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

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Department for Work and Pensions
Decumulation and Transfers Team
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8 November 2016

Dear Sir, Madam,

Department for Work and Pensions consultation on valuing pensions for the advice requirement and introducing new consumer protections

This is the response of the Financial Services Consumer Panel (the Panel) to the Department for Work and Pensions (DWP) consultation on valuing pensions for the advice requirement and introducing new consumer protections.

The DWP's proposed draft regulations to amend the pension valuation method will mean some consumers currently required to take independent financial advice before accessing the pensions freedoms will no longer be required to do so. Instead, these consumers will only receive a risk warning as a prompt to think before they act. This makes it all the more important that these risk warnings are clear and effective.

Past experience has shown that simply requiring firms to issue risk warnings without detailed rules is not enough. In January 2016, the FCA found some firms were not personalising warnings sufficiently, which meant consumers were unable to understand how the risks applied to them[1]. The latest FCA data on pension freedoms shows that out of 13,871 pensions with guaranteed annuity rates (GARs), 61% were not taken up[2]. This strongly suggests that consumers are not aware their pension has a safeguarded benefit, let alone what its value could be.

Consumers will need to understand what they are giving up and the value of it. In order to do this effectively the risk warnings will need to show standardised information, with a requirement for firms to use the same valuation method. We also believe the government needs to consider carefully the format and content of risk warnings before introducing them, supported by research to show what consumers will find effective. As this research will take time, we believe the government should delay implementing its proposals by at least a year.

We also recommend that the risk warnings are supported by compulsory guidance sessions, either delivered by Pension Wise or the new public financial guidance body when it is formed.

We agree the appropriate time to issue risk warnings is at the point consumers are considering, but had not yet instructed on, a transaction. We would also agree risk warnings

[1] Financial Conduct Authority's response to the Work and Pensions Select Committee's report on the pension freedoms January 2016: http://www.publications.parliament.uk/pa/cm201516/cmselect/cmworpen/719/71904.htm
[2] FCA Data Bulletin Issue 7, October 2016: https://www.fca.org.uk/publication/data/data-bulletin-issue-7.pdf

should be issued to consumers regardless of pot size, age or whether they are members or survivors.

Finally, we would suggest that further research is urgently needed to explore why people are accessing their pension pots early, what proportion of their retirement income the withdrawals represent, and what they are using the cash for. This information is vital to try and understand the long term implications of the pension freedoms.

Yours sincerely

Sue Lewis
Chair
Financial Services Consumer Panel

Consultation questions

The Panel has only answered questions where it has substantive comments.

Q1. Do you agree that the proposed amendments achieve the policy intention outlined above?

If the policy intention is to simplify the valuation process and to allow more people with safeguarded benefits to access their pension pots without the benefit of advice, then, yes, the proposed amendments will achieve that. However, we have concerns about the immediate and long term implications of the proposed amendments which we have outlined elsewhere in this response.

Q2. Are you aware of any unintended consequences which might occur as a result of amending the valuation process as set out in the draft regulations?

There is a high risk that individuals will either ignore or not fully understand the risk warnings and fail to grasp the fact they are giving up assets worth far more than their immediate monetary value. This is likely to lead to a reduced income for many people, or the prospect of running out of cash altogether.

We would urge the government to explore fully if there is any possibility of individuals cashing in policies with safeguarded benefits being subject to the deprivation of assets rules. If there is such a possibility the government will need to consider how to communicate this to consumers in a way they will understand.

Q3. Should risk warnings cover survivors or does this impose unnecessary burdens on schemes?

Yes, risk warnings should cover survivors. This is particularly important if a pension is subject to pension sharing rules. With some schemes it may be relatively easy to identify beneficiaries (if a nomination has been made), but with many, particularly personal pensions, there may be no nomination. The risk warnings will have to contain suitable wording to cover any potential beneficiaries of the safeguarded benefits, other than the member.

Q4. Do you think that the proposal for schemes to issue risk warnings within 1 month of any member request, or with the statement of entitlement if earlier, is workable?

Yes.

Q6. Do you agree that the proposed amendments will provide an appropriate level of protection for pension scheme members and ensure they understand the value of their safeguarded-flexible benefits?

Risk warnings must be clear, free of jargon and issued in a timely fashion. Even then, there is no guarantee they will have an effect. History has shown us time and time again that disclosure does not avoid consumer detriment. Warnings will need to be extensively tested with consumers, to ensure they understand them and the implications of ignoring them, and to determine the best way of presenting and distributing the information.

We would also recommend risk warnings be supplemented by compulsory guidance sessions. These sessions could tailor guidance to the individual's circumstances. We accept there may be some push back from those consumers determined to access their pension pots, however this would be less onerous than the requirement to take financial advice (for those with pots above £30,000) and there would be no cost to the individual other than time. This would be particularly beneficial for those consumers who are required to obtain financial advice under the existing rules, but will no longer be required to do so when the new rules come into effect.

We also agree that consumers should be presented with two tailored illustrations showing what they could get if they took up their guarantees and what they could get in the open market. The research we propose above should also cover how these comparisons could be presented to consumers in an effective way. To overcome a tendency to hyperbolic discounting, a forward projection could show consumers how much they may lose in 10 years' time if they choose to transfer out of a scheme with flexible safeguarded benefits rather than take the benefits.

Q8. Will applying the risk warnings to all pension scheme members with safeguarded-flexible benefits place unnecessary burdens on providers?

This is the minimum that pension schemes and providers should be doing for their members and it is for them to ensure they have efficient systems in place to serve their members properly.

Q9. *Should we also seek to offer schemes the alternative of generating the comparative income illustrations using other assumptions, such as those in Chapter 13 Annex 2 of FCA's CoBs rules? Would this offer greater flexibility for schemes and be helpful to members by ensuring consistency with other FCA mandated projections? Or could it add complexity, lead to member detriment, or have any other unintended consequences?*

The current regulatory regime means certain types of schemes can use different rules to calculate illustrations. However, in this case we believe it essential for the projections to be based on the same assumption and rules to maintain maximum clarity for consumers. However, we do understand that combining two sets of rules – or even choosing one over another – is not a simple task and any potential detriment from one route over another must be fully explored first.

We would urge the government to delay implementation beyond April 2017 until consumer testing of the risk warnings can be carried out, and a full analysis of how projections can best be provided.