



Building personal accounts: securing a retirement income

**A summary of responses following public consultation
May 2009**

**personal accounts
delivery authority**

helping millions save
for their retirement

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Foreword

Your responses to the consultation paper *Building personal accounts: securing a retirement income* have provided insight into a wide range of good practice and innovations that are currently used or being considered to support members through the process of taking benefits from their pension schemes. We are pleased to be able to draw on the expertise of all those who participated in the consultation and use this to inform our scheme design as we aim to improve the lives of millions of people in retirement.

I would like to express my personal gratitude, along with the gratitude of everyone at the Personal Accounts Delivery Authority, for the level and quality of the responses you sent us.

How members secure a retirement income at the end of their working lives represents a key challenge for the design of the personal accounts scheme. Getting the right outcome at retirement will be critical for our members so they can make the most of the pension they build up during their working lives, even if it's a small fund.

We received written submissions from 45 organisations, encompassing the financial services industry, existing pension scheme providers, consumer groups, employer groups and technology providers. We also received

a substantial amount of feedback from our two consultation events held in London and Edinburgh.

This publication summarises the key findings and includes some of our initial analysis of the views we received. While comments on some of the areas raised in the consultation document are varied, there is agreement about the qualities the process of securing a retirement income will need to succeed in getting more people saving for retirement. Stakeholders agree that the process will need to be fair, clearly communicated and help members to secure good retirement outcomes. The process must also help to ensure that the scheme will be sustainable.

Only by considering all of the different perspectives kindly submitted by the various stakeholders, will we succeed in balancing the relevant concerns and designing a robust scheme.

I thank you and hope you will continue to work with us as we design the framework that will support personal accounts.



A stylized, handwritten signature in black ink, appearing to read 'Tim Jones'.

Tim Jones
Chief Executive

Executive summary

Introduction

We carried out a consultation exercise between 2 December 2008 and 4 March 2009 to seek views on key propositions concerning the way in which personal accounts scheme members will access their benefits.

The consultation paper *Building personal accounts: securing a retirement income* outlined our proposals on the processes that scheme members would follow to buy an annuity and the support to be provided by the scheme to assist them.

We ran two consultation events, one in London and the second in Edinburgh, and we held meetings with a range of organisations.

This paper summarises the feedback from the consultation exercise and describes how the feedback will be taken on board in the next stages of developing the processes.

Securing a retirement income

In *Building personal accounts: securing a retirement income*, we consulted on whether lifetime annuities are the best way to provide a guaranteed lifetime income for our members and the majority of respondents agreed that our proposals are appropriate.

In designing the retirement income stage of personal accounts, we considered a number of issues including the need to keep scheme members' choices simple, providing a range of good value options for small funds, fairness between types and generations of members, allowing for innovation and helping to deliver low charges.

With these criteria in mind, we proposed that for most scheme members a lifetime annuity would be the best option, but members who want alternative options could choose to transfer out of the scheme.

Most respondents agreed that lifetime annuities can deliver the features we require and are therefore the best option for our members.

Choosing an annuity

In *Building personal accounts: securing a retirement income*, we summarised the research we commissioned on people's understanding of pensions, the retirement process and annuities.

The main finding was that there was a lack of awareness about the issues of securing an income at retirement. Most people were unaware of the choices that had to be made and the options that were available to them. All respondents agreed with our research findings and considered this lack of awareness to be one of the main obstacles to encouraging members to actively engage with the retirement process. Most respondents thought communication was the key and some respondents suggested a long-term education process, engaging with the member on an ongoing basis throughout their scheme membership.

We sought your views on a proposed *structured choice* approach, which would help to guide members through the process of choosing an annuity type, followed by a *focused choice* approach, which would allow them to purchase an annuity from a limited selection. This would largely be a self-service method, automated as much as possible to keep costs to members low. While generic information on the types

of annuities would be available to members, we would not provide the member with any regulated financial advice. There were mixed views in response to this question, with some respondents feeling there was no alternative and others considering even this approach to be too complex for personal accounts members.

In keeping with our principles of minimising employer burden, we asked how we could reduce the number of enquiries employers may receive from their employees. Respondents to this question were unanimous in agreeing that employers should not be involved in the retirement process. The suggestions again focused on the need for clear communication and information for members.

Buying an annuity

The consultation paper *Building personal accounts: securing a retirement income* outlined our proposals on the process that a personal accounts scheme member would follow to buy an annuity through the *structured choice* process resulting in a member buying an annuity either through the *open market option* or through the personal accounts scheme *focused choice* route.

We sought your views on a range of questions covering issues such as: how to communicate effectively with members; the range of annuity types proposed under the *focused choice* option and how to deal with more complex circumstances such as members who do not buy an annuity by age 75 or who are not traceable.

Respondents acknowledged the importance of keeping communications and processes simple for the majority of personal accounts scheme members with some suggesting ways in which this could be achieved.

A large proportion agreed with the range of annuity types proposed under the *structured choice* route. A number of respondents recommended a default option in order to simplify the process even further whereas others recommended extending the range to include impaired life and enhanced options. We also received a range of comments about how to deal with the more complex situations.

Supplying annuities

While many personal accounts scheme members will be willing and able to use the *open market option* to select an annuity type and provider, some will want an alternative. We proposed this could come through a panel of providers who would have to meet certain criteria in order to serve members' needs.

We sought to establish how to make a panel of providers operate effectively, how to select panel members, how often to review this membership, what technologies were in place to enable the scheme and providers to work together effectively and whether there were alternatives to our proposed panel of providers model.

Responses were divided in some areas with the regularity of reviews in particular generating a wide range of opinions. However, other questions, particularly those around technological solutions and selection of panel members, generated a far more consistent range of answers.

Many respondents suggested PADA should engage further with the potential supplier market in order to deliver an optimal solution and we will pursue this before finalising our options for supplying annuities to our members.

Taking small pension funds as cash

Personal accounts scheme members are likely, at least in the early years of the scheme, to have small pension funds. Currently they could struggle to find an annuity provider willing to provide an annuity and so it is important that we design the scheme to ensure that they have a range of good value choices available and they are not penalised as a result of their fund size.

We considered why members could have small funds and what options were available to support them in accessing their retirement savings. Generally respondents believed that we had identified the correct issues and felt these applied to many defined contribution schemes rather than just personal accounts. However, some respondents felt we had underestimated the difficulties these issues presented. Examples include legislative or administrative barriers that make transfers out of the scheme to consolidate pensions problematic.

Some respondents felt that the annuities market would start to cater for smaller funds if costs could be reduced and processes made simpler since they would become more viable for providers and advisers to deal with. Other responses felt that a change in legislation would be required, however, this is outside the scope of our consultation.

Introduction

We carried out a consultation exercise between 2 December 2008 and 4 March 2009 to seek views on key propositions concerning the way in which personal accounts scheme members will access their retirement income.

The consultation paper *Building personal accounts: securing a retirement income* outlined our proposals on the processes that scheme members would follow to buy an annuity and the support to be provided by the scheme to assist them.

We ran two consultation events, one in London and the second in Edinburgh and we held meetings with a range of organisations.

This paper summarises the feedback from the consultation exercise and describes how the feedback will be taken on board in the next stages of developing the processes.

Purpose of this publication

- 1** In 2006, the Government outlined a substantial programme of pension reform to both the State and the private pension system, to help tackle the estimated seven million people under-saving for their retirement, reduce complexity within the pension system, and overcome inertia in relation to pension savings.
- 2** As part of the Government's reforms, from 2012, all employers must ensure that eligible workers¹ are auto-enrolled into a pension scheme that satisfies certain quality requirements. The personal accounts scheme will be one of many pension schemes that will qualify as eligible to meet the quality requirements as set out by the reforms. It will be designed specifically to give those who are not currently saving in a pension scheme of comparable quality to a qualifying scheme under the Pensions Act 2008, in particular, moderate-to-low income earners, the opportunity to save for retirement.²
- 3** The Pensions Act 2007 established the Personal Accounts Delivery Authority (PADA) as a non-departmental public body (NDPB). Its initial remit was to advise Government on proposals about the personal accounts scheme. The Pensions Act 2008 gave PADA responsibility for delivering the personal accounts scheme in time for the onset of employer duties in 2012. This includes making provision for members who are going through the process of choosing and arranging their retirement income.
- 4** There is a great deal of good practice already in place in the financial services industry and we carried out a consultation exercise in order to draw on as much of that good practice as possible.
- 5** This publication summarises the feedback that we received from the consultation exercise. However, it is not the purpose of this publication to recommend agreed processes to support members of the personal accounts scheme towards securing a retirement income.

¹ Eligible workers are those aged between 22 and State retirement age, with earnings of more than £5,035 (in 2005-06 terms, and subsequently uprated on a basis determined by the Secretary of State).

² Self-employed people will also be able to save in the personal accounts scheme at a level of their choosing, subject to the cap on annual contributions which applies to all members.

- 6 The feedback received provides a valuable insight into practical solutions adopted by other organisations and will inform PADA's continuing work to deliver the personal accounts scheme.
- 7 It has also not been possible to include in this document every point raised during the consultation process or to include quotes from every organisation that sent in comments. However, PADA has read and considered every response.

Scope of consultation

- 8 The personal accounts scheme will operate within the same regulatory framework as other occupational, defined contribution pension schemes (apart from some exceptions that are required because of the unique nature of how the scheme is being established). The consultation paper *Building personal accounts: securing a retirement income* sought views on proposals that would apply specifically to the personal accounts scheme within the context of that regulatory environment.
- 9 A number of responses raised matters that were outside the scope of our consultation and outside of PADA's remit. We will forward all these comments on to the relevant organisations.

The consultation process

- 10 The consultation ran from 2 December 2008 to 4 March 2009.
- 11 To support the consultation process, on 2 December 2008 we published a consultation paper, *Building personal accounts: securing a retirement income*. We sent the paper to PADA's list of stakeholders and made it available more widely on PADA's website. In order to achieve widespread awareness of the consultation, we held a media briefing on 1 December 2008.
- 12 The paper outlined the choices we envisaged that members would have to make and explored the types of support the scheme would need to provide to help members make their choices and secure a retirement income. It sought views and comments on five broad themes:
 - whether a lifetime annuity would be the most appropriate product for the majority of personal accounts scheme members
 - the issues that personal accounts scheme members are likely to face when choosing an annuity
 - proposals on the processes that members will go through to buy an annuity
 - how to provide annuities to members who do not want to exercise the *open market option*
 - how to deal with small pension funds.

