Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 5268
Email: enquiries@fs-cp.org.uk

The Rt Hon Frank Field MP
Chair, Work & Pensions Committee
House of Commons
London, SW1A 0AA

28 August 2015

Inquiry into pension freedom guidance and advice: submission by the Financial Services Consumer Panel

Summary

1.1 The Pension Wise guidance service is essential to help people navigate the new pension freedoms, but it is not clear at present that it will lead to better outcomes for consumers. The Panel believes that, to be effective, the new guidance service must be independent; quality assured and professional; holistic; sustainable and seamless.

1.2 We remain concerned about inconsistencies in service standards between delivery partners, and the low numbers of consumers using Pension Wise. The service needs to have a stable source of funding to attract the right staff. It will also have to offer holistic guidance which takes into account all of a consumer's assets and liabilities, including equity in property. Accordingly, guidance providers should be able to answer complex individual queries relating to debt, equity, benefits and tax.

1.3 The Government needs to be more transparent about how Pension Wise is performing, and what would be considered good outcomes. The Panel believes it should regularly publish management information to show what proportion of eligible people is making use of the service. It also needs to conduct a thorough review to determine whether Pension Wise is leading to better outcomes for consumers.

1.4 Consumers need information on what level of income they might achieve if they choose a particular product or lump sum. The Government should consider how best to provide a universal retirement income calculator, showing what level of income individuals' pension pots might generate under different options such as drawdown or Uncrystallised Funds Pension Lump Sums (UFPLS). Consumers also need to be able to consider this against options such as equity release.

1.5 The Panel is concerned that the growing trend of consumers purchasing annuities via 'non-advice' sales is now likely to be mirrored in markets for more complex products such as drawdown. The FCA should take urgent action to ensure that intermediaries who perform non-advised sales adhere to a strict set of standards.

2. Introduction to the Panel

2.1 This is the response of the Financial Services Consumer Panel to the Work and Pensions Committee's call for evidence on advice and guidance related to the new pension flexibilities.

2.2 The Consumer Panel is a statutory body established under the Financial Services & Markets Act 2000. It provides advice and challenge to the Financial Conduct Authority (FCA) on the extent to which the FCA's general policies and practices are consistent with its general duties.

2.3 The emphasis of the Panel's work is on activities that are regulated by the FCA, although it may also look at the impact on consumers of activities that are not regulated but are related to the FCA's general duties.

2.4 The Panel represents the interests of all groups of financial services consumers and operates independently of the FCA.

3. General remarks on pension flexibility

3.1 Following the announcement in the 2014 Budget, the Panel gave a cautious welcome to the new pension flexibilities, particularly for those with smaller pension pots where an annuity did not represent an adequate choice.[1]

3.2 Research[2] undertaken on behalf of the Panel into annuities clearly showed that this market did not work well for consumers. Nonetheless, the Panel believes that annuities may still be the right retirement product for many consumers, as they provide a guaranteed hedge against longevity risk.

3.3 The Panel also believes there is a real risk that industry will develop inappropriate products (in relation to risks and cost) to replace the lost profits obtained from selling annuities. This could result in a similar mis-selling scandal to that we saw with personal pensions in the early 1990s, which led to £12 billion in compensation being paid out.[3]

3.4 The low interest rate environment is also making consumers more vulnerable to fraud in their search for yield. For example, City of London figures obtained by the Financial Times in July 2015 showed that consumer losses to pension scams increased by 235% in May compared to April this year, when the reforms first entered into force.[4]

3.5 Against this background, the provision of a high-quality, free and independent guidance service that consumers will trust, is all the more vital.

4. Pension freedoms: the need for advice and guidance

4.1 Financial capability in the UK remains low[5], meaning that consumers will often lack the knowledge and skills they need to make an informed decision about the

---

[1] https://fs-cp.org.uk/consumer-panel-welcomes-greater-choice-pensions
[2] https://fs-cp.org.uk/sites/default/files/annuities_position_paper_20131203.pdf
[3] http://www.fsa.gov.uk/library/communication/pr/2002/070.shtml
[4] http://www.ft.com/cms/s/0/b5bc71a0-3091-11e5-8873-775ba7c2ea3d.html
[5] Money Advice Service (2013), 'The Financial Capability of the UK' (https://www.moneyadviceservice.org.uk/en/corporate/the-financial-capability-of-the-uk)

types of retirement products available to them. Moreover, consumers will be faced with product types they have not encountered before, a challenge even for the financially literate. Equally, consumers may not fully appreciate the impact on personal tax and benefits of withdrawing their pension pots as a lump sum.

