NAPF

Securing the future of pensions

Freedom and choice in pensions: a response by the National Association of Pension Funds

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A summary of our key recommendations

Ensuring that appropriate new retirement income products are available:

- Scheme trustees should be permitted to define their own default pathways for scheme members who are unwilling or unable to make their own decisions.
- The Government should explore ways to encourage the development of scale, low cost drawdown products, to help those with smaller DC pots access their savings in a cost-efficient manner.
- The FCA should also remain vigilant regarding misselling activity targeted at members of DC and DB schemes.
- The FCA should engage with trust-based DC schemes as well as FCA-regulated firms as part of its market review.

Ensuring that Guidance is designed, tested and ready for scheme members in April 2015

- The NAPF supports the appointment of a not-for-profit organisation to establish a central service to support the development and testing of Guidance for April 2015. In addition, schemes should be permitted to continue to offer their own guidance, advice and support to members through providers of their choice.
- The Guidance Guarantee should be made available to members at the scheme's Normal Retirement Date (NRD) or where scheme members need or choose to take retirement or access funds at an earlier date. Guidance should be delivered at the level of individual pots.
- The Government should focus on web-based delivery supported by a telephone service with face-to-face offered only where other channels are rejected.
- We call upon the Government makes the following decisions by the end of July, to ensure that Guidance is available to scheme members by April 2015:
  - The definition of the guidance guarantee in terms of what areas it will cover and who it will be available to;
  - Which organisation(s) will deliver the guidance guarantee, in particular whether this will be a centralised service with a public service obligation;
  - Who will take the lead in setting up the service and establishing its standards;
  - How the funding framework will work.

  At the same time as a decision is made on what Guidance is, we also need the Government to set out a detailed delivery plan for April 2015, outlining how it envisages all those working in this market and the not for profit sector will contribute and deliver the changes necessary to ensure this policy is a success.

Developing a co-ordinated approach to policy implications

- The Government should ensure that the responsibilities of HM Treasury, the Department for Work and Pensions, the Financial Conduct Authority and The Pensions Regulator are clearly defined. Particular thought should be given to how the Budget proposals work alongside the charge cap and the new Pensions Bill that will introduce the concept of Defined Ambition pensions.
- The Government should delay the implementation of the DC charge cap, governance and transparency requirements until 2015 and the introduction of the pot follows member legislation until late 2017 at the earliest.

DB to DC transfers

- The right to a transfer from DB to DC for deferred members should be retained subject to members receiving advice. The right should not extended to pensioner members. Trustees must retain the right to set cash equivalent transfer values (CETV) at levels that appropriately reflect the ongoing level of deficit in the pension scheme and a further margin to reflect the uncertainties and volatilities of investment.

Introduction

1. There are more people saving in DC pensions than ever before. The proposals contained in *Freedom and Choice in Pensions* would increase greatly their freedom to access their pension savings in a way which makes sense for them as individuals. These major changes have the potential to transform retirement income for the better and thereby increase the attractiveness of retirement saving. We share the Government's desire to realise that potential.

Our response to HM Treasury's consultation sets out a number of recommendations that we believe will ensure that:

- pension scheme members have access to Guidance[1] from April 2015 and appropriate and good value products that meet their needs for retirement income;
- pension schemes are able to proceed with the redesign of investment, communication and support strategies that address not only the Budget proposals but also the DWP's proposals for the charge cap;
- suppliers of Guidance and other services to pension schemes feel able to develop of their business models to fit the new pension landscape;
- employers feel confident that their pension and HR strategies are fit for purpose in the new policy environment; and
- the Government is reassured that it can meet its objectives in delivering new freedom and choices in pensions allied to appropriate Guidance.

2. Delivering the high-level proposals set out in *Freedom and Choice in Pensions* will require a very significant effort from all those involved in delivering and managing pensions. It is vital that the Government works with pension schemes of all kinds to ensure their successful implementation. In our view, a successful implementation depends above all on three factors:
   - the development of appropriate and good value retirement income solutions and defaults;
   - the emergence of Guidance services that support people making retirement decisions; and
   - a coordinated and timely approach to implementation of both the Budget proposals and the DWP's proposals for governance, transparency, a charge cap and automatic transfers that minimises the risk of detriment for savers.

3. While it is tempting to think of the new freedoms as a 'dash for cash' we believe the majority of people are likely to want to access their money without taking it all in one go. For this to be realised, it will be important to:
   - make it as easy as possible for scheme members to access products that enable them to draw an income where this is their preference;
   - continue to improve efficiencies in the retirement income market;
   - facilitate the development of good value, mass market retirement income products; and

[1] In this report, we use the word guidance in two ways. The first relates to that envisaged by the Budget proposal where we capitalise Guidance. In other instances, we refer more broadly to guidance that members may need over an extended period where we use a lower case.

- remain vigilant on the potential for misselling.

4. High quality guidance at the point of retirement is a critical counter to the risk of individuals making poorly informed decisions which they subsequently come to regret. It needs to be focused on mitigating that risk and avoid creeping into areas which are better served by alternative guidance or advisory services. A 'free' Guidance service will ultimately be funded from scheme members; it is critical therefore that the specification of the guidance guarantee does not allow or, worse, encourage costs to have a disproportionate impact on those pots. Progress on the definition and development of simplified advice to help fill the advice gap that has widened with the advent of RDR will also be critical to delivering services beyond the Guaranteed Guidance (hereafter "Guidance").

