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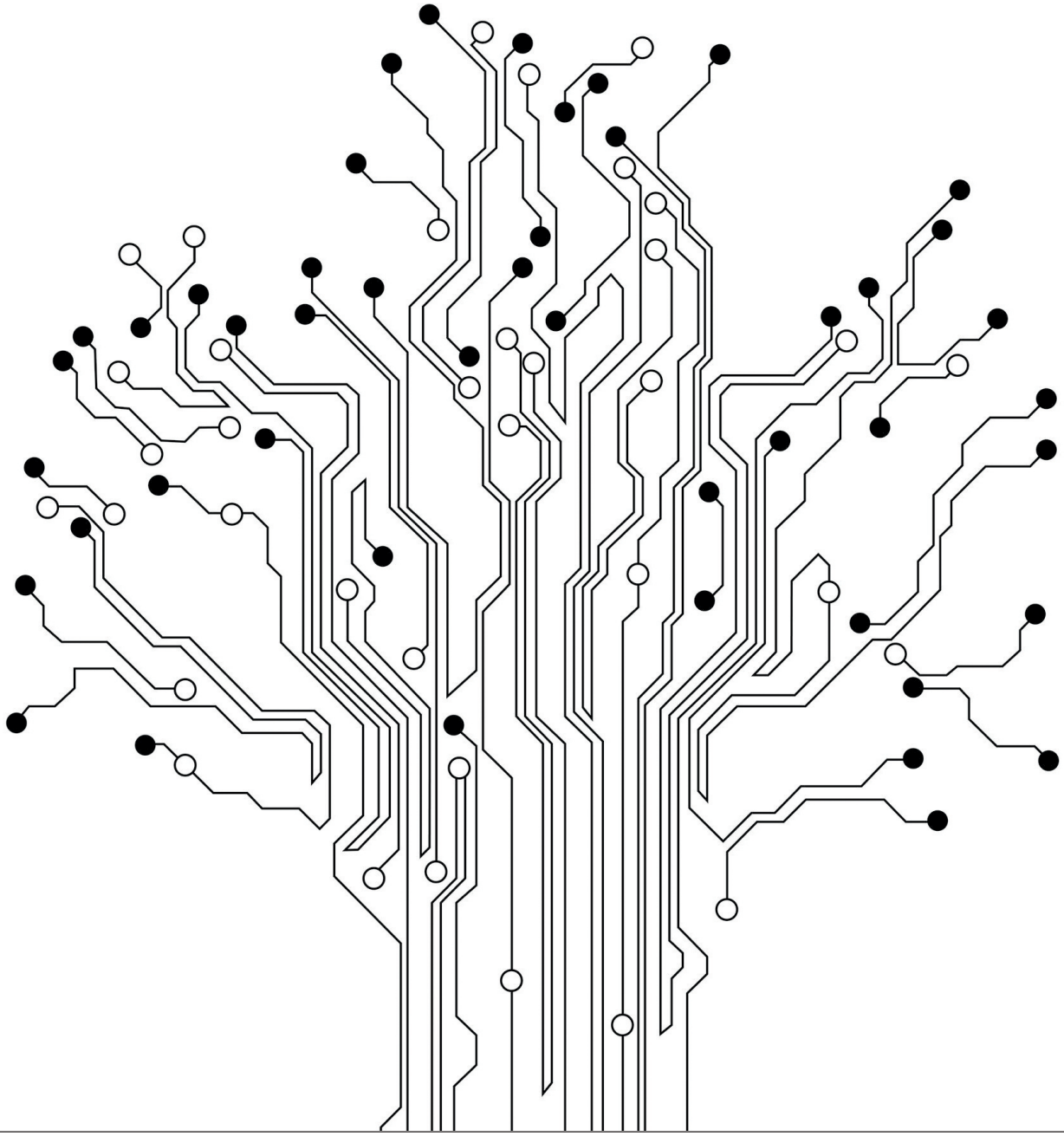

Supporting DC savers at retirement:

an analysis of the advice and brokerage market

June **2013**

About the NAPF

The National Association of Pension Funds ('NAPF') is the leading voice of workplace pensions in the UK. We speak for 1,300 pension schemes which collectively hold assets of £900bn providing benefits to 16 million people. We also represent over 400 providers of essential advice, products and services to the pensions industry. Our membership is diverse – from large to small organisations in both public and private sectors.

We are a progressive and proactive organisation, committed to ensuring there is a sustainable environment for workplace pensions so that millions of people can look forward to fair and decent retirement provision.

NAPF members receive a range of benefits, including:

- Guidance on best practice
- Industry news, opinion and knowledge leadership;
- Forums for debate, discussion and networking; and
- An influential voice and representation in front of Government, regulators and the media.

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List of abbreviations

ABI – Association of British Insurers

DC – Defined Contribution

DWP – Department for Work and Pensions

EBC – Employee Benefit Consultant

FCA – Financial Conduct Authority

HMT – HM Treasury

IFA – Independent Financial Adviser

NAPF – National Association of Pension Funds

OMO – Open Market Option

PICA – Pension Income Choice Association

TPAS – The Pensions Advisory Service

TPR – The Pensions Regulator

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Executive Summary

For members of Defined Contribution (DC) pension schemes, a key factor influencing outcomes at retirement is how they choose to take their pension income and their ability to choose the right product. For the majority of DC savers retiring today this means buying an annuity where the focus for members is selecting an appropriate 'shape' and then achieving the best price. The NAPF has previously argued that, to tackle the inertia in the market and secure better outcomes for DC scheme members, an effective shopping around service should be made part of the pension scheme.

