Financial Inclusion Commission

<u>Financial Inclusion Commission</u>
<u>Department for Work and Pensions: Stronger Nudge to pensions guidance consultation</u>
<u>2 September 2021</u>

About the Financial Inclusion Commission

The Financial Inclusion Commission (FIC) is an independent body made up of experts from financial services, businesses, the charity sector, academia and parliamentarians from across the political spectrum. https://www.financialinclusioncommission.org.uk/

Our mission is to champion financial inclusion as a policy priority for public bodies, businesses and civil society, and challenge exclusion wherever it occurs. Our vision is for a financially inclusive UK where financial services are accessible, easy to use and meet people's needs over their lifetime, and where everyone has the skills and motivation to use them.

Financial exclusion remains a significant challenge for 21st century Britain which prides itself on being a global leader in financial services.

Just over a million people in the UK do not have a bank account, one in four households lack insurance protection and one in five adults would not be able to cover more than one month of living expenses if they lost their source of income.

Financial inclusion is the means by which people can make their money work well for them, enabling them to maximise opportunities, move into employment, become more self-reliant, and enhance physical and mental wellbeing. Financial inclusion contributes to greater social mobility and levelling up, a more effective welfare system and greater national resilience from economic shocks.

This means a United Kingdom in which:

- every adult is connected to the banking system, through having access to – and the ability to make full use of – a transactional account of his or her own;
- every adult has access to affordable credit from responsible lenders;
- every adult, young person and child is encouraged and enabled to save, even in small or irregular amounts, to share in the importance of a common savings culture, to help build up resilience against financial shocks and as an additional resource for retirement;
- every adult has access to the right insurance cover for his or her needs, at a fair price;
- **every adult has access to objective, affordable and understandable advice on credit, debt, savings and pensions, delivered via the channel most suited to that individual;**
- every adult and child receives the financial education he or she needs, starting in primary school and carrying on throughout life and into retirement;
- **the overall level of pensions provision – state plus private – in the UK, does not lag behind other developed countries, especially for the low paid;**
- **every adult will have a clear picture of what their income in retirement is likely to be, so they can plan and get 'no surprises'.**

For more information about this response please contact Commissioner Laurie Edmans CBE via Commission@ukfinclusion.org.uk

Introduction

The Financial Inclusion Commission welcomes the consultation on a stronger nudge, following on from the consultation by the Financial Conduct Authority, as a positive step towards increasing the uptake of pension guidance.

Automatic enrolment has transformed the pension landscape, with 10 million more people saving into a workplace pension since 2012.[1] However, people in the UK generally have a poor understanding about what their financial position will be in later life.[2] This level of understanding has changed little over the past decade, which is not surprising when even answering a simple question like 'how much will I have to live on when I retire?' is complex. Human nature is to address concerns closer to crystallisation rather than those years away. In addition, around 8.5 million workers are excluded from automatic enrolment because they work in the gig economy, work part time, earn too little, are self-employed, or work in small firms where they are the only director and there are no other employees.

This is one of the consequences of the decisive shift in responsibility for pension outcomes from the State, employers and pension schemes, onto the shoulders of individual savers. While this new environment brings real benefits for the minority who are comfortable navigating their options or seeking impartial, professional support with their decision making, analysis from the Financial Conduct Authority supports our view that most do not. Taken together with what is known about UK financial capability and the range of risks facing pension savers, from pension scams to unexpected tax charges and unsuitable product outcomes, it is clear that more can and should be done to help savers. This is even more important given the potential impact of the current pandemic on employment levels, and even though pension contributions have had to be continued for furloughed employees, the long-term retirement provisions are harmed for anyone who has become unemployed. However, many people do not understand these risks and their implications for retirement and too many assume the state pension is enough to meet their needs. But the consequences of not thinking about this are significant in terms of financial inclusion in later life. Furthermore, the potentially large numbers of those currently furloughed may result in those people looking to access their pensions early if they face redundancy when furlough ends.

