Written evidence submitted by Just Retirement (TP 07)

Summary

1. The Taxation of Pensions Bill introduces major changes to the framework for how people can use their Defined Contribution (DC) pension savings in retirement. These changes should lead to improved outcomes for consumers but this will depend on the success of key provisions within the reforms – especially the Guidance Guarantee (GG) in helping people understand their options and risks at retirement.

2. Just Retirement is increasingly concerned by the risk of low take-up of the GG and the current absence of any regulatory response to address this risk ahead of the reforms' introduction next April. These concerns have been echoed in recent weeks by leading consumer advocates and industry representative bodies including the Association of British Insurers (ABI).

3. This briefing focuses on those aspects of the reforms which set out the GG framework, provides details on the gaps identified, and suggests remedies which we hope will help Bill Committee members address these failings.

Context

4. The Taxation of Pensions Bill creates the tax framework that will enable the "freedom and choice" reforms announced in Budget 2014. The improved access available to savers from April 2015 is welcome but brings new risks, including the specific risk of unanticipated income tax charges on sums drawn directly from pension savings.

5. Retirement decisions will be more complex than ever in the new system and consumers will have to understand and choose between an unprecedented range of options. With consumer engagement known to be poor; pension providers' lamentable track record for selling inappropriate or poor value retirement income products to their existing DC pensions customers; and the likelihood of attempts by some unregulated organisations to exploit vulnerable consumers – the thoroughness of consumer protection measures will be vital. This will be especially important if take up for the GG is low.

6. With less than six months until the reforms are implemented our major concern is that the regulatory regime being created by the Financial Conduct Authority (FCA) and The Pension Regulator (TPR) is incomplete, and will remain incomplete in the absence of safeguards to protect consumers who do not use the GG or receive regulated financial advice.

Recent developments in the at-retirement market

7. No less than three investigations into consumer detriment in the UK retirement income market have taken place since the Financial Service Authority's introduction of rules requiring pension providers to disclose the 'Open market option' (OMO) in 2002. Annex 1 charts the path of government/regulatory investigations and subsequent industry attempts to improve disclosure through Best Practice Guides and Codes of Conduct.

8. Each industry-led attempt to improve at-retirement disclosures has brought some marginal improvement, but no significant shift in shopping around activity. Despite the sustained efforts of the ABI to coordinate pension providers' sales and communication practices, the majority of DC pension savers still don't shop around at retirement.

FCA - current requirements, Thematic Review and Market Study

9. The FCA's Conduct of Business Rulebook requires pension providers to remind their customers of the OMO. Providers are required to flag this option in a "wake-up" pack 4-6 months prior to the customer's stated retirement date as the spur to action. The wake-up process is being reviewed by FCA to reflect the pension reforms. Following consultation, FCA will shortly set out its intended regulations for the GG and arrangements for how providers will direct consumers to the service – the "trigger" communication.

10. The FCA is also conducting a Market Study into the retirement income market following its February 2014 Thematic Report. This Thematic Review found fewer than half DC retirees had exercised the right to OMO and eight in ten retirees who bought an annuity from their existing pension savings company would have achieved a better deal had they purchased their annuity from the open, competitive annuity market. A majority of 'internal' annuity purchases are made on the default option offered – a conventional annuity rate on a single-life basis.

11. The scope of the FCA Market Study was revised following the announcement of the pension reforms in Budget 2014. This will examine competition and choice in the context of the various options open to consumers when retiring, and assess the value for money associated with different at-retirement products. Interim findings from the study are expected in December, with final results in Q1 2015. These findings are not expected to be available to inform the GG regulations FCA is due to publish in December.

Guidance and the Taxation of Pensions Bill

12. In its consultation on the regulatory framework for the pension reforms[1] the FCA identified the need for the GG to inform, educate and help consumers understand their options when accessing pension savings. The FCA is incorporating a mandatory requirement for product providers to help consumers understand the income tax implications of withdrawing lump sums from their DC pension savings. However, it has not proposed similar active interventions in relation to product feature choices where people have repeatedly made inadvertent poor choices that have been shown to cause regret and financial detriment in later life.

13. The Taxation of Pensions Bill does not contain the clauses that enable the FCA and TPR to set and regulate the GG – these are contained in Part 4 of the Pension Schemes Bill, shortly expected to go to Commons report stage. However, that Bill and the Taxation of Pensions Bill are closely connected, and Bill Committee members should be aware of the potential harm that will occur if no requirement is placed on product providers to help consumers avoid inadvertent poor decisions.