To support our fund members with both trust and contract-based schemes in helping their scheme members maximise their outcomes at retirement, we commissioned research to explore a range of issues in the advice and brokerage market. These included the barriers currently faced by trustees and employers when putting in place advice/broking services, the range of offerings on the market and the charging structures that currently apply to advice/broking. The aim of the research was not carry out an exhaustive review of the market but to develop a more informed view of how the advisers/brokers interact with corporate clients by speaking to a range of individuals and organisations representing advisers/brokers, EBCs, pension providers and insurers.

The conclusions from our research are that:

- Lack of prioritisation and concerns about going beyond the regulatory minimum remain significant barriers to trustees and employers when providing support to members at retirement, but these can be overcome when the alternative options and benefits to members of advice/broking services are understood.
- Capability gaps amongst those advising employers and trustees may mean that currently not all schemes are as well served as they could be.
- Non-advised guidance is the most utilised route for supporting members at retirement. The largest market players tend to offer a full range of services, including execution-only and regulated advice. The execution-only route is little used in practice as those that start off self-serving often seek guidance along the way. Regulated advice can be restricted to just the annuity decision or can cover more holistic financial advice.
- The general perception is that the non-advised guidance route is fit for purpose in delivering good outcomes for members cost-effectively. However, there is recognition that the non-advised guidance route can be sub-optimal for those with larger fund sizes for whom the consideration of other options (such as income drawdown) may be more appropriate.
- Price tends to be a key focus for competition between market participants. Advisers/brokers may also look to compete on other strengths and there is evidence of differentiation in service offerings. This includes the quality and tailoring of member communications, the quality of telephony and IT/online support and the degree of support for the member journey ahead of retirement.
- Both fee- and commission-based charging models are capable of delivering good member outcomes. A key decision for trustees and employers is whether they pay for the service (fee-based) or whether the cost is borne by the member (commission-based).
- Where fee-based, trustees and employers will want to ensure that the commission that is rebated has been negotiated on preferential terms. Where commission-based, trustees and employers will want to ensure that the basis is fair to members and that, for example, the commission is capped as appropriate.
- Trustees and employers need to understand who bears the costs related to setting up the arrangement which in turn depends on the scheme demographics.

- On a fee basis, the cost of different services typically varies from £250-£350 for a non-advised guidance service, to around £350 for regulated financial advice on the annuity purchase only, to upwards of £500 for holistic financial advice.
- Fee- and commission-based charging models both have advantages and disadvantages. A fee-based charging model will be uneconomic for a member with a small fund size relative to the expected gain from shopping around for an annuity. A commission-based model will be commercially unattractive to the adviser/broker where fund sizes are particularly low. Fee-based models are particularly transparent and tend to match the charge quite closely to the incurred cost. On the other hand the cross-subsidies implicit within commission-based models do permit those with smaller fund sizes to be served.
- There remain barriers to putting a service in place for those running smaller DC schemes (who may be less well served by advisers) and for those with DC schemes where members have smaller fund sizes (who may be less commercially attractive to advisers/ brokers to the point of being unviable).
- Given the high amount of defaulting that remains amongst retirees it is recognised that the market could be functioning more effectively. However, where members are being offered more than just information, the perception is that the market is competitive and functioning well.
- Interest in alternatives to conventional annuities, in particular in income drawdown for lower fund sizes, is identified as a potential growth area.

There were two potential areas identified where the NAPF could provide support to help the market operate more effectively:

- **Raising awareness amongst employers and trustees** – there was a strong belief that, once made aware of the alternative options, most employers and trustees will want to do more than the minimum. The NAPF can add value by clarifying the regulatory requirements, by highlighting the risks to member's benefits of employers and trustees only doing the minimum, and by raising awareness and capability around appointing an adviser/broker; and
- **Addressing specific barriers in the market** – this could range from the NAPF setting some minimum standards, to it developing a 'shortlist' of advisers/brokers for trustees and employers to use, to it developing its own service proposition or master-arrangement to support schemes when putting in place support for members. Such a proposition might also help serve those schemes which are less commercially attractive for the advisers/ brokers to serve currently.

To support our fund members to deliver a better service for their DC scheme members at retirement the NAPF will take forward action in three areas:

- We will deliver a Made Simple Guide for trustees and employers, which will provide them with practical guidance about the benefits to scheme members of support at retirement and the range of options available to them on the market. A key element of the Guide will be to tackle some of the perceptions about the risks of going beyond the regulatory minimum.
- We will review our existing training programme to offer trustees and employers running DC schemes support on how to implement these services, including guidance on the regulatory implications of providing different forms of support and advice and what to look for when appointing an adviser/broker.
- We will take forward a programme of work, based on the feedback from this research and from our fund members running DC schemes, to explore how the NAPF can improve the functioning of the market. This could include, for example, the setting of minimum standards for advisers/brokers to develop a shortlist for trustees and employers, or the development of a master-arrangement for advice/broker services that can benefit DC schemes so that they may be better served.

Chapter 1: Background to the research

1. For members of Defined Contribution (DC) pension schemes, a key factor influencing their outcomes at retirement is the way in which they take their pension income and their ability to secure the right product at the right price. For the majority of those saving in a DC pension and reaching retirement this means buying an annuity, and therefore taking critical decisions around the shape of that annuity (whether it is joint or single life, whether it is level or indexed, and whether lifestyle or health conditions mean an enhanced or impaired annuity is an option) and then securing the best annuity rate that is available on the market.