We believe the critical elements in providing a good value Guidance service are:

- A **not-for-profit provider or providers with a public service obligation**, operating under a single brand, to whom schemes can direct their members.
- **Freedom for schemes to provide access to an alternative accredited guidance service** where that enables greater continuity with pre-retirement communications outside of the guarantee scope. Schemes providing such access should be exempt from funding the PSO[1] provider(s) where the guidance is available to all members and meets FCA standards.
- Guidance covered by the Guarantee should be:
    i. predicated on the **recipient having undertaken sufficient preparation** to enable useful Guidance to be given;
    ii. **delivered in a single session**, lasting no more than 45 minutes and considerably less where circumstances are straightforward;
    iii. **generic in nature**, using examples and illustrations based on 'people like you'.
    iv. available by **telephone and through webchat**.

5. Harnessing the potential of the new freedoms and avoiding detriment also requires an implementation programme within and *across* policy initiatives which enables schemes to deliver in their members' interests. These are wide-ranging reforms which are too frequently characterised as solely about delivering Guidance. In practice, all schemes will need to:
    - review their investment strategy, ensuring that default approaches designed to cater for an environment in which most people could be expected to access DC savings at a single point in time as 25% cash/75% annuity are redesigned for an environment in which such norms no longer exist. Some may also need to review their administration platforms and other services;
    - review their member communications not just to comply with the new requirement to make guidance available but also to notify members of any changes to default investment strategies and to help members make sense of the new freedoms;
    - decide how to deal with members who prefer not to take their full pot at a specific date; in most cases this will require schemes either to create new transfer processes and systems or new income functionality.

6. This all needs to happen at the same time as schemes are implementing the proposals set out in the DWP's consultation response, *Better Workplace Pensions*. We have set our views on timing of a charge cap and related issues in our response to *Better Workplace Pensions*. **In addition, it is now imperative that the Government gives schemes early clarity on:**
   - **the delivery model, funding, triggers and standards for Guidance;**
   - **changes to tax regulations that will affect schemes;**
   - **how the Budget changes will feed through into TPR codes or guidance;**
   - **any statutory overrides that may be applied;**
   - **decisions about transfers from DB to DC; and**
   - **assurances that trustees are sheltered from the risk of calls for redress from members who make decisions with poor consequences whether in response to the Guidance or in the absence of Guidance.**

7. The timetable is very tight and a failure to provide certainty for schemes will risk the successful implementation of the reforms from April 2015. Government, regulators, providers and schemes must all work together to ensure that DC members are able to access good quality advice and guidance from next April, that barriers to members enjoying their new freedom and choices are minimised and the new freedoms and choice are balanced by consumer protection where necessary.

8. Our response explores:
   - what the changes could mean for pension scheme members;
   - the opportunities and challenges facing pension schemes in preparing for these important changes;
   - the changing needs of DC members for help and support around their retirement decisions;
   - the implications for DB schemes; and
   - the need clarity and a joined-up implementation programme in what is a very busy and compressed legislative and regulatory agenda for the coming year.

9. We review the specific consultation questions at appropriate places through this document and include a summary in appendix one.

About the NAPF

The National Association of Pension Funds is the leading voice of workplace pension provision in the UK. We represent 1,300 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. We represent both public and private sector schemes, including over 70% of Local Authority pension funds. Our members provide pensions for 16m people and collectively hold assets of around £900bn, making them major institutional investors. Our main objective is to ensure there is a secure and sustainable pensions system in the UK.

Making the most of freedom and choice

10. The Government's extension of greater choice and flexibility to the mass market of pension savers is to be welcomed. However, together with new opportunities, the changes also introduce new risks and responsibilities for DC scheme members and new challenges for DC schemes, trustees and providers.

11. For scheme members, the new freedoms offer considerable opportunity to employ their pension savings in a way which suits their personal circumstances. This might mean accessing their pension savings to pay off debt or mortgages, helping fund children's further education or setting them up on the property ladder, leaving the money invested to fund later care needs or funding some luxuries in early retirement. However, we anticipate that for the majority, the pension savings "pot" will still be viewed as a means of generating an income in retirement that supplements the individual's state pension.

12. For those who wish to use their funds to generate an income, the choices available are likely to expand beyond the current solutions of annuities and income drawdown. We anticipate that, in an environment of greater freedom and choice, the benefits of an annuity may become more obvious to those seeking to secure an income for life. However, for some the attraction of remaining invested and drawing an income from their pension 'account' will be appealing. Where members take up the option of new drawdown facilities, they will be faced with a wide range of new risks to consider, not least of which are longevity and investment risks.

13. Managing longevity risk is a complex issue. Research consistently shows that individuals typically underestimate their lifespan, which can lead to the risk of over-spending in the early years of retirement. A recent report supported by NAPF found that men aged 50–60 underestimate their life expectancy on average by around 2 years and women by 4[2].

14. However, there is also some evidence, particularly from the US, where annuitisation is much less common than in the UK, that the fear of running out of money can lead to some people underspending[3] and living on a lower income than is desirable or necessary.

15. The market will need to respond to these new consumer freedoms and choices by developing new drawdown solutions that help consumers manage these risks by offering default solutions and new tools to help consumers understand how their drawdown pot is performing. While we anticipate that those with larger pots may well be prepared to fund advice, the majority of DC members may be better served through default solutions allied to enhanced on-line tools and on-going guidance. These solutions are not widely available at low cost in today's market.

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[2] IFS 2012, Expectations and experience of retirement in Defined Contribution pensions: a study of older people in England, funded by NAPF and ESRC

[3] James B. Davies, Uncertain Lifetime, Consumption, and Dissaving in Retirement, , Journal of Political Economy, Vol. 89, No. 3 (Jun., 1981)

16. The changes are particularly significant for trust-based schemes where the usual practice is for members to leave the scheme at normal retirement date (or before), either through the purchase of an annuity, through trivial commutation or a transfer to an individual income drawdown plan. The new flexibility presents schemes with a number of complex decisions to be made about new default investment strategies for those in accumulation phase as well as new solutions for those in the decumulation phase.