- 13** During the consultation period, we ran two formal consultation events in:
- London on 22 January
 - Edinburgh on 25 February.
- 14** Both events attracted delegates from a wide range of PADA's stakeholders (see Annex 3 for organisations represented and evaluation feedback from the events).
- 15** The events opened in London with an overview presentation and a question and answer session with Tim Jones, PADA's CEO, and in Edinburgh, with Mark Fawcett, PADA's Director of Investments. The events went on to explore, in a round-table discussion format, the following key areas:
- PADA customer insight research
 - the proposed customer journey
 - the proposed panel of providers.
- 16** The events prompted lively discussions, which provided us with some very helpful insights into the topics. A sample of the points raised during discussions is set out in Annex 3.
- 17** During the consultation period, we also met a number of stakeholders including consumer groups, industry bodies and pension providers (see Annex 2).
- 18** The points raised during the consultation events and during the one-to-one discussions will be taken into account alongside the formal responses to the consultation paper.

Analysis of responses to the consultation

- 19** We received 45 responses to the consultation paper. The responses represent the views of a wide range of stakeholder views as follows:
- consumer organisations
 - consultants
 - financial advisers
 - one individual
 - IT/infrastructure providers
 - pension providers/insurance companies
 - policy/academic
 - professional and representative bodies
 - scheme administrators
 - regulatory bodies.
- 20** A full list of respondents is provided at Annex 1.
- 21** In general, the consultation paper was well received, with many respondents commenting on the quality of the work and the comprehensiveness of the matters covered.
- 22** Some respondents commented on other matters related to taking benefits that were not addressed in the consultation paper. For example, benefits in respect of members who die before securing a retirement income and provision for members in ill-health or serious ill-health. The benefits that will be provided in these scenarios are catered for in the draft scheme order and rules, published for consultation on 28 April 2009.³

³ *Pensions – Consultation on draft scheme order and rules* (Personal Accounts Delivery Authority and Department for Work and Pensions). The consultation period runs from 28 April 2009 to 20 July 2009. <http://www.padeliveryauthority.org.uk/scheme-rules.asp>

- 23** The draft scheme order and rules also includes provision for the trustee to purchase a lifetime annuity for a member and/or to pay a lump sum benefit.
- 24** More generally, the draft scheme order and rules provide for members to choose a Nominal Benefit Age, define what the scheme's default Nominal Benefit Age will be and make provision for what will happen in the case of unclaimed assets or untraceable members.
- 25** The responses we received broadly addressed the questions raised in the consultation paper. The chapters that follow summarise these responses. However, some of the key points to emerge are:
- acknowledgement that a lifetime annuity (or, where relevant, trivial commutation) is likely to be the most appropriate option for personal accounts members
 - recognition of the likely difficulty of engaging with our customers and the need to communicate to members early on that they will need to take action at the point of securing a retirement income
 - the need to use accessible language and simple communications
 - the need to use other channels alongside 'e'-communications such as a help-line for members, at least for part of the retirement process
- suggestions on the degree of benefit and underwriting options that should be offered to members ranging from a default, basic annuity type to a wide choice including impaired life/enhanced annuities (although views varied on whether the latter options could be delivered as part of a simple online process or whether such an approach would be compatible with the aim to keep costs to a minimum for the majority of members)
 - general acknowledgement that a panel of providers approach could be the most appropriate route for members not wishing to exercise the *open market option*
 - recognition that fund sizes are likely to be very small in the early years
 - general recognition that small funds and low initial volumes could make it difficult to achieve the right arrangements for any panel
 - concerns that the way in which any panel of providers is set up, i.e. length of contracts, should allow for a return on the capital outlay that providers would need to make to be on the panel or else it may not be attractive to annuity providers.

Securing a retirement income: some comments from respondents

“[...] we think that this discussion paper represents some thorough work, with a good understanding of the retirement income market, and the issues in it, being displayed.”

Institute of Directors

“We welcome the thoughtful approach to the end result that is reflected in the paper, and the leadership that PADA is taking in discussing issues that all defined contribution schemes face when the time comes to convert pension investment into income.”

Association of Pension Lawyers

“[...] it seems to us that many of the detailed questions cannot be answered until there is practical experience of maturing personal accounts and of indications of how the market will develop. In particular we suggest that insufficient discussion of the effects of possible inflation is a major problem with the consultation paper.”

UK Shareholders Association

“The work that PADA are undertaking, the findings of this consultation and the recommendations that are put forward should not be limited to those saving in Personal Accounts, the Government needs to also consider the process for those in alternative schemes.”

Equality and Human Rights Commission

“We agree that leaving members to negotiate the Open market option would be risky as the current annuity market is inappropriate for the needs of a large number of consumers, many with small accumulated funds.” **Which?**

“Overall the approach that the personal accounts delivery authority is proposing for scheme members to secure a retirement income seems to strike a reasonable balance between enabling scheme members to shop around on the open market to get the best retirement income that they can and recognising that not all scheme members will wish to shop around on the open market and providing a focused choice alternative.”

Pensions Policy Institute

“The consultation paper addresses a number of important questions, which existing defined contribution schemes already have to address.”

Society of Pension Consultants

“PMI welcomes this consultation exercise, and in particular believes that PADA’s idea for a panel of annuity providers offers an innovative solution to the problem of obtaining good value for members with small funds [...] We fear that PADA have overestimated the financial capability of many of your members at the point of retirement [...] Indeed, your experience is likely to be even worse in this respect than most pension schemes that PMI members are currently engaged with. This is because many of your members will have arrived at retirement entirely by default – they will have joined through auto-enrolment, contributed at the default contribution rate and invested their funds in the default fund. They may not even have read or understood any of your communications prior to their retirement.”

Pensions Management Institute

Securing a retirement income continued

“We recognise that PADA is required to deliver Personal Accounts at low cost but we have some concerns with the proposal to rely on a self-service customer experience delivered through the internet. Clearly there are tensions between delivering a cost efficient service and one that allows consumers access to advice and information to enable them to make informed choices and steer them towards a more suitable product.”

Financial Services Consumer Panel

“In general, we are in agreement with the broad thrust of the proposals in this document.”

Association of Consulting Actuaries

“We are broadly supportive of the framework suggested in the consultation document, and believe that it represents a further significant milestone on the road to constructing a new pensions settlement in 2012.” **TUC**

“We are supportive of the proposed suggestions contained in the consultation paper and strongly agree that a technological solution is vital to make the process viable.”

Hargreaves Lansdown

“This paper contains too many assumptions...” **Stephen Wynn**

How we will take your views on board

- 26** We are very grateful for the time and effort that our stakeholders have put into responding to the consultation exercise. As stated above, the responses will inform PADA’s continuing work on designing the processes to support members in securing a retirement income.
- 27** We are also very grateful for the offers that we have received from various organisations to provide more detailed information about their own solutions to the issues raised in our consultation paper. We will continue the dialogue with stakeholders on those matters.

Publication of responses

- 28** The consultation paper, *Building personal accounts: securing a retirement income* explained that, under the Freedom of Information Act 2000, all information contained in responses, including personal information, may be subject to publication or disclosure.
- 29** We can confirm that the responses received will be published on the PADA website on the same day that this summary of responses document is published.

Box 1 PADA's principles

The Pensions Act 2008 includes a set of principles that the Personal Accounts Delivery Authority (PADA) must have regard to when making decisions about the personal accounts scheme. These principles provide PADA's operational framework and are fundamental to the scheme's design. In summary, they are that:

- participation in qualifying schemes should be encouraged and facilitated
- the burdens imposed on employers should be minimised
- any adverse effects on qualifying pension schemes, and members and prospective members of those schemes should be minimised
- the cost of membership of should be minimised
- the preferences of prospective members should, so far as practicable, be taken into account in making any provision about investment choice
- diversity among members and prospective members of the scheme should be respected.

PADA will need to make balanced judgements between the principles where they give rise to conflicting priorities.

Glossary

A number of technical terms appear frequently in this document. These terms, and what they mean, are summarised below.

Alternatively Secured Pension (ASP)

An alternative to buying an annuity only available from age 75. As with income drawdown (see below), an income is drawn directly from the pension fund. These products were designed to meet the needs of those who have a principled objection to the way annuities work and are therefore considered something of a specialist area.

Annuity An insurance product, the most common of which is a lifetime annuity designed to provide a lifetime income in retirement. There are various types of annuity which can, for example, pay money to dependants (these are known as *joint life* annuities, a *single life* annuity only pays whilst the annuitant is alive) or keep pace with inflation (*escalating annuities* keep pace either with inflation or can rise by a fixed amount e.g. 3 per cent each year, whereas a *level* annuity pays the same cash sum every year).

Focused choice This term describes the support the personal accounts scheme will give to members who do not want to use the open market option. Focused choice will allow members to choose from a selection of annuity benefit options from providers who agree to meet certain conditions set by the personal accounts scheme.

Income drawdown An alternative to buying an annuity, properly called 'unsecured pension'. The retirement fund remains invested and may continue to grow (subject to the performance of the underlying investment). By the age of 75 the member has to convert the unsecured pension to a lifetime annuity, a scheme pension or an alternatively secured pension.

Member Unless stated otherwise, 'member' refers to a person who has a pension fund within the personal accounts scheme.

Nominal Benefit Age The *member's* Nominal Benefit Age is the age chosen by the member as the one at which he or she is most likely to take benefits from the scheme. When a member does not make a nomination, the *scheme's* default *Nominal Benefit Age* will be used (65 for members born on or before 5 April 1955 and State Pension Age for members born thereafter).

Open market option Pension scheme members do not have to choose a lifetime annuity offered by their pension scheme. They can shop around to compare rates and arrangements offered by other insurance companies and choose an annuity from another provider. This is called the open market option.

Pension Commencement Lump Sum (PCLS)

A cash lump sum, normally up to 25 per cent of the pension fund, paid out to the member, in most cases, tax-free.

Pension fund The member's accumulated savings within the personal accounts scheme consisting, usually, of all contributions made by or on behalf of the member, contributions from their employer(s), tax relief and fund growth less any account charges.

Prospective annuitant A person considering, or in the process of, buying an annuity.