2. Around 400,000 annuities are bought each year. The available evidence suggests that perhaps around 30[1]-44% of DC savers switch provider when they buy an annuity, with the higher 44% figure including those that may have switched provider under tied arrangements. The latest baseline research from the ABI suggests that, whilst the vast majority (91%) of annuity purchasers are aware of their option to shop around, only two thirds (63%) state that they shopped around and considered switching, and only 50% actively shopped around by approaching other providers to discuss annuity products or gather annuity quotes.

3. Whilst there may be good reasons why retirees choose not to switch provider at retirement, it is nonetheless alarming that only 50% of DC savers (perhaps 200,000 individuals each year, according to the statistics above) appear to be taking any steps to search the market. Estimates of the level of consumer detriment are difficult to pin down but the NAPF's report[2] with the Pensions Institute last year estimated that the total loss could be in the range of £500m-£1bn for each cohort reaching retirement.

4. To tackle these issues the pensions industry and consumer groups have been working with the Government and regulators through the 'OMO review working group' to develop proposals to make it more likely that members of DC pension schemes shop around for a good outcome at retirement.

5. Significant progress has been made in recent years, though for many DC savers there is still not a true 'default OMO' in place for their scheme. Key initiatives have included the ABI's Code of Conduct on retirement choices, launched in March 2013, and the ongoing work by members of PICA to develop a specialist directory of advisers. Both these initiatives should make it easier for the more proactive retirees to shop around in the market and find an adviser to help them with the choices they need to make. However, both initiatives are still predicated on the individual member taking some action, rather than this support being there as the default.

6. The true impact of these initiatives will be seen as clearer information becomes available about the numbers of DC savers shopping around, obtaining quotes, and using the OMO, and as industry, government and regulators develop clearer measures of member outcomes at retirement. A lack of clear evidence on the levels of consumer detriment at retirement has hindered robust policy evaluation in this area. Whilst the evidence base is improving there remain some significant gaps across both the trust- and contract-based landscape in

[1] Retirement choices: baseline to measure effectiveness of the code of conduct, May 2013
[2] Treating DC scheme members fairly in retirement, February 2012

understanding how many individuals receive good quality support at retirement, their decision making processes, and their motives for switching annuity provider or not.

7. Other activity includes the forthcoming publication of the Pensions Regulator's DC Code of Practice and supporting guidance[3], which at consultation stage advocated that "trustees should consider giving members access to independent financial advice or an annuity broking service", and the FCA's thematic review of the annuity market, which is expected to report later this year. The FCA have said that they "want to understand the level of the potential detriment for consumers if they do not shop around to see if there are ways to make this market work better for consumers". The ABI will also publish comparison tables over the summer to improve transparency around annuity rates and the Money Advice Service (MAS) and The Pensions Advisory Service (TPAS) have been refreshing the guidance materials they provide to individuals. Much of the activity remains predicated on the DC saver navigating their way through this very complex market alone, prompted by sign-posting to a number of different sources of information and guidance, adviser sites, and annuity rate comparison tables.

8. The NAPF has previously argued that to really drive a shift in behaviour the same principles around inertia and defaulting that apply in the 'accumulation' stage should be extended to the 'decumulation' or retirement stage. That would ensure that, in the event that the DC saver did nothing, they would still be guided through a process that led to a good outcome. Whilst this could come in different forms, it would tend to be predicated on an agreement between the employer, trustees or the provider, with an adviser that has the expertise and capacity to provide cost-effective advice and the OMO service even for smaller fund sizes.

9. Our 2012 Annual Survey indicated that around half our members running DC schemes have already appointed a broker or adviser to support their scheme members at retirement. These services are in place across both trust- and contract-based schemes, although within the Survey are more common amongst the trust-based schemes. Not surprisingly, the larger schemes were more likely to have already appointed a broker or adviser for their members at retirement.

10. TPR's latest governance survey[4] suggests that 52% of all trust-based DC schemes appoint an annuity broker to search the market for a competitive annuity to offer on their behalf, significantly up from 39% in 2012. 46% of smaller DC schemes (12-99 members) appoint a broker compared to 81% of larger DC schemes (1000+ members). Larger DC schemes are also more likely to report that their members take an annuity from the open market - 35% of larger DC schemes say that 100% of their members take an annuity from the open market, compared to 18% of members of smaller DC schemes.

11. To support more schemes with making the 'default OMO' a reality for their members, the NAPF commissioned some research, focussing on the perspectives of those active in providing services in this area. Ten in-depth interviews were carried out by Ian Costain, acting as an independent consultant to the NAPF, and those individuals and organisations that we spoke to (see Acknowledgements) included the advisers and brokers, EBCs, pension providers and insurers. The aim of the research was not to cover off the whole of the market or be exhaustive, but to develop a more informed view of the different service offerings that are currently available to trustees

[3] TPR consultation on regulating work based DC pension schemes, January 2013
[4] Occupational pension scheme governance, May 2013

and employers and to identify any particular barriers to more schemes putting these arrangements in place.

Chapter 2: Barriers for trustees and employers

Summary

- Lack of prioritisation and concerns about going beyond the regulatory minimum remain significant barriers to trustees and employers providing more support to members at retirement, but these can be overcome when the alternative options and benefits to members of advice/broking services are understood.
- Capability gaps amongst those advising employers and trustees may mean that currently not all schemes are as well served as they could be.

12. One of the headline recommendations from the report published by the NAPF and the Pensions Institute in February 2012 was that:

    'Employers and trustees should be able to support members at retirement without fear of regulatory reprisals'

13. Anecdotally, it was previously reported to us that trustees are reluctant to do more than the regulatory minimum for their members at retirement for fear of reprisals should the information or advice they receive turn out to be poor, or should the member be dissatisfied with their outcome at retirement. This is exacerbated by a lack of clarity for both trustees and employers around the area of non-regulated versus regulated advice. Employers are not always convinced of the business case to do more than the regulatory minimum and, with only a slow trickle of DC savers reaching retirement each year, corporate decision-makers may be pre-occupied dealing with issues around DB scheme deficits, implementing auto-enrolment, or reviewing DC default funds.

