI also committed to drafting a Code of Conduct which aims to improve the information customers receive at retirement.
7. In December 2011, the ABI launched a consultation on its draft Code of Conduct. The Code sets out 3 areas where providers must conform:
  - All communications to customers must take customers through a 3 step journey of understanding retirement, understanding different ways of taking retirement income, and understanding how to buy.
  - Illustrations provided to customers that have not been requested must be easily comparable with other products and must include information about enhanced annuities.
  - Providers' sales process must take customers through the key questions they should consider when taking retirement income.
8. Compliance with the Code will be a condition of ABI membership, and CEO's will be asked to sign a letter annually confirming that their communications and processes are encouraging their customers to shop around.
9. The NAPF supports any efforts to improve the way people make retirement choices and we welcome the opportunity to contribute to this debate by responding to the ABI's consultation. To help inform our thinking, we collaborated with Dr Debbie Harrison, a Senior Fellow of the Pensions Institute, to conduct research on best practices around decumulation choices in trust-based and contract-based schemes. The research report '*Treating DC Members Fairly at Retirement?*', looked at the impact current practices have on DC member outcomes and identifies structural problems in the workplace decumulation market which make securing good outcomes in retirement extremely challenging for members as well as those acting on their behalf.
10. The research concluded that for most members of a workplace DC pension scheme, the journey from accumulation through to decumulation represents an "illogical and uncoordinated journey". The journey begins with a series of "default" decisions – with automatic enrolment and default funds being purposefully designed to harness savings inertia. The journey ends with the requirement for members to select an annuity, a process that those interviewed said requires considerable knowledge about the financial services industry, as well as sophisticated literacy and numeracy skills.

*'If we know that most members need to be opted into a scheme, to have minimum contributions prescribed, and that they require a default fund to avoid having to make complex investment decisions, why aren't we comfortable with saying 'this is the default annuity process and it delivers value for money'? There's a mind-set problem here, but it's not*

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*clear whether it's a genuine mental block or if the industry collectively is avoiding responsibility for member outcomes – and in some cases profiting from member inertia' .-*  
Third party administrator

11. The research estimates that, as a result of barriers to securing the best outcome, each retiring cohort may be losing £500m-£1bn in lifetime annuity income, which is worth around £100-200 in lost tax revenue to the Government.
12. This suggests a number of issues around decumulation go beyond the provision of information to individuals at the point of retirement. The ABI's Code of Conduct should help change behaviour amongst pension providers who are also annuity providers, but the question still remains as to how to cater for the needs of default savers as they approach retirement. Preliminary analysis by the IFS for the NAPF suggests that shopping around is particularly low amongst lower earners and those saving in workplace rather than personal pensions. The Pensions Institute research identifies a number of problems with both the "buyer" side and the "supplier" side of the annuity market and proposes a series of recommendations for Government, the Regulators, and Industry which the NAPF believes would improve the way the annuity market currently works. These changes aim to complement, or develop further, the ABI's Code of Conduct by providing an efficient, cost-effective and transparent default annuity process in the long term. We have outlined some of these recommendations in the section below, and have offered suggestions for improving the Code of Conduct.
13. The NAPF believes that employers and trustees have an important role to play in improving the way people make choices in retirement. The research identified examples of excellent practice across both trust and contract based schemes and in schemes with higher levels of contributions, as well as some of the large multi-employer schemes operating at the tough end of the market. Publishing the research should help to share best practice, and the NAPF will consider how it can further promote best practice by developing information and/or guidance to NAPF members on decumulation.
14. It is therefore important that best practice around helping members at retirement is encouraged to flourish once the Code of Conduct is in place. We are concerned by the lack of clarity about how the Code of Conduct might interact with existing good practice where trustees of bundled schemes and employers with contract-based schemes already provide advice or annuity brokering services. Further work must be done to understand the variety of relationships between employers, trustees, employee benefit consultants, scheme and annuity providers, and annuity brokers. Additionally, TPR and FSA guidance outlines different at-retirement communication processes for trust-based and contract-based schemes. We are aware of one major employee benefit consultant that has reached agreements with its pension providers to ensure that scheme members receive a single, combined set of information from the annuity broker. The NAPF would like to work with the ABI and the Regulators to understand how the Code of Conduct can be implemented in a way that streamlines at-retirement communications with scheme members and does not conflict with existing good practice.