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[1] http://www.fca.org.uk/static/documents/consultation-papers/cp14-11.pdf

14. If measures are not taken to address the risk of people accessing DC pensions savings without first taking the GG, the freedoms created by the Taxation of Pensions Bill are likely to be greatly undermined at outset by failing to help consumers to identify a range of known risks. These include:
    - Risk of paying too much income tax
    - Risk of outliving your assets/running out of money
    - Risk of missing out on guaranteed annuity rates from existing company
    - Risk of not providing benefits for a spouse/other person on death
    - Risk of missing out on additional income resulting from medical conditions or lifestyle factors
    - Risk of savings and income erosion from inflation
    - Risk of purchasing an uncompetitive product
    - Risk of benefiting my combining pension pots
    - Risk of paying an exit charge when it could have been avoided

15. These negative outcomes are likely to be exacerbated by the absence of a backstop regulation or 'second line of defence' requirement to ensure consumers consider these risks.

16. Concern at this likelihood is growing given that GG take-up could be low. A pilot exercise conducted by The Pensions Advisory Service and the pensions provider Legal & General in May 2014 found that just 4 per cent of 9,000 pension savers took up the option to use a free, impartial guidance service. A separate survey by the Chartered Insurance Institute (CII) found that 44 per cent said they would "definitely" use the GG from April, while 48 per cent said they would "probably" use it.

Need for a second line of defence

17. Concerns over low take-up of GG has led to calls for a second line of defence requirement to be built into FCA/TPR regulations. A second line of defence regulation would help counteract these potential negative outcomes – first, by requiring product providers and pension schemes to encourage non-users to use the GG before making decisions about how to use their DC pension savings. Second, it would require product providers to ask mandatory questions to check consumers are aware of the implications arising from how they access their DC pension savings.

18. This would not prevent or impede savers from accessing their savings as they wish – but would merely provide a check against unintended negative outcomes.

19. Just Retirement is concerned by the absence of clear plans to introduce a second line of defence regulation in time for the start of the new freedoms. Pressed on this issue by MPs during last month's evidence sessions, FCA representatives said GG take-up will be "a matter for public choice". We believe this position creates great risk for the millions of people who, from April 2015, will be entitled to access DC pensions savings from age 55, despite the fact that FCA and TPR already have powers to implement a second line of defence requirement.

20. As noted in **Annex 2,** consumer advocates including Dr Ros Altmann (the government's Business Champion for Older Workers), Sue Lewis (Chair of the Financial Services Consumer Panel), Dominic Lindley (former head of head of personal finance at Which?) and Jane Vass (Head of Public Policy, Age UK) have recently expressed their concern at the FCA's apparent reluctance to implement these safeguards. The ABI has also called for a second line of defence regulation.

21. Witnesses also argued that the absence of a second line of defence contradicts the FCA's Treating Customers Fairly principles. These principles set out six core outcomes[2] which the FCA expects of regulated firms, with outcomes 1-3 specified as especially relevant to at-retirement processes. These are:

- *Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.*
- *Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.*
- *Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.*

Key points

22. The FCA and TPR are expected to publish final rules for the GG framework in December. Both regulators have the powers to create a second line of defence requirement, but there are currently no plans to introduce this safeguard. This contrasts with specific provisions being set in place to ensure consumers are made aware of potential income tax charges relating to withdrawals from DC pension savings.

23. As parliamentarians have already identified failure to address this risk will mean the first wave of retirees are likely to be "guinea pigs", whose negative experiences come at great personal and financial cost. These negative experiences could greatly undermine the reforms from the outset.

24. The FCA is an independent financial regulator but is accountable to HM Treasury and Parliament. Bill Committee members therefore have the opportunity to press for assurances that this gap in the reforms will be closed in time for the first wave of retirees in April 2015.

About Just Retirement

25. Just Retirement is a specialist provider of financial services to people at and in-retirement. We are the UK's leading provider of individually underwritten annuities, the second largest provider of equity release lifetime mortgages and are among the leading innovators in the care annuity market.

26. We are members of the Association of British Insurers, the Equity Release Council, the Council of Mortgage Lenders, the Pension Income Choice Association and the International Longevity Centre's Care Funding Advice Network.