Scheme pension A scheme pension is a lifetime entitlement to an income provided to a member of a registered pension scheme. Benefits can either be funded and paid by way of an annuity or directly by the pension scheme.

Structured choice A two-stage process that will help members decide the right type of product and then to use either the open market option or the focused choice process to choose a specific product and provider.

Target market Although the scheme will be open to all, it is designed to focus on the moderate-to-low income earner with no pension provision. That is, people who are typically aged between 22 and state pension age, earn between £5,000 and £35,000 (figures in 2005/06 terms) and are not currently saving in a qualifying scheme. The scheme will also be available to people who are self-employed.

Trivial commutation Where members have only saved a small amount, tax rules may allow them to take the entire fund as a lump sum rather than converting it into an income. Normally 25 per cent of the fund is tax free and the rest is taxable under PAYE arrangements.

Trustee In the case of the personal accounts scheme, the term 'trustee' refers to a group of individuals acting corporately. The trustee will be responsible for the proper running of the personal accounts scheme from the collection of contributions to the investment of assets and the payment of benefits.

Chapter one

Securing a retirement income

In *Building personal accounts: securing a retirement income*, we consulted on whether lifetime annuities are the best way to provide a guaranteed lifetime income for our members and the majority of respondents agreed that our proposals are appropriate.

In designing the retirement income stage of personal accounts, we considered a number of issues including the need to keep scheme members' choices simple, providing a range of good value options for small funds, fairness between types and generations of members, allowing for innovation and helping to deliver low charges.

With these criteria in mind, we proposed that for most scheme members a lifetime annuity would be the best option, but for members who want alternative ways of taking their income they could choose to transfer out of the scheme.

Most respondents agreed that lifetime annuities can deliver the features we require and are therefore the best option for our members.

The choices scheme members will need to take around securing a retirement income

- 1.1** Members of the personal accounts scheme will have a range of choices around securing their retirement income, including:
- what age to take their retirement benefits
 - how to take their retirement benefits
 - whether to take tax-free cash
 - whether to take a small pension fund as a cash payment rather than income
 - whether to transfer their personal accounts fund into another pension scheme to allow a greater choice.

The key issues for personal accounts

Keeping choice simple

- 1.2** Many of the members of personal accounts will have joined through automatic enrolment rather than having made a choice to do so. They may also have been in the default fund and contributing at the default rate. Therefore, they may have been relatively unengaged with their pension during their working life.
- 1.3** However, we want members to engage with their retirement planning and decisions as these are vital and irreversible choices that will affect them throughout their retirement. The best way of engaging our members is to keep these choices simple and manageable.

Dealing with small funds

- 1.4** Personal accounts members are likely, at least in the early years of the scheme, to have small pension funds. This is because of a number of scheme features, including:
- contributions paid to the scheme for a short amount of time
 - in general, no transfers in to the scheme
 - a cap on contributions
 - a focus on moderate-to-low income earners.
- 1.5** It is important that personal accounts members are not placed at a disadvantage through these smaller fund sizes. They should be able to get good value products and a range of appropriate choices.

Delivering a low-charge scheme

- 1.6** As personal accounts members are likely to have relatively small funds the importance of keeping the schemes charges low in order to help deliver better outcomes in retirement cannot be underestimated.
- 1.7** Therefore, any options provided for taking benefits need to be a good fit with the low-charge nature of the scheme.

Being fair to all

- 1.8** Members should not be disadvantaged by when they joined or retired from the scheme. Equally they should not be disadvantaged as a result of their smaller fund sizes or other choices they may make e.g. retiring later.
- 1.9** The options provided should also not be a burden on employers; they should not require employers' involvement in order to help keep their costs low.

Providing a lasting answer

- 1.10** While the average scheme member is likely to have a relatively small fund during the early years of the scheme as the scheme matures and members are able to save for longer periods, average fund sizes will increase.
- 1.11** The pensions market also provides ongoing innovation in the range of retirement income products being offered, for example, tools to help members make choices, annuity design and pricing. It is important that personal accounts members are able to benefit from these innovations when they are appropriate.
- 1.12** It is important to design a framework that provides a lasting answer for both the short term and the longer term and is flexible enough to allow the scheme to evolve within a changing retirement environment.

Are lifetime annuities the right product for our members?

The questions we asked

- 1.13** We sought in Chapter one of *Building personal accounts: securing a retirement income* to determine whether it was appropriate to offer our members a lifetime annuity in order to meet their retirement income needs.

What the consultation paper *Building personal accounts: securing a retirement income* asked

- Are lifetime annuities the best way to provide a guaranteed lifetime income for our members?

What you told us in response

- 1.14** Most of the responses we received clearly addressed this question, and the responses were almost always affirmative.
- 1.15** This affirmative answer was received across the entire range of organisations responding to the consultation including consumer representative groups, professional or trade bodies and pension providers.
- 1.16** One of the key themes to be brought out in many responses was the safety and security of an annuity which offers a predictable and guaranteed income for as long as a member lives.
- 1.17** Lifetime annuities were also widely perceived to offer a range of choices around the ‘shape’ of benefits, allow for innovation, be simpler to explain than other retirement income options, be able to cater for smaller fund values and support a diverse range of member types such as those with poor health.
- 1.18** There was a widespread recognition that for members with smaller pension funds an annuity was the most viable option. Alternatives such as income drawdown were probably either not suitable or available as they generally require larger funds in order to fund the higher costs of provision.
- 1.19** Many respondents also appreciated that transfers out permitted access to these alternative options if members wanted them. Several responses went on to note that there may be a range of reasons why scheme members might want access to these options e.g. having significant pension savings elsewhere or their religious beliefs.
- 1.20** Several respondents urged PADA to ensure that personal accounts would retain sufficient flexibility in the future to take account of developments in the retirement income market and to allow for the fact that the average pension fund is likely to increase in size as the scheme matures and members have had a greater opportunity to save into their personal accounts for a longer period.
- 1.21** Another key issue mentioned in several responses was the need for clear communications in order to help ensure that members are aware of the irreversible nature of the annuity decision and therefore the importance of their giving it due care. The importance of seeking professional financial advice in helping to make these choices also received some emphasis.
- 1.22** Several other responses suggested there may be some value from having a default annuity option for members who did not want to make an active choice about their retirement income. This issue is discussed further in Chapter two.
- 1.23** There was also a suggestion from a few respondents that the scheme may want to consider providing its own annuities rather than using the existing marketplace. This issue is discussed further in Chapter four.

Are lifetime annuities the right product for our members: some comments from respondents

“Yes. Lifetime annuities are the best way to provide a retirement income to most members of the Personal Accounts Scheme.” **Prudential**

“Assuming that the intention is to provide an income for life, we do not see that there is a realistic alternative for most people to lifetime annuities.” **UK Shareholders Association**

“We agree that the lifetime annuity is the best product to secure a guaranteed income for life [...] We welcome the flexibility for the member to pursue income drawdown or transfer their personal account fund to another registered pension arrangement for the purposes of crystallising retirement income. Income drawdown operated by the personal accounts scheme would add complexity and further administration costs which would be borne by the members.”

Capita Hartshead

“Since fund sizes, in particular in the early years of personal accounts, will probably generally be small, we agree that lifetime annuities will be the best way to provide a guaranteed lifetime income. Any other approach would add complexity and would be unlikely to be viable for smaller funds.”

Society of Pension Consultants

“We agree that, given the existing regulatory, tax and legal rules, lifetime annuities are the best way to provide a guaranteed lifetime income for personal accounts members. The fact that significant transfers into the scheme will be prohibited before 2017, together with the limits on contributions and the phased introduction of the scheme indicate that the overwhelming majority of members reaching decumulation before 2017 will only possess relatively small pension funds.” **Which?**

“We also recognise that while many of those using Personal Accounts will over time build up substantial savings pots, the experience of the first ten years at least will be characterised by a comparatively small accumulation of pension savings. In terms of product set specifically, conventional annuities may therefore be most appropriate for many savers, as the consultation suggests, while also providing access to the Open market option for those who wish to explore other avenues.”

Investment Management Association

“Yes. Annuities are simple products that meet the needs of your expected members. A small minority of your members may seek alternatives, such as unsecured pensions or alternatively secured pensions. This could be because they have substantial pension assets in addition to Personal Accounts, or because of religious conviction. We believe that the most appropriate way to cater for these people is to offer them a transfer at retirement age to another institution that offers such products.”

The Pensions Management Institute

“In the early years of the Personal Accounts scheme, the pension pots will be small and therefore we agree that a lifetime annuity will be the most suitable retirement product for the majority of scheme members.”

Canada Life

“On the assumption the maturing pension values will be relatively small (i.e. less than £50k), then we believe this is a sensible conclusion, as the other retirement income options are not guaranteed and present risk for the consumer.” **MGM Advantage**

Are lifetime annuities the right product for our members continued

“Yes. The NAPF believes that the degree of certainty and income protection provided through annuity purchase means it will be the best option for the vast majority of Personal Accounts scheme members.”

National Association of Pension Funds

“We agree that lifetime annuities are the best way to provide a guaranteed lifetime income for the vast majority of personal account holders, but have no objection to allowing scheme members to transfer their savings out to access other types of pension income” **TUC**

“Yes. Any other option creates additional levels of choice that will be almost impossible for the majority of your members to compare and decide between.” **Hewitt Associates**

“Yes. It is likely that members’ income from Personal Accounts will be their only retirement income, other than state retirement benefits. The primary financial need of Personal Accounts holders will be for a stable, predictable income that will last for the remainder of their lives. The lifetime annuity provides this certainty.”

Association of British Insurers

“We agree that lifetime annuities are currently likely to be the most suitable option for most members, and the ability to transfer funds out to another provider will be a valuable alternative for those for whom other options, such as income drawdown or an unsecured pension, are more suitable.”

Age Concern and Help the Aged

How PADA will take this forward?

Designing personal accounts

1.24 Respondents to this question are generally strongly in agreement that the approach PADA has proposed is the correct one, at least for the early years of the scheme when funds are likely to be small. On this basis we will proceed with designing the scheme to provide for a lifetime annuity and the draft scheme order and rules caters for this.

