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Independent Яeview of Retirement Income

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Press release

A major new report argues that pensioners need much more help to make sure the Government's pension reforms are a success

Millions of pensioners are exposed to risks that they do not understand and should not be expected to manage themselves

They need help to ensure that they receive a lifelong income from their pension pot, as well as enjoy the benefits of 'freedom and choice'

This requires a national consensus around retirement income

LONDON, 2 March 2016: The Independent Review of Retirement Income (IRRI), the body set up in 2014 by the Official Opposition to review the pensions market in the UK, today publishes the findings of its two year study. Commissioned following the introduction of the Coalition Government's 'freedom and choice' pension reforms announced in the 2014 Budget, the IRRI makes key recommendations on how best to boost defined contribution (DC) savers' retirement incomes. We consulted with key industry players and our report incorporates the findings of a hundred surveys and studies dealing with the reforms.

Pension savers need significantly more help

While the Government's reforms introduced in April 2015 have been widely welcomed, the Report concludes that most pension savers need much more help than they are currently getting in order to make sure that the reforms are a real success.

This is because there are significant risks involved in the generation of retirement income from pension savings, such as investment risk, inflation risk and longevity risk. Following 'freedom and choice', these risks are borne directly by DC scheme members. Unfortunately, many people do not understand these risks, even with improved financial education. Some risks have to be experienced before they can be genuinely understood, by which point it may be too late to reverse the damage caused by poorly informed decisions.

Auto-enrolment inertia v decumulation choice

The overarching question that the Report seeks to address is this: What is the best way for the private-sector DC pension system to reconcile the fundamental principle of auto-enrolment during accumulation – the success of which is predicated on member inertia – with 'freedom and choice' during decumulation – the success of which is predicated on the ability of members to make informed decisions?

If a large group of people cannot understand the risks they face, they should not be expected to manage these themselves. Instead, if there are well designed and regulated schemes which use retirement income products that manage these risks in the most efficient and cost-effective way, it might be possible to nudge or default savers towards one of these schemes. Can we build on the lessons of auto-enrolment by having a well-designed default decumulation process at retirement?

Appropriate products need to be developed

A good product for delivering retirement income needs to offer a combination of features, including: accessibility (the flexibility to withdraw funds when needed); inflation protection either directly or via investment performance, with minimal involvement by individuals who do not want to manage investment risk; and longevity insurance. No single product meets all these requirements, but a combination of drawdown and a deferred (inflation-linked) annuity does, for example. So a well-designed retirement income programme will have to involve a combination of products.

If any product satisfies these conditions as part of a hybrid solution, it might be considered a safe harbour product. Any adviser recommending such a product, having assessed its suitability for the customer, could not subsequently be sued for poor advice. Unfortunately, the Financial Conduct Authority has refused to grant safe harbour status to any UK investments.

The arrangement through which retirement income products are delivered is also important, and the Report considers the merits of large-scale decumulation schemes versus individual retail products. The former have the potential to be much cheaper and deliver more consistent results than conventional individual drawdown and annuity products, due to: economies of scale, trustee oversight, the use of a well-designed institutionally managed fund, and the potential for the bulk purchase of members' annuities. This strategy is a natural extension of the default fund used by successful modern multi-trust, multi-employer schemes for the auto-enrolment accumulation stage.

There is a need for 'safe harbour retirement income plans'

One of our key recommendations is that a 'safe harbour retirement income plan' is introduced. This would involve a simple decision tree with a limited set of pathways. This would allow people to get the best combination of retirement income products for them, given their assets, liabilities, health status, family circumstances, tax position, and risk appetite and capacity. The plan would be self-started following a guidance or advice surgery, and the plan member has the right to opt out until the point at which the longevity insurance kicks in. The plan would also deal with one of the important lessons from behavioural economics which is that too much choice is a bad thing. There are now far too many poorly designed and expensive choices of product available at retirement.

We need a 'national narrative'

Making decisions about retirement income are the hardest financial decisions people ever have to make, because the risks in pensions are so poorly understood. Getting it right requires a national narrative about what pensions are for. Everyone in Parliament – whatever their political affiliation – and industry has to sign up to this narrative – just as they did with auto-enrolment. This is why we also recommend that the Government establishes a permanent independent Pensions, Care and Savings Commission which reports to Parliament to ensure that there is cross-party consensus for all future pension reforms. It is also clear that we are not saving enough for our retirement, so another recommendation is that the Government adopts a national retirement savings target of 15% of lifetime earnings, achieved through auto-escalation, to avoid future pensioner poverty.

Making your money last

The unifying thread that runs through a funded pension scheme is the requirement to annuitise enough pension wealth, at the appropriate age, to provide an adequate lifelong income in retirement when combined with the state pension – which is the rationale for establishing a private-sector pension scheme in the first place. It is this requirement which makes a funded pension scheme different from any other type of savings scheme.

