

October 2015

Pensions freedoms: the unfolding picture – access to the freedoms, take-up, and ‘advice’ issues

The Chancellor’s pension flexibilities came into force in April 2015. The first six months have revealed some issues about product availability, encashment rates, and access to professional advice.

- Pension providers themselves have unsurprisingly received large volumes of calls. According to the Association of British Insurers (ABI) and the FCA, some 200,000 consumers have exploited the pension flexibilities, and have transferred over £2.5bn out of pension funds.
- After all the preparation and speculation about the role and importance of Pension Wise over the year leading up to implementation, anecdotal evidence suggests that take-up of this service has so far been limited.
- The Work & Pensions Select Committee has “particular concerns about the near complete lack of data about Pension Wise and the absence of a research programme tracking consumer outcomes”. This follows their inquiry in August and September gathering evidence from various stakeholders including the Government and FCA.
- While behaviours over the first few months should not be seen as representative a longer-term trends, there have been indications of some more structural issues: the extent to which providers are offering their consumer the full range of decumulation options; and access, need and availability of professional financial advice.

Next Steps:

- The FCA consultation into pension rules and guidance will close on 4 January 2016, after which the regulator will issue a Policy Statement setting out draft rules in Q2-2016.
- The Work & Pensions Committee will continue to gather evidence in its inquiry into pension freedoms advice and guidance.
- The Treasury and FCA will continue to monitor implementation of the freedoms.
- The Treasury and FCA published a Call for Input for their Financial Advice Market Review, which they hope will address some of the issues set out above.

Background

The Chancellor’s pension flexibilities went into force in April 2015 after a year of preparation following the famous announcement in Budget 2014. The reforms amounted to changing the personal tax treatment of individuals accessing their accumulated Defined Contribution (DC) pension savings at time of retirement to allow open choices; and introducing a national, impartial, free-at-point-of-use guidance service called Pension Wise.

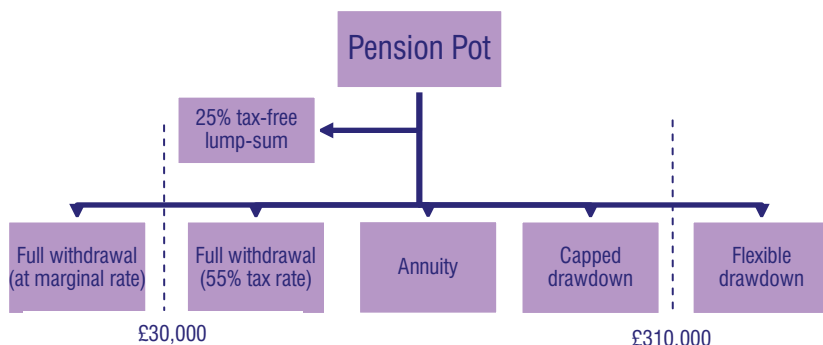
Pension freedoms

Core to the reforms were changes to the tax rules so that consumers reaching Minimum Pension Age (55 rising to 57 in 2028) with DC pension schemes can withdraw as much as they wish and only pay a maximum of their marginal tax

rates (basic or higher personal rates depending on their earnings and expenses). They can also apply tax-free the 25% initial commencement lump-sum but also to 25% of what remains in that unused (ie not annuitised or invested in a flexi-access drawdown) DC pension pot. The process of applying the 25% to subsequent withdrawals is known as Uncrystallised Funds Pension Lump-Sum (UFPLS).

