

# Financial Advice Market Review



A response from NEST (National Employment Savings Trust)

## About NEST

NEST is a trust-based occupational pension scheme. We were set up to make sure that every employer would be able to enrol their employees into a qualifying pension scheme following the introduction of automatic enrolment. Auto enrolment is a policy response to inertia, and draws heavily on lessons from behavioural economics. After failed attempts to engage consumers through an ‘informed choice’ approach it was recognised by the Pensions Commission in the 2000s that defaulting workers into saving would be more successful. This has been proven to be the case with less than 8 per cent of workers opting out of saving in NEST. It’s worth noting that this process is ongoing with millions of workers in small companies to be enrolled by 2018. Currently the NEST scheme has over 2.6 million members and over 30,000 participating employers.

NEST’s members are low to moderate earners and are often saving for the first time. This is a new market of savers who have not been well-served by the pensions market to date and have a history of very low engagement with retirement savings. The scheme has a lot of members, most with small or very small funds. The scheme also has a low median age, with the majority of our members being under 40. Their contribution rates are largely low as this is a function of the low initial contribution rates set at the start of automatic enrolment, currently 2 per cent of qualifying earnings, rising to 8 per cent in 2018.

## Overview

NEST welcomes the Financial Advice Market Review (FAMR) review and its aspiration to find ways to improve the availability of advice to people, particularly those who don’t have significant wealth or income. We particularly welcome the focus on people with some money but without large wealth, a description which applies to a large proportion of NEST members which number 2.6 million and growing, and agree with the government that this is the group most exposed to any ‘advice gap’.

While we welcome the focus of this review on closing the ‘advice gap’, there’s a compelling weight of evidence showing that people tend not to engage with advice. We think any solution to this problem for retirees must combine both action by government to facilitate the development of cheaper, more accessible advice and guidance throughout people’s lives, in combination with well-governed products at retirement that will cater for a broad range of needs.

In our response we wish to emphasise the following points:

- Auto enrolment has so far been a great success in increasing participation in pension saving, but it functions by harnessing inertia. Now that we have a large and growing population participating in workplace pension saving, government and providers need to work together to consider how to better engage that group as they save, both to ensure they’re saving an amount adequate to their personal circumstances and to prepare them for the choices they’ll face at retirement.
- At retirement, this group now faces a set of choices that we expect a large proportion of them to find difficult and complex, as evidenced by NEST’s consultation, *The future of retirement*<sup>1</sup>. As FAMR acknowledges, this group tends to be put off from seeking advice, through lack of engagement or for reasons of access or affordability.
- We’re keen to work with government and industry partners to ensure that its members reaching retirement have access to suitable forms of guidance and advice, as well as to products that meet their needs. We would encourage government to:

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<sup>1</sup> <https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/The-future-of-retirement.pdf>

- **Continue to improve the quality and tailoring of free guidance** provided by Pension Wise, and to widen the scope of the guidance to cover interactions between pension saving, debt and benefits; as well as encouraging cross-industry collaboration to develop better, more engaging tools and service for consumers, that can underpin guidance services like Pension Wise, like a pensions dashboard.
- **Take steps to encourage industry to develop simplified advice and guidance products**, and provide them with the necessary assurances to encourage them to put them out on the market.
- **Support industry to develop products** that are suitable for a broad range of members, and are suitable for signposting via basic forms of advice and guidance; and over time, consider regulating or certifying those products to make high quality retirement pathways clearer for consumers.

NEST welcomes the flexibility offered to consumers by the Freedom and Choice reforms and shares the goal of consumers making good, active decisions about their retirement. In its role as trustee, NEST Corporation has considered the risks and potential detriment to members who aren't adequately supported to make optimal choices at retirement.

- Our view is that NEST members will need access to products like the one described in *The future of retirement* which we published earlier this year, and which we've shared with the review team. The NEST retirement income blueprint is designed to provide a high degree of flexibility in the early years of retirement by incorporating drawdown and cash elements while securing a regular income in the later years. It offers a risk profile we expect to suit a large proportion of NEST's members.
- We believe products like the one described in the blueprint could be suitable for signposting via basic forms of guidance and advice, or even as a default pathway for those who fail to engage at all. Such products are therefore a critical component of making the Freedom and Choice reforms a success for all pension savers.
- We encourage government to work with the industry to encourage the development of products like this, and to facilitate the development of advice and guidance frameworks that easily enable members to be routed towards them, in a way that limits the risk exposure to both member and provider.