## NAPF Recommendations

### Transparency and pricing

15. The NAPF supports the intent of the ABI's Code of Conduct. We think that encouraging shopping around through communications with scheme members is an important step towards making the OMO a true default. The Code of Conduct will place more stringent requirements on pension providers around the provision of at-retirement information to scheme members. However, we are not convinced it goes far enough in addressing the underlying barriers to shopping around and securing better annuity outcomes, and it does not challenge some of the issues we have identified with the pricing of annuities and the access to specialist advice.
16. Evidence gathered in the NAPF and Pensions Institute research points to highly complex pricing structures which obscure information from scheme members, and those acting on their behalf, and make it more difficult for them to make an informed choice about switching providers. The Code of Conduct should make it more difficult for scheme members to default into an internal annuity by requiring providers to remove the internal application form from wake-up packs. But the Code has very light touch compliance and does not challenge scheme providers and insurers to share information that would help to monitor the impact of the Code of Conduct, or that would improve the functioning of the Open Market Option. Issues that need to be addressed where greater transparency and disclosure could help the functioning of the market include retention rates, differential pricing between internal and OMO rates, potential manipulation of internal rates to take advantage of internal roll-over business, and cliff edge pricing around commonly quoted rates.
17. These features of the annuities market mean that even if members do try to shop around for the best annuity, after a discussion with their scheme provider, it is very difficult for them to gain access to the whole of the market and secure the best outcome – largely due to these pricing practices and due to the difficulties in identifying specialist annuity brokers. The Code of Conduct would be reinforced by a drive across ABI members who are annuity providers to support disclosure and transparency about retention and pricing practices and this could be done through the process of annual confirmation of compliance with the Code. The research we carried out with the Pensions Institute found that many annuity providers would not reveal their retention rates or confirm that their internal rates and OMO rates were the same. However, those interviewed remarked that differentials between a provider's own internal and open market rates could be as high as 20%.

**NAPF Recommendation 1: The Code of Conduct should encourage pension providers to publically disclose some simple information about retention rates and pricing practices. This will help to monitor compliance with the Code of Conduct and improve the operation of the Open Market Option.**

## Making Shopping Around the Default

18. The Code of Conduct will require pension providers, during the course of a conversation and in any communications, to signpost scheme members to a number of sources where they can find more information about annuities, the Open Market Option, and shopping around. However, it is important to be aware of the powers of inertia and the limitations of simply signposting to generic information websites and annuity search engines. The Pensions Institute research found that members are unlikely to secure the best type of annuity without seeking advice from a specialist annuity broker, yet annuity search engines and/or generic information websites are often not explicit about who the specialist brokers are.

*“At present the key decision-makers all know which firms offer specialist annuity advice. Why are they so reluctant to tell members?” - Independent trustee*

**NAPF Recommendation 2: The Code of Conduct should, at a minimum, require scheme providers to give members a list of specialist annuity brokers when providing information on how to shop around, so that members are directed straight to the best sources of support, including those that can service smaller pots.**

19. Beyond signposting to other sources of information and advice, the Code of Conduct could go further by actively encouraging scheme providers to provide a full at retirement service through an arrangement with a specialist annuity advisor.
20. As currently drafted, the Code of Conduct will require providers to provide information to scheme members about the variety of ways to take retirement income. However, it is unclear from the drafting whether providers are obliged to discuss their own products only, or all the options available to members through the whole of the market.
21. If providers are required to discuss all options available through the whole of the market, there is a question of whether this could stray into the realm of regulated advice or be subject to future accusations of mis-selling. Given the potential costs for the scheme provider of putting systems and process in place to comply with (and ideally monitor) the proposed Code of Conduct, and the commission that is already priced into annuities, there is a strong case for providing scheme members with a full, third party advice and brokerage service instead. The research spoke to one large asset manager, who is not also an annuity provider, who already provides members with such a service, and another large asset manager in the process of setting one up.
22. We believe a full at retirement service that can actively help members to access the whole of the market is a necessary step because the forces of inertia are so strong in this market. With the introduction of auto-enrolment later this year, those members reaching retirement will increasingly have been serial defaulters, and will have become accustomed to trusting professionals for advice. The research suggested that this brand loyalty may be misguided and that members may not be aware that an annuity is a completely separate product.

