Securing the future of pensions

Competition in at-retirement market: an initial response by the National Association of Pension Funds to the FCA Market Study

March 2014

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Executive Summary

The NAPF welcomes the FCA's market study on retirement income. The NAPF believes that any review of the at-retirement market should consider:

- the information gap and complexities for consumers;
- the lack of transparency in annuity rates and the sales process;
- the supply and demand of at-retirement advice; and
- the role governance plays in ensuring good member outcomes for DC scheme members at retirement.

The NAPF believes that, given the forthcoming changes to the at-retirement market as announced in the 2014 Budget, the FCA market study is not only timely, but also critical for ensuring people have access to the right at-retirement products, clear information and have adequate support to make decisions.

The NAPF looks forward to supporting the FCA over the course of the year as it undertakes this study. The NAPF encourages the regulator to consider all aspects of, and all players in, the at-retirement market, and to consider recommendations that address the conflicts of interest that exist in this market. The FCA should work closely with the Pensions Regulator to ensure a thorough analysis of the needs of all consumers of at-retirement products – those in trust based schemes as well as those in contract based arrangements.

About the NAPF

The National Association of Pension Funds (NAPF) is the leading voice of workplace pension provision in the UK. We represent some 1,300 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 £900 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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NAPF concerns

1. The NAPF welcomes the FCA's market study on retirement income. The NAPF has, for a number of years, expressed its concerns with current practices in the at-retirement market which have led to a loss of up to £1bn in retirement income a cohort of retirees.

2. Currently £193bn of assets are in annuities and £53.2bn in income drawdown. And, until the 2014 UK Budget that seeks to substantially reform the at-retirement market from April 2015, this was expected to increase to almost £305bn in annuities and 135bn in income drawdown in the next 10 years.[1] Under automatic enrolment up to 9 million people will be newly saving or saving more in to a pension scheme by 2018, most likely a DC scheme given the current trend in the closure of DB schemes.[2] If the issues in the at-retirement market are not addressed, the consumer detriment from the sale and purchase of at-retirement products that do not offer the best deal will increase substantially, affecting both people's financially well-being in retirement, as well as their trust in pensions as a vehicle for long term saving.

Consumer knowledge and expectations

3. Most consumers are savings in to pension schemes set up by their employers. Their choice is limited to staying in or opting out of the employer's pension scheme. Having never had to fully engage with or manage their pension savings, those approaching retirement are asked to make critical financial decisions that are often irreversible on turning their pension savings in to retirement income. Therefore, it is not surprising that for those approaching retirement the process of converting pension savings in to an income can be a complicated. NAPF research shows that, when asked, almost half of consumers are not confident that they have the knowledge to make a decision on the best deal on an at-retirement product like annuities. 58% of women respondents believe that they do not have the knowledge to make such a decision, as do over a third (35%) of 55-64 year olds – those approaching State Pension Age.[3]

4. Any decision that consumers of at-retirement products would need to be based on the pension savings and assets they have. Currently, however, most people saving in to DC scheme are unaware of the savings they have accumulated over their working life and the income these savings may buy them at retirement. Research conducted by the Institute for Fiscal Studies,[4] and which is based on the English Longitudinal Survey, shows that only 45% of DC pension scheme members aged 50 and over were able to state the expected size of their pension savings at retirement. 37% of DC scheme members aged over 50 were unable to give

[1] Spence Johnson, *retirement Income Market Intelligence.* January 2014.
[2] ONS, *2012 Annual Survey of Hours and Earnings: Summary of Pension Results.* 22 February 2013.
According to the Annual Survey of Hours and Earning, 28% of employees were members of DB schemes in 2012 compared to 46% in 1997, while 17% were in a DC scheme compared to 10% in 1997.
[3] NAPF, *Workplace Pension Survey,* October 2013
[4] IFS (sponsored by NAPF and ESRC), *Expectation and experience of retirement in defined contribution pensions: a study of older people in England*. November 2012

any estimate of their future retirement income or their fund value at retirement given their current savings. The research found that those able to provide information on their expected income at retirement overestimated the income they would receive from their pension savings. These scheme members would need to, on average, increase their pension savings by 25% to achieve their expected retirement income. Part of the disconnect between expectations and reality can be explained by the fact that scheme members approaching at-retirement overestimate annuity rates and underestimate their life expectancy and the years of retirement their savings will need to fund.

5. The knowledge gap in understanding savings, at-retirement products and forecasting future needs and requirements amongst pension savers is evident, and often this translates in to a significant number of savers members failing to secure the best at-retirement product for their circumstances.