When annuitisation becomes optional, that unifying thread is no longer present and there is a real danger that the pension system begins to unravel. At best, it just becomes a tax-favoured arrangement for operating a multi-purpose spending pot – once the money has been spent for one purpose, it cannot be spent on another. At worst, it becomes a honey pot for thieves and other opportunists.

Lying between these extremes are millions of people now in control of their pension pot and who will be trying to do the best for themselves and their families. But for anyone who understands the risks involved in retirement income provision, it is clear that many of these people will find themselves in the same kind of control as a yachtsman in the middle of the Atlantic in a force nine gale.

Professor David Blake, Chair of the IRRI and Director of the Pensions Institute at Cass Business School, said: 'A great deal of effort will now have to go into re-establishing what a good pension scheme is. This will need a commonly agreed national narrative. Without this, people's aversion to annuitisation combined with their willingness to pay highly for both flexibility and guarantees could leave them worse off than if they purchased an annuity to begin with. This is a significant challenge. But it is one that is well worth the effort because, as the Pensions Minister, Ros Altmann, says: "pensions are precious"'.

The key elements of a national narrative are listed in the table below.

The key elements of a national narrative
• The primary purpose of a pension scheme is to provide an income in retirement for however long the scheme member lives – that is, it will not run out of money before the member dies. • A pension scheme needs to offer accessibility, inflation protection (either directly or via investment performance) and longevity insurance. • A pension scheme needs to provide value for money with the benefits clearly and transparently exceeding the costs. • Individuals should not be expected to manage the risks involved in the generation of retirement income from pension savings themselves. • Middle Britain – with pension assets between £30,000 and £100,000 – should be recommended to use a retirement income plan that involves a simple decision tree with a limited set of pathways. • The retirement income plan would be self-started following a guidance or advice surgery. • The plan member would choose from a set of safe harbour products approved by the regulator. The purpose of the decision tree is to identify the products that are most suitable for meeting the plan member's needs. The aim is to achieve a simple solution that is appropriate (i.e., 'good enough') for those who do not wish to make any financial decisions themselves. • The safe harbour products would include annuities, drawdown products and longevity insurance that meet minimum design standards in terms of efficacy and deliver clear value for money. • The plan member would have flexible access to the pension pot until the point that longevity insurance kicks in. • A national narrative requires the integration of the accumulation and decumulation phases. An essential part of this narrative is 'an adequate pension needs adequate contributions'. To have an adequate pension in retirement, Middle Britain, needs to understand that – together with the employer – it has to save 15% of its lifetime

earnings in a pension scheme.

- A parallel narrative is required to address the needs of the millions of private-sector workers who are self-employed or whose contracts of employment exclude them from auto-enrolment.

The Report, called 'We Need a National Narrative: Building a Consensus around Retirement Income' can be found here: http://www.pensions-institute.org/IRRIReport.pdf

A summary of the Report can be found here: http://www.pensions-institute.org/IRRISummary.pdf

The response to the Consultation can be found here: http://www.pensions-institute.org/IRRIConsultation.pdf

The press release can be found here: http://www.pensions-institute.org/IRRIPress.pdf

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Notes to Editors

On 29 May 2014, Rachel Reeves MP, then Shadow Work and Pensions Secretary, launched an Independent Review of Retirement Income to look at how to boost defined contribution (DC) savers' retirement income following the introduction of the Coalition Government's 'freedom and choice' pension reforms announced in the 2014 Budget. She invited Professor David Blake, Director of the Pensions Institute at Cass Business School, to lead the review, with Professor Debbie Harrison of the Pensions Institute as a senior consultant.

The terms of reference are as follows. 'The Independent Review of Retirement Income will consider how to support a pensions market that works for all, retaining flexibility and choice on how savings are accessed and drawn down, while ensuring all savers, including those on low and modest incomes, are able to secure a decent and reliable retirement income.

Specifically, this will include:

- How to ensure that the workplace pension retirement products available to people are those best suited to ensure they have security and confidence in retirement
- The support savers need to make the right choice at retirement for them and their family and how to build on the lessons of auto-enrolment
- How savers can be helped to manage longevity risk
- The role of the National Employment Savings Trust (NEST) in helping savers to access good quality retirement products

- The role of collective pension schemes and how these could be introduced in the UK'.

On 24 November 2014, the Review team issued a Consultation Paper containing 76 questions. As part of the consultation process, we also held a number of meetings at which representatives of consumer groups, trade unions, scheme sponsors, providers, consultants, and fund managers participated. These meetings generated very useful feedback and we are also grateful to the participants in those meetings. They were held under Chatham House rules which means that the quotations we use from these meetings are unattributable. A summary of the feedback to the consultation paper has been prepared by Dr Edmund Cannon from Bristol University and a Fellow of the Pensions Institute. Again, the responses that we cite are unattributable.