1.25 We will also consider the most appropriate means of communications with scheme members to ensure that:

- they consider at what age to retire and notify the scheme of their intentions
- members know that they will need to make retirement income decisions and understand what is required of them
- members are aware of the *open market option*
- members know the consequences of the choices they make e.g. taking tax free cash will reduce ongoing income
- members know that an IFA might be able to assist them in selecting their retirement income. The member can then decide whether to explore this option at the member’s own cost.

Chapter two

Choosing an annuity

In *Building personal accounts: securing a retirement income*, we summarised the research we commissioned on people’s understanding of pensions, the retirement process and annuities.

The main finding was that there was a lack of awareness about the issues of securing an income at retirement. Most people were unaware of the choices that had to be made and the options that were available to them. All respondents agreed with our research findings and considered this lack of awareness to be one of the main obstacles to encouraging members to actively engage with the retirement process. Most respondents thought communication was the key and some respondents suggested a long-term education process, engaging with the member on an ongoing basis throughout their scheme membership.

We sought your views on a proposed *structured choice* approach which would help to guide members through the process of choosing an annuity type, followed by a *focused choice* approach, which would enable them to buy an annuity from a limited range. This would largely be a self-service method, automated as much as possible to keep costs to members low. While generic information on the types of annuities would be available to members, we would not provide the member with any regulated financial advice. There were mixed views in response to this question, with some respondents feeling there was no alternative and others considering even this approach to be too complex for personal accounts members.

In keeping with our principles of minimising employer burden, we asked how we could reduce the number of enquiries employers may receive from their employees. Respondents to this question were unanimous in agreeing that employers should not be involved in the retirement process. The suggestions again focused on the need for clear communication and information for members.

Research findings

- 2.1** PADA commissioned qualitative research⁴ to explore people’s understanding of pensions, retirement and annuities.
- 2.2** The research found that the majority of people did not understand that they had to make decisions to secure an income in retirement. There was an assumption

that many of the options, such as provision for a spouse, were included in their provider’s default option, usually a *single-life* level annuity.

- 2.3** This research, and research undertaken by others, has helped us to understand the issues and assumptions so that we can tailor personal accounts to better address them.

⁴ Awareness, knowledge and attitudes regarding the retirement process for PADA’s target audience. Research to explore people’s understanding of issues regarding pensions, and their information requirements when approaching retirement.
http://www.padeliveryauthority.org.uk/documents/decumulation_report.pdf

Issues people face when purchasing an annuity

- 2.4** The purchase of an annuity is a significant financial decision, indeed for many people it might be one of the last such decisions they take. The choice of annuity may have a major impact on their income during retirement.
- 2.5** We need to strike a balance between providing sufficient choice for the member and reducing the complexity of the annuity purchasing process.

Questions members will have to address to secure a retirement income

2.6 Whether to buy an annuity

At the point of taking benefits, the member has three choices:

- they can purchase an annuity
- they may be able to take all of their funds as a taxed lump sum if these are below a certain value
- they can transfer their funds to another provider either for consolidation of all their pension savings before securing their retirement income or if they want an alternative to an annuity.

2.7 When to buy an annuity

The member will need to decide whether to take their retirement income at the scheme's default Nominal Benefit Age⁵ or at a date of their choice (subject to the normal tax rules).

2.8 How much to take as a lump sum

Members will need to balance the attractiveness of taking the maximum amount as a tax free cash lump sum against a reduction in their monthly income.

2.9 What type of annuity to buy

There are several options available to prospective annuitants and members will need to select those that are the most appropriate for their circumstances. Members will, therefore, not be offered a default option unless they fail to choose an annuity by age 75.

2.10 Whether to buy the annuity offered by their scheme provider or shop around for another provider

Many defined contribution occupational schemes have a default pension provider who members can purchase a default annuity from. Personal accounts are likely to want members to make choices around who provides their annuity. We want to maximise this choice, within the limits of the scheme's principles.

2.11 Whether to use an independent financial adviser

The scheme does not plan to offer regulated financial advice to its members, although we will offer clear information and guidance through the proposed *structured choice* process; but we will also make it clear to members that an IFA might be able to assist them in selecting their retirement income. The member can then decide whether to explore this option at the member's own cost.

⁵ The scheme's Nominal Benefit Age will be 65 until April 2020 and State Pension Age thereafter.

Research findings and other factors to be considered

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

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

What you told us in response

- 2.12** The findings from our research agreed with the research findings of respondents.
- 2.13** Respondents agreed that there was limited knowledge of pensions, the retirement process and purchasing an annuity. Nearly all respondents, from consumer groups to annuity providers and financial advisers, agreed that there was a widespread lack of knowledge about pensions in general. This is almost universal and not confined to just the personal accounts target group.
- 2.14** A large majority of responses focused on the need for clear and relevant communication to increase the understanding of our members.

Research findings and other factors to be considered: some comments from respondents

“[...] information provision alone will not support people in making informed decisions. Many people find the choices difficult to understand and that is why, as a minimum, AXA believes that support and guidance should be offered to members to assist them in making the correct choice.” **AXA**

“[...] the main obstacles that need to be overcome are helping individuals understand the options they have when choosing what type of annuity to buy and how they can ensure they are obtaining a competitive rate.”

The Pensions Advisory Service

“[...] there is a reluctance to believe that escalating annuities offer reasonable value.”

UK Shareholders Association

“[...] there are typically two broad audiences. These can be classified as:

- (i) ‘Confused and concerned’ – these are people who are not financially literate, feel they do not have enough income in retirement and are more likely to take a default option.
- (ii) ‘Relaxed and Ready’ – these people are financially literate, believe they have adequate income and are more likely to shop around and/or seek independent financial advice.” **Prudential**

Research findings and other factors to be considered continued

“[...] most members of a pension scheme understand that they will receive an income at retirement. It is the nature of how that income is provided (e.g. through the scheme, another policy, etc.) where better understanding is needed, particularly with regard to the shape of the income and how best to provide for dependents in the long term.”

Canada Life

“Our own research also identifies that communication is one of the greatest challenges facing employers who run occupational defined contribution schemes. We agree that the target market is not engaged in the annuity buying process [...]” **Mercer**

“We believe the research was very thorough, and identified very clearly the issue of customer inertia and apathy in dealing with the ‘at retirement’ process [...] We believe further work is required to understand what types of communication and customer process will engage the ‘non OMO’ or as referred to in the paper ‘reluctant engagers’.” **MGM Advantage**

Levels of choice

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

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

What you told us in response

- 2.15** Responses were received from across all groups and many went into detail about what should be provided to our members.
- 2.16** There was a definite split between those who thought members should have increased choice; particularly in the form of impaired or enhanced annuities; and those who thought too much choice would confuse the members. Annuity providers were slightly more likely to favour giving members a wider choice, regardless of the complexities involved.
- 2.17** Some respondents thought PADA had overestimated the financial capability of our members and we were offering too much choice. Other respondents thought we should limit the choice to standard annuities.
- 2.18** In the responses suggesting a simpler process, there was also a call for a default option, as proposed for the accumulation phase. This would be a default annuity type and would be in addition to the proposed default annuity at age 75. Many responses queried why there was no default annuity before age 75, particularly as members are unlikely to be actively engaged in the retirement process.

2.19 A couple of respondents suggested members could be offered one annuity based on their answers to the *structured choice*, rather than the full range. Members would not see the name of the annuity provider and providers would receive an equal share of annuities. This would focus members' thoughts on the annuity type, rather than the provider.

2.20 Some respondents had an opposing view and thought personal accounts should offer members as wide a choice as possible. A number of responses focused on the developments in the market which are moving towards a more individually tailored approach. There were concerns that personal accounts may be developing a system which may not be fully supported by the time of its launch.

Levels of choice: some comments from respondents

“One option that might provide lower cost annuities is to allow annuity purchase only on limited dates [...] A default annuity might thereby be arranged on bulk purchase terms.”

Association of Pension Lawyers

“[...] it [focused choice] could lead to information overload for some customers and could also cause them to focus on the choice of provider more than on the type of annuity [...]”

Scottish Widows

“The focused choice approach would need to be extensively tested [...] in order to be sure the process is used, understood and leads to an appropriate purchase outcome [...]”

Association of British Insurers

“While we support the idea of online transaction, we think there are serious challenges to building an “information room” and appropriate “decision trees” given the huge annuity choices available.”

Institute of Directors

“Certain factors can be pre-decided on behalf of individuals to simplify the whole process.

For example, PADA could decide that annuities for all retirees should be set up on a basis which includes a five year guarantee and income is paid monthly in advance. This would reduce the number of choices which people need to make.”

Standard Life

“Impaired life annuities and enhanced annuities should be included in the range of annuities offered by Personal Accounts, as these can increase the retirement income of those with disability or illness.”

Equality and Human Rights Commission

“The fewer choices that are presented to members the more likely it is that they will exercise those choices [...]” **HBOS**

“We are concerned that there is no default pension available before 75. Given that, at least in the early days, Personal Accounts are likely to be under £10,000, there should be a simple ‘if you do nothing’ focused choice option. This would be a single life level annuity, with a 5 year guarantee [...]”

Investment and Life Assurance Group

Levels of choice continued

“Given the complex choices and the likely existence of many very small pots, particularly in the early years, having some form of default option for decumulation is likely to be desirable [...] A default solution could offer an element of helpful tailoring: for example, taking account of known marital status to propose a joint life rather than single life annuity [...]”

Investment Management Association

“The more choice is offered, the greater will be the complexity and the potential for indecision, confusion and additional cost. We therefore broadly agree with the approach suggested in the consultation paper. In the case of personal account funds smaller than £2000, we suggest that the only choices available should be to take the fund as a lump sum or to transfer it to another arrangement, in order to avoid the need to provide very small annuities [...]”

Society of Pension Consultants

“You are placing a burden on your members that they do not need to carry. The trustees of the scheme could operate a default annuity which would make these choices for consumers.”

The Pensions Management Institute

“Members should have the choice of annuities with different payment frequencies, escalation rates and guarantees. Investment-linked annuities should be out of scope as they are more complex [...] It might be possible to offer smoker/non smoker rates and/or simple lifestyle based annuity.”

Legal & General

“It is assumed the customer will have two primary choices, the OMO route or a focused

choice. And in the least likely scenario there may be some kind of default option. We understand, however, maturing pensions will not be offered a standard default annuity, and we 100% agree with this approach.”