Annuity purchases

6. Pension scheme members that do not shop around for the best deal on their annuity and switch providers are at risk of losing more than 40% of their retirement income.[5] According to the ABI's most recent briefing on annuity sales, only 48% of annuity sales in 2012-2013 were external.[6] The NAPF believes that it is important for the FCA to seek clarification on how many of these external sales were with a tied provider, where a pension provider that does not offer an annuity has an agreement with one that provides annuities. Further insight is particularly necessary given that ABI consumer research suggests that even though 63% of consumers state that they have shopped around for an annuity, only 50% actually took steps to search the market.[7]

7. The ABI advises that most internal annuities are bought by those with a pension pot of £10,000 or less.[8] This is particularly concerning given that 29% of pension pots are worth less than £10,000, and that by 2050 at least 12m pots will be valued at £2,000 or less.[9]

8. ABI statistics also show that, in 2013, enhanced annuities accounted for only 8% of all internal annuities sold – this figure increases to 28% when we include enhanced annuities bought on the Open Market.[10] According to the ABI's consumer research, less than a quarter (22%) of those that are eligible for an enhanced annuity actually consider buying one. Similarly, only 58% of consumers eligible to buy joint life annuities actually consider them, and in 2013 only a third of consumers actually bought a joint life annuity.[11]

[5] NAPF and Pensions Institute, *Treating DC scheme members fairly in retirement?.* February 2012
[6] ABI, *The UK annuity market: facts and figures.* March 2014
[7] ABI, *Retirement Choices: baseline to measure effectiveness of the Code of Conduct.* May 2013
[8] ABI, *The UK annuity market: facts and figures.* March 2014
[9] DWP, *Improving transfers and dealing with small pension pots: Government response to the consultation*. July 2012
[10] ABI, *The UK annuity market: facts and figures.* March 2014
[11] ABI, *Retirement Choices: baseline to measure effectiveness of the Code of Conduct.* May 2013

9. The NAPF continues to express concerns over the lack of transparency in annuity rates set by providers. Qualitative research conducted in 2012 showed that, for example, some providers may be adjusting their internal rates in anticipation of a large number of internal DC funds being used to purchase an annuity.[12]

10. The NAPF believes that the ABI's Code of Conduct on Retirement Choices that came in to effect in March 2013 does start to address some of the concerns around knowledge and use of the open Market Option. The NAPF remains, however, concerned about the transparency of rates and the incentive for pension providers to retain the business of scheme members that start to retire. A conflict of interest will undoubtedly exist where those that manage pension savings as they are accumulated over a significant number of years also offer decumulation services through their own company or through arrangements with other insurers. Research sponsored by the NAPF and Pensions Institute in 2012 found that strong retention rates at decumulation are part of the business model for many pension providers.[13]

11. To increase transparency the ABI has started publishing examples of annuity rates on its website as part of the Code of Conduct on Retirement Choices. IFS shows that those accessing the internet or email are twice as likely to buy an annuity externally than those that do not have access to these services. In light of this evidence the ABI's rate examples are welcome – however given that the information in not available on a consumer website, given the complexity of the information and given that notional rates are listed rather than real rates available to pension savers, the NAPF believes that it falls short of supporting pension savers in understanding annuities and the choices available to them. For regulators and policmakers the webtool would prove to be more useful if it showed retention rates and disclosed each provider's general pricing models for internal and OMO rates.

12. Given the complexities in the annuity market, the NAPF believes that advice is essential for ensuring people make the best decision on turning their savings in to regular income in retirement.

At-retirement advice

13. Accessing pensions related advice through the scheme or employer arrangement would ensure that people are able to use expert services offering independent advice and at a reasonable cost.

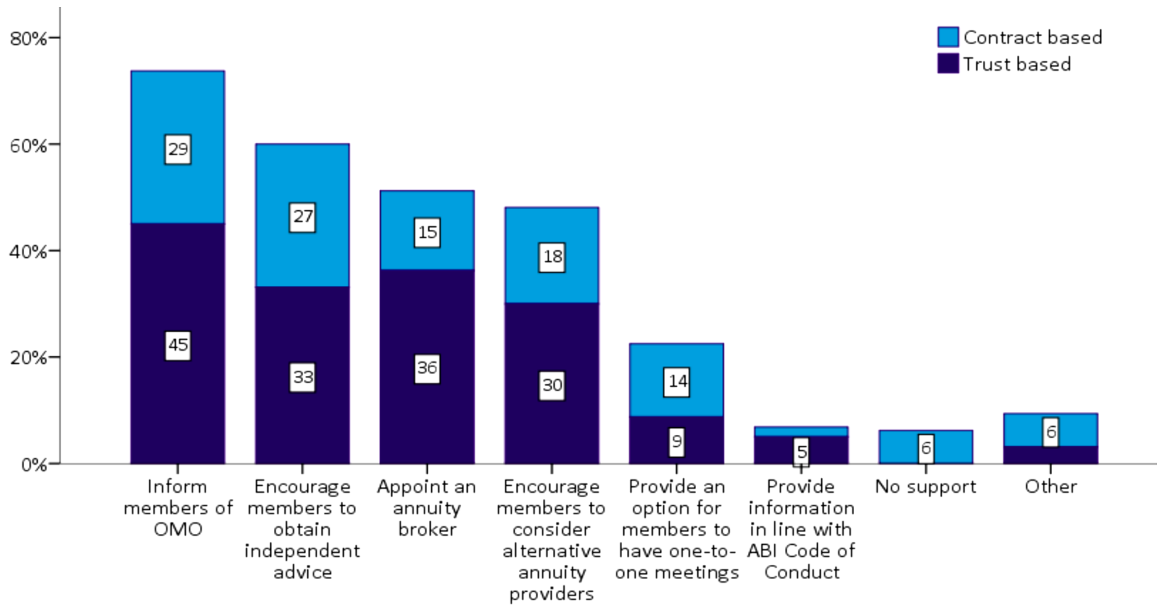
14. However, just as employers ultimately make the key decision of which pension scheme to bring in to their workplace, trustees in trust-based schemes and pension providers in contract-based schemes (currently) are the bodies that can appoint independent advice services to support scheme members at retirement. In some contract-based schemes, employers have put together management committees that provide governance support for