## Supporting savers to build an adequate retirement income

Auto enrolment has so far been a great success in increasing participation in pension saving. However, while minimum contribution levels are a good start in encouraging persistency of saving, they may not be enough to provide some savers with an adequate income in retirement.<sup>2</sup>

Without a disruption of individual inertia, it's more than possible that an individual could save at minimum statutory levels for their entire savings career. In some cases this could be more than adequate, but in others, particularly those who start saving later on in life, there's a very real risk that it will not.

We'd therefore encourage government to ensure that any guidance service aimed at working age adults, such as the guidance currently provided by the Money Advice Service, continues to incorporate strong and effective mechanisms to encourage people to actively plan for their retirement and to recognise the potential need to save more to secure their target income.

At the same time, we recognise the challenges of encouraging people to seek out information about pensions during their working lives and see a clear and continued role for industry in addressing this, through proactive and targeted member communications. NEST is actively considering ways of developing this messaging through a programme of analysis and research.

Consumers should be encouraged to consider the adequacy of their pension savings through a series of contact points throughout their working lives, provided by both government and industry, with the aim of building engagement and encouraging all individuals with pension savings to take personal responsibility for their retirement income. This should be supported by work between government and industry to build a richer picture of what adequacy looks like for different groups, in order to inform future advice, guidance

<sup>2</sup> <http://www.pensionspolicyinstitute.org.uk/publications/reports/what-level-of-pension-contribution-is-needed-to-obtain-an-adequate-retirement-income>

and member communications which support key moments in people's lives like paying off a mortgage or seeing children gain independence.

We also believe that advice, guidance and member communications are only as good as the data that underpins them, and that government should encourage cross-industry and cross-government collaboration to facilitate the development of tools and services that better engage consumers both during their working lives and at retirement. Services like Pension Wise, for example, could be more engaging if consumers came to them understanding what they'd saved, and how to access it. A tool like a pensions dashboard would support this.

NEST is working with both government and industry partners to help work towards the development of this type of service, and would encourage government to continue to strengthen its co-ordinating role in this space.

## Supporting savers to provide an income in their retirement

NEST welcomes the flexibility offered to consumers by the Freedom and Choice reforms, and shares the goal of consumers making good, active decisions about their retirement. But we also recognise the significant challenges they present consumers who may have been largely inert during the accumulation phase.

As we noted in our consultation *The future of retirement*<sup>3</sup> many of NEST's members lack relevant experience and the confidence to make decisions. The environment in which individuals are exposed to pension schemes is product regulated. During accumulation, most consumers don't engage with the pension industry and the products that are on offer. If they do, they'll largely encounter well-regulated pension products with distinct quality standards and price restrictions. In contrast, at retirement consumers are exposed to a developing market offering broad choice. This is arguably much harder to navigate and as a result, there's a risk of consumer detriment. At the same time, this same group tends not to actively seek advice, through lack of engagement or for reasons of access or affordability.

NEST is keen to work with government and industry partners to ensure that its members wishing to access their pension savings have access to suitable forms of help and guidance as well as to products that meet their needs. We believe this work is a critical enabler to making the Freedom and Choice reforms work for all pension savers.

For those who actively seek guidance as they approach retirement, we'd encourage the government to continue to improve the quality and tailoring of the free guidance provided by Pension Wise, including through the provision of tools to enable consumers to understand the possible impact of different choices. We would also encourage government to broaden the scope of Pension Wise guidance to encompass how people's pension choices are impacted by personal debt, and any benefits they might claim. These factors are critical in making any retirement decision, and particularly apply to the group with whom FAMR is most concerned.

We'd also encourage government to take steps to encourage the industry to develop simplified advice and guidance products, including robo-advice, and provide them with the necessary assurances to encourage them to put these products out on the market. We think the FAMR is right to consider industry protections in this context in order to provide the right assurances to providers that they're not taking on disproportionate liabilities, including through safe harbours and longstops.

Additionally, we'd encourage government to consider how over time, product certification or regulation, in the same way as it's done for pensions accumulation through the use of the charge cap, could assist consumers in making appropriate choices, and provide a framework that better enables trustees and providers to signpost members to suitable products in a way that limits risk of detriment.