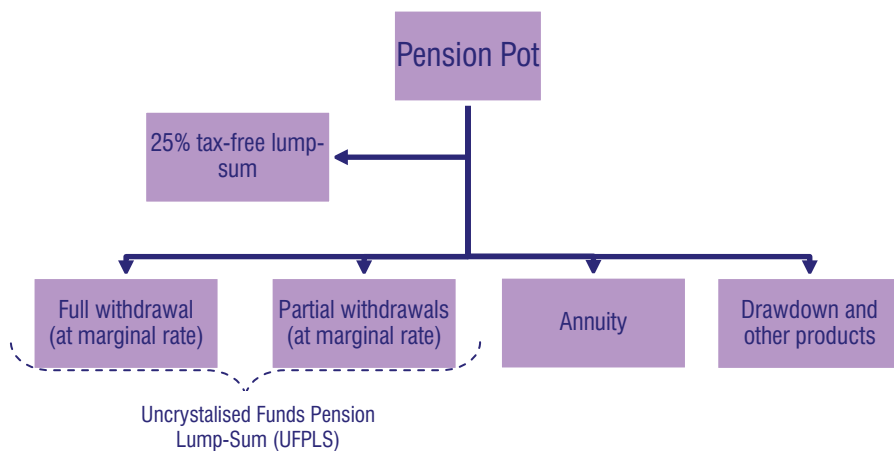
These rule changes effectively removed the incentive for customers to purchase an annuity to avoid the previous 55% tax rate (see Figures 1 and 2 below).

Figure 1: Pension decumulation taxation as at 27 March 2014 (adapted from HMT *Freedom & Choice in Pensions*, Mar 2014)



Under the former system, people's choices are constrained by the size of their DC pensions pot. After the initial tax-free commencement lump-sum, only withdrawals up to the first £30,000 are subject to marginal tax rates; and full withdrawals above this amount were caught by a 55% tax charge. This effectively encourages an annuity purchase, except for those with very small or very large pots. However the FCA had found that that market is not working competitively. The Treasury was also concerned that people were overly focused on one particular product rather than properly considering the range of options.

Figure 2: Pensions reforms effective 6 April 2015 (adapted from *ibid*):



Regardless of the size of their defined contribution pension pot, everyone will be able to choose any of their available options. This will mean that everyone reaching Minimum Pension Age have access to a full withdrawal immediately, partial withdrawals subsequently of any amount, an annuity or drawdown, and potentially other products created by providers.

Also introduced the concept of Uncrystallised Funds Pension Lump Sums which allow an individual to apply part of the 25% tax-free lump sum to subsequent withdrawals.

There had been some criticism of these reforms, with concerns that many would find the widened choices daunting and thus consumers would be liable to poor outcomes. During her maiden speech as Pensions Minister in the newly elected Conservative government, Baroness Altmann said the following:

The reforms are particularly helpful in that they use the tax system to incentivise people to keep money in their pensions into later life. By taxing lump sum withdrawals, removing the 55% tax on death and allowing pension savings to pass to the next generation free of inheritance tax, there are strong reasons for people to keep pensions rather than spend them too soon.¹

¹ Department for Work & Pensions press release, Reforms to state and private pension systems, Minister for Pensions maiden speech to the House of Lords on proposed reforms to state and private pensions systems, 18 June 2015.

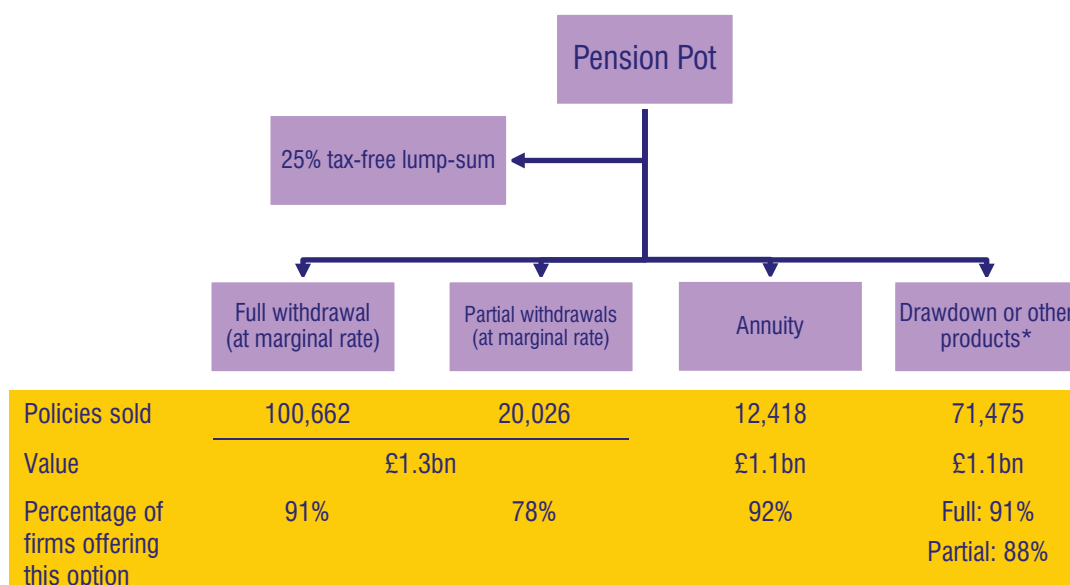
Take-up indicators: not the mass “dash for cash” that was feared