Delivering new ‘at retirement’ options

17. The NAPF welcomes the greater flexibility afforded by the changes announced in the Budget. We believe they will enable some individuals to make choices that suit their specific circumstances and that increased flexibility ‘at-retirement’ may increase incentives to save. The NAPF’s latest Workplace Pensions Survey shows that over a quarter (28%) of consumers are now more likely to start saving or save more into a pension following the reforms announced in the Budget[4].

18. However, the changes present a very real structural and administrative challenge for pension schemes. It is important that the Government makes it as easy as possible for schemes (and their advisors) to understand and manage the transition, in order not to put their scheme members at risk.

New challenges for trust-based schemes

19. Most trust-based, and some contract-based, DC schemes are set up for members to leave the scheme at normal retirement date (NRD). Exit typically occurs in one of three ways: the purchase of an annuity by the individual or trustees; a transfer into an individual income drawdown plan; or trivial commutation where a cash sum is paid. Schemes are not traditionally set up to manage assets beyond retirement.

20. Furthermore, investment strategies for default funds often incorporate an element of lifestyling, an approach whereby the volatility of funds is gradually reduced (through the switch to fixed income instruments such as gilts and cash) as individuals approach their NRD in order to help secure growth ahead of the purchase of an annuity.

21. The Government’s proposals raise the question of whether this approach is appropriate for individuals who may now wish to withdraw funds much earlier or indeed much later. Many schemes will want to review their default investment and retirement income strategies in the light of these changes, but will be doing so with no clear sense of how members themselves will respond to the changes. A default strategy for an individual approaching retirement with a view to withdrawing all of their funds could be very different to that required by an individual anticipating taking an income from their fund.

22. Where schemes currently ‘default’ to the purchase of an annuity where a drawdown transfer is not requested, it is not clear how schemes should respond in the new environment. Schemes will therefore want to consider whether they can or should develop alternative default pathways and what those new defaults should be. Moreover, schemes will need to determine a default for those members who simply fail to engage or make a decision.

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[4] NAPF Workplace Pensions Survey, April 2014.

23. Default pathways could involve transferring member funds to other pension arrangements that offer an income facility (albeit that appropriate mass-market arrangements are not yet available). A very small number may wish to develop their own drawdown solutions that provide limited or complete flexibility to members to make regular or *ad hoc* withdrawals of funds. **However, given the costs involved, the NAPF believes that it is critical that schemes are not be required to provide an income facility within schemes.**

Recommendation 1: We recommend that scheme trustees be permitted to define their own default pathways for scheme members who either fail to make an active decision and for those wishing to extract an income from their accumulated fund but who do not wish to purchase an annuity.

24. If schemes retain members well beyond their normal or state pension age, schemes may find themselves with deferred members aged 80 or more. There are some concerns about how schemes would deal with members with declining numerical and cognitive abilities.

Recommendation 2: The Government should engage with pension organisations and with consumer groups representing older people (eg Age UK) to assist in the development appropriate strategies for dealing with older scheme members who have not made an active decision to disinvest from the scheme.

25. The development of new internal defaults for those in retirement also raises the question of how the default funds or strategies interact with the DWP proposals for a charge cap on default funds of qualifying schemes. It is not apparent to the NAPF's members that the Government has given sufficient thought to the interaction of these two policy developments.

26. Recommendation 3: We recommend that The Pension Regulator provides further guidance to trust-based schemes on their new responsibilities while being mindful of the compound effect of the Budget proposals and the DWP's consultation on Better Workplace Pensions.

Navigating the new 'at-retirement' environment

27. Clearly the Budget announcement has had a significant impact on the annuities market with a number of firms reporting an immediate and significant fall in annuity sales. However, the full ramifications have yet to be played out. Annuities still play an important role at retirement and are likely to continue to do so in the future. Therefore, making the market more efficient is even more important in the new world of freedom and choice.

28. NAPF has undertaken consumer research that suggests people were generally fairly cautious about how they plan to use their pension pots[5], with:

- 58% preferring to receive a regular income for life rather than risk their money running out, with only 7% disagreeing with this statement;

[5] NAPF Workplace Pensions Survey April 2014. Sample 897 employed adults in GB.

- just under half (47%) worrying that their pension would run out and that they would need to rely on the State; and
- 24% agreeing that they expect to take all of their pension savings in cash because they have other sources of income and, one in five (19%) agreeing that they would take the lump sum irrespective of whether they had other savings elsewhere.

While the survey covers all employed respondents, not just those with a DC pension, it does indicate a range of possible outcomes from the actions of pension scheme members.

29. Given that a significant proportion of people will still be looking to secure a form of regular income in retirement, is it vital that Government is aware of and manages the miss-selling risks. In particular, income drawdown products currently available are costly and generally not available to those with smaller DC pots. Typical costs of current income drawdown include annual administration / platform charges, charges for managing income payments, annual management charges on some of the assets held in the fund and transaction charges. Many individuals also pay for independent financial advice related to their income drawdown. Taken together these charges can represent in excess of 1% a year of the fund. There are no collective solutions available, especially as individual schemes are unlikely to be able to offer drawdown. Given the increased choices people will face, it is vital that these products offer value for money and that the saver understands what the arrangements.