The Review team are members of the Pensions Institute, an independent academic research centre, based at Cass Business School. We believe that the subject of this Review is crucial to the long-term success of both 'freedom and choice' and auto-enrolment, the latter being a policy decision which has cross-party support. We agreed to undertake this study because we believe it is important to have pension schemes which generate good consumer outcomes in the face of the significant structural and social challenges facing people at retirement. The Report is independent and not party political. We would have undertaken the same task had we been invited to do so by any other organisation. The Labour Party has not sought to influence the Report in any way. Our model for writing the Report was the Pension Commission and its two reports of 2004 and 2005.[1] Nevertheless, we believe that this is the kind of report that the Government should have commissioned before introducing the pension reforms announced in the 2014 Budget.

The Report's recommendations

Chapter 1. Introduction

Recommendation 1.1: Criteria for a good DC pension scheme

We recommend that scheme providers should be required to demonstrate to scheme trustee (or governance) committees and to regulators how their schemes provide good outcomes for members in terms of the following criteria:

[1] U.K. Pensions Commission 2004, *Pensions: Challenges and Choices: The First Report of the Pensions Commission*, TSO, London.
(image.guardian.co.uk/sys-files/Money/documents/2005/05/17/fullreport.pdf);
U.K. Pensions Commission 2005, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission*, TSO, London.
(webarchive.nationalarchives.gov.uk/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf)

- *Delivers adequate and sustainable pensions; by sustainable, we mean having support mechanisms in place that help people not to spend their pension fund too quickly after retirement*
- *Produces stable and predictable lifelong retirement incomes, even if those incomes cannot be guaranteed (unless a lifetime annuity is purchased)*
- *Offers the flexibility to purchase a lifetime annuity at any time (or at regular predetermined intervals)*
- *Has the flexibility for members to withdraw funds to meet 'lumpy' expenses, such as the cost of a new boiler*
- *Provides an investment strategy that reflects the scheme member's attitude to and capacity to take risk, and generates a return at least as high as inflation*
- *Provides value for money for every pound saved in the scheme*
- *Has transparent charges and costs*
- *Provides reliable and efficient administration*
- *Delivers effective communications to members*
- *Protects scheme assets from fraud or theft*
- *Has minimum quality standards in terms of operational efficiency, charges and governance with a duty by the governance committee to act in members' best interests.*

Recommendation 1.2: Explaining key risks involved in the generation of retirement income from pension savings

We recommend that scheme providers should be required to explain to scheme trustee (or governance) committees (and where possible to members) the following key risks in retirement income provision and how their scheme deals with these risks:

- *Contribution risk – The risk that pension contributions (and hence pension savings) are lower than planned, e.g., because the scheme member becomes unemployed, is unable to work due to ill health, or is unable to pay off their debts*
- *Retirement timing risk – Uncertainty about when the scheme member will retire and/or begin to make withdrawals*
- *Product choice risk – Uncertainty about how the scheme member will make withdrawals, not least because of the very large set of choices now available*
- *Investment risk – The risk that investment performance is worse than expected or the risk that investments do not generate incomes in a way that matches the desired pattern of consumption in retirement. A particularly important example of investment risk is sequence-of-returns risk*
- *Inflation risk – The risk that inflation is higher than anticipated*
- *Interest rate risk – The risk that interest rates are low at the point of annuity purchase*

- *Longevity risk – The risk that individual savers live longer than their life expectancy (i.e., idiosyncratic longevity risk) and the risk that savers as a whole live longer than anticipated (i.e., systematic or aggregate longevity risk)*
- *Cost risk – The risk that the total costs of running the pension scheme during accumulation and decumulation are higher than expected or understood*
- *Political risk – The risk that the Government changes the rules in an adverse way (e.g., reduces the level of tax relief)*
- *Regulatory risk – The risk that regulations change in an adverse way (e.g., the regulator increases regulatory capital requirements, which has the effect of reducing annuity rates)*
- *Demographic/cultural risk – The risk that younger cohorts refuse or are unable to honour the implicit intergenerational contract that underlies many pension schemes. For example, the next generation of workers refuses – or is unable – to pay the pensions the retired generation expects to receive, because they are unwilling to honour the implicit contract or because there are too few of them in relation to the size of the retired population. Also, an arrangement that works in one culture (e.g., Holland) might not work in another (e.g., the UK)*
- *Market conduct risk – The risk that those who provide services to the scheme act in a way that disadvantages scheme members (e.g., investment managers subject to a charge cap negate the effects of the charge cap by increasing portfolio turnover, or the benefits of economies of scale go to scheme providers' shareholders rather than to members); fraud and the activities of scammers would be included here*
- *Behavioural risk – The risk that scheme members behave in a way that is not considered to be rational (i.e., is not in their long-term interests, since they make short-term decisions that they subsequently regret and are unable to learn from past mistakes). Inertia and lack of engagement would be included here, as would be the risk that members fail to understand the risks they face*
- *Financial knowledge and understanding risk – The risk that a member's financial knowledge and understanding are insufficient for the member ever to make an 'informed' choice*
- *Mental impairment risk – The risk that a scheme member's mental faculties are reduced due to the onset of dementia, for example.*