4.2 In some cases, the Government has acted to protect consumers by requiring them to take regulated advice before making a decision. For example, the Pension Schemes Act 2015 only permits transfers from Defined Benefit (DB) to flexible schemes after the pension scheme member has obtained independent advice.[6]

4.3 This requirement often leaves people angry and confused as they do not understand why they have to pay an adviser to withdraw their pension pot. Moreover, in the vast majority of cases they will be advised to keep the DB pension.[7] As a result, the only way members of DB schemes can access their pension funds flexibly is by becoming an "insistent client", which entails taking sole responsibility for the decision and thereby foregoing recourse to the Financial Ombudsman Service and the Financial Services Compensation Scheme.

4.4 While the Panel welcomed the decision to make advice for transfers out of DB schemes mandatory, it would observe that it does not seem logical to protect certain groups and not others from taking decisions that are not likely to be in their best interests. The approach to mandatory advice has not been consistent.

4.5 While the pension reforms are a positive step to give consumers more choice and encourage competition in the market, the Panel is concerned that most people approaching retirement age are, in reality, ill-equipped to decide how to use their pension pot in a way which helps them meet their financial goals.

4.6 As a result, advice and guidance will be crucial in preventing the considerable consumer detriment which might arise from ill-informed decisions, and which could see many people drain their savings prematurely and become reliant entirely on the state for their income in retirement.

5. Pension Wise guidance service

5.1 With the development of a free, independent guidance service, the government had the unique opportunity to bridge some of the 'advice gap' in the area of retirement products. However, because of the restrictions imposed on the service, the Panel has concerns about its effectiveness.

5.2 By its nature, the service cannot make personalised recommendations, as that would take it into regulated advice. However, by taking people through the options open to them and acting as an independent and unbiased third party, Pension Wise can play a vitally important role in helping give consumers the confidence to take the next step.

5.3 For those who cannot or will not, for whatever reason, seek regulated advice, it may be the only conversation they have with an impartial third party about their retirement options. This makes it especially important that Pension Wise can provide guidance on the interplay between a pension product and a consumer's existing assets and liabilities, including equity in property. For other consumers, it can be the 'bridge' to regulated advice.

[6] http://www.legislation.gov.uk/ukpga/2015/8/section/48/enacted
[7] http://www.thepensionsregulator.gov.uk/guidance/db-to-dc-transfers-and-conversions.aspx#s18742

Content of guidance sessions

5.4 There is little information currently publicly available on the exact content of Pension Wise sessions.

5.5 The guidance can take into account DB schemes and any other personal pension products. However, an extension to the scope of the service is urgently needed so that counsellors can take a holistic view of individuals' balance sheets, including equity in property, and incorporate guidance on tax, benefits and debt.

5.6 A person's income in retirement does not solely depend on the type of retirement product they choose, but also on the resulting implications for their tax liability and eligibility for means-tested benefits.

5.7 Consumers may not be aware that taking their pension pot as a lump sum could render them ineligible for housing benefit or other means tested benefits. In particular, if the withdrawal of a pension pot as a lump sum leads a consumer to have more than £23,000 in capital assets, they would be ineligible for local authority assistance in meeting care costs.[8]

5.8 There is also a risk that people will not understand how the tax system operates in relation to their pension pot, and pay too much tax by withdrawing the money too quickly.

5.9 Pension Wise also needs to be able to provide guidance on the linkages between debt and the pension freedoms. While the opportunity to take their pension pot as a lump sum will be tempting to many consumers on low incomes, it could have far-reaching consequences for those on debt management plans or Individual Voluntary Arrangements (IVAs).

5.10 Opting for an Uncrystallised Funds Pension Lump Sum (UFPLS) would constitute a change in financial circumstances, which could lead to a re-opening of debt repayment arrangements. Pension Wise should make consumers aware of the potential repercussions for the size and frequency of repayments they will be required to make if they acquire a capital sum.

5.11 A consumer's equity in property should also be included in the consideration of a consumer's options in retirement. For some, turning to an equity release product may be a beneficial option.