14. Those interviewed in this research generally had day-to-day contact with trustees and employers. The views they shared are based on their own perceptions of trustees and employers but were in line with the earlier analysis in the NAPF and Pensions Institute research published in 2012. The issues they identified included:

    - Prioritisation. Support for members at retirement remains a relatively low-priority area for many trustees and employers. This is understandable given the challenges those running pension schemes may face with existing or legacy DB provision and, and the strong focus within DC provision on accumulation issues.
    - Risks. Trustees, mindful of their fiduciary duty to act in the best interests of members, understand that there are some risks to the members of only doing the regulatory minimum. The regulatory minimum is seen to be the provision of information sent to members at least 6 months before their expected retirement date which highlights to the member their options but leaves them to their own devices to shop around. However, the risk around doing only the regulatory minimum appears secondary to consideration of the risks associated with doing more than the minimum. The perception appears to be that trustees will be held legally liable should the quality of any service they provide or appoint be shown not to represent best practice.
    - Doing more than the minimum. There is a strong belief that, once trustees and employers are engaged in discussions around the issues and have a better understanding of how they can support members at retirement, there is then a real desire from them to do more. Many

in the industry question why trustees and employers would not at least put in place a broking solution in order to ensure better outcomes for members. However, there does appear to be a capability gap in the market, with not all employee benefit consultants, administrators and advisers driven to engage with trustees and employers on these matters. This is exacerbated by support and advice at retirement appearing to be a relatively low margin business for many of these players.

- Costs of additional support. The cost of doing more than the minimum can be funded in two ways – by fees (which is normally paid for by the trustees, the scheme member, or the employer) or by commissions (which is effectively paid for by the member, as some or all of this commission might otherwise be rebated into the member's pot). The cost of providing additional support will be a major decision factor for the employer though there is a growing recognition that cost savings, for example in HR, can be derived from putting in place more than the minimum. Commission-based models have their advantages but can have a tarnished image amongst many trustees and there remains some cynicism about the commercial drivers of the brokers. Within contract-based schemes (often, though by no means always, associated with the less engaged employers) the commission-based model is far more popular.

Chapter 3: Existing offerings on the market

Summary

- Non-advised guidance is the most utilised route for supporting members at retirement. The largest market players tend offer a full range of services, including execution-only and regulated advice. The execution-only route is little used in practice as those that start off self-serving often seek guidance along the way. Regulated advice can be restricted to just the annuity decision or can cover more holistic financial advice.
- The general perception is that the non-advised guidance route is fit for purpose in delivering good outcomes for members cost-effectively. There is recognition however that the non-advised guidance route can be sub-optimal for those with larger fund sizes for whom the consideration of other options (such as income drawdown) may be more appropriate.
- Price tends to be a key focus for competition between market participants. Advisers/brokers may look to compete on other strengths and there is evidence of differentiation in service offerings. This includes the quality and tailoring of member communications, the quality of telephony and IT/online support and the degree of support for the member journey ahead of retirement.

15. The offerings to DC savers range very broadly from an 'execution-only' service, to support and guidance, to regulated financial advice. The employee benefit consultants, advisers and brokers who are active in this market may deliver one or all of these services, and within a DC scheme different types of members (for example, depending on size of fund) may be directed, or may self-select, to different types of service. Some schemes will also offer more active member engagement and communications well in advance of retirement, for example through an EBC's front end service for members.

16. To broadly categorise these different offerings:

    - 'Execution-only' services represent the straight broking of an annuity – this is effectively order-taking for those that are happy to self-serve and the member will not receive specific help from an individual in choosing the shape of their annuity.
    - 'Guidance' is technically non-advised – members are given help in selecting, for example, the shape of their annuity but the service stops short of being regulated financial advice. Guidance can come in a number of forms, whether through a guided web-based tool or through telephone-based support and provision of information via the internet.
    - 'Regulated financial advice' involves an adviser making a specific product/provider recommendation – this will typically be holistic advice and at retirement involves considering alternatives to conventional annuities such as income drawdown. In some cases, however, regulated financial advice can be focused on a specific area of interest to the member such as the purchase of a conventional annuity.

17. It is apparent that in practice the execution-only route is not much utilised since many members who begin the process self-serving then proceed on to using non-advised guidance services. The non-advised guidance services are the principal form of offering in the market and, once in place,

appear fit for purpose in terms of being able to cost effectively deliver good outcomes at retirement for DC scheme members. Regulated financial advice is principally offered to those scheme members with larger funds where there is the appetite to explore alternatives to conventional annuities, including income drawdown. However, some examples do exist of regulated financial advice being delivered cost effectively solely for the purpose of buying conventional annuities.

18. The current regulatory framework is based around a definition of what does, and what does not, constitute regulated advice. The offering of regulated advice confers certain liabilities on advisers, and those offering non-advised guidance are therefore cautious of straying into the territory of regulated advice. Given the desire of advisers and intermediaries to steer well clear of boundary issues it is suggested that the experience of some members when receiving support and guidance may be sub-optimal.

19. The market continues to evolve with some of the major players extending the range of their services to also include execution-only services or to also include regulated advice. This may be driven by a desire to offer a more holistic service or 'USP' to trustees and employers, or by a perceived commercial opportunity. Particular concerns have been raised as to whether those with the larger fund sizes are as well served as they could be (for example, when considering routes other than an annuity) when they are not being offered regulated advice.