Recommendation 4: The NAPF calls on HM Treasury and the FCA to ensure that market solutions that emerge in the next few years to serve members of DC schemes deliver value for money and are transparent. In addition we believe the Government should explore ways to encourage the development of scale, low cost drawdown products, to help those with smaller DC pots access their savings in a cost-efficient manner. The FCA should also remain vigilant regarding mis-selling activity targeted at members of both DC and DB schemes.

30. We are supportive of the FCA's decision to extend its market study of the 'at-retirement' market. While we recognise the shifting nature of the market under review we are concerned that the findings of the study and any policy that emerges from it will not be published until well into 2015.

Recommendation 5: We would encourage the FCA to engage with trust-based DC schemes as well as FCA-regulated firms as part of its market review. We would also encourage the delivery of interim findings from the review by the end of 2014.

Consultation questions

Q1. Should a statutory override be put in place to ensure that pension scheme rules do not prevent individuals from taking advantage of increased flexibility?

31. The NAPF believes that it is important to allow schemes flexibility in how they accommodate the changes introduced in the Budget and that changes to scheme rules should not be forced upon schemes and employers. We support a permissive override, by which schemes and their sponsors who choose to embrace the new flexibilities have an efficient means of incorporating these into their rules.

Q2. How can the Government design the new system such that it enables innovation in the retirement income market?

32. The NAPF calls on HM Treasury and the FCA to ensure that market solutions that emerge in the next few years give members of DC schemes deliver value for money and are transparent solutions. In addition we believe the Government should explore ways to encourage the development of scale, low cost drawdown products, to help those with smaller DC pots access their savings in a cost-efficient manner.

Q3. Do you agree that the age at which private pension wealth can be accessed should rise alongside the State Pension age?

Q4. Should the change in the minimum pension age be applied to all schemes which qualify for tax relief?

33. The primary purpose of a pension has always been to provide individuals (and their dependents) with an income in retirement. It therefore makes sense for the normal minimum pension age to increase as the age at which people can access their state pension benefits increases.

34. We believe that schemes should be allowed to retain early retirement protections for current members where they wish to do so. However, any change to normal minimum pension age (NMPA) should not impose undue burdens on schemes, in particular the creation of complex protections which are difficult and costly to administer.

Q5. Should the minimum pension age be increased further, for example so that it is five years below State Pension age?

35. While we agree that NMPA should be aligned with state pension age, we see no reason to narrow the gap to five years, thereby reducing flexibility for the individual still further.

Helping members make informed decisions

> In this section, we use the word guidance in two ways. The first relates to that envisaged by the Budget proposal where we capitalise Guidance. In other instances, we refer more broadly to guidance that members may need over an extended period where we use a lower case.

36. The NAPF welcomes HM Treasury's proposals for helping individuals through the guarantee of individual Guidance but recognises that a number of important questions remain to be addressed.

37. The solutions must balance the needs of members at retirement while not imposing unaffordable and uncontrollable, costs on scheme members, who will ultimately pay for the Guidance. Furthermore, the proposals should not be implemented in a way that prevents schemes from delivering their own parallel Guidance solutions. They must also shelter trustees from the risk of calls for redress from members who make decisions with poor consequences whether in response to the Guidance or in the absence of Guidance.

Guidance – credibility and deliverability

38. Good DC schemes already provide considerable support for members as they approach retirement, often beyond that required by TPR's DC guidance. The NAPF has played its part in encouraging better scheme member communications. For example, standards for acquiring the Pension Quality Mark include good member communications.

39. However, those schemes that do not already offer guidance and support to their members will need to access a new resource. However, given the urgent need to help those who plan to take their pension from April 2015 (and those who have delayed making a decision during 2014), the tight timescales involved in development, testing and implementation, and the need for a simple mechanism for funding and managing the costs of the service, the NAPF believes that it is important that Guidance as envisaged in the Budget should be concentrated in a single brand, organisation or delivery channel.

Recommendation 6: The NAPF supports the appointment of a not for profit organisation to establish a central service that will enable trustees and providers to meet their new obligations to members at retirement. The organisation should have appropriate levels of expertise and skills and the systems and infrastructure to support the development and testing of Guidance for April 2015.

40. A recent NAPF survey of DC members[6] revealed that 59% already provide some access to advice or guidance as members approach retirement; either through personalised advice, workplace seminars and/or website guidance. However, much of this advice and support is geared towards

[6] NAPF survey 'Delivering a Guidance Guarantee' March / April 2014, sample 67 DC members.

members investing in a separate drawdown product or purchasing an annuity after they have taken their tax-free lump sum. Some of these services are funded directly by the employer; others are funded through the member-borne charges of the scheme. In the case of the latter, these services will need to be reviewed in the light of the Budget proposals and the proposed charge cap.

The description in the box below has been created from the feedback from a small number of members about their existing at retirement service for scheme members. For the sake of anonymity, the description reflects a blend of the services provided.

Key features of members' at retirement services

- All scheme members written to between 5 and 10 years before retirement to alert them to the decisions they may want to make in advance of retirement and at retirement.
- All members have access to on-line tools and a helpline which guide them through their options and helps them make decisions.
- A broking service also provides help for those looking to purchase an annuity.
- The costs of the services are borne collectively by members of the pension scheme through the annual management charge, except where an annuity or other product is purchased where the costs are borne by the retiring member.

41. Whether paid for by the scheme member via scheme charges or directly by the employer, current providers of advice and guidance to scheme members include pension consultancies, IFAs, annuity brokerage services and, in the case of some bundled schemes and most contract-based DC, insurance providers or fund managers. Not all of these organisations can be considered to be impartial providers of guidance, but the NAPF is concerned that, should these organisations not be permitted to incorporate Guidance into their modified services, there is a risk of a disconnect for members where they are forced to move from one provider of generic guidance or advice to the provider of Guidance and potentially back again to clarify their needs and fulfil their decisions. Moreover, we do not believe that it is appropriate or possible to ban the provision of generic information, guidance or advice by any of these service providers.