5.12 A holistic guidance service that takes into account all these different aspects of the consumer's circumstances is crucial to ensure they benefit from Pension Wise. If the guidance does not take into account all their assets and liabilities, and in particular equity in property, the outcome of the session may well be meaningless.

5.13 The Panel remains concerned that Pension Wise does not offer personalised guidance to individuals on these issues. While Pension Wise may be able to signpost consumers to other organisations that offer guidance on tax, debt and benefits, it undermines the purpose of the service if people cannot get a holistic view of the choices they face all in one place. It increases the likelihood that people will just focus on their choice of retirement product, and not the impact this will have on their overall retirement income.

[8] https://www.moneyadviceservice.org.uk/en/articles/means-tests-for-help-with-care-costs-how-they-work

5.14 In addition, Pension Wise guidance should also make it clear to consumers that they may face a myriad of costs and charges if they keep their pot invested, which could have a significant impact on return, and thus their income in retirement.

5.15 Research commissioned by the Panel in 2014[9] showed that reported figures for the cost of keeping funds investment represent only a fraction of the true costs investors pay. Notably, they do not include undisclosed transaction costs, which evidence suggests could add almost 1.5% per annum to the costs of an investment scheme.

5.16 Consumers should be made aware of these facts by Pension Wise, as these hidden costs can have a significant impact on retirement income. Calculations by the Department for Work and Pensions in November 2013 show that an individual who saves throughout their working life into a scheme with just a 1% annual charge could lose around 24% of their pension pot at retirement as a result of charges.[10]

5.17 **<u>Conclusion</u>: Pension Wise providers should incorporate personalised guidance on the implications for tax liability and eligibility for means-tested benefits into their service. They should also highlight the significant impact that (hidden) costs and charges may have on returns if consumers keep their money invested**.

5.18 **In the meantime, Pension Wise should ensure there are "hot" hand-offs to other services, such as regulated advice or debt advice. Consumers who require regulated financial advice should be passed to the Money Advice Service's retirement adviser directory, as it was built for this purpose.**

5.19 Ultimately, it is essential that Pension Wise provides consumers with information about what level of income could be achieved either through the purchase of a guaranteed income (such as an annuity or a flexible income in the form of drawdown or UPFLS) using certain assumptions (including longevity, investment costs and taxation). This could be achieved by building a universal calculator.

<u>Conclusion</u>: HM Treasury and the Department for Work & Pensions should determine the best way of building a universal retirement income calculator for use by Pension Wise. The calculator should show at what point a pension pot might be exhausted if a given level of income was drawn down each year or what level of income the pot might be able to provide given a certain level of growth throughout the consumer's expected lifetime. These calculations should incorporate the estimated impact of *total* costs and charges deduced by the asset manager.

Consistency between delivery partners

5.20 In our response to the FCA's consultation paper on "Retirement Reforms and the Guidance Guarantee"[11], the Panel stated that for the guidance service to be effective it must have consistent standards irrespective of the delivery method.

---

[9] https://fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf
[10] DWP (2013), "Pensions Bill 2013, Information Pack for Peers" (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/269318/pensions-bill-2013-information-pack.pdf)
[11] https://fs-cp.org.uk/sites/default/files/cp_response_fca_guidance_guarantee_final_23_sept.pdf

This is vital to build consumer confidence in the service, and to guarantee good consumer outcomes from every guidance session

5.21 The Panel has argued consistently that simply stating that guidance counsellors "are competent and have sufficient knowledge and expertise to deliver the guidance" is not enough. We have asked the FCA to be more prescriptive about minimum qualifications and the number of years of relevant experience counsellors should have. We believe that the level of service required by consumers in this area can only be delivered by confident, competent, experienced professionals who do not have to rely on a script. They need to be as qualified and experienced as regulated financial advisers.

5.22 However, this consistency has not been achieved. The Pension Wise telephone service delivered by the Pensions Advisory Service requires its counsellors to have a minimum of 5 years relevant experience, whereas Citizens' Advice (which delivers the face-to-face service) requires no prior experience, expertise or any relevant qualifications.

5.23 The Panel also understand there is inconsistency between the telephone service and the face-to-face service over hand-offs to other organisations, such as the Money Advice Service retirement adviser directory.