As noted, only a small proportion of DC pension pots accessed for the first time have used the Pension Wise service. The FCA's most recent data shows that of the nearly 700,000 Defined Contribution pension pots accessed between April 2019 and March 2020, just 14% of these were accessed after Pension Wise guidance had been used. A further 36% of pots were accessed after a regulated financial adviser had been used.[3] It is a source of major concern to us that around half of those people accessing their DC pension benefits are doing so without impartial guidance or regulated advice. As with financial decision-making at other life stages, significant losses can follow hasty decisions, made without a good understanding of the available options and their attendant risks and benefits. But the risks are even greater in relation to pensions access, when low awareness can have a profound and enduring negative impact on outcomes for savers. Speaking to an

[1] Department for Work and Pension (June 2020), *Workplace Pension Participation and Savings Trends of Eligible Employees Official Statistics: 2009 - 2019.*
[2] For further details see: https://moneyandpensionsservice.org.uk/2020/09/15/3-million-over-50s-will-leave-planning-retirement-finances-to-final-two-years-before-stopping-work/
[3] FCA (September 2020), *Retirement income market data 2019/20.*

informed, impartial person can make the difference between a good decision, that leads to a contented and financially secure retirement, and a life-changing bad one.

Yet, MaPS' Pension Wise user evaluations show the impact of the service among users. For example, 77% said they were very satisfied, 17% satisfied and just 5% fairly or very dissatisfied, with 93% of users feeling very or fairly well informed of their pension options, compared to 60% among non-users. Crucially, 97% said they would recommend the service to others or had already done so. Similarly high levels of sentiment have been found in each of the annual user evaluations since Pension Wise was established in 2015.[4] Given this, increasing the consumer uptake of Pension Wise could significantly impact the decision making of many.

Given the risks facing savers and the clear scope for badly-informed decisions leading to reduced financial security in retirement, the Financial Inclusion Commission welcome the suggestion of a stronger nudge which will require that a consumer is given a final opportunity to take Pension Wise guidance at the point they wish to access their pensions savings. But this welcome is limited because evidence suggests that the current proposals would only have limited impact. Whilst we believe this stronger nudge is an important step in increasing uptake of Pension Wise, more can be done to increase take-up of guidance. This could include first, 'automatically enrolling' people into a Pension Wise appointment, albeit with an opt-out option. Secondly, we advocate introducing an opportunity to receive appropriate guidance or advice earlier than the point of wishing to access pension savings, thereby enabling high levels of take up.

We think that before the approach is finalised, 'automatic enrolment' into an appointment should be trialled, in a similar manner to the way the stronger nudge approach was trialled, to see whether its effect is indeed markedly greater.

1) Do you agree with our proposed approach to defining when the Stronger Nudge should be delivered? If not, what changes do you consider necessary?

The Commission welcome the proposals to deliver a Stronger Nudge when an application to access or transfer pension benefits for the purpose of accessing pension flexibilities is received. This will ensure that consumers are given a final opportunity to take Pension Wise guidance at the point they wish to access their pensions savings.

However, whilst this is an important step, we believe more can be done to increase take-up of guidance including when the Stronger Nudge is delivered. Crucially, providing an opportunity to receive appropriate guidance or advice earlier than the actual point of wishing to access their pension savings is important. This is because by the time consumers are at the point of accessing their pensions they often have little time to make changes which would significantly impact their retirement prospects. This is merited by the disconnectedness that many people feel with their likely financial situation in retirement, reported in numerous studies, including the International Longevity Centre's report which said many 'Generation Xers' are 'sleepwalking' towards financial hardship in retirement.[5] Leaving guidance or advice until the point of accessing benefits is too late.

[4] MaPS (September 2020), *Pension Wise service evaluation Experiences and outcomes of customers using Pension Wise in 2019/20*.

[5] International Longevity Centre (March 2021), *Slipping between the cracks? Retirement income prospects for Generation X.*

The Commission believe, further, that at an appropriate time, an additional nudge to guidance should be introduced earlier in the consumer journey. This could be included as part of a mid-life MOT, to ensure people are considering their options while they have time to make changes to their saving patterns.

This is supported by findings from the MaPS trials, which found that take-up of guidance was significantly greater amongst those still exploring their options, compared with those that called to ask for a specific decumulation option. As to the best point in time for an earlier nudge, age 50 seems a logical point, at which age people may be more likely to become engaged than earlier, where other financial priorities – like housing or children – will often seem more pressing.

2) Do you agree with our proposed approach to appointment bookings? If not, what changes do you consider necessary?