20. It is generally recognised that there are 4 or 5 large scale advisers and brokers active in the market. In addition a number of EBCs offer services either in-house or using an adviser or broker. There is then a long tail of other advisers and brokers ranging from corporate IFAs through to high-street financial advisers. For trustees and employers the decision to appoint an adviser or broker is likely to require them to take consultancy advice and run beauty parades, unless they are already served by a consultant with a default service in place, and this may be an expensive and time consuming process.

21. Price tends to be a key focus for competition with evidence of differentiation also in the service offering. The advisers and brokers may display particular strengths which will appeal to trustees and employers depending on their own preferences and their scheme demographics. For example, the breadth of the proposition (whether one single adviser or broker can offer the full range of support) will vary, as will the quality and tailoring of member communications, the quality of telephony and IT/online support (which in turn affects the scalability of the service) and the degree of support for the member ahead of retirement.

22. Other features that some advisers and brokers provide that will particularly appeal to some trustees and employers include:

    - audit trails of the decisions taken by the member (of particular appeal to trustees);
    - the provision of personalised, named representatives; and
    - checks which aim to ensure that any execution-only decisions have not made major errors in selecting the shape of the annuity or by missing the option to take an enhanced or impaired annuity.

23. For those trustees and employers stopping short of appointing these services there are a number of information-only services (e.g. Money Advice Service and The Pensions Advisory Service) where members can access price comparison tables. These do not, however, help them with the execution of the annuity purchase itself, and so only go some way to helping members shop around for a better outcome at retirement.

Chapter 4: Charging structures – understanding the differences between fee and commission based models

Summary

- Both fee- and commission-based charging models are capable of delivering good member outcomes. A key decision for trustees and employers is whether they pay for the service (typically fee-based) or whether the cost is borne by the member (typically commission-based).
- Where fee-based, trustees and employers will want to ensure that the commission that is rebated has been negotiated on preferential terms. Where commission-based, trustees and employers will want to ensure that the basis is fair to members and that, for example, the commission is capped as appropriate.
- Trustees and employers need to understand who bears the costs related to setting up the arrangement which in turn depends on the scheme demographics.
- On a fee basis, the cost of different services typically varies from £250-£350 for a non-advised guidance service, to around £350 for regulated financial advice on the annuity purchase only, to upwards of £500 for holistic financial advice.
- Fee- and commission-based charging models both have advantages and disadvantages. A fee-based charging model will be uneconomic for a member with a small fund size relative to the expected gain from shopping around for an annuity. A commission-based model will be commercially unattractive to the adviser/broker where fund sizes are particularly low. Fee-based models are particularly transparent and tend to match the charge quite closely to the incurred cost. On the other hand the cross-subsidies implicit within commission based models do permit those with smaller fund sizes to be served.

24. There are essentially two ways of charging for support provided to members at retirement: either through a fee-based approach or a commission-based approach.

25. Within the fee-based model, an upfront fee is paid to the intermediary, adviser or broker and the commission which would be otherwise paid to them by the insurer is rebated back into the member's fund. Where the adviser or broker is able to negotiate preferential terms with the insurer the commission available to be rebated back to the member may be as high as 1.7% for standard annuities and as high as 3.5% for enhanced annuities.

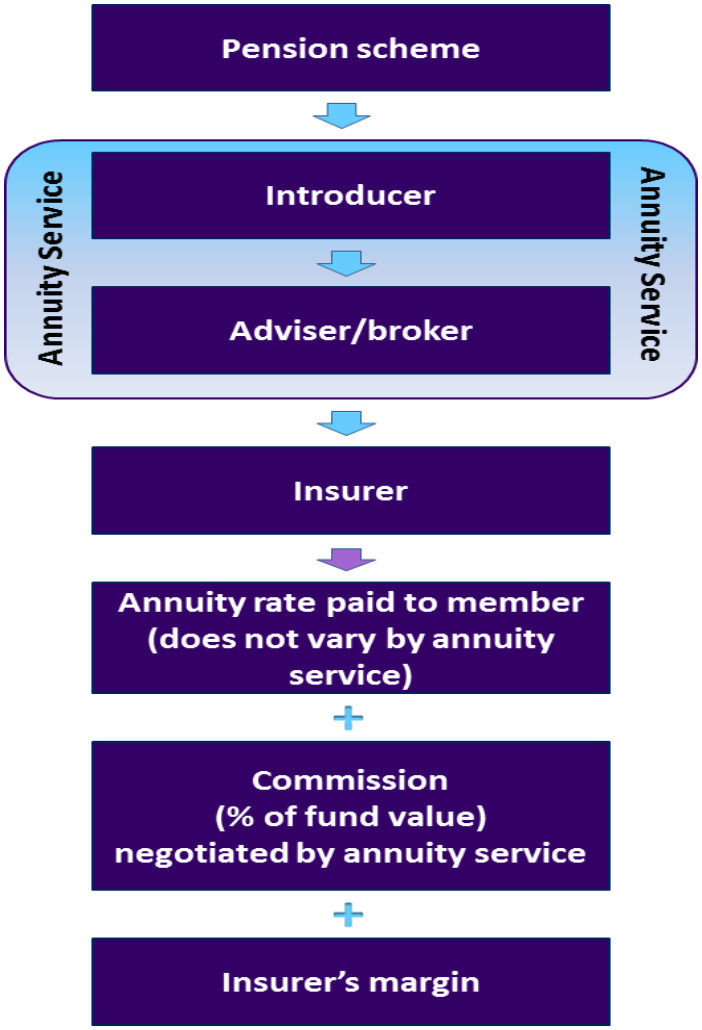
26. Within the commission-based model, it is possible for caps to be put in place to reduce cross-subsidies and make the remuneration more similar to the fee-based model. Commission caps may vary considerably from one scheme to another, and can be in the form of a single flat maximum cap on commission taken to a double commission cap comprising a maximum commission percentage and a maximum fund size to which it applies. Capped commission structures can ensure a closer match with a fee-based model whilst still delivering some cross-subsidies which helps to service members with smaller pension funds. Where fund sizes are low, a commission basis may be uneconomic for the advisers and brokers due to the fixed costs involved in setting up the service for the individual scheme. This can be overcome if the scheme is willing to cover some or all of the fixed costs of set up or make a contribution towards the cost of advice/broking.