MGM Advantage

“The annuity market is becoming increasingly individualised with new underwriting techniques and technology. [...] PADA’s decumulation process must reflect these trends and allow providers to use similar techniques or it will risk being out of date before it is even live to the public.”

Norwich Union

“Even with a focused choice option we think that most members in the target market will still find this bewildering. We do not recommend offering further choices.”

Xafinity Paymaster

“No. This should be a simple low cost Money Purchase scheme and offering too much choice would create complexity. In fact, we believe the choice should be eliminated.”

The Institute of Chartered Accountants in England and Wales

“The fact most people are not engaged in buying a retirement product sits uncomfortably with PADA’s primary suggestion that people self-serve by choosing the right type of annuity for themselves. [...] We also suggest PADA carries out rigorous trials of the retirement process to test how the target market uses, understands and values it and so to develop and refine it ahead of launch.”

AEGON

Minimising enquiries to employers

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

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

What you told us in response

2.21 Respondents were generally in agreement that employers should have minimal involvement with the retirement process. Key to this was clear communications and signposting to information sources, such as a helpline or web tool.

2.22 In addition, some responses suggested that increased member engagement could be achieved by positioning personal accounts as a product that is owned by the member, rather than something provided by the employer and that this approach could encourage members to make their own decisions.

Minimising enquiries to employers: some comments from respondents

“The scheme needs to engage effectively with members throughout the retirement process to ensure the member can make an informed decision and reduce the burdens on employers.” **Capita Hartshead**

“The key here is to establish ‘personal ownership’ by members of their Personal Account fund. Personal Accounts must be positioned as ‘the personal pension pot to which the employer contributes’, rather than an employer scheme which holds the employees’ pension funds.”

Association of British Insurers

“One possibility seems to us that a specialist group of advisers dealing entirely, or primarily, with annuity purchase would come into being as a natural source of advice for this area.”

UK Shareholders Association

“The Personal Accounts Scheme could establish and widely publicise a dedicated general telephone helpline and website.

This dual information source could become the initial contact point to which employers could immediately redirect queries regarding all aspects of the Personal Accounts scheme.”

National Association of Pension Funds

“Information on Personal Accounts and online access could be provided through outlets such as public libraries and Citizens Advice Bureaux.”

Investment and Life Assurance Group

“A direct proactive education campaign for scheme members in the years and months approaching retirement would be required in order to minimise the number of enquiries to employers.” **Canada Life**

“[...] the best thing that the personal accounts scheme can do is provide a consistent and empowering message to members throughout their membership. The message needs to be along the lines of: “This is your money, only you know what financial requirements and obligations you have [...]” **Mercer**

How PADA will take this forward?

Designing personal accounts

2.23 The responses we have received suggest our key task is ensuring members have sufficient and appropriate information to enable them to make an informed choice about their retirement income. As mentioned in responses, this includes providing clear and relevant communication at appropriate times for the member.

2.24 The consultation has prompted a number of responses about the level of choice that should be provided to members. There is a split between offering as wide a choice as possible and restricting the choice of annuities to keep the process simple. We will continue to fully explore the requirements of our members and balance our aim of providing a straightforward self-service approach with developments in the annuities market.

2.25 One of our principles is to minimise the burden on employers. Again, the conclusion from the responses received seems to be to have high quality and relevant communications for the members. We will continue to develop our communication strategy in the interests of our members and their employers.

Chapter three

Buying an annuity

The consultation paper *Building personal accounts: securing a retirement income* outlined our proposals on the process that a personal accounts scheme member would follow to buy an annuity through the *structured choice* process resulting in a member buying an annuity either through the *open market option* or through the personal accounts scheme *focused choice* route.

We sought your views on a range of questions covering issues such as: how to communicate effectively with members; the range of annuity types proposed under the *structured choice* option and how to deal with more complex circumstances such as members who do not buy an annuity by age 75 or who are not traceable.

Respondents acknowledged the importance of keeping communications and processes simple for the majority of personal accounts scheme members with some suggesting ways in which this could be achieved.

A large proportion agreed with the range of annuity types proposed under the *structured choice* option. A number of respondents recommended a default option in order to simplify the process even further whereas others recommended extending the range to include impaired life and enhanced options. We also received a range of comments about how to deal with the more complex situations.

Communicating annuity choices to personal accounts scheme members

- 3.1** The consultation paper *Building personal accounts: securing a retirement income* outlined our proposals for the process that our members would follow to buy an annuity.
- 3.2** We explained that our objective was to provide members with:
- effective communications at the right time
 - guidance on how to search the market for the best deal through the *open market option*

- a *structured choice* approach that allows members to focus on an annuity type
- a *focused choice* option that will enable us to point members to a competitive range of products through a panel of providers
- a process that is compatible with working practices of annuity providers, and which will allow products to be bought in as straightforward a way as possible.

Communicating with members about securing a retirement income

- 3.3** The consultation paper proposed that the scheme would provide members with information about their retirement options and ask them to confirm their chosen retirement date as they approach six months before their Nominal Benefit Age.⁶ This communication would be followed by another, two to six weeks before the retirement date, containing more detailed information, including an up-to-date fund value and further details of how to purchase any annuities available through the *focused choice* facility.
- 3.4** Where, following the initial notification of retirement options, a member fails to contact the scheme we would send a reminder before the member's Nominal Benefit Age. If there is still no response following the second notification, we would assume that the member had not received the notifications and take action to trace the member.

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

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

What you told us in response

- 3.5** All but a handful of respondents addressed the question about timing and content of information. About a third agreed with our proposals. Many of those agreeing acknowledged that the proposed approach matched the current legislative requirements as well as the provision that was currently being made in schemes with which they were involved.
- 3.6** The remaining two thirds of respondents expressed some concerns about the proposals, either on timing or content or on both. Many suggested a range of alternative approaches with a few recommending a default option.
- 3.7** On timing, a number of respondents made the point that reliance on the member's Nominal Benefit Age for the first communication could result in the person not receiving information at the correct time. For example, they may have decided to retire before the age they had originally nominated.
- 3.8** Others feared that reliance on the Nominal Benefit Age could encourage people to retire without considering flexible retirement options. For example, it could prevent them from understanding how these options to work and save for longer could improve their retirement income.
- 3.9** A number of respondents expressed concern about timing the second communication, containing the details of the fund, two to six weeks before the retirement date because this would not leave people sufficient time to make appropriate arrangements.
- 3.10** There were further concerns that reference to the scheme's default Nominal Benefit Age could lead members to believe that pension payments would commence from that date but the shorter of the proposed range

⁶ The member's Nominal Benefit Age is the age chosen by the member as the one at which he or she is most likely to take benefits from the scheme. When a member does not make a nomination, information will be sent at the scheme's default Nominal Benefit Age – which will be 65 until April 2020 and State Pension Age thereafter. For further details see: Consultation on draft scheme order and rules (Personal Accounts Delivery Authority and Department for Work and Pensions.) <http://www.padeliveryauthority.org.uk/scheme-rules.asp>

of timings for the second communication would not allow sufficient time for this to happen.

- 3.11** Many respondents felt that providing members with information about annuity options just before they were being asked to make such an important one-off and irreversible decision would be placing too heavy a burden on the members if they had not already been fully prepared for making that decision.
- 3.12** A significant number commented that communications required further, careful thought especially in light of the expected low financial capability of the personal accounts scheme's target group. One respondent suggested that the introduction of personal accounts provided an ideal opportunity for further research into innovative ways of delivering simplified and engaging member communications.
- 3.13** For this reason, many respondents recommended an educational approach to communications throughout the lifetime of the membership of the scheme. This would include generic information, for example, in the member's annual benefit statement, of the need to make a decision at the point of securing a retirement income.
- 3.14** In addition to this, many suggested a phased information package. For example, general information throughout the member's lifetime about the need to make a decision at retirement. This would be stepped up at age 55 and at regular intervals, such as every five years, up to age 75 to prepare members for making a decision on an annuity.
- 3.15** Many respondents commented on the content and form of the information to be provided. This ranged from information in advance to prepare members about the need to provide documents, such as birth certificates and bank details up to feeding members information to help them understand the potential effects on retirement income of taking different annuity options.
- 3.16** Responses discussed the merits of different channels for communicating annuity information to members. For example, reliance on established information sources such as the Pensions Advisory Service as well as technology such as mobile phones, automatic teller machines and e-communications. Others recommended the use of independent financial advisers.
- 3.17** Many commented on the presentation of communications, citing the need for clarity and simplicity. One suggestion was for simple up-front messages that signpost to more detailed information so that the member would be taken through manageable steps. A further suggestion was for the information to be simplified by only including relevant options, such as annuity purchase and not those, such as income drawdown, that were likely to be inappropriate.
- 3.18** A number commented on the language used in communications. For example, the terms annuity and *open market option* came in for particular criticism as lacking clarity and respondents felt that it would be more helpful to members for these words to be replaced by more descriptive terms that would aid understanding and increase member confidence in making decisions.
- 3.19** Those recommending a default option envisage that many of these problems could be overcome by providing all the details of the default option annuity on the first page of the communication sent to the member, with the rest of the information for those wishing to engage more actively with the process on subsequent pages.

Communicating annuity choices to personal accounts scheme members: some comments from respondents

“We think that the timing is important, but so also is the amount and type of information given at each point. Many users of our service complain that they get swamped with information at retirement, others that they are told to start thinking about retirement but get no help after that till the day arrives. We would consider it would be better for the second pack to be sent four to six weeks prior to the nominal retirement age, rather than build in variation between two and six weeks. If people are aware there is a nominal age, they expect their income to start at that date and two weeks does not leave enough time for the retirement process to be completed.”

The Pensions Advisory Service

“To help member understanding, additional information to provide in the run up to retirement (whether at the six month stage or earlier) could include:

- The need to gather together information about the different sources of income that will be available to them in retirement
- Information on life expectancy in retirement and the variability of outcomes (they will not all die young or at average life expectancy)
- An explanation or illustration of the effects of inflation

- Enhanced rates (lifestyle, ill-health, impaired life)
- Factors that affect the annuity income payable (i.e. age, gender, socio-economic group, tax free cash taken)
- The need to consider provision for spouse and that there is no automatic provision of a spouse’s pension
- No automatic return of fund on death and explanation of death benefit options (guarantee periods, value protection)
- Key steps/timetable of events/what happens next
- Information about obtaining financial advice
- Sources of further information (for example State Pension, means-tested benefits)”

Prudential

“Our internal rollover process and timeline broadly compares to the process you have outlined.” **Canada Life**

“Members can access their retirement savings at any point between age 55 and 75. The nominal retirement age is likely to be 65. It is crucial that the member is communicated with about their retirement options throughout their membership. This should be generic information prior to age 55 and gradually build up after that age” **Capita Hartshead**

Communicating annuity choices to personal accounts scheme members continued

“Individuals need to be made aware from the start of saving that there are two processes involved in a defined contribution scheme, accumulation and decumulation [...] The options presented in the paper appear to focus on retirement being a one off process, moving away from full time work and into full time retirement.