Recommendation 7: The NAPF believes that it is important that schemes be permitted to continue to offer their own guidance, advice and support to members through providers of their choice, thereby permitting a smooth support and advice pathway for members as they approach and enter retirement. Where schemes provide such a service to all of their DC members, and where that service meets the standards for Guidance set down by the FCA, they should be exempt from funding any centrally provided Guidance. If the scheme is funded through a levy, schemes providing their own Guidance would notify the levy raiser of their exemption.

Access to Guidance

42. The Government's proposals imply that all DC scheme members reaching retirement will be offered a Guidance session. However, the advent of automatic enrolment has led to the existence of some extremely small pots.

43. Analysis conducted for the Making Automatic Enrolment Work Review[7] showed around 30% of automatically-enrolled scheme members are likely to have no other pension rights. With a limited time to build a substantial pot from minimum contributions it is likely that this could translate into thousands of people accessing Guidance in respect of pots in the low thousands of pounds or less over the next few years. This carries cost for all scheme members but may only bring limited benefit to those accessing guidance; for many, taking a cash lump sum would be the only sensible outcome. However, we recognise that personal circumstances within this group may vary considerably with some perhaps better advised to leave the money invested.

44. While in principle we think that all savers should have access to at least some degree of Guidance, we recognise that this may impose a disproportionate cost on all scheme members.

Recommendation 8: The Government should consider ways to limit expenditure on Guidance for those with extremely small pots, including the option of setting a level of pot size below which members will not qualify for Guidance.

Triggers and timing of Guidance

45. Good schemes already recognise that DC members need help and support well in advance of their expected retirement date in order to help them prepare for an event whose timing may in fact be uncertain but also to protect their fund from market volatility. The dialogue with members may begin up to 10 years in advance of retirement date. In future, schemes may well need to maintain dialogue and support for members beyond their retirement date.

46. The nature and timing of Guidance is complex. On the one hand, members will need help and support over a potentially long period. On the other, the Budget proposals suggest that the Guidance should be provided 'at retirement'. Moreover, for many consumers it is not clear when retirement is likely to happen or even whether it can be defined as a single event. For some, it may come as soon as age 55. For others it may be a gradual transition from mid-50s until a point in their 70s or beyond when they retire fully from paid work. Schemes tend to establish a normal retirement date, set either by the scheme or chosen by the member and this has in the past been used to determine when the member has to purchase an annuity or move their funds to income drawdown. In the new environment of freedom and choice, and with no default retirement age, it is less predictable when this date will arise.

[7] DWP 2010, Making automatic enrolment work: A review for the Department for Work and Pensions

47. Setting a date or event when members qualify for Guidance and trustees are obliged to offer it will be critical both in terms of the number of individuals that access Guidance, the capacity that has to be built to deliver Guidance and the cost to scheme members. The NAPF estimates that, in 2015, there will be in excess of 2.5 million[8] members of DC schemes aged 55 or over. It is entirely feasible that a significant number of these may approach their trustees or providers with questions about whether and how they can access their funds during 2015. Trustees will require clarity on their obligation to provide and fund Guidance for these members.

Recommendation 9: The Guidance Guarantee should be made available to members at the scheme's Normal Retirement Date (NRD) and the offer of Guidance should be made only once per scheme. However, we are alert to the need to provide Guidance in circumstances where scheme members need or choose to take retirement or access funds at an earlier date. In such circumstances, trustees should invite members to take guidance while clarifying that they will qualify for a Guidance session (related to that scheme) only once.

48. Allowing scheme member-triggered access to Guidance will require the PSO[9] provider(s) to hold records of those who have used the service in order to reduce the scope for multiple Guidance sessions. Schemes will also want to put in place record-keeping of their referral of members to the service. However, having alerted members to their right to Guidance, trustees and providers should be deemed to have met their obligations.

49. The Budget proposals also imply that individuals with more than one DC pot will qualify for more than one Guidance session. Since different schemes may have different NRDs, it is possible that individuals may be offered Guidance at more than one point in their approach to full retirement. While ideally it might be appropriate and more cost-efficient to limit Guidance to one session per individual, the difficulties of schemes knowing what other pension arrangements individuals have and deciding which scheme should give / fund the Guidance are likely to make this approach impractical.

Recommendation 10: The NAPF recommends that, in the absence of a central database of pension holdings at an individual level, Guidance should be delivered at the level of individual pots but that each incidence of Guidance should establish whether or not the individual has more than one pot. We would encourage the Government to explore the feasibility and costs of establishing a central database of pension scheme membership with a view to moving from a pot-based Guidance session to one that is more individually focused.

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[8] Source: NAPF's analysis of Wealth & Assets 2008/2010 data, ASHE and population estimates.
[9] Organisations with a public service obligation

Content and delivery of Guidance

50. As with other aspects of Guidance, there is a tension between the needs of many members for comprehensive and personalised support and advice (whether regulated or not) and the need to contain the costs of Guidance where those costs will be passed on to scheme members.

51. The 'how' and 'what' of Guidance will influence the cost to scheme members, the outcomes for members and the ability to deliver within the very tight timeframe set by HM Treasury. The Budget proposals suggest that members should be offered face-to-face Guidance but does not provide any further details of what constitutes face-to-face, where the Guidance will be available and what alternatives to face-to-face will be available. The Budget proposals are also silent on what precisely Guidance should seek to achieve, how long the sessions are intended to be, what experience, qualifications and skills will be required of the person delivering the Guidance, to what extent the Guidance will be personalised and what level of detail the Guidance will achieve for the individual. All of these details will shape the cost of the service to scheme members as well as the outcomes for the individuals concerned.

