

# Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Sirs,

## **Personal Accounts Delivery Authority: Building Personal Accounts – securing a retirement income**

The Financial Services Consumer Panel is pleased to be able to comment on the proposals for implementing the delivery of the Personal accounts scheme.

Our comments on the issues raised in the consultation follow but as an overall point we support measures which are intended to encourage greater saving for retirement.

Choosing an annuity is a very significant decision for individuals to make; indeed within the Paper it is acknowledged that few people really understand annuities. There is already evidence that current annuitants do not end up with the annuity that might provide the largest income – for example, many eligible for impaired / enhanced annuities do not realise this. Under this proposal, members of the scheme will need to decide whether to take an annuity; what kind of annuity they should take and which provider to choose – all without the benefit of advice. Given that members of the scheme could be expected to have poorer levels of financial capability than current annuitants we have some concerns with this element of the proposal.

We recognise that PADA is required to deliver Personal Accounts at low cost but we have some concerns with the proposal to rely on a self-service customer experience delivered through the internet. Clearly there are tensions between delivering a cost-efficient service and one that allows consumers access to advice and information to enable them to make informed choices and steer them towards a more suitable product. However, we are troubled that the scheme will encourage members to make such a significant financial decision, without the benefit of advice. In summary, we believe that if the annuitisation process is largely automated, an alternative advisory service should be offered to those feeling they need advice in relation to this important decision. If the advisory service is externally provided, then this should be very clearly signposted. It should also be clear from the outset, that consumers may achieve better annuity rates if they do not follow the automated process, but search the Open Market.

We believe that PADA needs to give greater consideration to how they might encourage members to seek appropriate advice or guidance. Money Guidance can play a role, but there is already an organisation providing specialist, free at point of use, advice to those choosing an annuity – The Pensions Advisory Service (TPAS). We think there is a case for TPAS to play a specific role in providing advice to Personal Account holders around annuity choices. We would support the enhancement of TPAS' resources, so that Personal Account holders can access support if they need it.

As an alternative, we would also encourage PADA to explore the options for introducing a mechanism for paying for advice – perhaps following some of the approaches being considered as part of the FSA's Retail Distribution Review. This acknowledges that many consumers do not wish to pay for advice in an 'up front' lump sum, and allows for the consumer to pay for advice in increments. The product provider sets the charge or premium level to pay for the cost of advice, in addition to the product price and hands over payments for advice to the advice provider as the payments are collected. If a method could be found to facilitate a more attractive method of paying for advice, we believe that members would be more likely to seek advice and take suitable decisions.

We also believe that PADA should consider whether it might be appropriate to allow members more access to pension pot savings that may encourage increased investment into the fund. Research for the ABI<sup>1</sup> suggests that lack of early access was inhibiting people from taking out a pension or saving more in their pension. What is needed is a system which brings out individual needs and ensures that the individual does as well as they can financially from their pension pot.

We would welcome further analysis and comparison of the costs and benefits of the options for accessing annuity providers for Personal Account holders; namely a Panel of providers, a single provider, or accessing providers through the Open Market Option (OMO). We broadly support the reasoning, and therefore the high level proposal of a small panel, but would like this choice to be further validated and evidenced. In particular, any panel must provide access to impaired or enhanced annuities. As the scheme moves forward we will wish to satisfy ourselves that the criteria against which the providers are appointed are in the best interest of the members.

Alternatively, we would suggest that by building in a mechanism for the provision of advice, the scheme could rely entirely on open market options and that this would remove the need for maintenance of the panel.

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<sup>1</sup>ABI (2007) *The State of the Nation's Savings 2006/07*.

Finally, whilst we broadly support empowering the trustees to purchase an annuity on the member's behalf where the member has reached 75 and has failed to exercise their choice, you will no doubt be aware there is a risk of considerable consumer detriment where a decision is made without full understanding of the member's circumstances. We would therefore wish to be satisfied that significant effort was being made to encourage members to 'engage' and to trace individuals who had not engaged by the time they reached 75 years old, before being comfortable with empowering the trustees, particularly given that in many cases the account will be the member's sole source of investment funds. Finally, there is the issue of compelling people to take out annuities in poor market conditions, which may affect the income levels the annuity can provide. We would like to see protection for the scheme's members in this regard, for example the 'lifestyling' of the individual's funds.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Adam Phillips', with a long horizontal flourish extending to the right.

Adam Phillips  
Acting Chairman  
Financial Services Consumer Panel

## **Responses to the Questions for Consultation:**

### **• Are lifetime annuities the best way to provide a guaranteed lifetime income for our members?**

Annuities are the only way to provide a guaranteed lifetime income for members; however, we expect that in many cases the funds will be small, particularly in the early days of the scheme. We therefore ask that further consideration be given to the circumstances under which members will be able to access the whole fund, recognising the tax and benefits implications of doing so.