The move to extend working lives has to encompass encouraging and enabling a flexible approach to retirement, and this should be supported in the way Personal Accounts presents retirement options, for example:

In the information that individuals receive, by way of wake-up letters or other correspondence, they could be actively encouraged to explore the potential financial benefits of working and saving for longer.”

Equality and Human Rights Commission

“[...] Information about the member’s options and the service offered by the personal accounts schemes should always be available on the personal accounts website” **Which?**

“You are in danger of overloading members with information.

- This information could be parcelled up through the mechanism of a default annuity:
- On the front page, you would set out the key information pertaining to the default annuity;
- Turning over the page, you could set out the rest of the information for members keen to engage in the process of choosing their annuity benefit.”

Pensions Management Institute

“[...] there is a risk in relying on the scheme’s nominal retirement date for notification, as many members would have already decided to retire at this point and they would not receive the information in time.” **Just Retirement**

Structured choice for members

- 3.20** The consultation paper outlined a proposed two-stage *structured choice* process that would support members in choosing the right type of product and then choosing a specific product and provider. This would be either through the *open market option* or, for those preferring an alternative to the *open market option*, buying an annuity through the *focused choice* route using a panel of providers.
- 3.21** We set out the key information that we believe members would need to understand their pension options. We also outlined the information that they would need, to help them understand the impact of any choices they make when choosing an annuity type. For example, protection against inflation, providing benefits for a spouse or civil partner or another dependant.
- 3.22** An underlying consideration when formulating these proposals was the need to find the right balance between providing a service that meets the needs of the personal accounts scheme members and keeping costs low.

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

- To what extent have we identified the key components, and key questions, that will need to underpin our processes for helping members access retirement income products?
- Given the objective of delivering low-cost products that are easy to arrange, are there other types of annuity product we should be considering via the panel of providers?

What you told us in response

- 3.23** The majority of respondents to these questions believed that we had correctly identified the key questions and components that would result in a scheme member securing a retirement income, appropriate to their individual circumstances, through a basic annuity product.
- 3.24** A number of those respondents acknowledged that the *open market option* provided an alternative for those who wanted different products. They also felt that, for the majority of our members, especially in the early years when fund sizes were likely to be small, there would be relatively small gains for members from taking the *open market option*.
- 3.25** However, these comments were qualified in a number of cases with concerns about the suitability of the proposed questions and components for our members, in the light of their expected low financial capability.
- 3.26** A number of respondents believed that our members would have difficulty acting on or understanding the options, either because they would find them too complex or because there would be too many questions, leading them to switch off from the process. The question of using everyday language rather than pensions terminology was also raised in this context.
- 3.27** Respondents felt that members would not be able to make good decisions without any form of advice or assistance and that we had overestimated the financial capability and understanding of our target group.
- 3.28** One respondent highlighted that trustees have responsibility for providing members with the appropriate support and guidance.

- 3.29** A number suggested the need to signpost members to an independent financial adviser, for example, at the beginning of the process or at regular stages during the process. Although, many acknowledged that this would be more relevant to those with larger funds. A few respondents suggested referring members to alternative advice services such as the Pensions Advisory Service or the Financial Services Authority. Others recommended a telephone or postal service for those not comfortable with using the internet for such transactions.
- 3.30** The respondents who had recommended using a default annuity type, felt that the default approach would overcome many of the difficulties that members would otherwise face under the proposed *structured choice* approach.
- 3.31** Opinion was divided on the question of the proposed range of annuity types. Many respondents believed that offering a simple choice between level and escalating annuities, single and joint-life and a guarantee was pitched at the right level for the personal accounts scheme's target group and that offering more options would result in too complex a process for the majority of members.
- 3.32** A frequent comment was that these options would be suitable in the early years when fund sizes were likely to be low, but that more options could and should be introduced over time as fund sizes grew and member engagement increased. They recognised that, in the early stages, those wanting more flexible options or with larger funds, could find them on the open market.
- 3.33** Other respondents suggested alternative annuity products that we had not proposed, such as capital protected annuities or annuities offering investment growth and a guaranteed income. However, in some cases they recognised that these products were likely to prove expensive for those with small funds in the early stages.
- 3.34** Organisations representing consumers and a number of annuity and pension providers recommended that the *structured choice* option should include impaired life and enhanced annuities. They cited the need to achieve the best pension outcome, especially for those in the personal accounts scheme's target group, who were more likely to benefit from such products because of health and lifestyle factors.
- 3.35** A particular example was given of people with disabilities who are more likely to be on lower incomes, so building up smaller pension funds and whose needs may not be met under the range of annuity products proposed through the *focused choice* route. Other respondents argued the need to avoid members being disadvantaged by being offered an incomplete range of options.
- 3.36** Many respondents who recommended offering impaired life and enhanced annuities did so, on the grounds that such annuity types are becoming more widespread and the personal accounts scheme would need to keep abreast of innovations, such as lifestyle annuity products as well as postcode-based annuity products.

3.37 Many respondents believed that it would be difficult to cater for impaired life and enhanced annuities within the context of the proposed *focused choice* route. The reasons cited were the complexity of completing medical questionnaires online and the need to strike a balance between supporting members through the process of securing a retirement income and keeping costs low. Although others suggested that this would only require a simple, online questionnaire.

3.38 One significant observation emerging from a number of responses was that the range of annuity products provided under the *focused choice* option would need to evolve over time to take account of:

- increasing fund sizes
- increasing member engagement, as defined contribution schemes become more widespread and understood
- the need to keep pace with innovations in annuity products.

3.39 A number of respondents raised other questions about the administration and relative responsibilities of the scheme administrator and pension providers. For example, they commented on a need for clarity about who would be responsible for meeting legal requirements on Benefit Crystallisation Events⁷ and who would be responsible for making payments of the pension commencement lump sum or trivial commutation.

3.40 Others raised questions about how personal accounts would verify dates of birth or how we would deal with the need for wet signatures.

⁷ The term Benefit Crystallisation Event derives from tax legislation and refers to any occasion when a member of a registered pension scheme uses up part of their lifetime allowance. The legislation specifies the occasions and provides a means for calculating how much of the allowance is used up. For example, when pension rights are used to pay a lump sum or to pay a pension benefit.

Structured choice for members: some comments from respondents

“The paper outlines all of most significant areas we would expect to be covered in a conversation about retirement choices. However, it is the individuals that have unusual or difficult personal circumstances that will present the biggest challenge to the attempt to standardise process.” **AXA**

“We consider that you have identified the key issues and critical segments and have recognised that fundamentally different approaches may be needed for different groups of people.” **Mercer**

“Members of personal accounts will generally have little or no knowledge of pensions and the choices which they have to turn their pension pot into an income stream. So people need led through a simple process outlining when and where the need to make decisions – such as the ability to take all benefits under the triviality rules, the option of taking a tax-free lump sum and the ability to defer taking benefits. It would also appear beneficial to continually signpost the option of independent financial advice, or other options people have to get more information (eg Money Guidance, the Pensions Advisory Service) as people move through this process.” **Standard Life**

“Overall the approach that the personal accounts delivery authority is proposing [...] seems to strike a reasonable balance between enabling scheme members to shop around on the open market [...] and recognising that not all scheme members will wish to shop around [...] providing a focused choice alternative.” **Pensions Policy Institute**

Structured choice for members continued

“It is important in this process that the member is in a position to be able to make properly informed choices and is also aware of the financial implications of their choices. The situation to be avoided is where, for instance, a member decides on a *joint life* annuity and is presented with a quote for this option without realising that a much higher income would be available with a *single life* annuity. Members should be encouraged to revisit ‘stage 1’ if need be.”

The Pensions Regulator

“The communication wording will need to be as jargon free as possible, and as a sign of good intent, we suggest two examples of jargon that should be abandoned as soon as possible. ‘Decumulation’ is not a term in common usage and should be replaced by something like ‘pay out’. And the phrase ‘trivial commutation’ fails on two counts in that ‘trivial’ gives the wrong message to potential PA participants, and ‘commutation’ is not a term in common usage.”

Association of Consulting Actuaries

“We think that the choice available should also include Lifestyle and Underwritten annuities, which now account for about 20% of the market and rising.” **Institute of Directors**

“Postcode, enhanced, and impaired are all effectively conventional rate driven annuities and quotations for these products can be produced online in seconds. As such, a sufficient range of providers for all these products should definitely be considered for the panel. The only other forms of annuities are With Profit, Unit Linked and Flexible annuities. Whilst quotations for these products can be obtained online, they are not suitable for small pensions, and as such the PADA target market.” **MGM Advantage**

“If people with disabilities are not able to access the appropriate choice of annuity to maximise their income within the restricted choice option then their diversity is not being respected.”

Equality and Human Rights Commission

“We consider that the basic annuity product offering set out in the consultation paper is the right one, if the overriding aim is to keep costs to the minimum. The addition of further choice, even if potentially beneficial, is likely to start to increase costs and slow down decision making. Identifying potential purchasers of more complicated annuities, will itself add to costs, even if then dealing with them is straightforward.”

Society of Pension Consultants

“Hewitt does not believe other options need to be included [...] there should be regular reviews of this position so as to allow the introduction of innovative products subject to sufficient confidence in the robustness of their design.”

Hewitt, Bacon and Woodrow Limited

“We strongly support proposals for focused choice through a panel of providers, provided that they meet minimum standards [...] however, our support is conditional on the following:

- Adequate support within the process to ensure that those who are eligible for trivial commutation make a suitable decision [...]
- Coverage of impaired or enhanced annuities within the “focused choice” option.”