52. At one extreme, it would be possible to deliver a very personalised session based on the individual's full personal and financial circumstances, the rules of their pension scheme(s), their tax circumstances etc. Although not advice, such sessions are nevertheless likely to be lengthy in nature and will require the individual to come armed with considerable information about their lifestyle, expectations and their finances. A service of this nature is also likely to be costly to deliver, particularly with the likely demand so uncertain.

53. At the other extreme, it would possible to present a more generic and information-based session that sets out the broad options available to individuals (withdrawing their pension funds, annuitising, drawdown, leaving the money invested), describes the potential consequences of those options, the risks involved and where to go next for further help.

54. The former approach has the potential to be more helpful and provide a more personal steer to DC members but is likely to require more face-to-face or lengthy telephone calls as well as web support. It will also require considerable capacity in terms of skilled individuals to deliver the Guidance. The latter is likely to be considerably more cost-effective for scheme members and could be delivered in a range of formats, requiring less face-to-face contact and shorter telephone calls. While a mid-point between the two may be feasible, it could suffer from the worst of both options. The latter option has the benefit of being more capable of delivery by April 2015 and achievable within the charge cap.

55. The outline below represents the NAPF's high-level thoughts about the structure and content of a Guidance session of approximately 45 minutes.

Introduction (3-5 minutes)
Sets and manages expectations of the session
Describes importance of decision to the individual's retirement and family welfare in retirement

Your circumstances (10-15 minutes)
Size and importance of this pension pot (in context of other private pension benefits)
Expectations of retirement and work
Family circumstances
Personal health
Other savings and investments
Mortgage and debt
Home ownership
Welfare benefits

Your options (15 -20 minutes)
Description of the options open (leave the pot as it is, take all money, take some of the money, take a regular income from pot / drawdown / new products, buy an annuity)
Describe for each the benefits and risks including the tax consequences
Discuss how the options square with the individual's personal circumstances
Test whether the individual has understood the options

What next (5 minutes)
Where you can go for further information (TPAS, MAS, scheme provider, IFA, others)
What questions to ask your scheme
What questions you might want to discuss with family before making a decision

Recommendation 10: The NAPF recommends that HM Treasury focuses on the second of the options outlined above for April 2015 with an emphasis on web-based delivery supported by a telephone service with face-to-face offered only where other channels are rejected. However, Guidance should be allowed to evolve and, in particular, HM Treasury should review the service in 2017 in the light of the success of Guidance in helping members make informed decisions, the implications of the charge cap and any further reviews of costs, governance and regulation of schemes and automatic enrolment.

56. HM Treasury should also work closely with the FCA and the regulated advice sector to ensure that scheme members who need and want access to regulated advice are able to do so at a reasonable cost. Progress on the definition and development of simplified advice to help fill the advice gap that has widened with the advent of RDR will also be critical to delivering services beyond the Guaranteed Guidance. We also anticipate increased demand for low cost advice on the tax implications of the new choices and believe that these will need to be readily accessible to the mass market.

Q6. Is the prescription of standards enough to ensure the impartiality of guidance delivered by the pension provider? Should pension providers be required to outsource delivery of independent guidance to a trusted third party?

57. The NAPF believes that it should be possible to define the standards in such a way that they can be delivered by a range of third-party organisations. The NAPF agrees that Guidance should be delivered independently of any transaction advice. However, it is important to recognise that a decision on the part of the member to do nothing and to leave their money invested could be considered to equate to a ‘product sale’, particularly in contract-based schemes.

58. Trustees, with their legal obligations to members, should be granted the option of appointing their own Guidance delivery partner, not least because employers will have existing relationships with providers of pre-retirement information and support that are working well for members. It will be important that the standards are applied consistently across the market.

Q7. Should there be any difference between the requirements to offer Guidance placed on contract-based pension providers and trust-based pension schemes?

59. We see no reason to differentiate between trust-based and contract-based schemes in the nature, content or delivery of Guidance.

Q8. What more can be done to ensure that guidance is available at key decision points during retirement?

60. The NAPF supports the efforts by MAS and TPAS to provide access to information and guidance to those approaching and beyond retirement. The need for these services is likely to increase as a result of the Budget and the emergence of the Baby Boomer generations into retirement. Where schemes or other providers develop and deliver new product solutions for those in retirement, the respective regulators should set out new information and disclosure requirements that enable individuals to track and understand the benefits and risks of their chosen retirement vehicle.

Funding the Guidance Guarantee

61. The Budget imposes new obligations on trustees and providers of DC pensions at a time when both face new challenges from DWP proposals to cap the charges for default funds within qualifying auto-enrolment schemes at 0.75% a year [10]**.** Both parties will be required to offer, and by implication, pay for, impartial, face-to-face Guidance at retirement that is free to the member at point of use but may need to be accounted for within the charge cap. In trust-based schemes, contributions flow directly into members' accounts with deductions then made for the costs of running the scheme (fund management, administration, communication, compliance etc), except in a minority of cases where employers pay for administration or other benefits directly. While individual members will not be asked to pay for their Guidance, members of both trust-based and contract-based DC schemes will ultimately bear the costs of Guidance in some shape or form. As a result, charges on member funds may be higher than would otherwise have been the case or trustees or employers may need to withdraw other services to members to contain costs where the charge cap is applied.