The Commission recognise that the provider offering to book an appointment on behalf of the customer when the offer for guidance is accepted will likely mean a higher percentage of consumers are reached. In particular, we support the suggestion that providers will be unable to proceed to the next step of the retirement risk warning process until the customer confirms they have attended an appointment and received guidance, or communicates their decision to opt out.

However, giving administrative control of the opt-out process to providers could also increase the likelihood of opt outs. This is because they may have commercial incentives to encourage opt outs so they can retain the customer for their decumulation product, rather than risk that they might shop around after receiving guidance.

3) Do you agree with our proposed approach to requiring an opt out in a separate interaction? If not, what changes do you consider necessary?

The Commission agrees that requiring an opt out in a separate interaction will ensure that the process is not too easy for consumers to opt out. In particular, as recognised, an immediate opt out could create a disincentive to take guidance, as it would allow a consumer faster access to their pension savings.

As noted above, to further disincentivise consumers to opt out, we believe that introducing a 14 day 'cooling off' period – unless a customer has had recent guidance or advice – would help to overcome any risks associated with opt-out being too easy.

However, we believe that the opt out process suggested in the consultation alone, is unlikely to go as far as the Minister's ambition (which we support) for usage of Pension Wise to become the norm. To go one step further, we believe that to harness inertia towards positive ends people accessing their savings should be 'automatically enrolled' into an appointment if the Government's ambition of Pension Wise usage being the norm is to be achieved. Although, we recognise that the level of opt-outs is likely to be greater than we see with automatic enrolment into workplace saving, because even if an appointment is made automatically, the person concerned still has to take action, by attending it.

A sound approach to considering whether 'auto-enrolment with opt out' would work, its costs, benefits and process, would be to test it in a similar manner to that in which the 'stronger nudges' were tested. It would be wise to see if the approach does actually deliver take up much greater to 'the norm' before making it mandatory. At the recent Work and Pensions Select Committee hearing, the ABI and others said they would be receptive to the concept of a trial.

4) Do you agree with our proposed approach to prevent trustees and managers proceeding with the application until they are in receipt of confirmation that the individual has opted-out or received appropriate pensions guidance? If not, what changes do you consider necessary?

The Commission fully agrees with the proposed approach to prevent trustees and managers proceeding with the application until they have received confirmation that the consumer has opted out or received the appropriate advice.

5) Are the proposed exemptions sufficient? If not, what changes do you consider necessary?

The Commission agree that the nudge should be delivered even if the consumer has previously received guidance from Pension Wise or received regulated financial advice about how to access their pension savings. However, because many people have pension savings in multiple pots, arrangements would need to be made to avoid duplication of nudges, which could be off-putting and a barrier to take up. For example, people could be given a reference number to cite if they have already received guidance or advice, which would show the date of that guidance or advice, enabling a fresh nudge or appointment if sufficiently long ago to risk significant change in circumstances. Although we recognise there would be practical hurdles to overcome with this such as issues when the reference number is not retained.

6) Is an exemption for small pots necessary? If so, how should a small pot be defined?

The Commission agree that small pots should not be exempt from the Stronger Nudge because as noted, a small pot may be the beneficiary's only pension provision, and many may still find appropriate pensions guidance beneficial. However, as noted above, arrangements should be made to avoid duplications of nudges if consumers have more than one small pots, which could be off-putting.

7) Will our proposed exemption for those accessing their pension as a Serious Ill Health Lump Sum cover all those who should be exempted from the enhanced opt out on health grounds? If not, what changes do you consider necessary?

Yes.

8) Do you believe our proposed approach to record keeping is proportionate? If not, what changes do you consider necessary?

We think that there could be a positive interaction between the Pensions Dashboard and this initiative. It could beneficial if trustees and managers did not just have to keep their own records of whether a person has received appropriate pensions guidance, but to show this on the relevant entry on that person's pensions dashboard.

9) Do you agree with our proposed approach for coordinating the Stronger Nudge and Scams Guidance appointments? If not, what changes do you consider necessary?

We agree with the proposed approach.

10) Do you foresee any problems with the interaction between the Stronger Nudge and existing signposting provisions? If so, what changes do you consider necessary?