Pension Wise funding

5.24 Given consumers' need for high-quality guidance, the need for a stable Pension Wise service is clear. The Panel would therefore encourage the Government to provide funding agreements for guidance delivery partners on a long-term basis. The uncertain employment prospects generated by the current annual grant agreements are unlikely to be attractive to the highly-qualified staff needed to provide the service.

5.25 It is also important to get the service delivery incentives for Pension Wise right. HM Treasury should ensure that financial incentives are linked to the number of guidance sessions that actually take place. The incentives should also, as far as possible, take into account the quality of the guidance provided.

Pension Wise signposting by providers

5.26 The Panel is concerned that some pension providers may be respecting the letter but not the spirit of the rules requiring them to signpost people to the official Pension Wise guidance. There are indications that consumers who contact their providers are encouraged to use the firm's 'in-house' guidance providers, who are obviously not independent and impartial.

5.27 The Panel does not believe that providers themselves should play an active role in delivering non-regulated guidance related to pensions. The conflicts of interest inherent in this approach cannot be overcome as the firm, from a commercial standpoint, will likely seek to maximise its profits from the customer without necessarily paying due regard to the latter's needs and circumstances. It is crucial that consumers can access independent guidance to ensure they can make an informed choice that is in their best interest.

5.28 **<u>Conclusion</u>: The FCA should take a proactive approach to monitoring firm behaviour as regards signposting their customers to Pension Wise, to**

ensure that consumers are actively encouraged to contact the service for independent and impartial guidance.

Pension Wise review and evaluation

5.29 The overall effectiveness of the Pension Wise service will depend to a large extent on how many eligible consumers are making use of it. HM Treasury figures indicate that 18,000 people used Pension Wise from April to July 2015.[12] This is only a small proportion of the 60,000 UK residents who made use of the pension freedoms between April and June.[13] It is safe to assume that a majority of the remainder either cashed in without guidance, or only discussed options with their pension provider. Both options carry a risk of poor outcomes for those consumers.

5.30 More detailed management information must be put in the public domain at regular intervals to allow stakeholders and the general public to determine whether Pension Wise is being accessed by a sufficient number of consumers.

5.31 **Conclusion: The Government should publish management information on how often and by whom the Pension Wise service has been used. This should include the number of sessions completed (both face-to-face and via telephone), as well as the mean and median pension pots of those who accessed the service. This information should be published regularly, ideally every quarter.**

5.32 HM Treasury has committed to "a wider programme of evaluation… to ensure that Pension Wise is working effectively, delivers value for money, and meets consumer needs". [14] To ascertain whether Pension Wise is making a positive impact on individual consumers, the Panel believe the Treasury should conduct statistically robust research into the choices made by those who did access Pension Wise, and those who did not, as part of the evaluation.

5.33 The review should also track what people are doing with the cash taken out through an UFPLS, for example what type of investments or cash purchases are being made. Without this kind of information, the Government and other stakeholders can only acquire a partial understanding of consumers' experience. In turn, this means that there is too little insight into the support that people need from Pension Wise.

5.34 The FCA does not regulate Pension Wise delivery partners and so cannot take enforcement action to improve standards, only recommend changes. Enforcement is the prerogative of HM Treasury, but as it is also responsible for delivery, the Panel is concerned it may be reluctant to shut down poor providers.

5.35 **Conclusion: The Government should review the performance of Pension Wise now and annually thereafter to ensure it is delivering value for money and improving consumer outcomes. This should include an evaluation of what money is being used for if withdrawn through a UFPLS. The outcome of these annual Pension Wise reviews should be**

[12] http://citywire.co.uk/new-model-adviser/news/pension-wise-has-delivered-18000-guidance-sessions-since-launch/a828741
[13] http://www.publications.parliament.uk/pa/cm201516/cmhansrd/cm150616/debtext/150616-0001.htm#15061658000993
[14] http://www.parliament.uk/written-questions-answers-statements/written-question/commons/2015-06-24/4210

made public. HM Treasury should be prepared to take robust action if there is evidence that the service is not delivering as it should.

Secondary annuities market

5.36 The Government has also committed to creating a market for secondary annuities by spring 2017[15]. The Panel has expressed serious concerns about the feasibility of this timetable, given that it involves the creation of an entirely new and untested market.