62. The way in which the cost of Guidance is levied or paid for will also affect the costs to members of the scheme. If a levy is placed on all schemes to fund Guidance, the way in which this is calculated may affect schemes in different ways. A levy based upon the number of members approaching retirement may impose a high cost on those schemes with an older workforce and very little on those with a younger member profile. A levy based on some other metric, irrespective of number of retirees, will spread costs across all members and impose an implicit cross-subsidy between members, regardless of the size of their pots. A levy based on numbers of members could be difficult for new schemes set up for automatic enrolment which have many members but low levels of assets.

63. The NAPF recommends that Guidance should be framed and delivered in a way which is cost-effective for all schemes. The solution on funding is very closely related to the issue of who is permitted to provide the Guidance. If Guidance is delivered through or by a PSO provider and funded by a levy, this should be applied across all DC schemes and other financial services organisations that will benefit from the new choices open to scheme members. Where the levy is applied to schemes it should be determined by the size of the scheme, rather than the number of retirees. If trustees and providers are permitted to appoint their own Guidance service provider, it makes sense for schemes to bear their own costs. In either case, the content and delivery model should be developed with a close eye on the costs that scheme members can bear.

Recommendation 11: The NAPF recommends that levy for Guidance should be charged to schemes on the basis of funds under management, thereby aligning it with the funds under management-based charge cap.

[10] Better workplace pensions, DWP, March 2014.

64. The cost of guidance is one of the areas where schemes urgently need clarity so that they can understand the impact on their charges to members. Until decisions are taken on Guidance design and funding mechanism schemes cannot know whether they are looking at a one or ten basis point addition to charges.

Helping schemes take decisions

65. In order for schemes to begin redesigning processes and structures to sit around the new freedom and choices for their members, it is critical that a degree of urgency is injected into the design, delivery and testing of Guidance. Our members have told us that they require clarity over the delivery of the guidance guarantee by the end of July in order to ensure that other communication, investment and products developments required by the Budget proposals can be delivered to customers / scheme members in a way which ensures good outcomes.

Recommendation 12: We call upon the Government makes the following decisions by the end of July, to ensure that Guidance is available to scheme members by April 2015:

- The definition of the guidance guarantee in terms of what areas it will cover and who it will be available to;
- Which organisation(s) will deliver the guidance guarantee, in particular whether this will be a centralised service with a public service obligation;
- Who will take the lead in setting up the service and establishing its standards;
- How the funding framework will work.

At the same time as a decision is made on what Guidance is, we also need the Government to set out a detailed delivery plan for April 2015, outlining how it envisages all those working in this market and the not for profit sector will contribute and deliver the changes necessary to ensure this policy is a success.

Defined benefit pension schemes and financial markets

Q9. Should the government continue to allow private sector defined benefit to defined contribution transfers and, if so, in which circumstances?

66. The NAPF is of the view that deferred private sector DB members should retain their existing right to a transfer. Retaining such flexibility is entirely consistent with a policy intention that individuals should have "freedom and choice" in how they take pension benefits. It also preserves important flexibilities for both members and employers. We believe that the options to limit transfers set out in the middle three bullets of paragraph 5.15 are unworkable as they would place significant burdens on schemes and trustees.

67. We have surveyed our members on the implications of DB to DC transfers. Nearly 80% of schemes believe that the right to transfer from DB to DC should be retained, with 25% noting that they do not think there will be a negative impact on the scheme. A majority (54%) believe that they will be able to manage expected cash flows without making any changes to the scheme's investment strategy – though a significant minority expect some reduction in appetite for less liquid assets and/or a reduction in fund performance to result from the changes.

68. NAPF members do not believe they would need to make significant amendments to their investment approach or asset mix as a result of allowing transfers. Therefore, provided that the provisions below are in place, we do not believe that the impact should be significant. This view of our members applies even for those which have already de-risked significant portions of their DB pension pool. However, there are three important prerequisites to such transfers taking place.

    - **First, the right to transfer should not be extended to pensioner members. Such a move could have a significant impact on the corporate bond and Gilt holdings of schemes.**
    - **Second any individual considering a switch from their DB pension fund should receive access to regulated advice.**
    - **Finally, trustees must retain the right to set cash equivalent transfer values (CETV) at levels that appropriately reflect the ongoing level of deficit in the pension scheme and a further margin to reflect the uncertainties and volatilities of investment; only in this way can the interests of all scheme beneficiaries be protected.**

69. The Government has long-established policies seeking to ensure the long-term stability and viability of pension provision, and the Government has no wish to increase the number of pension schemes obliged to fall back on the support of the Pension Protection Fund. If there were scope for individuals to leave DB pension schemes at prices which were not fair to ongoing members there would be a risk that deficits could be increased to unsustainable levels and of real additional instability could be created. This is in no one's interests.

Q10. How should the government assess the risks associated with allowing private sector defined benefit schemes to transfer to defined contribution under the proposed tax system?

70. We have not identified significant risks in respect of taxation. Applying the tax thresholds at the point of withdrawing cash from the DC pension pot seems to us the appropriate moment for any tax burden to crystallise.

A.4 The government would welcome views on any potential impact of the government's proposals on investment and financial markets.

71. As set out above, we believe that allowing DB to DC transfers will not have a significant market impact while changes to DC investment strategies will take some time to work through and are as yet unclear.

Recommendation 13: The right to a transfer from DB to DC for deferred members should be retained subject to receiving advice. The right should not extended to pensioner members. Trustees must retain the right to set cash equivalent transfer values (CETV) at levels that appropriately reflect the ongoing level of deficit in the pension scheme and a further margin to reflect the uncertainties and volatilities of investment.