Chapter 2. How to ensure that savers can get the best products in retirement

Recommendation 2.1: Implementing the retirement financial strategy

We recommend that providers offering retirement income solutions make clear to customers how their solutions for implementing the customer's retirement financial strategy – comprising an investment strategy, a withdrawal strategy, and a longevity insurance strategy – make use of products that offer:

- *Accessibility – the degree of flexibility to withdraw funds on an ad hoc basis*
- *Inflation protection, either directly or via investment performance, with minimal involvement by individuals who do not want to manage the investment risk*
- *Longevity insurance.*

We recognise that there may be important differences in implementation strategy and disclosure requirements, depending on the distribution channel, i.e., these will be different where a customer pays a fee for a personal recommendation – selected from the retail product market and based on an adviser's understanding of the customer's complete financial position/objectives – and where a trustee (or governance) committee offers a decumulation product to auto-enrolled members (which might also be via a default or default pathway). It is also important to bear in mind that many customers in the mass market may not have a clear retirement financial strategy.

Recommendation 2.2: Terminology

We recommend that the pensions industry reviews the terminology it uses in order to both modernise the language and bring greater clarity to customers. In particular:

- *Arrangements which do not involve longevity insurance should not be allowed to call themselves 'pension schemes', but should be required to use another name, such as 'drawdown management schemes'. The term 'pension scheme' should be a protected name*
- *Annuities should be rebranded as 'guaranteed income for life products', and deferred annuities need to be rebranded as 'longevity insurance'*
- *Arrangements which do not involve longevity insurance should be classified as complex and high risk from a regulatory standpoint.*

Recommendation 2.3: Criteria for granting safe harbour status to key retirement income products

We recommend that regulators agree a set of criteria for granting safe harbour status to key retirement income products. Providers and advisers could not subsequently be sued for offering or recommending a safe harbour product, having first determined its suitability for a client as part of a safe harbour retirement income solution.

We recommend the following criteria are used to do this:

- *Design and construction – There needs to be a much clearer picture of how products are designed and constructed, especially if they involve guarantees. For example, if the guarantees are hedged with options, there needs to be clarity over whether the options are exchange traded or over-the-counter and, if the latter, the nature of the counter-parties involved. It is also critically important that the charges, particularly for guarantees, are not excessive*

- *Investment strategy – It needs to be made clear how the investment strategy meets the aims claimed for the product. The circumstances under which the investment strategy might fail to meet these aims also needs to be specified*
- *Projected real returns – Providers of drawdown products should present stochastic projections of the range of likely real outcomes (i.e., income adjusted for inflation and total charges and costs) that their products could deliver based on the product's underlying investment strategy*
- *Accessibility – The degree of flexibility to withdraw funds on an ad hoc basis*
- *Longevity protection – The degree of longevity protection afforded by the product, illustrated by the probability of running out of money at different ages for a range of possible withdrawal strategies. Also included here will be the impact of the amount, if any, paid on death*
- *Value for money – The benefits and costs of the product need to be clearly stated and the balance between them assessed.*

The regulator should establish minimum standards for each of these criteria. Any product satisfying these minimum standards could be classified as a safe harbour product. As part of the process of product regulation, a product rating service should be established to assess whether products satisfy the minimum standards.

Recommendation 2.4: Modelling outcomes for different retirement income products

As indicated in Recommendation 2.3, an important aspect of product design and construction is modelling outcomes. We recommend that:

- *The use of deterministic projections of the returns on products should be banned*
- *They should be replaced with stochastic projections that take into account important real world issues, such as sequence-of-returns risk, inflation, and transactions costs in dynamic investment strategies*
- *There should be a commonly agreed parameterisation for the stochastic projection model used, i.e., a 'standard model' should be developed*
- *There should be a commonly agreed set of good practice principles for modelling the outcomes from retirement income products.*

As in the case of Solvency II, product designers would be free to use an 'internal model', so long as they explained the differences between this and the standard model.

Recommendation 2.5: Establishing a metric for measuring product value for money

We recommend that the regulator establishes a metric for measuring product value for money that would:

- *Reflect the benefits and costs of the product and the balance between them*
- *Reflect key risks*

- *Have credibility and transparency*
- *Be clear, simple, difficult to dispute and difficult to manipulate (i.e., avoid room for gaming the process).*

An example of such a metric would be the money's worth (MW) of a product, which is the ratio of the expected present value of payouts on the product to the price, with due allowance made for the greater flexibilities of some products in terms of accessibility and death benefits. The MW of a product could be measured relative to the benchmark provided by a lifetime annuity. Similarly, the risk of a product could be expressed in terms of the likelihood of a potential shortfall relative to a lifetime annuity.

Recommendation 2.6: Measuring and reporting charges and other costs

We recommend that:

- *A standardised method for measuring the charges (and other costs) for all retirement income products is introduced. The measure should cover all the costs borne by the customer either directly or indirectly, including operational (administration) costs, fund management (including transaction and guarantee) costs, and delivery (platform) costs*
- *A standardised method for reporting the charges (and other costs) for all retirement income products is introduced.*

Charges are a key aspect of a product's money's worth. They could be reported in the form of both a 'rate of charge' – which could then be deducted from the gross rate of return to give a net rate of return – and as a monetary amount – which can then be compared with the monetary value of the customer's fund.