*“When the ABI and insurance companies talk about the importance of ‘brand’, what they mean is that brand is good for business, not necessarily for the member. Members assume that the scheme provider, chosen by their employer or the trustees, will see them right at retirement. In behavioural terms this is logical – brand and the employer or trustees’ endorsement of the scheme serve to crystallise member inertia.” - Annuity adviser*

*“If the provider or scheme does not have a strong independent advisory system in place for the annuity process then it should be the norm or default to make this the case. It’s up to the industry to make this happen; otherwise the government will step in.” - Employee Benefit Consultant*

**NAPF Recommendation 3: To truly drive a default OMO the Code of Conduct should go further and actively encourage providers, as best practice, to route their members straight to a specialist annuity advice and brokerage service, so that members are contacted by an organisation that can provide support and advice on a full range of products. We are aware of some scheme providers that already do this.**

23. Where a full at retirement service is not provided, either by the employer or the provider, research should be conducted into the behavioural impact of the Code of Conduct’s proposals and, in particular, whether in some cases they serve to strengthen brand loyalty and inertia through a guided conversation. This is important as the research heard that some companies may be actively looking to increase their retention rates.
24. The customer journey as outlined in the Code of Conduct will be an improvement on some current practices, where some scheme members will simply default into an internal annuity without clear signposting of other annuities available and the potential for enhanced or impaired annuities to increase their income. Ensuring that members understand their options around retirement, the different ways to take their retirement income, and how to buy retirement income is one of the most important ways pension providers can help their members secure the best outcomes.
25. There are other ways providers can help streamline the customer journey. There are already a number of schemes, both contract-based and trust-based, that offer an annuity brokering service to their scheme member but we think more can be done to encourage trustees, pension managers and governance committees to engage the services of a specialist annuity broker. According to the 2011 NAPF Annual Survey, 51% of trust-based schemes provide a brokering service to their members. This compares to only 19% of contract-based schemes. One reason the figure may be lower for contract-based schemes is because ownership of member data rests with the pension provider. The NAPF and Pensions Institute research found that some pension providers appear reluctant to share member data with employers, or their appointed advisors and brokers, and where they do so this may only happen on a sampling basis.

*“It’s a question of transparency and visibility. With a trust-based scheme, I have access to all the information I need through service agreements with asset managers and the third-party administrator. With contract-based DC, access depends entirely on the provider’s willingness to share data. I’ve had situations with contract DC when I’ve had no idea what benefits members are building up and when they plan to retire. How can I assess how well the scheme is working at retirement under this scenario?” - Pension manager*

**NAPF Recommendation 4: Where the scheme provider does not use a specialist annuity service, the Code of Conduct should encourage providers (and employers and pension managers setting up contract-based DC schemes) to put in place service agreements about data sharing so that information about scheme members can be passed to the employer and their own appointed annuity broker.**

### Understanding what success looks like

26. Although we are supportive of the Code of Conduct, we feel it will only be successful if it is possible to measure improvements in shopping around and outcomes in retirement. The evidence currently available on the numbers of people who shop around, how shopping around is defined, and how shopping (or not shopping) around impacts on outcomes at retirement is inconsistent and unsatisfactory. The Government, regulators, and industry should work together to improve the evidence base and evaluation in this area. The Code of Conduct will not require providers to submit examples of their wake-up packs or follow-up packs to the ABI, so it is important that the Code is used to monitor member outcomes effectively.

**NAPF Recommendation 5: The ABI should monitor and publish analysis of the impact of the Code of Conduct on member behaviour and shopping around, with a clearer understanding of what 'shopping around' means – in terms of actual levels of engagement and whether members have considered their annuity options and secured themselves a good outcome. The ABI statistics on shopping around should separate out workplace pension scheme members and personal pension members, as current improvements in shopping around statistics may be driven by personal pensions only.**

### A National Annuity Advice Service and Clearing House

27. With these changes to the Code of Conduct, it might be possible to achieve enough change in the annuity market to deliver real and measurable improvements in DC member outcomes. Without these changes, and with automatic enrolment and the proliferation of small pots and the lack of financial literacy amongst the automatic enrolment target market, regulatory intervention may become necessary in the future. The NAPF and Pensions Institute research proposed that the creation of a National Annuity Advice Service, which could act as both an aggregator for small pots and as a provider of low cost annuity advice and brokerage, should be considered. The NAPF believes there is merit in investigating the costs of providing large-scale annuity brokering services if the industry collectively fails to respond to the challenge of securing good outcomes for all members at retirement.

## Answers to specific questions

### 1. Is the timetable for implementation appropriate?

The NAPF is unable to comment on the time needed for providers to make changes to their communications and systems in order to comply with the Code of Conduct. We are, however, of the view that the Code should be in place as soon as possible prior to the introduction of automatic enrolment.

### 2. Is the customer journey set out in the Code appropriate?

The NAPF and Pensions Institute research has found that, for most people, membership of a workplace DC pension represents an uncoordinated and illogical customer journey. Government has accepted that in the accumulation phase, people are not actively engaged in making the decision to save (indeed that is the point of automatic enrolment), nor in decisions around investment, and had designed policy around this framework. Currently 80-90% of scheme members remain in the default fund and this could increase further under auto-enrolment.

