CII thinkpiece

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Money guidance and retirement savings advice: a critical view

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Summary

- Otto Thoresen's recently published review calling for a money guidance system available to all is laudable with the exception of one crucial area: pensions.
- Pension advice requires much more careful construction and consideration than other areas of personal finance, such as debt management or insurance products, and it is not clear that Thoresen's money guidance proposals would be able to cope with their complexities.
- Pensions are a 'locked box' option and people must understand their risks before contributing. Unfortunately, money guidance could merely be offering more of the so-called 'impartial information' that the Government distributed about final salary pensions. Suitability and risk must be dealt with honestly.

***CII Introduction:* The Government's feasibility study into a national financial advice service was long awaited by both industry and consumer groups alike. However there are some practical issues still outstanding as the recommendations are taken forward as pathfinder projects over the next year. In this inaugural article in the series of think pieces launched by the CII, accomplished pensions expert and commentator Ros Altmann takes a critical view of Thoresen's proposals with respect to the new pensions accounts.**

Otto Thoresen has recently published his recommendations for reforming and enhancing the UK's system of financial education and advice. He recommends a high level blueprint for a national money guidance service available to all, aiming to provide free, impartial financial information and 'advice' covering budgeting, saving, debt management, borrowing, insurance and retirement planning.

This is a laudable aim. Thoresen is certainly correct that learning to manage money properly is as important as eating sensibly. He has recommended a pilot project, costing over £10million, to test out his proposals via 'regional pathfinders', which would establish money guidance centres to cover all aspects of generic financial advice. These might be seen as a 'National Wealth Service' which can be consulted by everyone periodically to help with their financial health, just as our National Health Service looks after physical health. In fact, the Citizen's Advice is already running its own generic financial advice pilot scheme (in association with the Personal Finance Society [PFS]), called 'Moneyplan', which has highlighted that there is significant demand for help with financial matters, such as managing debts or understanding financial planning. However, an important element of Thoresen's remit was 'to determine a range of models for achieving greater access to generic financial advice on a national scale…in particular (for) personal accounts'. Can such 'money guidance' really work well for personal accounts? I believe there are serious dangers with generic advice when applied to pension savings for the mass market.

It is disappointing that Thoresen has not really considered carefully enough the important differences between generic advice for retirement products and other types of financial decisions.

Advice on pensions and retirement planning needs much more careful construction than generic advice for other areas such as debt or insurance products. It is not clear that Thoresen's proposed generic advisers would be able to cope with the complexities of the interaction of personal accounts with state pensions.

For example, would such advice really encourage people to opt out of personal accounts when they should? The system will be funded jointly by Government and the financial services industry, but both bodies have strong, short-term vested interests in ensuring people actually do contribute to pensions and personal accounts. It is therefore difficult to imagine the system working fully in the interests of the mass market general public.

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Retirement products have specific characteristics that make them different from most others and the Government already has a dreadful record in trying to encourage private pension savings without explaining the risks properly. For example, after the personal pensions 'mis-selling' scandal in the late 1990's and early 2000's, the Government encouraged workers to contribute to their employers' final salary pension schemes and assured the public that these pensions would be totally safe and protected by new laws. In reality, however, the pensions were not really safe and, despite knowing this to be the case, the Government failed to warn of the risks, while continuing to encourage people to contribute. This resulted, a few years later, in 150,000 people discovering that they had lost most or all of the pensions their contributions were supposed to have provided. But new Ministers denied all responsibility and suggested that the workers who had lost out so badly had been wrong to trust the official information, issued by Government departments and even the FSA. It has taken nearly 6 years for the Government to finally agree to offer a decent settlement to those affected.

During that time, many people died, some committed suicide and lives were ruined because workers saved their money, in good faith, in a pension that turned out to be worthless. Even some of their state pension was tied up in their company scheme and there was nothing they could do to get their money back.

That is the problem with pensions. They are a 'locked box', unlike ISAs which can be cashed in or changed if things go wrong or if individuals find that means testing will otherwise take away their savings. Once the money has gone into a pension, it cannot be recovered, often for decades. Therefore, it is vital that people understand the risks of pensions before contributing.

Unfortunately, Thoresen's proposed money guidance could end up providing 'generic advice' that resembles the official so-called 'impartial information' leaflets which the Government produced about final salary pensions. Having released them with much fanfare, supposedly to help people make informed decisions about their pension plans, workers read and relied on them, unaware that they were being badly misled. Ministers at the time had been afraid to highlight the true risks to members' future pensions because they feared that telling members the truth might stop them contributing and, in any case, they believed most people would be better off. However, truly independent and impartial information should have explained the risks. The Thoresen national money guidance service will make similar mistakes if people are not warned that state pension credit could take away much or all of their personal account pension. Then, in future, they may feel forced to seek redress from the Government because it knew people could be wasting their money, but failed to ensure they were properly warned. Pension providers and politicians may well judge the success of Thoresen's generic advice service by how much money is contributed or how many people are contributing to personal accounts, however the real measure of success will be whether people receive decent pensions from them in years to come. There is a danger that short-term factors will continue to outweigh the important long-term issues and such problems should not be ignored.