Both the Association of British Insurers and the FCA published data in early September covering the first three months since the reforms went into force.² All indications suggest that while the predictions of a significant rise in transactions from previous years were correct, there was hardly the “mass dash for cash”.

According to the FCA and ABI data on 107 pension and retirement providers:

- Nearly £2.5bn has been paid out to customers
- Almost 205,000 policies have been accessed, compared to 95,300 in same period in 2013; of which
- Nearly 71,500 (about 35%) accessed a drawdown option;
- 120,700 (about 62%) accessed a cash withdrawal;
- 12,400 (about 6%) bought an annuity, compared to about 46,400 in Q2-2014, and 89,900 in Q2-2013.

Figure 3: Headline data on decumulation activity, April-June 2015 (sources: ABI and FCA)



The FCA data collection exercise also looked at the availability of all the options across providers, a pertinent topic bearing in mind that the pension freedoms were just about changes in tax treatment rather than enforcing providers to make products available. The regulator found that the products that most needed contractual changes (including switching providers) were income drawdown and tax-free lump sum only:

- 77% of customers needed to change contract to access partial encashment drawdown;
- 74% needed to do this to take out their tax free lump-sum
- 40% needed to do this to take out a full encashment drawdown;
- just 20% needed to do this for an annuity; and
- nobody needed to do it for full encashment lump sum.

In terms of analysis of these figures, the life and pensions sector was asked during the Work & Pensions Select Committee inquiry into pension freedoms advice and guidance about the implications:³

² ABI Press Release, [Payments made to savers since the pension reforms reach nearly £2.5 billion, ABI stats show](#), 2 Sep 2015; Financial Conduct Authority, [FCA pension freedoms: data collection exercise: analysis and findings](#), Sep 2015.

³ House of Commons, Work & Pensions Committee, Oral Evidence: Pension Freedom Guidance and Advice, HC 371, Wed 7 Sep 2015, pp17-18

Huw Evans, Director-General, Association of British Insurers: *“Our data shows that people have used the freedoms, but they have also used them quite sensibly, as we always thought. People have not rushed off to buy Lamborghinis; they have been quite sensible in terms of what they have done, and some have taken the decision to take a small pot; others have used it to invest for their long-term. It has reinforced our view as providers that customers can take sensible decisions and what we want to see for the next stage is a series of further changes to ensure that the implementation challenges that have affected a minority of customers can be tackled effectively so that we can all be confident that all customers, whatever their wish, whatever their preference, can access the freedoms effectively and with the right advice and guidance.”*

Chris Hannant, Director-General, Association of Professional Financial Advisers: *“We have seen a number of companies already start [in firms developing new advice strategies and offerings]. It has been tentative. We think roughly 150,000 enquiries were made, and they are not unique enquiries, so there may be people phoning around a number of advisory firms. It is still a relatively small fraction, considering the 200,000 calls a week that initially went into pension providers, but I was encouraged that the volume of the people at least thinking about advice and thinking about approaching an adviser was higher than I initially thought it would be.”*