It is only after a member has been saving in a pension for 40 years that they are required to make an active choice about their retirement income. According to sources in the research, only around 15% of DC scheme members are thought to have the financial capability to choose an appropriate annuity product for themselves. It is therefore absolutely necessary that DC members are properly prepared to make decisions about their retirement income. This will depend not only on the quality of information they receive but also on their ability to access appropriate guidance or advice should they need it.

28. The customer journey as described in the ABI Code of Conduct is an improvement on the current requirements. But we think more needs to be done around the transparency of annuity prices. The Code will not expose and address issues like differential pricing between internal and OMO rates, deliberate manipulation of rates to take advantage of internal roll-over business, or cliff edges around commonly quoted rates. Even if members do shop around for the best annuity, they cannot navigate their way through the annuity market without specialist support – largely due to these practices.

29. There are other ways providers can help streamline the customer journey. There are already a number of schemes, both contract-based and trust-based, that offer an annuity brokering service to their scheme members. But we think more can be done to encourage trustees, pension managers and management committees themselves to engage the services of a specialist annuity broker. The NAPF will be taking forward work in this area.

**3. Do you have any evidence about the impact that illustrations have on customer engagement or behaviour?**

In 2008, the DWP conducted extensive qualitative research on the information individuals need to make appropriate decisions at retirement. *Information needs at retirement: Qualitative research on annuitisation decisions*<sup>1</sup> explored DC members' understanding of the choices available to them when they purchase their retirement income and of the information and what information DC members use to make their decision.

During the course of the research, participants were asked whether personalised illustrations were helpful. The results were mixed. Some participants, particularly those who were more financially aware, found illustrations allowed them to better predict the income they would need in retirement. Other participants found illustrations less helpful. In some cases this was because the illustrations were too complicated to understand. In other cases, participants had been sent generic illustrations which they did not feel were appropriate to their own circumstances.

The DWP research did not explore whether own-company illustrations impact individuals' decisions differently than generic illustrations. However, we do share concerns expressed by other stakeholders that own-company illustrations could serve to reinforce inertia, tying people to their existing provider. The research revealed that, for some providers, 60-86% of their existing DC members purchase annuities internally. We are therefore minded to prefer generic illustrations rather than own-company illustrations and we welcome the ABI's commitment to undertake further research on the impact illustrations have on individual behaviour.

**4. Are the requirements for each stage in the Code appropriate?**

The Code of Conduct currently covers three aspects: the customer journey, the sales process and own-company illustrations. During each of these stages, providers will be required to give information and support to members with the aim of helping them understand the decision they need to make.

The fact remains, however, that members still need to make a decision to shop around and face considerable behavioural and practical barriers to doing so. In the section above we set out why the requirements placed on providers during each stage of the Code of Practice are insufficient and cannot deal with the needs of default savers. We believe our recommendations will improve the effectiveness of the Code of Conduct and will help ensure good outcomes for all types of DC members.

**5. Are there any other useful customer resources we should be signposting customers to and which are not mentioned in the Code?**

In addition to the list of resources currently included in the Code of Practice, we believe individuals should be signposted to a list of specialist annuity brokers. The NAPF and Pensions

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<sup>1</sup> DWP Research Report 515, *Information needs at retirement: Qualitative research focusing on annuitisation decisions*, 2008.

Institute research indicates that, in the current market structure, it is very difficult for DC members to locate specialist annuity brokers and/or advisers who provide access to the whole of the market. Without change, the situation is likely to worsen for individuals with smaller pots post-RDR because of further restrictions on the provision of advice at the lower end of the market.

**6. Do you have any other comments on the Code of Conduct?**

We would like to emphasise our concerns around the scope of the Code of Conduct. Although the consultation document states that the Code does not apply to trustees, it is unclear how the Code will affect current practices around at-retirement communications in cases where annuity brokering services are already offered by trustees of bundled schemes and employers with contract-based schemes. As mentioned above, the NAPF is keen to explore with the ABI how the different relationships between employers, trustees, employee benefit consultants, scheme and annuity providers and annuity brokering services will be affected by the requirements of the Code of Conduct. Additionally, we should explore how different TPR and FSA guidance around the at-retirement communication processes for trust-based and contract-based schemes could be aligned. Where it is possible, a more joined-up communication process should be in place so that scheme members experience a logical and orderly stream of conversations with their employer, their provider and their annuity broker. Crucially, the Code of Conduct should not serve to override or conflict with existing good practice that provides a fuller service to members.