Age Concern and Help the Aged

Use of self-service channels and other technological solutions

3.41 We explained that, in order to keep costs low, we propose to maximise the use of self-service channels, such as the internet, to support members making choices about their pension fund. We wanted to find out how confident our members were likely to be finding and buying an annuity online. We also sought views on the potential of other electronic media in helping members choose annuities.

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

- How can we identify the numbers and groups of people who will need alternative communication channels to using the internet? What alternatives may be appropriate?
- What technological innovations are likely to make internet transactions more attractive?
- What views do you have on the potential to use other electronic media, such as digital TV, in helping members choose annuities?

What you told us in response

3.42 We received a number of suggestions in response to the practical question of how to identify those needing alternative channels. A number of respondents advised carrying out research, for example, among employees who would make up the potential target group or asking new personal accounts members to provide their e-mail addresses to broadly identify those with internet access.

3.43 We also received a number of comments about why some of our members may not or cannot use the internet, for example:

- incapacity
- geographical location
- religious or moral grounds
- affordability
- lack of access.

3.44 The majority of respondents, however, felt that our proposed internet-based solution assumed that the greater number of our target group would be familiar with using the internet for making financial transactions when this is highly unlikely to be the case.

3.45 Respondents believed that our members were unlikely to feel comfortable with using the internet to buy an annuity. They cited a number of reasons for this based on current patterns of internet usage and the likely experience of internet use of the personal accounts target group.

3.46 One of the main reasons put forward was the fact that people are generally content to use the internet to research financial products or to find out other information, but are reluctant to purchase long-term financial products online without the benefit of advice from another person, whether face-to-face or over the telephone.

3.47 They believe that our members would be all the more reluctant to purchase an annuity online as this would be a one-off and irreversible decision for which they would have no prior experience. Where people have experience of purchasing products or carrying out transactions online, they gain confidence in the process but, in the case of annuity purchase, they would lack that experience and confidence.

3.48 All of these considerations pointed to suggestions on alternatives to the internet. These included:

- a well-staffed call centre
- paper-based solutions, for example, using benefit statements to educate
- training the Pensions Advisory Service staff to help people through the process, but without providing advice
- using local authorities and charities as channels to support the message about maximising income.

3.49 A number of respondents suggested that the use of the internet for securing a retirement income would depend on the experience of our members during the accumulation phase. For example, if a member has little or no engagement with the scheme via the internet throughout the lifetime of their account, they were unlikely to feel confident in using the internet at the point of retirement.

3.50 This led one respondent to emphasise that the personal accounts scheme should clearly establish the internet as its primary communication channel and for any other channels used for communications to be closely aligned with the scheme's web presence and designed to encourage use of the internet over time.

3.51 Other factors that were felt to influence the use that people make of the internet were concerns about privacy and security and that if these concerns were properly addressed, more members would be likely to use it to carry out financial transactions such as purchase.

3.52 We received a number of suggestions about alternative technological innovations that could be used to assist annuity purchase and communicate with members. These included:

- mobile phone technology
- online chat
- webcams
- online advisers who can take remote control of a member's PC
- video broadcasts of a real or virtual person going through the process
- links to guidance services
- touch screen applications
- use of digital TV, although more for information rather than processing.

3.53 However, respondents advised against using new technology for its own sake but to ensure that the process was secure, simple, quick and easy to use with efficient interfaces and fast transactions.

Use of self-service channels and other technological solutions: some comments from respondents

“We think consumers may be reluctant to transact online, although the good news to counterbalance this is their willingness to buy other, annual insurances this way.”

Tax Incentivised Savings Association

“We do not have any information about the level of internet access for consumers in the PA market. However, internet usage demographic studies indicate that internet usage generally:

- applies to around 70% of the population;
- decreases as age increases (although this does not take account of future projections);
- is likely to be lower if you are less qualified;
- is slightly lower with women than men; and,
- is likely to be lower if income is lower.

All of which indicates that Personal Accounts should offer an alternative communication channel.” **HBOS**

“Depending on the type of client any other channel, including interactive TV, call centres and paper communications would be appropriate for those who are not IT literate and for those who have less than straightforward arrangements.”

Investment and Life Assurance Group

“At present the process is heavily paper-based, and using the internet as the main medium will be a significant change. To some extent the use of paper has been caused by requirements to get customer signatures [...] but there remains a preference among many people for having significant financial transactions

paper-based. Because current processes rely so heavily on paper, it is difficult to use past experience to assess the difficulties of internet-based processes.” **Scottish Widows**

“We understand that PADA has already undertaken some research into this area and expect further research will be performed in the time before launch. The key will be both to understand the channel preferences from the target audience and to quantify the likely volumes [...] this will include [...] the segmentation of audience against internet penetration, mapping to socio-economic groups and estimating propensity to actually use different channels.”

International Financial Data Services

“You will need to consider alternatives for those who are not comfortable on the internet, and in the end a well staffed call centre [...] may be required [...] indeed we wonder whether members should be encouraged to make such an important decision using only online tools.”

Association of Pension Lawyers

“We believe PADA could make the internet a default option and communicate with members via email and internet throughout the accumulation phase, making it a natural extension to procure the retirement product online. However, for those members that cannot or will never consider going online, create an opt out choice and provide an offline paper version. Alternatively, consider if there is some kind of government branch they can visit to get access to an internet kiosk.” **MGM Advantage**

Use of self-service channels and other technological solutions continued

“A dedicated telephone helpline along with basic ‘hard copy’ scheme booklet and factsheets providing general information on the Personal Accounts scheme would be alternative methods of communication.”

National Association of Pension Funds

“We perceive that there will continue to be a need to have some sort of interaction with someone at the point of buying an annuity. If the purchase has to take place over the internet, we would imagine that there could be links to a service that could give some guidance – for example a Voice Over Internet Protocol (such as Skype) link to a helpline or IFA, or a web link to planning tools etc. Alternatively, there may be some way of broadcasting an example of someone going through the same process – whether that be a video of a real person or a virtual reality-style video guiding the user through the steps they need to take.”

The Pensions Advisory Service

“[...] the process needs to be fast, simple, convenient and fully automated. Access at libraries/workplace (with people available to provide help) will be important as well as the possibility of using touch screens – the process needs to be as simple as using a bank cashpoint. It would also be helpful to

provide a high level ready reckoner that can provide indicative estimates of the impacts of selecting annuities with escalation, spouse pension etc.” **Friends Provident**

“The major issues around the use of internet transactions are concerns about privacy and security [...] provided these concerns are addressed we do not see any reason by most scheme members should not be able to conduct their research and confirm or purchase their annuity online.”

Association of British Insurers

“Our own research suggests that online proposition with call centre support would be the most acceptable approach but other delivery options should be investigated if consumer uptake of alternative media were to increase.” **Legal and General**

“As digital television continues to replace analogue it seems reasonable to assume it could provide a useful information channel, particularly for those customers who do not have access to the internet. However interactive digital TV has yet to make the impact of the internet and may be suitable more as an information source than a transaction channel.” **Norwich Union**

Exceptional cases

- 3.54** In *Building personal accounts: securing a retirement income*, we sought views on our proposed approach when a member has not engaged with the retirement process and has not secured a retirement income by age 75.
- 3.55** We also sought views on the approach to take if the member did not provide bank details and on how to cater for members with whom the scheme has lost contact and for non-UK members.

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

- What are your views on our proposal for the trustee to buy an annuity for members who reach age 75 and don't get around to choosing an annuity?
- What good practice can you share regarding how to deal with making payments to members who have not provided bank account details?
- How should we address any issues raised by the need to support non-UK residents through the process of securing a retirement income?

What you told us in response

- 3.56** The proposal to provide a default annuity at age 75, where a member is in contact with the scheme but has not engaged with the process for securing a retirement income, prompted a wide range of comments.
- 3.57** A number of respondents commented that the incidence of non-purchase of an annuity by age 75 was likely to be very small, although some acknowledged that this could be greater in personal accounts than in other occupational defined contribution pension schemes.
- 3.58** A large proportion of respondents believed that a default was the right approach if the personal accounts scheme was in contact with the member. Many highlighted the importance of making clear from the outset, the approach of providing a default annuity at age 75 and of pursuing attempts to contact the member to encourage them to engage with the process after their Nominal Benefit Age.
- 3.59** The respondents who recommended offering a default annuity type from the outset, believed that their suggested approach would encourage members to engage with the process and avoid the issue of non-purchase of an annuity by age 75.
- 3.60** Those who opposed the proposed default annuity at age 75 raised a number of points. The most common being the risk of purchasing an inappropriate annuity, especially if the scheme did not have sufficient information about a member's specific circumstances, such as state of health or marital status. One example was if a married member died shortly after the purchase of a *single-life*, non-guaranteed annuity. This led to the suggestion of providing for a guarantee on *single-life* annuities.

3.61 Others expressed concerns about the administration of such an option, for example, how payments would be made if the scheme did not have bank account details, including the additional complexity and costs.

3.62 Other points raised were:

- The potential for trustees choosing a default annuity coming within the scope of regulated financial advice.
- The need for the pension provider to have information about the member in order to underwrite the annuity.
- The need for the personal accounts scheme to have engaged effectively with the member to avoid such situations arising.

3.63 Some respondents proposed an *alternatively secured pension* or an unauthorised payment as alternatives to a default annuity. Some also suggested that the tax payments that would have to be made to HM Treasury could act as an incentive to purchase an annuity. Another response proposed paying as a cash sum any fund meeting the £2,000 trivial commutation rules.

3.64 Where a member was not traceable, respondents suggested that the member's fund should remain in suspense in the scheme or be used to provide an *alternatively secured pension*. However, they also flagged up the need to consult death records.

Draft scheme order and rules

3.65 The draft scheme order and rules make provision for a default annuity shortly before age 75 and provision for dealing with untraced members.

3.66 Where a member has not engaged with buying an annuity by age 75, the draft scheme order and rules would enable the corporate trustee to use the member's fund to provide a lump sum and to purchase a *single-life, non-escalating lifetime annuity* with the balance, in the name of the member.

3.67 In the case of a member who cannot be traced by age 75, the draft scheme order and rules allow for the member's account to be held in suspense either until the member is traced or the member dies. If the member is still untraced when he or she would have reached the age of 105, their account would become forfeited.

Paying annuities

3.68 Half of the respondents to the consultation addressed the issue of how to make payments to members without bank accounts. Many of these comments were based on the respondents' own experiences.