5.37 Such a market would carry considerable risk of consumer detriment, as people may forfeit their guarantee of a lifelong income without being able to assess whether they are receiving value for money for their annuity.[16]

5.38 The provision of independent advice to warn consumers of the potential pitfalls will be vital.

5.39 However, the Panel believes there is currently no market solution to the question of how adequate advice and support can be provided to consumers, irrespective of income level, to help them assess whether they are being offered a fair price for relinquishing the right to such a valuable asset. Regulated financial advice may be available, but at a high price. In most cases any reputable financial adviser would recommend that the annuitant should not sell.

5.40 **Conclusion: The lack of available independent advice for consumers who may sell their annuity in the future should be examined by the Government as part of its Financial Advice Market Review.**

6. Non-advised sales of retirement products

6.1 The Panel is concerned that the growing trend of consumers purchasing annuities via 'non-advice' sales[17] is now likely to be mirrored in markets for more complex products such as drawdown. .

6.2 Non-advised sales of financial instruments such as annuities often have opaque cost structures and offer greatly reduced consumer protection if things go wrong, for example in terms of recourse to the Financial Ombudsman Service (FOS)[18] or the FSCS.[19]

6.3 However, the Panel's 2013 research on annuities[20] concluded that firms that sell annuities via non-advice websites often provide misleading or incomplete

---

15 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/443300/50325_HMT_Red_Book_Complete.pdf#page=90

16 https://fs-cp.org.uk/sites/default/files/fscp_response_-_secondary_annuity_market_june_2015_0.pdf

17 https://fs-cp.org.uk/annuities-time-regulatory-change

18 http://www.financial-ombudsman.org.uk/publications/technical_notes/execution-only.htm

19 For example, consumers have more limited recourse to the Financial Ombudsman Service for non-advised sales.

20 https://fs-cp.org.uk/annuities-time-regulatory-change

information to consumers. These findings have recently been confirmed by a separate FCA market study.[21]

6.4 Given the persistent problems associated with non-advised sales, and the likelihood of an increase in such sales for retirement products following the recent reforms, the Panel believes that it is now even more important that the FCA should introduce a robust code of conduct for non-advised sales.

6.5 Such a code of conduct, which would be embodied by the FCA through regulatory rules and mandatory standards, should emphasise the need for high professional standards, the transparent disclosure of charges, and a clear explanation of the implications of non-advice for consumer protection.[22]

6.6 **Conclusion: the Panel believes the FCA should embody in its rules and mandatory standards the equivalent of a code of conduct for the non-advice market.**

EU Markets in Financial Instruments Directive

6.7 The EU's second Markets in Financial Instruments Directive (MiFID II)[23] requires firms that conduct execution-only sales of financial instruments to conduct an "appropriateness test" for each customer. This is an obligation on the provider to ensure that a potential customer who does not receive advice has the knowledge and experience required to understand the risks of a given complex financial instrument.

6.8 Although MiFID II does not apply to pension products, the FCA is considering extending the "appropriateness" test to pensions because it considers "pensions liberalisation could give rise to new risks of inappropriate sales of insurance-based investments to consumers".[24]

6.9 The Panel supports extension of the MiFID II "appropriateness" test to pensions as an interim measure. It does not offer the protection to consumers that would result from the non-advice Code of Conduct described above, but it would require firms, when making a non-advised sale of a pension product, to ask their client to provide information regarding their knowledge and experience of the specific type of product offered or demanded.[25]

6.10 Separately, the Panel would also encourage the Government to look at raising standards for non-advised sales as part of its Financial Advice Market Review (FAMR).

6.11 **Conclusion: The Panel would encourage the FCA to apply the "appropriateness" test contained in MiFID II to pensions. This should not preclude it raising standards for the non-advice sector further in the future by establishing a non-advice Code of Conduct**

---

[21] Financial Conduct Authority (2015), "Retirement income market study" (https://www.fca.org.uk/static/documents/market-studies/ms14-03-3.pdf)
[22] The Panel's draft for such a Code of Conduct can be found here: https://fs-cp.org.uk/sites/default/files/annuities_position_paper_20131203.pdf#page=5
[23] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN
[24] Financial Conduct Authority (2015), 'Developing our approach to implementing MiFID II' (https://www.fca.org.uk/static/documents/discussion-papers/dp15-03.pdf)
[25] This requirement already exists under previous EU law but it being expanded to cover a much wider range of products under MiFID II.