[12] NAPF and Pensions Institute, *Treating DC scheme members fairly in retirement?.* February 2012
[13] NAPF and Pensions Institute, *Treating DC scheme members fairly in retirement?.* February 2012

the pension scheme, otherwise no formal governance arrangement is available in contract-based schemes.

15. The NAPF's Annual Survey 2013 shows that 51% of DC schemes have an at-retirement adviser or broker in place for their scheme members. 71% of schemes that have an at-retirement advice service in place for their members are governed by trustees, while 39% are contract based schemes run by a pension provider.[14]

Graph 1: At-retirement support offered to scheme members.



Source: NAPF Annual Survey 2013

16. The NAPF's research on the at-retirement advice market published in the summer of 2013 shows that concerns about going beyond the regulatory minimum remain a significant barrier to the appointment of such services by schemes. Trustees can be concerned about the potential liabilities associated with inadequate advice to a scheme member or that a member is unhappy with the advice provided. The Pensions Regulator has addressed these fears in the Guidance published in November 2013 along with its Code of Practice, suggesting that where trustees appoint an at-retirement adviser they are not liable for the advice provided to scheme members through this arrangement.

17. Even where any concerns of redress are addressed, trustees and paternalistic employers may still face knowledge and resource constraints around shortlisting and selecting an adviser or broker for their scheme's members. NAPF research has also shown that schemes that have

[14] NAPF, *Annual Survey 2013.* December 2013

many small pots and small schemes are less likely to be commercially attractive to at-retirement advisers.[15]

18. The at-retirement advice providers that have previously been interviewed for NAPF research have also advised of capability gaps due to the low margin of profit they make from the provision of these services.[16] Scheme members often have a choice between paying for guidance and getting regulated independent financial advice. The fee for each scheme member, or commission where guidance in place, can be anywhere from £200 to 1,500.[17] The costs for at-retirement guidance or advice are not always covered by employers. The NAPF recently conducted a survey of 100 DC schemes[18] that are NAPF members, finding that 47% of those that have appointed an at-retirement adviser also say that this support is paid for by the employer – this is more common in trust-based schemes (54%) compared to contract-based schemes (36%). A significant proportion of scheme members share costs with their employer or pay for the advice entirely through their pension pot.

19. The Financial Services Consumer Panel in December 2013 raised concerns about consumer understanding and knowledge of the costs associated with guidance and advice – in part due to the lack of information on affiliated websites.[19] The FCA, in its thematic review, has advised that it is consulting on guidance in this area.[20] The NAPF believes that it is essential that such guidance extends to all organisations that signpost consumers to at-retirement advisers, brokers and/or annuity providers.

20. The 2014 Budget directs the FCA to develop standards for the face-to-face guidance that will be guaranteed to be available to pension savers through their schemes. Therefore the market study needs to consider the impact the 'guidance guarantee' will have on the current market for advice and guidance, and how it fits with existing services being offered by employers and schemes. The FCA will need to investigate the current issues and barriers faced by schemes in appointing at-retirement guidance and advice services and the capability of advisers to deliver face-to-face guidance to all pension savers that may wish to access it starting April 2015.

Recommendations

21. The NAPF strongly believes that the FCA market study should consider the current and changing landscape for at-retirement guidance and advice and the governance models (contract- and trust-based schemes) that support the accessibility of such advice and support to pension scheme members approaching retirement.

[15] NAPF, *Supporting DC savers at retirement.* June 2013
[16] NAPF, *Supporting DC savers at retirement.* June 2013
[17] Ibid.,
[18] NAPF internal research – unpublished. October 2013
[19] FSCP, *Annuities: time for regulatory reform*. December 2013
[20] FCA, *Thematic Review of Annuities.* February 2014.

22. The NAPF offers its support to the FCA in engaging pensions professionals in this market study and considers it critical that the FCA considers all aspects of the at-retirement market and considers the concerns and experiences of all players that interact with it, including trustees in trust based schemes. The FCA should work closely with the Pensions Regulator on issues that affect trust based schemes.