Since the state pension system relies on mass mean-testing of pensioners as a supposedly long-term solution to state pension 'affordability', pensions are not a suitable investment for many people. It is certainly not safe to assume pension credit will be abandoned, since Government forecasts indicate it will still be in place in 2050. How will generic advice deal with our ludicrously complex pension system? It seems highly implausible that generic advice can cope with truly explaining the real long-term risks involved in contributing to personal accounts, without actually putting most of the 'target group' off the whole idea!

Probably the only conclusion that honest generic advice would lead to, is that large numbers of people should not contribute to a pension. This applies to many different groups, including, for example, the young, anyone in debt, people who have not yet bought a home, those who may need some rainy day savings to call on, or indeed people in their 50's and 60's with no other savings and little time left before retirement. Impartial independent financial advice would suggest all these groups should not contribute to a pension. They might consider ISAs but not personal accounts, because they are at severe risk of pension credit taking away *at least* 40% of any pension they receive. So we may go to the trouble and expense of providing Thoresen's generic advice – designed to help advise people about contributing to personal accounts – only to find that, if the advice system is actually working properly, a significant proportion would be generically advised not to put money into personal accounts at all!

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It is vital that the Government wakes up to these issues and it is somewhat disappointing that Thoresen has not properly focused on them. The state pension is so inadequate that all workers will need private sources of income in later life. However, the majority do not have the necessary skills to prepare themselves properly. They are the ones for whom means-testing in the state system is such a significant barrier to saving in a pension. It is also a barrier to working part-time at older ages too. All of this has serious implications for the long-term health of the UK economy and the welfare of the population.

Another danger has also recently arisen. Proposals to extend the Savings Gateway pilot scheme to help lower earners to save, may provide equal or better savings incentives for lower earners than the tax relief available on pension contributions. So this Savings Gateway could potentially be a much better option for lower earners than pension contributions. Again, how will generic advice cope with this and, if it does, will it not simply direct such people away from personal accounts?

On a more positive note, however, it seems to me that Thoresen's pilot projects could be very helpful in testing out generic advice for the open market option for annuities. Government policy will force most lower or middle-earners to convert their retirement savings into an annuity when they want to draw their pension. Every year, hundreds of thousands of people buy standard annuities from the company they happen to have saved with, rather than shopping around for the best annuity at the best rate. Often a standard annuity is not the most appropriate product but once the annuity is bought, people are stuck with it for the rest of their lives. It is absolutely vital, therefore, that

people have correct and appropriate advice before they buy an annuity.
There are only a few basic questions that people taking the open market option need to consider before buying their annuity. For example, do they have an impaired life or could they qualify for some kind of enhanced rate, do they need to cover a spouse or dependant, do they want some inflation protection, do they want a ten-year guarantee – all these questions are vital in choosing the right annuity. Then people need help in finding the best rate.

Thoresen's suggested pilot schemes could help people go through the important issues before they buy an annuity with their retirement savings. This should improve retirement income prospects for soon-to-be pensioners immediately, by preventing so many people ending up with the wrong annuity and a poor rate. Those closest to retirement need help now, not in a couple of years time. Furthermore, much of the money to fund such an advice prototype is in the product. On a typical £30,000 pension pot, £300 - £600 is currently deducted as 'commission' even though individuals receive no help with the most vital, but basic, questions they need to consider *before* buying their annuity. Why not use some of this money to pay for pilot money guidance schemes specialising in annuity advice?

In conclusion, there are areas in which Thoresen's proposals could take us in the right direction. For annuity advice, debt management, financial planning or insurance, generic rules can assist in making better decisions. For pensions, however, it will be much harder to accommodate the interaction with future means-tested state pension entitlements, and perhaps even the cross-over with the newly proposed 'savings gateway' pilot schemes.

The bottom line is, if this really is to be 'sales free' advice, it is hard to see it encouraging people to contribute to pensions! If generic advice *does* properly explain the risks (of being unable to access the money contributed and of losing at least 40% of personal account pensions later) people will be unlikely to contribute, for fear of doing the wrong thing and not being able to 'undo' it. Of course, if the state pension system was reformed to provide a simple basic pension without mass means testing of around half the pensioner population, or if pensions were disregarded in the pensioner means-test, it would be much easier to see generic advice working as it should. In the current UK environment, however, I think Thoresen's proposals will not be suitable for retirement planning, except when it comes to annuity purchase.

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