Recommendation 2.7: Candidate products for safe harbour status

Subject to meeting Recommendations 2.3 – 2.6 and to meeting suitability requirements, we recommend that the regulator grants safe harbour status to the following products used to provide retirement income:

- *In the annuities class:*
    - *Lifetime annuities (with/without capital protection) – fixed and inflation-linked*
    - *Investment-linked annuities (with a minimum income underpin and with/without capital protection)*
    - *Enhanced annuities*
- *In the drawdown class:*
    - *Capped drawdown (with a minimum income underpin)*
- *In the hybrid class:*
    - *Variable annuities (with a minimum income underpin)*

    - *Guaranteed drawdown (with a minimum income underpin).*

It is important that there is full transparency over the product design and over charges for each of the above products – and that the charges are demonstrably not excessive.

Recommendation 2.8: Provider regulation and the economics of both institutional solutions and retail retirement income solutions

We recommend that the regulator:

- *Aligns provider regulation with Recommendations 2.1 – 2.7*
- *Reviews the economics of both institutional solutions and retail retirement income solutions, and*
- *Encourages the use of institutional solutions over retail solutions where it can be demonstrated that these provide better value.*

Recommendation 2.9: Capping charges

*We recommend that, in due course, a charge cap should be imposed on a simple default decumulation product. The regulator should undertake preliminary work on what a reasonable level for the charge cap would be***.**

At a minimum, the following should be included in any cap:

- The total expense ratio or ongoing charges figure on the default investment strategy (including the costs of any guarantees)
- Transactions costs (what is covered to be agreed)
- Cost per ad hoc withdrawal subject to a maximum number of withdrawals.

The following additional costs would apply to any cap for retail drawdown:

- Platform charge
- Adviser fee if any.

We do not have a view on the size of the charge cap or when it should be introduced. However, if there is little further evidence of innovation, there would be little point in delaying its introduction. Of course, products outside the decumulation default would not be subject to a charge cap.

Recommendation 2.10: Stranded pots

We recommend that the Government investigates the feasibility of introducing one the following two models for dealing with the issue of stranded pots: a) the aggregator model and b) the scheme-follows-member or the one-member, one-scheme model.

While both have disadvantages (principally switching costs and the requirement for a central clearing house, respectively), they are both consistent with a transition of the UK pension system towards a small number of large trust-based schemes – which might be the natural outcome of the auto-enrolment process, an outcome that the Government should encourage.

The pause on dealing with this issue, announced by the Government in October 2015, gives the Government an opportunity to completely rethink the problem of stranded pots.

Chapter 3. Supporting savers to make the right choice at retirement for them and their family and how to build on the lessons of auto-enrolment

Recommendation 3.1: Safe harbour retirement income plans

We recommend that a quasi-default retirement income plan is designed and used by providers and advisers. This will involve a simple decision tree and a limited set of default pathways. The plan would be self-started following a guidance or advice surgery, and the plan member has the right to opt out until the point at which the longevity insurance kicks in.

The guidance or advice surgery needs to collect information on:

- *pension pot size*
- *other sources of lifelong income (especially any state and defined benefit pensions)*
- *other sources of wealth (such as housing equity)*
- *liabilities (e.g., mortgage, credit card debts)*
- *health status*
- *family circumstances, including bequest intentions*
- *given other income sources, health status and family circumstances, decide the levels of expenditure that are considered essential, adequate and desired*
- *tax position*
- *risk attitude*
- *risk capacity.*

The plan could be operated by a provider or an adviser. Two forms of the plan would be acceptable:

- *drawdown plus a deferred annuity, or*
- *layering – first secure essential life-long expenditure ('heating and eating'), then allow for luxuries.*

The plan must allow for:

- *access – the flexibility to withdraw funds on an ad hoc basis*
- *inflation protection (either directly or via investment performance), and*

- *longevity insurance.*

The customer will choose from a set of safe harbour products approved by the regulator. The purpose of the decision tree is to identify the products that are most suitable for meeting the customer's needs. To be feasible, any default pathway using a decision tree would need to be aligned with the guidance guarantee process in a way that it is not classified as regulated advice or a personal recommendation. This is because a decision tree is advisory – not advice – and so would be granted safe harbour status. Any adviser or provider making use of such a retirement income plan would be protected against future mis-selling claims.

A whole range of problems that emerged during the early months of 'freedom and choice' can be overcome by using such a default, e.g., lack of financial engagement and capability by members, ineffective communications, and scammers.