Pension Wise take-up

After all the preparation and speculation about the role and importance of Pension Wise over the year leading up to implementation, anecdotal evidence suggests that take-up of this service has been limited. On 16 September, Economic Secretary to the Treasury Harriet Baldwin released some data to the Work & Pensions Select Committee:

- Pension Wise website has received 1.5 million unique hits;
- 20,000 people have had a Pension Wise appointment (about 10% of the 205,000 people who have taken advantage of the freedoms according to FCA data above);
- 90% of people who have used Pension Wise since launch say they are satisfied with the service received;

The Commons committee stated in its report later in October that “while some limited industry statistics were published during the course of our inquiry, information about Pension Wise remained particularly sparse.”⁴

When asked about the relatively low proportions taking up, the Minister rebutted by citing the hit-rate data, and went on to claim that she thought nearly all of the 4 million customers retiring were taking up some form of guidance even if it was not the official variety:

Q111 Debbie Abrahams: *Given the point that you have made as well about a steady state in terms of people that are interested in using the pension freedoms, it is still a very small number, and an even smaller number, between 10% and 20%, that are accessing Pension Wise. How are you going to try to improve and increase the uptake?*

Harriett Baldwin: *I somewhat dispute what you just asked in the sense that I think that if you have had 1.5 million hits from unique users out of a population of 4 million [who would potentially need guidance], and if you consider this is only one channel that people can get help, guidance, advice from—they may also be able to get it from their provider, for example, so I have been to some of the advisers and listened in on some of the calls that they have had from customers and seen the kind of conversations that they are having—I would ask the question the other way and say of the people who have acted, so we have quoted that number of 200,000, how confident am I that all those 200,000 people who have acted have had the opportunity to get at least guidance? I would be very confident that it is really all of them.*⁵

The Work & Pensions Committee were still not impressed, and highlighted this as a major concern:

The Government’s reticence in publishing statistics on the effects of its pension freedom policy, a full six months after the reforms, is unacceptable. The scarcity of information regarding Pension Wise in particular is not

⁴ House of Commons, Work & Pensions Committee, *Pension freedoms guidance and advice, first report of session 2015-16*, 14 Oct 2015, p7, ¶ 8.

⁵ House of Commons, Work & Pensions Committee, Oral Evidence: Pension Freedom Guidance and Advice, HC 371, Wed 16 Sep 2015, p20.

conducive to effective scrutiny. It is also not conducive to effective policy: it would be fortunate in the extreme if such radical change operated as hoped without any need for adjustment. Regular collection and reporting of the take-up of guidance and advice options on offer, and the decisions taken, is imperative. This should also provide assurance that another mis-selling scandal is not on the horizon.⁶

Encashment rates

Following the initial launch, a large amount of pension holders have accessed their cash: 60,000 people have taken advantage of the pension flexibilities, with 53% accessing their savings in full or partial encashment, transferring £1bn out of pension funds.

However these rates have not raised too much concern, as they have been nowhere near the rates originally predicted when the reforms were first announced. In reality, and consistent with expert predictions, encashment likelihood seems linked to size of pot, with smaller pots most common. In the words of Baroness Altmann:

Those that cash in small funds may well be acting rationally, especially if they are repaying debt. Just buying an annuity with a small fund will hardly make a huge difference to their retirement income. I am sure we will encourage far more pension saving if we empower people to take responsibility for their own income rather than forcing them to do something that may not be right for them.⁷

Some of these issues were explored in more detail by the Work & Pensions Select Committee in their inquiry, and the evidence session especially with the regulator revealed some insightful responses. For example the exchange between Craig Mackinlay MP and Christopher Woolard, the FCA Director of Policy:

Q93 Craig Mackinlay: *This is all down to the quality of advice people are given. I know there are some providers that will offer a limited amount of advice quite cheaply. I think we have created our own complex environment, where advisers are very fearful of advising because of future liability. I think you are looking at if there was a safety net for advisers to give limited advice without a huge amount of liability. Have you done any work on that, and is that likely to come forward at all? [...] Particularly for small pots. I used to be a chartered accountant in practice and worked with IFAs, and the small pots, they think it is just not worth the effort, sadly, or the value. These people could do with advice. Is there a means of getting them in front of somebody efficient without the whole liability of the FCA landing on their shoulders that perhaps could come back to haunt them in 10 years' time?*

Chris Woolard: *Within our existing rules there are various options whereby you can give limited or restricted advice. You can say, "I am only telling you about this particular aspect of your financial decision-making. I am not looking at your circumstances completely as a whole" and those kinds of questions. Those I think are not always well understood as options by advisers, and indeed I think it is fair to say there is a degree of fear around, "Even if I thought it was limited, will there be some kind of liability that follows on from that that goes wider?" We understand those sentiments. One of the issues that we will need to think about within the FAMR review, particularly around pensions, is whether there is something that is clearer and simpler both from the consumer's point of view but also the adviser's point of view. [...] I think there is a further jump behind that to somehow create a safe harbour, where you can give someone advice and charge for giving that advice in some way and yet not take some responsibility for the advice you have given, and personally that feels like a step too far if it is described like that, but I think there is a lot we can do to listen to some of those concerns and come up with things that work for both consumers and the advisory community.*

Longer-term fund access issues

The first three months has also seen the emergence of some more structural issues that threaten to persist well beyond the initial phase. They seem to centre around two separate but interlinked concerns: the first being the

⁶ Work & Pensions Committee, first report (*op cit* Note 4 above), p 9, ¶ 16.

⁷ DWP press release, *op cit* Note 1 above.

consumer's access to different decumulation options from that pension provider; and the second being about access or the need for professional financial advice.

Access to decumulation options

The national press has been running stories through the summer about some pension providers were not offering their customers the full range of at-retirement choices afforded by the pension flexibilities.

An investigation by The Telegraph, for example, found that five of 18 pension providers examined are refusing to allow consumers to dip into their pension funds as often as they wish.⁸ It also found savers are:

- Prevented from making withdrawals of less than £5,000;
- Limited to three or four withdrawals per year;
- Are denied flexible access from funds worth less than £30,000;
- Some of those that do offer the freedoms are charging not insignificant fees to access their pots, in some cases upwards of £240 per withdrawal; finally
- Providers imposing excessive or in some cases pre-emptive wait periods for processing encashment or switching.

Pensions transfer issues

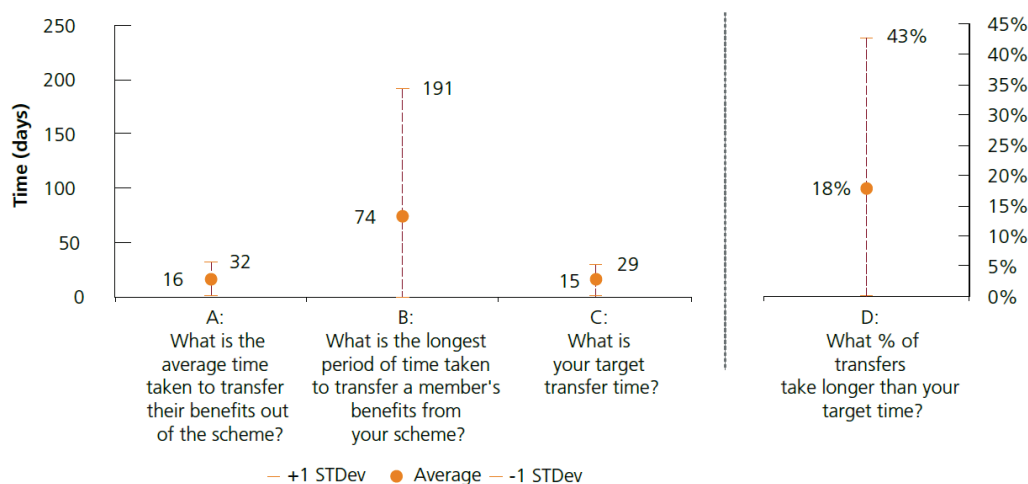
The FCA data collection exercise found that pension transfer times are generally low (average 16 days), though in a minority of cases, specific features of the transfer result in transfer times significantly higher than average (the longest in our data sample was as much as 191 days). Firms have a range of suggestions for improving the speed of pension transfers. A number of firms explicitly referred to using the Origo Options pension transfer service. Seventy pension providers currently participate in this process, including all of the largest 15 firms in their sample.