27. Figure 1 below illustrates the parties involved in an advice and annuity purchase transaction, when the pension scheme passes the member to the 'annuity service'. In this illustration, the 'annuity service' is defined as the combination of the introducer and the adviser/broker. In terms of this research, examples include:

    - the Towers Watson Annuity Service – where Towers Watson is the introducer; and TOMAS is the adviser/broker; and
    - Fidelity's RetireWise – where Fidelity is the introducer; and Annuity Direct is the adviser/broker.

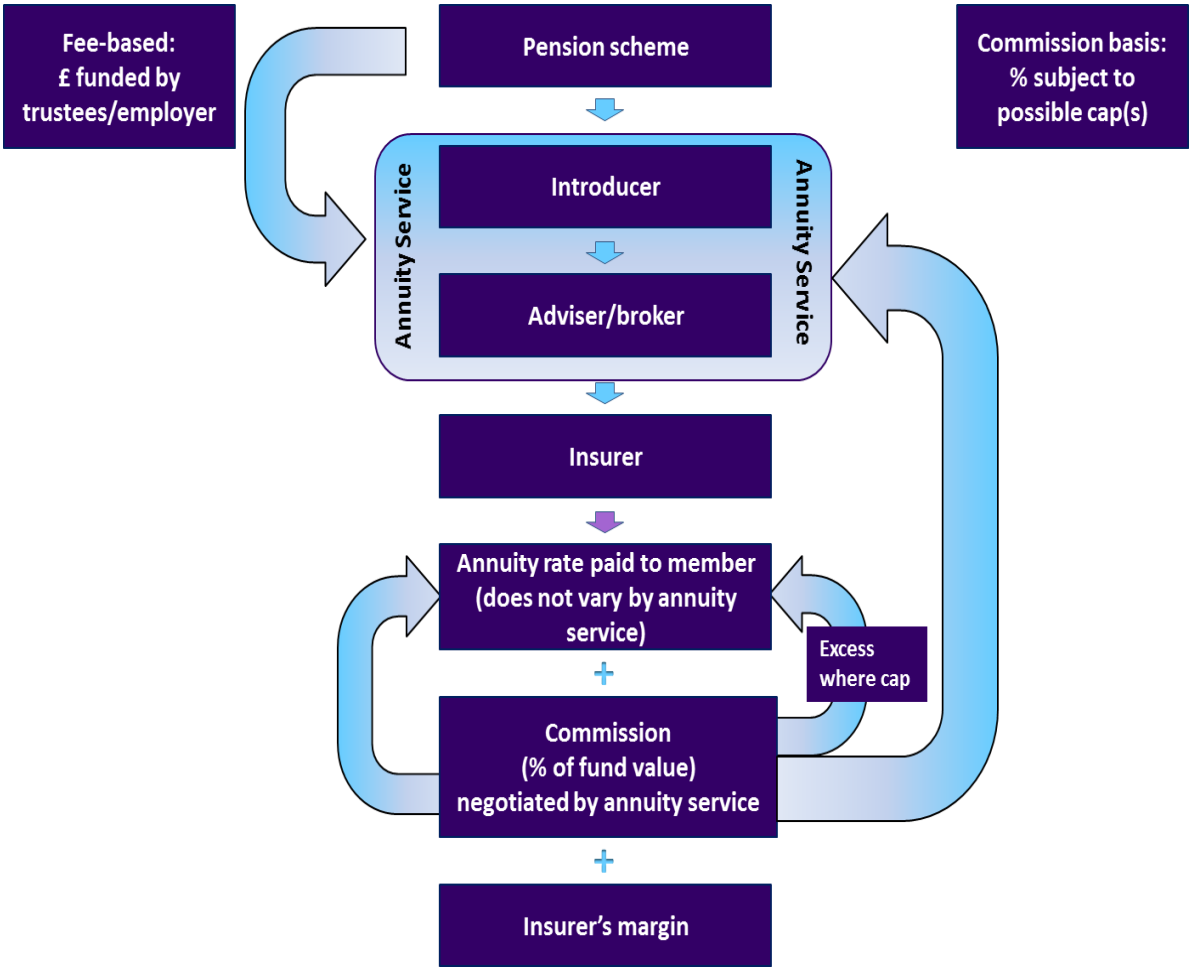
28. If the pension scheme deals directly with the adviser/broker then there is no introducer as such.

Figure 1 – The parties involved in the advice-annuity decision



29. Figure 2 below illustrates how the funding flows between these different parties under both a fee-based model and a commission-based model.

Figure 2 - The funding flows between parties involved in the advice-annuity decision



30. In the fee-based model the fee is generally expressed as a fixed cash amount and is funded by the trustees/employer (in some cases, from the income the scheme receives as an annual management charge to cover the costs of administration). The annuity service receives the fee as its source of income, and the commission that the insurer would otherwise have paid is fully rebated into the member's fund in order to increase the amount of annuity payable. The adviser or broker looks to negotiate preferential terms with the insurer which can be up to 1.7% for standard annuities and up to 3.5% for enhanced annuities.