Recommendation 3.2: Simplifying the definitions of information, guidance and advice

We recommend that the Financial Conduct Authority:

- *reviews its multiple definitions of information, guidance and advice with a view to replacing them with just two categories: 'personal recommendation' and 'financial help', with the latter replacing everything that is not full regulated fee-based advice where the adviser takes responsibility for the personal recommendation*
- *recognises that a quasi-default decumulation strategy is 'advisory' rather than 'advice' and that advisers and providers should be able to explain the quasi-default decumulation strategy and assess suitability without this being classified as regulated advice.*

The simplest solution involves only three routes:

- execution-only – the customer makes all the decisions ('I want to do it myself')
- 'financial help' – the customer is helped or steered towards tailored options using a decision tree; but this is currently classified as advice ('Help me do it')
- personal recommendation or full regulated advice ('Do it for me')

It is also important to recognise that guidance and advice cannot be a single event, but has to be a process. There needs to be periodic financial health checks or just simple reminders:

- 10 years prior to the nominated retirement date to confirm whether a de-risking glidepath is required and, if so, when it needs to begin
- 1 year prior to the nominated retirement date to re-confirm commencement date
- at age 74 to review death benefits
- at ages 80 and 85 to confirm implementation of longevity insurance (i.e., the switch to annuitisation if drawdown was used at the beginning of retirement).

Recommendation 3.3: Appropriate segmentation of the advice market

We recommend that:

- *an attempt is made to segment the advice market in a way that would be helpful to consumers. There are a number of ways of doing this, e.g.:*
  - *by level of assets – Is there a level of a ssets below which 'financial help' alone will be adequate (for most people) and above which full regulated advice is recommended?*
  - *by spending type – Are there spending types for whom 'financial help' alone will be adequate and are there spending types for whom full regulated advice is recommended?*
  - *by behavioural type, e.g., 'econ' or 'human'. Econs only need information in order to make informed decisions. Humans face behavioural barriers and biases which need to be identified early on (e.g., low levels of financial literacy, overconfidence, and self-control and hyperbolic discounting problems). Are there simple nudges that would improve effective decision making by humans, such as:*
    - *help*
    - *What do 'people like me' do?*
    - *advice (simple and targeted)?*
- *an attempt is made to agree on:*
  - *the appropriate level of help or advice for each market segment*
  - *the appropriate role of technology (e.g., robo-advice) for each market segment.*

The service in economy class is broadly similar across different commercial airlines and the same is true for business class and first class. Millions of people are content with this simple classification. Why can't the financial advice market be segmented in a similar way?

Recommendation 3.4: Turning financial advisers into a recognised profession

We recommend that financial advisers undertake a review of their industry with a view to transforming themselves into a recognised profession. The following issues would be covered in the review:

- *formalising and improving the professional (including training) standards of advisers*
- *introducing a fiduciary standard for financial advisers who provide full regulated advice*
- *the appropriate charging model for the service offered (fixed fee or percentage of assets), with the charges demonstrably delivering value for money to the customer and with full transparency over charges.*

Financial advisers are not a recognised profession, yet they wish to provide advice on billions of pounds of UK retirement savings. Further, research by the FCA shows that customers are put off seeking financial advice because they are unable to trust the advice they receive or judge its quality. The obvious solution is to transform themselves into a recognised profession. They should continue to improve their professional standards, accepting that the advice market might be smaller, although more profitable as a result. In particular, the professional training of advisers should be improved, with a much greater emphasis on understanding the risks involved in delivering retirement income solutions and how those risks can be measured, monitored and managed.

Advisers should also consider introducing a fiduciary standard for those who provide full regulated advice, as in starting in the US. This requires advisers to act solely in their clients' best interests.

The current disparate views expressed by the industry on both the nature of the service offered (ranging from 'everyone needs bespoke advice' to 'advice is only necessary for the very well off') and the charging model (fixed hourly rate vs percent-of-assets) is not helpful to consumers or in the long-term interests of advisers. We need a common national narrative on both these issues, bearing in mind that surveys show that most consumers are not currently prepared to pay very much for advice, because they do not place much value on it.

In terms of adviser fees, there needs to be much greater justification of ad valorem fees where the fee is unrelated to the amount of work done. Such fees are now very uncommon in most other types of professional services organisations. Charges also need to be transparent and easy to understand. It is not acceptable in this day and age that a potential client needs to have a long face-to-face meeting with an adviser before they are told what the charge will be, and then feel under some moral pressure to accept this charge.

Recommendation 3.5: Review of the unresolved implementation challenges of the pension reforms

We recommend that the Financial Conduct Authority:

- *reviews the circumstances where mandatory advice is necessary*
- *clarifies the legal consequences for customers, advisers and providers when 'insistent clients' act against advice.*

We support proposals, made by the ABI and others, to deal with the remaining implementation challenges of the pension reforms.

Recommendation 3.6: Review of the powers of independent governance committees

We recommend that the Government reviews the powers of independent governance committees (IGCs) in contract-based schemes with a view to making them equivalent to the powers of trustees in trust-based schemes.

This essentially means giving IGCs a fiduciary duty to act in the best interests of scheme members. For example, IGCs should be given the power to fire an underperforming fund manager without requiring the members' express consent.