Where the Origo transfer process is not used, then firms' responses show that transfers are completed via paperwork and post. While each firm's process will vary, the responses show that there are common steps in the paperwork process across firms, such as:

- relevant paperwork is sent to the consumer, which is completed and returned to the pension provider;
- the provider will then check whether the forms are completed correctly and conduct necessary due diligence checks, including assessing the validity of the receiving scheme; and
- risk warnings are delivered to the customer and processing takes place. Once these steps are completed payment takes place.

⁸ "Pension freedoms scandal: savers blocked from using new rules", by Dan Hyde, *The Daily Telegraph*, 15 June 2015. See also "Pension companies accused of stopping retirees from accessing their pots," by Harriet Meyer, *The Observer*, 14 June 2015; and "6 fatal flaws strangling the pensions revolution," by Sam Dunn and Ruth Lythe, *The Daily Mail*, 10 June 2015.

Aggregated view of pension transfer times



Members aged 55+ who are transferring out to access decumulation options, from the time a member's initial request to transfer to the point the funds leave the scheme [sample all firms]. From: FCA Pension Freedoms Data Collection Exercise, p.21, figure 13.

Q94 Craig Mackinlay: *I think a lot of these pots are crystallising now. I think this needs looking at quite quickly. It might be a level, a pot of less than £50,000, there is a safe harbour option. Over £50,000, then perhaps you are into the full gambit of FCA and liability for IFAs, but I think this wants looking at now, frankly, because a lot of people are crystallising their smaller pension pots with, from what I can see, not really sufficient advice. In my practice in the old days, I would have said to many people, "Get out of your pension as soon as you can, minimising your tax liability. Get it drawn down as soon as you can". You need somebody to give that advice without huge liability, particularly in smaller pots, and I will say that now that is needed.*

Chris Woolard: *We would absolutely recognise that particularly for individuals with smaller pots at this moment in time there is a range of guidance available. I think that is being taken up both through Pension Wise and indeed people using the risk warnings that they get from their own providers as a means of framing those choices. For the very small pots, tax questions do not come in that much, but you can be at £30,000, which is an average pot, and be running into those tax questions if you are still working and those kinds of issues. We recognise the issue is there. The experience that we are seeing at the moment is people are finding ways of navigating the system and getting to the outcomes that they feel they want to get to at this moment in time. One of the things we have to do as part of Financial Advice Market Review, though, is to ask ourselves, is there a better way of doing that.*

FCA consultation on pension reforms rules and guidance

On 1 October 2015, the Financial Conduct Authority published a consultation on proposed changes to its rules and guidance on pension reforms. This was in part a follow-up to its 'second line of defence' rules that were introduced at short notice in the Spring, and in part a response to some emerging reactions to the reforms.

The regulator is looking for views to improve the cooperation of the transfer process in connection with accessing the various decumulation options, as well as views on how the benefits and risks to each are taken into account. Various proposals are being considered:

- Setting maximum timescales for transfers to take place, such as ten working dates from the date introduced by HMRC in relation to ISAs. Firms have suggested that timescales should be introduced including maximum turnaround times for changes in the process.
- Standardising and digitising the transfer process: providers could create single, coherent transfer processes through mandatory requirements for providers to use options systems or interoperable transfer providers such as Orgio,
- Streamlining the transfer verification process in a number of areas was also suggested by firms, in particular using web-based technology for proving member identity and scheme registration; and removing the requirement for signed customer declarations for transfers via the Orgio Options service

- Providing easier access to the information necessary to facilitate a more efficient transfer process was another idea given in response to the FCA survey. In particular, firms wanted access to occupation scheme rules made available freely to all, rather than having to request them on an individual member basis; the creation of an up-to-date, accurate register of occupational schemes; and extending the availability of risk information (such as credit and liquidity risk) on counterparty schemes/providers to transfers beyond authorised firms.