31. For workplace pension schemes, and assuming reasonable volumes, the cost for a non-advised guidance service is typically between £250 and £350. Where the fund size is low, the model may not make sense for the member, because the marginal benefit from shopping around is unlikely to offset the cost. The fee for regulated financial advice, where focused solely on the annuity

purchase, is typically around £350. Holistic financial advice, where alternatives to conventional annuities such as income drawdown are considered, will likely start at a minimum of £500.

32. In the commission-based model the annuity service's income is effectively paid from the member's fund. It is generally expressed as a % of the fund and is paid to the annuity service by the insurer. The commission basis is equivalent to up to 1.7% for standard annuities and up to 3.5% for enhanced annuities.

33. Where there are caps in place the excess commission over and above the cap that would otherwise have been paid by the insurer is rebated into the member's fund in order to increase the amount of annuity payable. This allows some replication of the fee-based model and is seen as particularly important for non-advised guidance where the costs of commission on larger fund sizes might otherwise look disproportionate.

34. For workplace pension schemes, their commercial attractiveness to the advisers and brokers will depend on the volumes of members and the distribution of fund sizes at retirement. A commission-based model is considered attractive where the average fund size is in the region of £25-£35,000. For average fund sizes below £10,000 the commission basis starts to look far less attractive to the adviser or broker (and likewise the fee basis looks relatively costly to the value of the total fund). For small schemes sizes and/or low fund sizes, the commercial considerations for advisers/brokers are such that they cannot provide a service unless some of the set-up costs are covered and/or some element of fixed amount per member is paid.

35. Combination approaches are possible which are part fee and part commission, for example where the trustee or employer makes a contribution of say £50 towards the provision of the service. Where an annuity service is comprised of both an introducer and an adviser or broker there would typically be a revenue sharing arrangement in place that shares any fees and commissions.

36. Table 1 demonstrates some practical examples of the charging arrangements in place for different services available on the market.

37. Whilst illustrations are provided for the range of fees and charges that might be faced, in practice negotiations will tend to take place on a scheme-by-scheme basis and will depend on the commercial models of the organisations involved. For example, in some cases it appears that introducers (typically EBCs) will offer the service on a cost-neutral basis to enhance their overall offering to clients.

Table 1 – Examples of Charging Structures

	Illustrative Charges	Notes:
Execution-Only	Providing a basic broking service on an annuity: fee based cost of around £150.	In practice, few members go down this route as most seek some guidance.
Fee-Based – guidance	Typically in the range of £200-£350 for non-advised guidance.	Discounts may be available for volume. Costs can be broken down into costs of pre-retirement information and the broking service itself.
Fee-Based – regulated advice	Can range widely from £350 to £1,500 and above, depending on whether the advice is solely on annuity decision or more holistic financial advice.	Commission route no longer permitted for regulated advice under RDR.
Commission-Based – through an introducer or provider	Non-advised guidance and execution only services offered on a commission basis with the commission capped, potentially by % and fund size or up to a fixed maximum commission. Any excess rebated into the member's fund.	Some introducers will cap the commission at a low level so that most of it is rebated into the member's fund as they see this service as part of their wider client offering rather than a commercial opportunity in its own right.
Fee and Commission combination arrangements	Employer pays fixed fee of, say, £50 per member with rest picked up through commission.	Appears to be rare in practice but could be put in place to ensure the scheme is still sufficiently commercially attractive to the adviser or broker.
Costs of consolidating additional funds	Providing a service to consolidate funds. A charge of, say, £100-£150 may be levied.	In some cases is provided at no further cost.

Chapter 5: Market effectiveness and future developments

Summary

- Given the high amount of defaulting that remains amongst retirees it is recognised that the market could be functioning more effectively. However, where members are being offered more than just information, the perception is that the at-retirement market is competitive and functioning well.
- Interest in alternatives to conventional annuities, in particular income drawdown for lower fund sizes, is identified as a potential growth area.
- There remain barriers to putting a service in place for those running smaller DC schemes (who may be less well served by advisers) and for those with DC schemes where members have smaller fund sizes (who may be less commercially attractive to advisers/ brokers to the point of being unviable).

38. There is still a strong perception amongst advisers and brokers that the market is inefficient overall – given the significant number of DC savers who buy an annuity from their default provider at retirement. A default provider may be an insurer who is a pension provider and an annuity provider (e.g. in a GPP arrangement) or an annuity provider who is in a tied arrangement with a pension provider or third party administrator.

39. The latest research from the ABI[5] showed that, whilst two thirds (63%) of annuity purchasers stated that they had shopped around and considered switching provider, only 30% had actually switched provider, and only 50% had approached other providers (either themselves or via a financial adviser) to discuss annuity products or gather annuity quotes. There may be good reason why an individual chooses not to switch provider, but only 50% of savers appearing to actively shop around (albeit ahead of the ABI's Code of Conduct being implemented) is a serious concern.

40. Where scheme members are being offered more than just information the at-retirement market appears to be competitive and well-functioning. The natural conclusion, therefore, is that if more trustees and employers were to facilitate an advice or brokerage service on behalf of scheme members then the overall market would be more efficient.

41. Cost reduction opportunities were identified from potential process improvements, in particular through insurers improving the application form process to better facilitate straight-through processing.