We also wish to encourage how the accounts should be managed during the time that the fund is built up. If we focus on the outcome which is intended from personal accounts, it is to encourage those who are currently without pension provision to save for their retirement. Currently in the UK, people cannot make withdrawals from their pension fund before the age of 50. There is evidence to suggest that allowing more flexibility in saving and withdrawing could further increase the number of people saving into a pension fund and the total amount saved. This is evident in the US 401(k) system where people who save in 401(k) plans which permit early access voluntarily contribute from 0.6% to 3% more salary to their pension fund than those in plans without early access.

### **• Does our research into the way our target market views the process of buying annuities reflect your own views and experience? What other factors do we need to consider that will help us better understand our audience?**

We agree that the evidence suggests that consumers do not understand annuities. It is also said that people do not understand the OMO option and fail to engage with the process.

We would expect there to be more engagement with the process if the quality of information and communication around the OMO process was adequate. Last year, FSA work in the area found poor standards of communication and widespread failure to explain what the OMO process actually means. Several firms stopped short of actually explaining that exercising an OMO can result in a higher pension. Other firms explained the OMO as where 'you can get another firm to pay the pension' which in itself does not suggest any advantage to the customer. In particular, very few firms mentioned the advantages of shopping around for customers with health problems, who could be better off buying an annuity from providers offering impaired life or enhanced rate annuities.

In the absence of appropriate information consumers make their financial decisions on the basis of their perception of the brand. We believe that producing more effective communication will enable customers to take more capable decisions and we will encourage the FSA to take action to raise performance in this area.

- **Are the levels of choice we are offering to enable members to buy annuities the right ones? Should we be offering others?**

The Paper suggests offering an Open Market Option; and a choice of annuities from a number of providers. In the absence of any appropriate advisory channel, we believe that the choices need to be kept simple in order to engage the members in active choice. However, we would argue that members should be encouraged to seek advice and we would ask PADA whether in those circumstances members' needs could be satisfied through the open market option only.

- **What could the personal accounts scheme do to minimise enquiries from employees to employers about the process of securing a retirement income?**

The scheme should aim to ensure that all holders of Personal Accounts end up with the annuity that represents the best choice for that individual. There will need to be access to guidance on an individual basis to ensure that the person is fully aware of all annuity options and helped to make an informed choice. We believe that TPAS should be resourced to undertake this role.

- **Have we identified the right type of information to give to scheme members and are we providing this at the right points in the process?**

**To what extent have we identified the key components, and key questions, that will need to underpin our processes for helping members access retirement income products?**

The paper proposes to provide an explanation of what needs to be done, i.e. choosing an annuity type and a provider; basic information about annuity types; personalised projections for each annuity type; access to lists of annuity providers and their rates and information about these providers; and a final step which allows the user to purchase an annuity. It is proposed to contact members outlining their choices 6 months before the nominal retirement age; with further contact between 2 and 6 weeks before the retirement date.

It is suggested that members will require general information explaining the types of retirement income products available, and their respective advantages and disadvantages; choices around trivial commutation; option to transfer savings into another pension fund where they want an income drawdown product; to use the transfer option to amalgamate their personal account savings with other pension funds; the option to take some of their savings as a lump sum; and information that helps them to understand the impact of any choices they make.

This seems appropriate; however we repeat our assertion that this will be a difficult decision for many members to take in isolation. We believe therefore that all communication requires clear signposts to encourage members to seek guidance to help them make the decision that best suits their circumstances.

- **Given the objective of delivering low-cost products that are easy to arrange, are there other types of annuity products we should be considering via the panel of providers?**

The Panel will offer a limited range of annuities focusing on straightforward annuity products that can be arranged with the minimum of supporting information. Whilst this is welcome in the context of delivering a simple scheme, clearly there will be members who are better covered by the OMO option. We believe though that PADA should address this by promoting the need for guidance rather than offering a complicated suite of annuity products.

- **What are your views on our proposal for the trustee to buy an annuity for members who reach age 75 and don't get around to choosing an annuity?**

We would like more thought to be given to the alternatives to empowering the trustees to purchase an annuity on the member's behalf where the member has failed to exercise their choice. Again, there is a risk of considerable consumer detriment where a decision is made without full understanding of the member's circumstances.

Failure to engage could be for any number of reasons, but amongst them is that consumers are intimidated by making long-term financial decisions. We would wish to be satisfied by the steps that PADA was making to encourage members to engage before being comfortable with empowering the trustees, particularly given that in many cases the account will be the member's sole source of investment fund.

- **What factors do we need to consider to ensure that the panel of providers approach works effectively?**

- **How should panel members be selected? Should it be by invitation only or should potential panel members be given the opportunity to bid, or register interest?**

- **How frequently should the membership of the panel be reviewed?**

The Panel of providers needs to be selected to give consumers sufficient choice and access to provision at appropriate cost. We believe that PADA should draw up criteria to illustrate how the scheme should operate for the consumer and invite any firm who is prepared to meet those criteria to bid. Performance against those criteria should be monitored. We would also like to be satisfied that members will be better served by the panel approach as opposed to one which relied on the provision of advice to access the Open Market Option.