In response to these issues, the ABI also issued an action plan called a *Customer Control Mechanism* to tackle these implementation challenges with the freedoms (see box opposite).⁹ It was prefaced by a joint statement by the ABI chief executive and Chairman calling for the following: “while the vast majority of customers so far have successfully exercised their choices without complaint, it is clear that implementing the law and regulatory requirements as they currently stand is not enough to ensure the benefits of the reforms can be universally felt.”

The FCA consultation examines the regulatory response to the pension reforms in terms of the following areas:

- promoting competition
- ensuring the market works well
- protecting consumers

Promoting competition

Communications concerning accessing pension savings:

- to add guidance to ensure that, in the new pensions environment, firms understand what the FCA requires them to do when communicating with their customers about accessing their pension savings.
- to add rules and guidance requiring timely, relevant and adequate information to:
- encourage consumers to explore the full range of options for accessing their pension savings, including on the open market.
- enable informed decision-making about consumers’ options for accessing pension savings at their intended retirement date and beyond.

Pension freedoms communications:

- to make new rules on the methodology for providing illustrations to members wishing to access their pensions flexibly, including adding guidance to set out the type of ongoing information consumers are provided with once they start accessing their pension savings but still remain invested.
- to extend the rules and guidance in the FCA’s Conduct of Business sourcebook (COBS) 9 to uncrystallised fund pension lump sums (UFPLS).

Advice suitability assessment:

- the FCA rules and guidance on suitability reports and providing personal recommendations specifically refer to income withdrawals, they should be extended to include UFPLS
- SIPP retained interest: to clarify that self-invested personal pension (SIPP) retained interest charges should be included in projections and charges information.

⁹ [ABI sets out action plan to help customers get the most from pension freedoms](#), 19 June 2015.

Ensuring the market works well

- **Design and distribution of retirement income products and facilities for accessing pension savings:** to remind firms of their obligations regarding the operation, distribution and communication of existing products, as well as when developing new products. To set out some example scenarios to help firms in this area.
- **Retirement risk warnings:** to retain FCA rules in this area that were introduced by fast-track process in February/March. To introduce a pension pot value *de minimus* of £10,000 (and where there are no safeguarded benefits), above which the question and answer process set out in these rules would only apply. Firms will still be required to give appropriate risk warnings.

Protecting consumers

- **Cancellation rights:** the way in which the FCA's rules apply in the new environment has not changed and, in many cases, cancellation rights will apply because an existing contract is being varied or a new contract put in place. The FCA believe the risk that a consumer enters into an arrangement whose features, risks and consequences they do not fully understand should be mitigated by other measures, for example the availability of guidance from Pension Wise and the retirement risk warning rules.
- **Restrictions on the promotion and distribution of high risk investments:** to amend the FCA's 'certified high net worth investor' and 'restricted investor' certification criteria so that it is clear.
- **Using pension savings to repay debt:** to add Handbook guidance to make explicit the application of existing rules in the Consumer Credit sourcebook (CONC), in the context of pension reforms, particularly in relation to debt collection and debt advice. Also, to remind debt collection and advice firms that advising on the conversion or transfer of pension benefits is a regulated activity.
- **Attachment orders:** to add Handbook guidance for providers and advisers on pension attachment orders following divorce or dissolution of a civil partnership.
- **Determining maximum projection rates:** to standardise the methodology for determining maximum projection rates.
- **Projections including guarantees:** to require firms to show contractually obliged future values in projections, including Guaranteed Annuity Rates (GARs).
- **Projecting a future annuity:** mortality assumptions: to update references in the FCA's rules to the 2008 mortality tables and propose that, in future years, firms use the improvement factors published the previous year.
- **Glossary amendments:** to amend the Glossary definitions of 'income withdrawals', 'short-term annuity' (and by consequence 'drawdown pension') to ensure that the rules align with legislation.