42. Recent trends and developments in the market highlighted by those interviewed included:

    - A drop off in recent business volumes following a surge in volumes at the back end of 2012 aligned with the introduction of unisex annuity rates;
    - A continued withdrawal of financial advisers offering regulated advice at-retirement in the wake of the implementation of the Retail Distribution Review, either as a result of advisers

[5] Retirement choices: baseline to measure effectiveness of the code of conduct, May 2013

moving out of the market altogether, or focussing on non-annuity business or on non-advised business;

- A growing interest in alternatives to conventional annuities and, in particular, the development of lower-cost income drawdown plans; and
- A growing recognition from employers and trustees that information is not enough and more support at retirement is needed.

43. Remaining inefficiencies and barriers in the market highlighted by those interviewed included:

- Levels of member engagement and, in particular, awareness in the run up to retirement and ahead of the 6 month 'wake up' pack stage;
- Overcoming employers and trustees concerns about the value and benefits of doing the right thing for their members;
- The challenge for smaller DC schemes, which have often been put in place by smaller IFA firms, and the extent to which is it cost effective for an adviser to provide support to retiring members; and
- The challenges for DC schemes with a large number of small pots where some significant element of subsidisation may be needed for the arrangement to be commercially viable for the adviser or broker – typically by the scheme or employer covering the set up costs and some of the per member costs.

Chapter 6: Role for the NAPF

Summary
There were two potential areas identified where the NAPF could provide support to help the market operate more effectively:

- **Raising awareness amongst employers and trustees** – there was a strong belief that, once made aware of the alternative options, most employers and trustees will want to do more than the minimum. The NAPF can add value by clarifying the regulatory requirements, by highlighting the risks to member's benefits of employers and trustees only doing the minimum, and by raising awareness and capability around appointing an adviser/broker; and

- **Addressing specific barriers in the market** – this could range from the NAPF setting some minimum standards, to developing a 'shortlist' of advisers/brokers for trustees and employers to use, to it developing its own service proposition or master-arrangement to support schemes when putting in place support for members. Such a proposition might also help serve those schemes which are less commercially attractive for the advisers/ brokers to serve currently.

44. Those interviewed were asked for their views on where the NAPF could add value in this area. No prompts were given to interviewees as to possible areas for potential NAPF intervention.

45. It was universally suggested that the NAPF should expand its awareness and education offering to trustees and employers in the at-retirement space. Suggestions included:

    - promoting the message that guidance and advice can make a real difference and that trustees and employers should at least facilitate a broking solution;
    - developing generic member communications that could be applied by trustees and employers across both trust- and contract-based schemes;
    - developing tools to support trustees and employers with communicating with scheme members, investigating the options and appointing advisers and brokers;
    - supporting trustees and employers with scheme member education, including the key decisions in the accumulation and decumulation stages, the risks of inertia and the risks inherent in DC, and the jargon and complexity inherent in pensions.

46. There were also suggestions from some, though not all, of the interviewees that the NAPF should go further, either by setting some quality standards for advisers and brokers or by developing its own proposition in this area. It was noted that the setting of minimum quality standards by the NAPF could bring due diligence, on behalf of employers and trustees, to the process of selecting an adviser or broker and therefore overcome some of the barriers that they face around going beyond the minimum regulatory requirements. This could, for example, lead to the NAPF providing its members with a reliable shortlist of advisers/brokers for trustees and employers to use in their selection process.

47. It was suggested that the NAPF could develop a master-arrangement that DC schemes could readily adopt and that this could significantly reduce the set-up costs that are currently incurred in contract discussions.

48. The potential to develop a universal access service was also identified as a possibility, which could leverage off insurer sponsorship to provide some form of low cost brokerage support to scheme members who are currently uneconomic for the brokers and advisers to serve, in particular those with smaller fund sizes.

Chapter 7: Conclusions and next steps

49. The NAPF takes the view that, to deliver optimal outcomes for DC scheme members at retirement in both trust- and contract-based schemes, a default shopping around service should be in place. The structure of this service can vary between schemes, but should be predicated on an agreement between the employer, trustees or the provider, with an adviser or broker that has the expertise or capacity to provide a shopping around service or 'default OMO' for those members with all but the smallest pots.

50. Our Annual Survey tells us that around 50% of our fund members running DC schemes already have these services in place, though it is not clear whether all or only some of their scheme members have access to the service, and how many currently use it. These services are also more commonly in place for trust-based schemes, and for larger schemes, and so members of smaller DC schemes are likely to be particularly at risk.

51. Whilst members of contract-based schemes appear less likely to have an adviser or broker appointed to their scheme, many of them should benefit from improved communications about the benefits of shopping around as the ABI's Code of Conduct is implemented. Only time will tell whether the Code will succeed in breaking the inertia that currently sees only around 1 in 3 members switch provider at retirement.

52. To support our fund members to deliver a better service for their DC scheme members the NAPF will be taking forward action in three areas:

    - We will deliver by the end of October 2013 a Made Simple Guide for trustees and employers, which will provide them with practical guidance about the benefits to trust- and contract-based scheme members of support at retirement and the range of options available to scheme members on the market. A key element of the Guide will be to tackle some of the perceptions of trustees and employers about the risks of going beyond the regulatory minimum.
    - We will review our existing training programme to offer trustees and employers running DC schemes support on how to implement these services, including guidance on the regulatory implications of providing different forms of support and advice and what to look for when appointing an adviser/broker.
    - We will take forward a programme of work, based on the feedback from this research and from our fund members running DC schemes, to explore how the NAPF can improve the functioning of the market. This could include, for example, the setting of minimum standards for advisers/brokers to develop a shortlist for trustees and employers, or the development of a master-arrangement for advice/broker services that can benefit DC schemes so that they may be better served.

NAPF

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