No, but the effect of the current signposting provisions is poor, and we believe that changing them will not make a significant difference, which is why we advocate at least trialling an automatic appointment making process.

11) Are you content that regulation 2 successfully achieves its purpose? If not, what problems do you foresee and what changes do you consider necessary?

We are not able to comment on the strict legal effect of the wording of the regulation but agree with its intent.

12) What do you anticipate will be the one-off impact of implementing the Stronger Nudge in to each channel (phone/post/digital) you offer? Where costs are incurred, please provide an estimate and any information you feel would be useful to us in understanding these costs.

The Commission are unable to provide details of the likely costs incurred to businesses. We do, however, acknowledge that extra costs will be incurred, and that these could be substantial if the desired goal, of Pension Wise usage becoming the norm, is achieved. So, whether incurred directly or by way of increased costs for MaPS as a consequence of the introduction of the measures – such additional costs should be identified and included in any assessment of the 'value for money' of charges made by providers or others.

13) What do you anticipate will be the on-going impact of implementing the Stronger Nudge in to each channel (phone/post/digital) you offer? Where costs are incurred, please provide an estimate and any information you feel would be useful to us in understanding these costs.

We are not able to comment on the likely ongoing costs or impact incurred.

14) Where costs are incurred, would you expect the cost to be absorbed, passed on to employers, or passed on to individual members?

The Commission feel it would be inappropriate to pass on any additional costs to members or employers directly. However, we recognise that outsourcing this task to MaPS will ultimately add cost, which one way or another will be borne by consumers.

Equally as important, the Commission is concerned that, if increasing the uptake of Pension Wise guidance is achieved, there may be a heavy burden on MaPS to provide an increased level of service. By consequence, there must be the appropriate steps taken to ensure MaPS is sufficiently resourced to cope with any increase in demand. We think this will be clearly justifiable in the consumers' interests, but that the additional costs – not just to MaPs, but to providers for the enhanced and additional steps required – should be acknowledged and be taken into account in the assessments of 'value for money' which are made of providers and the charges borne by savers.

It is also conceivable that MaPs via Pension Wise might not have to be the sole provider of the guidance. There is evidence that MaPS is extremely good at delivering high level information about the options available. However, we understand that it may not be able to provide guidance at a granular level. Different standards and types of pension schemes can be confusing for consumers and the providers of those schemes and financial services firms are often better equipped to provide enhanced guidance or limited advice. The model for debt advice, in which the process and standards are set and monitored by MaPS, but implemented by a number of service providers, may be one which could be deployed for other forms of guidance. Clearly, Chinese walls between such guidance and product sales would be essential if commercial providers or advisers were to undertake the task; this would need to be carefully managed.

However, the current regulatory framework limits pension providers provision of streamlined or simplified advice models. Despite FCA guidance on those models, take up has been low because the obligations and liabilities placed on advisers do not account for simplification. Advisers are subject to the same suitability standards, training and competency requirements as if they were providing full advice and this creates cost challenges for both the adviser and the consumer. Firms should be able to obtain and rely on the accuracy of information provided by consumers and allow solutions to be personalised, including prompts and calls for action without it being viewed as full regulated advice. We believe this will drive a material step-change in the provision of advice and guidance and provide consumers with a much richer and engaging experience and ultimately greater insight on the choices available to them and what this means for their short and long-term goals. The regulatory system needs to recognise that simplified or limited advice should also come with limited obligations and liabilities which will drive down costs.

15) Do you anticipate any benefits to your business from implementing the Stronger Nudge? Please provide a monetary value where possible.

Not applicable to the Commission.

16) Do you anticipate any wider non-monetised impacts from the Stronger Nudge?

The Commission recognise that there are a number of wider non-monetised benefits from the implementation of the Stronger Nudge not only for consumers but also the industry. The uptake in pension guidance is likely to result in more shopping around for decumulation rather than sticking with existing pension providers, and we believe this will enable competitive providers to grow business. Furthermore, better advice to consumers may reduce the propensity to hold cash and instead encourage buying more products instead.

Many providers would welcome a dual nudge to enable the provision of simplified advice. However, we note that industry remain concerned about the level of regulatory burdens and litigation risk which will accompany a Stronger Nudge. Due consideration must be given to ensure that the ability of providers to give this simplified advice is improved rather than constrained by additional regulatory burdens.