Recommendation 3.7: Dealing with pension fraud and investment scams

We recommend the following measures are taken to deal with the problems of pension fraud and investment scams:

- *all financial product sales (covering both regulated and unregulated products) should be brought under a common regulatory umbrella*
- *telemarketing (cold-calling) should be made illegal*
- *penalties for pension fraud and investment scams should be greatly increased.*

There can be no hiding place for pension fraudsters and investment scammers.

Recommendation 3.8: Customer responsibility

We recommend that the Government initiates a national debate amongst relevant stakeholders on the appropriate degree of customer responsibility and what industry and regulators need to do before consumers can reasonably become liable for their decisions in retirement.

Associated with this should be attempts to improve customer engagement via better customer communications.

Recommendation 3.9: Introduction of an 'early warning system' to help retirees

We recommend that the Government introduces the following measures to support consumers as soon as possible:

- *a 'pensions dashboard'*
- *'personal pension alerts' to help policymakers intervene where appropriate with the sub-groups it has identified as at particularly high risk.*

We support the various proposals that have been made to develop a 'pensions dashboard' that would enable consumers to view all their lifetime pension savings (including their state pension) in one place. In the past, this idea has been dismissed as too much of a technological challenge, given the multiple data bases that this information is held on, but we understand that the technology is now available to do this.

We also support the proposal for introducing 'personal pension alerts', developed by the Social Market Foundation, which would enable potential interventions, such as 'targeted support and advice; initiatives to make retirees think twice before taking one-off decisions such as withdrawing all their pension savings; and, a "mid-retirement financial health check" to encourage older people to reconsider their financial position for their later years'.

Recommendation 3.10: Monitoring outcomes

*We recommend that the Government puts in place a monitoring mechanism to assess the success of the 'freedom and choice' pension reforms. This should be benchmarked against the criteria for a good pension scheme listed in **Recommendation 1.1**.*

Data should be collected from sources such as Pension Wise, the ABI, the FCA and HMRC. Focus groups should be established to discuss their experience. We support the Work and Pensions Select Committee's request for better information on: 'customer characteristics of those using freedoms from pot size to sources of retirement income; take-up of each channel of guidance; reasons for not taking up guidance and advice; subsequent decisions made and reasons for those decisions'.

Recommendation 3.11: The annuities market

We recommend:

- *The sale of immediate annuities should be via an auction*
- *The Government should facilitate and encourage the development of a market in deferred annuities.*

The first point deals with the problem identified by the FCA in 2014, namely 'consumers' tendency to buy from their existing pension provider [which] weakens competitive discipline. Not only do incumbent providers feel less pressure to offer competitive vesting rates, but challengers find it difficult to attract a critical mass of consumers. As a result, there has been limited new entry into the decumulation market in recent years'. It is also likely that these annuities will be medically underwritten, i.e., applicants have to fill in a medical questionnaire which asks health and lifestyle questions.

The second point attempts to address the problem that an open market in deferred annuities does not exist in the UK, yet is essential to provide the longevity insurance needed for the decumulation default to work (see **Recommendation 3.1**). The various reasons why a deferred annuity market does not exist (e.g., onerous regulatory capital requirements under Solvency II) need to be addressed.

Recommendation 3.12: The self-employed and non-eligible job holders for auto-enrolment

We recommend that the Government:

- *considers revising the qualification for auto-enrolment from a 'per job' basis to an 'combined jobs' basis*
- *begins to collect more reliable information on the pension arrangements of the self-employed and non-eligible job holders for auto-enrolment*
- *investigates the possibility of establishing a Government-backed arrangement (like an ISA) to help these groups save for their retirement*
- *considers how to help these groups draw a retirement income in a cost-effective manner.*

The combined size of these two groups is significant: 4.5m self-employed people (17% of the employed population) and 6.2m non-eligible job holders (24% of the employed population), implying that around 11m people working in the UK will not be auto-enrolled onto any pension scheme.

The qualification for auto-enrolment is assessed on a 'per job' basis, which implies that individuals with a number of low-paid jobs will be excluded from auto-enrolment onto a pension scheme. The PPI estimates that 'if the income from both first and second jobs was taken into account when assessing eligibility for automatic enrolment, then a further 80,000 people (60,000 women and 20,000 men) would earn enough to meet the qualifying criteria'. We fully recognise the practical difficulties of implementing this recommendation. Further, the recommendation might not actually be desirable if it results in workers falling into a benefit trap. Indeed, it might be the case that the only feasible way of dealing with this group of workers is through the state pension system.

We could find no accurate data on the combined number of the self-employed or non-eligible job holders with individual DC policies. Similarly, when it comes to decumulation, it is likely that these groups will fail to benefit from institutional value for money solutions and instead will have to rely on the high-cost retail market, unless NEST establishes a decumulation scheme which they could join.