Timescale for policy changes

72. The short legislative, regulatory and implementation timescale introduces a number of risks for schemes, members and other stakeholders. The Budget changes present all of the pensions market, but trust-based schemes in particular, with a very significant number of challenges, including, but not limited, to:
    - understanding the details of how the new rules interact with scheme rules, pension taxation and administrative capabilities;
    - reviewing default and other investment strategies for those approaching retirement. Trust-based schemes are generally not set up to retain members beyond normal retirement date but may need to put in place new arrangements to do just that;
    - understanding how flexibility and choice are reflected in the options that schemes offer and perhaps developing new drawdown facilities or new default pathways for retirees;
    - how best to help and support members reaching retirement age in 2014/2015 and developing new communication strategies for a wider group of members approaching or beyond age 55;
    - how to fund and deliver Guidance and developing support that goes beyond the guaranteed Guidance; and
    - how to do all of this within the confines of a 75bp price cap which will not be fully defined until the end of 2014, establishing new processes for measuring and reporting charges and transaction costs, complying with the new governance requirements and also considering how to put automatic transfers in place.

    Trust-based schemes have little or no access to additional funds for services beyond those generated by the charges paid by members. Where they do have access to employer funds the corporate decision-making process means that trustees will have to approach employers for any additional budget required. The vast majority of budgets up to and beyond April 2015 will have already been set before the Budget announcements were made.

73. Most employers with trust-based schemes also have legacy DB arrangements to manage which means that, in addition, they will be allocating (often the same) resources to:
    - managing the abolition of contracting out;
    - reconciling their GMP records;
    - assessing the impact of the new PPF Levy determination; and
    - dealing with changes to the day-to-day administration of the Annual and Lifetime Allowances which is proving a real burden for DB schemes.

74. At this stage, many questions remain to be answered, not least how Guidance will be implemented. There are 213 working days between the closure of this consultation and the start of the 2015/2016 tax year. The Government and FCA timescales appear to envisage clarity around Guidance emerging at the end of 2014. There is even less clarity around changes to tax rules, discussions around default arrangements for schemes, any new guidance from TPR on the ways in which trustees should communicate with members as they near retirement and how the

Budget proposals fit within the DWP's proposals for a price cap on default funds for qualifying schemes.

75. We fear that this timescale will place scheme members at risk and will prevent trustees from putting in place the solutions and processes that they will need to ensure good outcomes for members. It may also put schemes under pressure to make decisions in short order which could be sub-optimal simply in order to meet a timetable.

Recommendation 14: The Government should ensure that the respective responsibilities of HM Treasury, the Department for Work and Pensions, the Financial Conduct Authority and The Pensions Regulator are clearly defined and that particular thought should be given to how the Budget proposals work alongside other policy developments, including, but not limited to the DWP's proposals for the charge cap and the new Pensions Bill that will introduce the concept of Defined Ambition pensions to the UK market.

76. The Government must also acknowledge that these pension changes take priority. Attempting to implement all of these pensions reforms set out above in tandem risks damaging good member outcomes.

Recommendation 15: The Government should delay the implementation of the DC charge cap, governance and transparency requirements until 2015 and the introduction of the pot follows member legislation until late 2017 at the earliest. A short delay will enable schemes to make more considered decisions about changes to investment and communication strategies that will be in the interests of members

Appendix One – Answers to the consultation questions

Q1. Should a statutory override be put in place to ensure that pension scheme rules do not prevent individuals from taking advantage of increased flexibility?

The NAPF believes that it is important to allow schemes flexibility in how they accommodate the changes introduced in the Budget and that changes to scheme rules should not be forced upon schemes and employers. We support a permissive override, by which schemes and their sponsors who choose to embrace the new flexibilities have an efficient means of incorporating these into their rules.

Q2. How can the Government design the new system such that it enables innovation in the retirement income market?

The NAPF calls on HM Treasury and the FCA to ensure that market solutions that emerge in the next few years to give members of DC schemes deliver value for money and are transparent solutions. In addition we believe the Government should explore ways to encourage the development of scale, low cost drawdown products, to help those with smaller DC pots access their savings in a cost-efficient manner.

Q3. Do you agree that the age at which private pension wealth can be accessed should rise alongside the State Pension age?

Q4. Should the change in the minimum pension age be applied to all schemes which qualify for tax relief?

The primary purpose of a pension has always been to provide individuals (and their dependents) with an income in retirement. It therefore makes sense for the normal minimum pension age to increase as the age at which people can access their state pension benefits increases.

We believe that schemes should be allowed to retain early retirement protections for current members where they wish to do so. However, any change to normal minimum pension age (NMPA) should not impose undue burdens on schemes, in particular the creation of complex protections which are difficult and costly to administer.

Q5. Should the minimum pension age be increased further, for example so that it is five years below State Pension age?

While we agree that NMPA should be aligned with state pension age, we see no reason to narrow the gap to five years, thereby reducing flexibility for the individual still further.

Q6. Is the prescription of standards enough to ensure the impartiality of guidance delivered by the pension provider? Should pension providers be required to outsource delivery of independent guidance to a trusted third party?

The NAPF believes that it should be possible to define the standards in such a way that they can be delivered by a range of third-party organisations. The NAPF agrees that Guidance should be delivered independently of any transaction advice. However, it is important to recognise that a decision on the part of the member to do nothing and to leave their money invested could be considered to equate to a 'product sale', particularly in contract-based schemes.

Trustees, with their legal obligations to members, should be granted the option of appointing their own Guidance delivery partner, not least because employers will have existing relationships with providers of pre-retirement information and support that are working well for members. It will be important that the standards are applied consistently across the market.

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