The regulator will monitor the market and, where necessary, use the appropriate regulatory tool to take action. It welcomes views from stakeholders as to whether the FCA's cancellation rules expose some consumers to risks that are not appropriately mitigated and how the regulator might reduce those risks and improve consumer outcomes.

Retirement Outcomes Review

Following the FCA's Retirement Income Market Study which reported earlier this year, the regulator will be launching early next year an outcome review which is likely to look areas like product options, consumer decision marking and impact of advised/non-advised distribution channels.

The market study identified a number of risks to consumers making good decisions on a product or strategy to generate an income from their pension savings. The FCA wants to understand whether these risks have become more or less acute in the new landscape. Increased flexibility, product complexity and opaque charges for products (such as income drawdown) could make it harder for consumers to compare and shop around, weakening competitive pressure. Likely areas of focus for the outcomes review:

- **Product options, features, charges and access:** what new products, options and features are appearing on the market, and do consumers find these easy to understand and compare? How are the charges for income drawdown and other products structured, and how clear and comparable are they?
- **Consumer decision making:** given the behavioural biases and increased flexibility and complexity consumers are subject to, what are the barriers to consumers making good decisions when accessing their pension savings? How are consumers taking account of factors such as longevity risk, inflation and charges when making choices?
- **Impact of advised and non-advised distribution channels:** are firms ensuring that they have appropriate distribution arrangements for complex and higher risk products? The regulator anticipates that issues around access to guidance and financial advice will be covered by the joint HM Treasury/FCA Financial Advice Market Review (FAMR).

Before publishing the terms of reference and launching the Retirement Outcomes review in early 2016, the FCA is seeking comments on the shape and scope of the review. These are requested before 30 October.

Broader financial advice issues: the Financial Advice Market Review

On 12 October, HM Treasury and the Financial Conduct Authority published a joint Call for Input on the Financial Advice Market Review (FAMR). The FAMR review had been launched back in August by Harriett Baldwin MP, Economic Secretary to the Treasury, to look at how financial advice broadly defined could work better for consumers:

- the extent and causes of the “advice gap” for those people who do not have significant wealth or income;
- the regulatory or other barriers firms may face in giving advice and how to overcome them;
- how to give firms the regulatory clarity and create the right environment for them to innovate and grow;
- the opportunities and challenges presented by new and emerging technologies to provide cost-effective, efficient and user-friendly advice services; and
- how to encourage a healthy demand side, including addressing barriers to consumers off seeking advice.

The Review will look to balance reducing costs and uncertainty for firms and continuing to provide adequate consumer protection. Any recommendations will need to be workable under EU law, unless there is a need to do so to improve market function. Project governance is through an advisory panel comprising of industry and consumer experts chaired by Nick Prettejohn, Chairman of Scottish Widows.¹⁰

Next steps

Several strands of work are being taken forward in relation to the pension freedoms:

- The FCA consultation into pension rules and guidance will close on 4 January 2016, after which the regulator will issue a Policy Statement setting out draft rules in Q2-2016;
- The Work & Pensions Select Committee will continue to gather evidence in its inquiry into pension freedoms advice and guidance;
- The Treasury and FCA will continue to monitor implementation of the freedoms;
- The Government/FCA Financial Advice Market Review (FAMR) Call for Input closes on 22 December. Feedback will be considered by the Treasury and FCA, who will then publish recommendations ahead of the next year’s Budget.

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¹⁰ For more information, see our policy briefing, **HM Treasury/FCA Financial Advice Market Review Call for Input**, 16 Oct 2015, www.cii.co.uk/38407