17) Do you believe there are reasons to include a statutory review provision in the proposed regulations?

We think there should be a statutory review. It is important that whatever measures are put in place actually work – that consumers, in a part of their financial lives with which they are rarely engaged, do get sound guidance and advice. Whether or not they are doing so should be monitored and, if it is not working, changes should be made.

18) Do you consider the proposed regulations achieve the policy intent?

The Commission believe that the proposed regulatory changes could provide a *step* towards achieving the Minister's ambition (which we support) for usage of Pension Wise to become the norm.

However, we believe that the opt out process suggested in the consultation alone, is unlikely to go far enough. We believe that at least a trial of automatic enrolment into Pension Wise appointments should be put in place, with careful monitoring of costs and benefits, with the acknowledgement that the services delivered and the cost of them, either directly or via increased costs incurred by MaPS and passed on, constitute part of the 'value for money' received by members. In addition, at the right time, the proposals should go further to introduce effective access to similar guidance and advice earlier in life as well as at the point of accessing savings.

Ideally, take up of Pension Wise would be accompanied by a significantly greater promotional effort, even though it has proved difficult over time to convince those who bear the cost, via industry levies, to support generic efforts to improve engagement, despite the likelihood that a more engaged and active membership would save more. Efforts to use messaging via providers or employers have not yet shown that they can produce the scale of increase needed.

Evidence from Sweden, examined by behavioural economics Nobel Laureate, Richard Thaler suggests that, contrary to widely expressed doubts, a sufficiently effective promotional effort would make a significant difference in prompting action.[6] Furthermore, we believe that it would be better to test, extensively, different approaches to see what works, rather than pick on one approach – the stronger nudge – and wait to see whether it does deliver a 'new norm'. If it does not deliver the quantum change needed, many hundreds of thousands of people will access their pension saving sub-optimally. Testing could be akin to that used by Fast Moving Consumer Goods (FMCG) businesses wanting to assess the best approach to the launch of a new or changed major product line.

19) Do you foresee any unintended consequences in our proposed approach?

There is a risk that if people think that, in having a nudge but not acting on it, the 'optimism bias' which has been widely observed in many people could be perpetuated, even encouraged.

20) Do you have any comments on the impact of our proposals on protected groups and/or views on how any negative effects may be mitigated?

The likelihood that the measures as proposed will not have a sufficiently transformative effect on the proportion of people who take up pensions advice or guidance will, of course, affect people in protected groups as well as those who are not. The fact that (for example) women and people in protected groups generally have lower pay and hence lower pensions provision than those who are not[7], and that the same is true for ethnic minorities [8]means that getting the best out of the savings

[6] Conqvits, Thaler and Yu (May 2018), *When nudges are forever: inertia in the Swedish Premium Pension Plan.*
[7] The Pensions Regulator (2020), *Gender Pay Gap Report.*
[8] The People's Pension (2017), *Measuring the ethnicity pensions gap.*

they have is even more important. There is evidence that some groups with lower pay also have lower take up of Pension Wise appointments.[9]

We think that the current proposals will not go far enough, and that automatic enrolment into a Pension Wise appointment is likely to be of even greater benefit to people with protected characteristics.

Conclusion

The Commission welcome the objective of the proposals which will lead to a consumer being more likely to take Pension Wise or similar guidance at the point they wish to access their pensions savings. Once people have had impartial support to understand the attendant risks and benefits of their pensions access options, they should be better placed for retirement decision making, whether they are considering investment pathways or any of the other options available to them, not just with their pensions savings, but taking into account their broader money and life needs.

But we do not think the stronger nudge proposals as set out will be sufficient, if the ambition for such guidance or advice to become ‘the norm’ is to be reached, to increase take up of Pension Wise guidance. In particular, we believe that:

- at least a trial of automatic enrolment into Pension Wise appointments should be put in place, with careful monitoring of costs and benefits, with the acknowledgement that the services delivered, even if costly, could be very valuable to many people, and should therefore be included in assessments of whether the providers delivering them are giving consumers value for money.
- steps should be taken to introduce effective access to similar guidance and advice earlier in life as well as at the point of accessing savings.

[9] Money and Pensions Service (September 2020), *Pension Wise Service Evaluation.*