NEST's retirement income blueprint is a design for a product that might fall into this category. It's been designed to harness the flexibility offered by freedom and choice by incorporating drawdown and cash elements while providing a regular income and risk profile we expect to suit a large proportion of NEST

<sup>3</sup> <https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/The-future-of-retirement.pdf>

members. A key element of this blueprint is the strength of Trustee governance which would oversee member outcomes throughout the lifetime of the member.

We've already shared a description of this product and the research underpinning it with the review team, and would be happy to talk it through in more detail if the reviewers would find it helpful to consider how products such as these could be part of a new choice architecture for retirees, operating within a suitably regulated 'light touch' advice or guidance framework.

### The provision of structured retirement pathways

Whatever framework is established to support consumers in making the right choices at retirement, the weight of evidence suggests that a significant proportion will continue to fail to engage at all.

For this group, we propose that government and the industry should work together to actively consider how any member failing to make an active choice could be routed either by default or by a very simple 'tick box' process into a core product, like that described in our retirement income blueprint. The core product would need to be considered suitable for a broad range of needs, and preferable to the member's pot remaining invested in an accumulation vehicle over the long term.

## Questions

The nature of this call for evidence is broad and wide-ranging. We've chosen to answer only the questions of most relevance to NEST.

### 5. Do you have any comments or evidence on financial needs for which consumers may seek advice?

We agree with the findings of the review that saving for retirement and providing an income for retirement can involve complex decisions which will make it appropriate for many consumers to seek advice. Our own research has shown that in the main, consumers tend to start to engage with their savings around 'moments of truth' largely centred on their own lives.<sup>4</sup> Further, NEST research into improving consumer confidence in saving<sup>5</sup> suggests that, especially with long term savings products, consumers feel disconnected from their savings. Once the money leaves their pay packet, they feel as if someone else is taking control of their finances and feel like passive users. We believe that these 'moments of truth', life triggers such as leaving a job, children moving out, conversations with peers for example, should be seized upon as an opportunity to reconnect passive savers with their futures.

### 7. Do you have any observations on the segments and whether any should be the subject of particular focus in the Review?

We believe that a core focus of the review should be on those people coming up to retirement in the next decade who'll be largely dependent on the value of their defined contribution (DC) pot. For this 'DC Dependent' generation, we believe that it's absolutely vital that the right tools are developed to help them navigate a new regulatory landscape providing them with total freedom and choice.

While we welcome the focus of this review to close the 'advice gap' we believe that the solution will ultimately be a combination of better advice for some and better, well governed products for many.

### 9. Do you have any comments or evidence on why consumers do not seek advice?

We consider that the review captures the core reasons that prevent consumers from seeking professional advice. Of those listed, we believe that price and engagement are the key drivers behind consumers not seeking financial advice. Further, we believe that in some cases, access to advice is not necessary, as pointed out by the review. The review rightly identifies cases where the cost of advice is disproportionate to the potential benefits or the required decision is straightforward.

### 12. Do you have any comments or evidence about the role of new and emerging technology in delivering advice?

We believe that robo-advice could prove a suitable option for our members, and would support government in encouraging innovation and testing in this area. In particular, we would encourage the Financial Conduct Authority (FCA) to consider how it can provide industry with suitable protections in order to feel more confident about testing and then delivering robo-advice products on the open market.

### 17. What do you understand to be an advice gap?

We agree that an 'advice gap' exists in that the cost of advice for many, especially relative to the size of their pension pot, makes the provision of advice uneconomic. We believe it's imperative that cheaper, more accessible forms of advice are developed for this group both during accumulation and at decumulation. But at the same time, there's a compelling weight of evidence to suggest that

<sup>4</sup> <http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/NEST-research-into-retirement-decisions,PDF.pdf>

<sup>5</sup> <http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/improving-consumer-confidence-in-saving-for-retirement,PDF.pdf>

people tend not to take advice even where it's offered. Consequently, basic advice must be delivered hand in hand with simple, well-governed retirement products if we're to limit the risk of consumer detriment.

#### 18. To what extent does a lack of demand for advice reflect an advice gap?

There's a strong body of evidence to suggest that a large proportion of people will not take advice, even where it's cheap and accessible. Take-up figures for Pension Wise have added to this evidence base.