We support the call of the Resolution Foundation 'for greater intervention to ensure the self-employed [and and non-eligible job holders for auto-enrolment] are adequately prepared for their later years'. These groups should be encouraged to save more for their retirement, but in a way that allows them flexible access to their savings and has low charges. We therefore support the recommendation of the RSA for the introduction of a Government-backed ISA (e.g., provided by National Savings & Investments) to facilitate this. In addition, the groups could be encouraged to join NEST. We also support the RSA's 'Save When Paid' proposal which automatically diverts a percentage of every pay cheque to a savings account.

When it comes to drawing an income in retirement, both groups should be allowed access to a national decumulation scheme like NEST (once its decumulation blueprint has been implemented).

Chapter 4. How savers can be helped to manage longevity risk

Recommendation 4.1: Longevity bonds working party

Since longevity bonds have a potentially important role to play in hedging systematic longevity risk, we recommend that the Government sets up a working party to undertake a cost-benefit analysis of government issuance of longevity bonds to help manage the associated longevity risk exposure.

The terms of reference would cover: the benefits that would accrue to all stakeholders; the scale of the longevity risk that Governments would be assuming; the actions Governments can take to mitigate this risk; inter-generational equity; the practicalities of issuing longevity bonds, such as the construction of reference longevity indices, potential demand, pricing, liquidity and taxation

Chapter 5. The role of the National Employment Savings Trust in helping savers to access good quality retirement products

Recommendation 5.1: A role for NEST in decumulation

We recommend that NEST should be allowed to compete in the decumulation market from 2018 to provide a value-for-money decumulation product in the same way that it has in the accumulation market.

This would enable NEST to set a competitive charge and governance standards that would provide a market benchmark.

Chapter 6. The role of collective pension schemes and how these could be introduced in the UK

Recommendation 6.1: Collective individual defined contribution schemes

We recommend that the Government looks at the feasibility of establishing collective individual defined contribution schemes.

Such schemes would be compatible not only with the defined ambition agenda, they would also be compatible with the new pension flexibilities following the 2014 Budget, while, at the same time, exploiting economies of scale to the full and allowing a high degree of risk pooling.

Chapter 7. Conclusion: Developing a National Narrative

Recommendation 7.1: Reviewing the working relationships within the pensions industry

We recommend that the pensions industry – via its trade associations – conducts a review of the working relationships of its various components – providers, advisers, investment *managers and insurers – to remove the serious fissures and thinly disguised hostilities that currently exist, and which impede customers getting the best solutions for their needs.*

All these parties are necessary to provide appropriate, effective and value-for-money retirement income solutions. Yet the evidence we have gathered for this report suggests that the working relationship between the parties is not working effectively in the best interests of customers.

Recommendation 7.2: Creating a single pensions regulator

We recommend that the Government creates a single pensions regulator, with the regulatory powers of the Financial Conduct Authority over contract-based schemes transferred to The Pensions Regulator.

This would be consistent with the enhancement of the powers of independent governance committees in contract-based schemes to match those of the trustees in trust-based schemes proposed in **Recommendation 3.6**. It would also help to provide greater consistency of treatment between trust-based and contract-based schemes. Particularly important in this context is the issue compensation in the event of the insolvency of a pension scheme or a service provider to a scheme. Our research shows that there are many serious and significant discrepancies between the compensation rules of trust-based and contract-based schemes. The creation of a single regulator would help to bring clarity and consistency to pension savers' rights and protections.

Recommendation 7.3: Establishing a pension tax and tax relief framework that reflects how people behave

We recommend that the Government establishes a pension tax and tax relief framework that encourages the optimal level of pension savings given the reality that most people are 'humans' not 'econs'.

The aims of the pension tax and tax relief framework would be:

1. To encourage the level of pension savings needed to achieve a target standard of living in retirement which might be defined as:
    a) 'essential' – income sufficient to cover an individual's minimum basic expenditure needs
    b) 'adequate' – income sufficient to achieve a minimum lifestyle to which an individual aspires in retirement
    c) 'desired' – income sufficient to achieve the full lifestyle to which the individual aspires in retirement.
2. To encourage individuals to make provision for long-term care. (While this is not directly a pension issue, the relationship between the increases in longevity and morbidity inevitably link the two.)

3. To achieve tax neutrality over the life cycle. One objective of pension tax relief is to encourage larger pension funds than otherwise, but to do so in a way that is tax neutral to each generational cohort, so that the cumulative value of tax reliefs during the accumulation phase broadly equals the present value of tax that will be collected during the decumulation phase (both valued at the date of retirement).
4. To achieve a degree of equity between members of the same generation through a redistribution of resources between low- and high-income individuals, men and women etc.
5. To achieve a degree of equity across generations and, in particular, to avoid unfair burdens falling on future generations.

Recommendation 7.4: Establishing a permanent independent Pensions, Care and Savings Commission

We recommend that the Government establishes a permanent independent Pensions, Care and Savings Commission which reports to Parliament.

Recommendation 7.5: Adopting a national retirement savings target of 15% of lifetime earnings

We recommend that the Government adopts a national retirement savings target of 15% of lifetime earnings, achieved through auto-escalation, to avoid future pensioner poverty.