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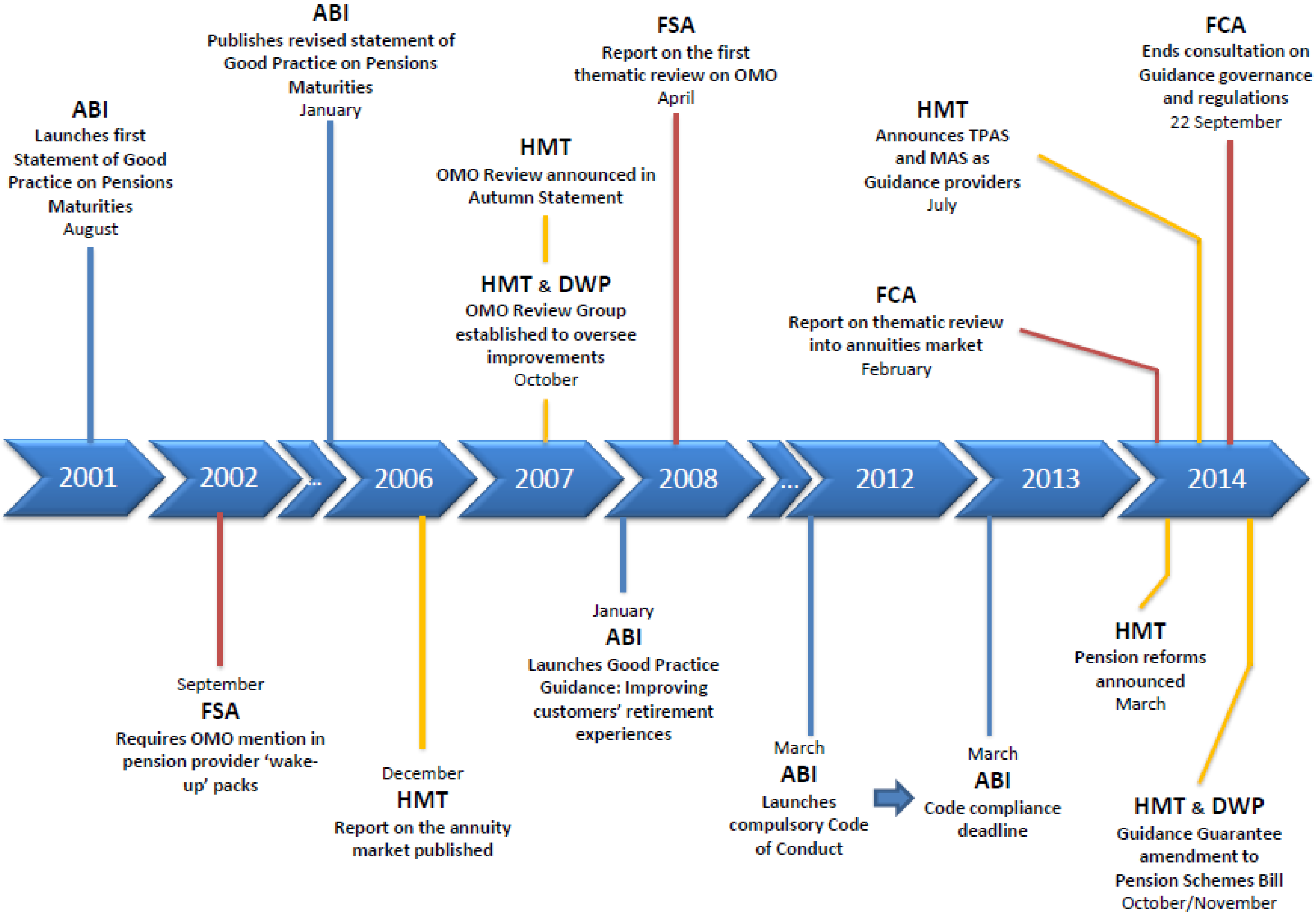
[2] http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/fair-treatment-of-customers

Annex 1: Analyses, assurances and past attempts to reform DC pension retirement processes



Annex 2: Witness comments from Pension Schemes Bill evidence sessions 23-24 October 2014[3]

Dr Ros Altmann (Business Champion for Older Workers): *"Consumers have been left in the dark and at the mercy of the providers for years. Providers must be required to know who they are selling something to before they sell it. In other words, I believe they must be required to ask some fundamentally important questions of whoever it is they are selling a product to, whether or not that person has had guidance, but particularly if they have not had guidance.*

"I would call on the FCA to ensure that providers are required to treat customers properly and fairly, and to have this safeguard so that if you do not get the guidance, someone will at least take notice of your circumstances when you buy a product and help you with what questions to consider before committing."

Dominic Lindley (Consumer rights consultant): *"The guidance guarantee is absolutely welcome but unless we take further action and introduce extra lines of defence, you are still going to get insurance companies defaulting people into very poor value products. They have been defaulting people into poor value annuities for years.*

"We are kind of relying on the FCA, and as you saw earlier in the week, the FCA does not seem to want to introduce even the second line of defence by getting providers to ask specific questions at the point at which people access their pension."

Jane Vass (Age UK): *"There is a list of questions, which is not that long and which providers should always have asked and should always have been required to ask but have not asked, and we could now ensure that they do ask them before selling a product.*

"If somebody is considering rolling over with the existing provider, again, I think we need safeguards there. I am a bit anxious about the concept of just asking people a list of questions and getting them to tick a box, because we know in the past that sometimes less reputable providers have used that as an opportunity to get people to tick the box and then say, "It wasn't me, guv. They said they were okay." In that case, I think we would be looking at building sensible defaults into the system.

Dr Yvonne Braun (ABI): *"We are asking the FCA to make its expectations clear that, from next April, providers of retirement income products make customers aware—those customers who have not taken the guidance especially—of a number of risks that they need to be aware of before they buy a product...*

"It is not clear whether everybody is going to take up the guidance, so there needs to be some sort of second line of defence—guard rails, back-stops, or whatever you want to call them."

[3] http://services.parliament.uk/bills/2014-15/pensionschemes/stages.html