#### 19. Where do you consider there to be advice gaps?

We believe the advice gap that currently carries the most risk is amongst those retiring with DC pensions who aren't seeking advice despite having access to the new pension freedoms. Because we know that so far large parts of this group aren't taking guidance via Pension Wise, government has a role in facilitating the development of advice and guidance better tailored to this group.

#### 22. Do you agree we should focus our initial work on advice in relation to investing, saving into a pension and taking an income in retirement?

Yes.

#### 23. Do you agree we should focus our initial work on consumers with some money but without significant wealth (those with less than £100,000 investible assets or incomes under £50,000)?

Yes.

#### 26. What can be learned from previous initiatives to improve consumer engagement in financial services?

We understand that the government's desire to improve consumer engagement in financial services is rooted in a desire to encourage consumers to save more and make well-informed decisions. But in this context it's striking that the most effective intervention towards boosting savings in recent memory has been the introduction of auto enrolment, an initiative which arguably works because of a lack of engagement.

We believe that advice and guidance services are only as good as the data that underpins them, and that government has a continued role in encouraging cross-industry and cross-government collaboration to facilitate the development of tools and services that better engage consumers both during their working lives and at retirement. Services like Pension Wise, for example, could be more engaging if consumers came to it understanding what they have saved and how to access it, which a tool like a pensions dashboard could support.

NEST is working with both government and industry partners to help work towards the development of this type of product.

We also believe that there's scope in learning from initiatives that take lack of engagement at retirement as a given, and work to protect against it. In particular, we'd point the review towards the introduction of requirements for trustees to pre-select comprehensive income products for retirement (CIPR) in Australia.<sup>6</sup> This, we consider, mitigates many of the risks which are prevalent at retirement. We'd encourage the review to consider the potential of safe harbour products as well as safe harbour advice.

<sup>6</sup> <http://fsi.gov.au/publications/final-report/chapter-2/>

**29. To what extent might the different types of safe harbour described above help address the advice gap through the increased incentive to supply advice?**

We believe that the existence of some form of ‘safe harbour’ will be crucial as trustees seek to adequately transition their members from accumulation to decumulation in their retirement journey.

As above, we believe that the solution to bridging the ‘advice gap’ is in the combination of accessible forms of advice and guidance with the provision of good quality, low cost default products for savers. We believe that without the existence of some kind of safe harbour, trustees will not feel empowered to direct their members into these products.

**35. Do you have any comments or suggestions for an alternative approach in order to achieve an appropriate level of protection for consumers?**

We believe that the solution to bridging the ‘advice gap’ lies in the combination of accessible forms of advice and guidance with the provision of good quality, low cost ‘core’ products for savers.

In the absence of any active or informed choice by savers, trustees are required to consider the best outcome for their members as part of an extension of their fiduciary duty. It’s important that in this context government supports trust-based schemes to signpost their members through simple forms of advice and guidance to high-quality ‘core’ products, like the one described in NEST’s retirement income blueprint’. Over time, government may wish to consider regulating or certifying those products to make high quality retirement pathways clearer for consumers.

**39. What are the main options to address the advice gaps you have identified?**

We believe that the government’s response to closing the advice gap can be overcome through a three pronged approach.

Firstly, we’d welcome any initiatives from the government which made the provision of high quality guidance or advice more accessible to the mass market, including giving the industry greater legal assurances around the liabilities they might be taking on in providing simple forms of advice, to encourage them to innovate. We believe that a major deterrent for many people is the cost of advice, and that ultimately the benefit of advice needs to outweigh the impact that its cost will have on pension pots.

Secondly, in the absence of affordable and or free advice to consumers, we’d encourage the government to consider how its current guidance services could be developed and improved. We believe a key component in increasing consumer engagement in these types of services is in encouraging collaboration to develop better tools and online services for consumers. Please see response to question 21.

Finally, we believe that the quality of advice and guidance can only go so far in helping some people plan for their retirement. For this group, a large proportion of NEST’s 2.6million members, we propose that government and the industry should work together to actively consider how any member failing to make an active choice could be routed either by default or by a very simple ‘tick box’ process into a core product, like that described in the NEST retirement income blueprint. The core product would need to be considered suitable for a broad range of needs, and actively preferable to the member’s pot remaining invested in an accumulation vehicle over the long term.