3.69 Most recommended making the provision of bank account details mandatory as electronic transfers offer the most secure and least expensive option. They recommended restricting the use of cheques to starting payments but requiring a bank account for subsequent payments.

3.70 A number of respondents suggested the use of a Post Office payment card for those unwilling to open a bank account, however, we were not told of any direct experience of using such an approach.

- 3.71** An alternative suggestion was the use of a payment card that could be charged with the person's pension payment and then used to withdraw money or for making payments in shops.
- 3.72** A number of solutions were put forward to deal with the issue of payments to non-UK nationals. Many of those responding believed that there were already sufficient provisions and procedures in legislation and guidance issued by HM Revenue and Customs, as well as in legislation allowing for transfers to overseas arrangements.
- 3.73** In practical terms, a number of suggestions were put forward, such as:
- paying in sterling and the recipients arranging their own foreign exchange
 - the provider paying in the member's local currency, with the member bearing the cost of conversion being normal practice.
- 3.74** Some respondents mentioned the need to make recipients aware of the need to comply with local legislation regarding tax, marketing of annuities and currency payments. Although, it was recognised that matters would be more straightforward with EU countries. Others raised the difficulties arising from money laundering legislation.
- 3.75** However, one of the potential issues that was highlighted was the need to maintain contact with members, possibly through e-communications, in order to ensure that they can engage in the process at the point of retirement.

Exceptional cases: some comments from respondents

“One could argue that those who have arrived at age 75 without vesting their personal account must have adequate other means and so the additional income from the annuity is not important to them.”

UK Shareholders Association

“Standard Life's experience is that a very small number of people don't get around to choosing an annuity, less than 0.1 % of people reaching retirement. The majority of these are because we can't contact the individual, although some are due to the individual not making a choice.

There is a possibility that personal accounts will have a higher incidence due to the fact that members are auto-enrolled and so have less involvement in their saving. However, we would still expect the numbers involved to be very small.”

Standard Life

“We would counsel caution here. On what basis would the annuity be purchased? Certain insurers have this practice written into their Personal Pension terms and invariably attract bad publicity when, as is inevitable, they purchase a standard annuity with no survivor's benefit for a critically ill 75 year old who is still married.”

Legal and General

“[...] while we broadly support empowering the trustees to purchase an annuity on the member's behalf [...] there is a risk of considerable consumer detriment where a decision is made without full understanding of the member's circumstances.”

Financial Services Consumer Panel

Exceptional cases: some comments from respondents

“The age 75 rule combined with the obligations of occupational pension trustees provide a clear case for the trustee to buy an annuity for those members who have made no active choice of annuity by age 75 despite best efforts to contact them.”

Norwich Union

“The provision of bank account details should be a mandatory part of the annuity purchase process. This will reduce any delays in making payments and avoid the high cost of making payments by other means, such as by cheque.”

Standard Life

“We are working with our clients to eliminate cheque payments [...] we can provide a pre-paid card facility. The card can be issued to members and benefits loaded on to this card at regular intervals [...] such a facility can be issued at no initial charge and without attracting transaction charges when used in retail outlets and for the withdrawal of cash once a month.” **Xafinity Paymaster**

“For annuity providers particular issues relating to overseas annuitants arise because of complexities in different personal taxation rules, any double taxation agreements and different bank account processes and other requirements.

From an annuity provider’s point of view the simplest and most cost-effective option is for payments to be made into a UK bank account and then repatriated by the annuitant. This means that the provider does not have to be engaged with the cost and complexity arising from overseas taxation and banking requirements.” **Prudential**

“Providing an income to non-UK residents is only practical if annuity providers can pay a gross income and advise customers to assess this in the context of their domestic tax regime. In addition:

- Non-UK residents should be directed to access advice as the decumulation process particularly for non-EU residents may be incompatible with the pension rules in their resident country.
- Non-UK residents will not have access to the OMO therefore there must be a mechanism for the trustees to buy an annuity on their behalf.
- Equally some countries (such as the USA) forbid the marketing of insurance, investment and annuity products from non-authorised providers and consideration must be given to the legality of some communications.”

Norwich Union

“We have heard from at least one overseas resident who is having problems receiving income from a UK account, apparently because of money-laundering regulations. We also hear regular reports about the costs of money transmission overseas. PADA cannot be expected to solve all these potential difficulties but we recommend that PADA should:

- Ensure that any non-resident members are made aware of the trivial commutation option where possible.
- Require members of its focused choice providers panel to sell annuities to non-UK residents. Even if it is not possible to pay their annuities in overseas currencies, we would hope that they could explore offering a link to a reputable money transmission service.”

Age Concern and Help the Aged

How PADA will take this forward?

Designing personal accounts

3.76 Respondents have provided many practical examples of ways in which messages about securing a retirement income could be communicated to members, in terms of timing and content.

3.77 We do not underestimate the importance of providing our members with the right information at the right time and this constitutes a significant part of our continuing design work.

3.78 The scheme will provide effective information and communication to members in order to:

- ensure they are fully aware of the choices available to them and the effects of taking various options.
- make it clear to members that an IFA might be able to assist them in selecting their retirement income, the member can then decide whether to explore this option at their own cost.
- work towards delivering an effective lifetime engagement strategy to avoid losing contact with members, regardless of the size of their pension fund.

3.79 Our intention is to make maximum use of e-based solutions in order that the costs to scheme members are kept to a minimum. To this end, we will design a process that will allow our members to follow an online journey from beginning to end.

3.80 We plan to work with annuity providers and other stakeholders to explore ways in which the annuity purchase process can be made more efficient and also executed primarily through electronic channels. We believe that a move to more efficient ways of working would be mutually beneficial for the scheme and its members, annuity providers and the wider pensions industry.

3.81 We recognise, however, that for some members, there may be points in the process where they will need to seek support that is provided off-line. We continue to consider what additional, off-line support is likely to be necessary and at which points in the process, as part of our ongoing work in this area.

3.82 We do not propose to offer flexible retirement options via the *focused choice* process, at least, in the early years of the scheme. This is because flexible retirement options are usually better suited to people with larger pension funds and we believe that personal accounts scheme members would be generally better served by the one-off purchase of a lifetime annuity.

3.83 This position will be reviewed as the scheme evolves and fund sizes increase. In the meantime, those members seeking flexible retirement arrangements will have the option of transferring their funds out of the scheme from age 55 onwards.

Chapter four

Supplying annuities

While many personal accounts scheme members will be willing and able to use the *open market option* to select an annuity type and provider, some will want an alternative. We proposed this could come through a panel of providers who would have to meet certain criteria in order to serve members' needs.

We sought to establish how to make a panel of providers operate effectively, how to select panel members, how often to review this membership, what technologies were in place to enable the scheme and providers to work together effectively and whether there were alternatives to our proposed panel of providers model.

Responses were divided in some areas with the regularity of reviews in particular generating a wide range of opinions. However, other questions, particularly those around technological solutions and selection of panel members, generated a far more consistent range of answers.

Many responses suggested PADA should engage further with the potential supplier market in order to deliver an optimal solution and we will pursue this before finalising our options for supplying annuities to our members.

Issues for personal accounts

Designing a solution

4.1 Many personal accounts scheme members will be happy to use the *open market option* to shop for annuity products and providers across the full range available in the market. However, some will not and we need to offer an alternative for this group.

4.2 Currently many defined contribution occupational pension schemes do this through provision of a default product and/or provider, which can remove the need for a choice. But, in many cases, this default product might not offer the features that suit a member's individual circumstances or the provider might not offer good value for the scheme member.

4.3 In *Building personal accounts: securing a retirement income* we considered how to provide annuities for scheme members who did not want to use the *open market option*. We identified a number of important factors any solution we designed should have, including:

- **Promoting competition**, as we felt using a single supplier could potentially distort the annuities market in the longer term given the likely scale of the scheme and that there could also be limited incentives for any single supplier to offer competitive prices.
- **Protecting members interests**, by being set up in a way that would attract high-quality suppliers able to deliver good value annuities in a timely manner.
- **Providing support but not regulated financial advice**, since it is unlikely to be appropriate for this to be delivered through personal accounts.

Alternative options

4.4 We considered alternative options for supplying annuities to those members who did not want to use the *open market option*, including:

- **the scheme providing its own annuities**, which we rejected on the grounds that it could expose the scheme to the financial risks of incorrectly forecasting members' longevity.
- **bulk purchase of annuities**, which we rejected as it could create administrative difficulties and inflexibility for both scheme members and potential suppliers without generating any gains from economies of scale.

A panel of providers

4.5 We instead proposed that personal accounts could offer a panel of providers, whose members would meet all the legal requirements to trade in this market, but would also:

- **operate systems that link to personal accounts** in order to enable fast, accurate and low cost electronic quotes and transactions.
- **compete for members' funds** through the need to quote for all business, including small fund sizes on at least the same terms as are available through the open market.

- **deliver minimum standards** for security, administrative capability, financial viability.
- **enable comparisons** through provision of common product features.
- **guarantee quotes** for a minimum period in order to allow purchases to be completed.

The questions we consulted on

4.6 We sought in Chapter four of *Building personal accounts: securing a retirement income* to establish how we could make a panel of providers operate effectively, how to select members, how often to review membership, what technologies were in place to enable the scheme and providers to work together effectively and whether there were alternatives to our proposed model.

Making a panel work effectively

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

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

What you told us in response

4.7 Around three quarters of responses addressed this question with responses being received across a wide range of organisations.

4.8 A number of different issues were picked up in responses, including:

- the need for clearly defined and rigorously monitored minimum service standards covering areas such as timeliness, charges, information supplied, minimum fund values that will be accepted, providers' financial strength
- the need for consistency of approach, and possibly pricing, to enable like for like comparisons
- the need for a robust technological solution allowing real-time quotations, applications and purchasing
- the need for a range of providers able to cater for individuals' circumstances, including ill health
- the need for the panel to be attractive enough that a range of providers are willing to join, as this will afford customer choice etc
- the need for flexibility to allow for providers' different approaches, for example some might use postcodes to help determine annuity rates, whereas others will not.

Making a panel work effectively: some comments from respondents

"The main consideration is consistency of approach. Providers should follow the same processes and offer the same general terms, though obviously the rates offered may differ."

Scottish Widows

"The 'terms of engagement' with the panel providers will have to be negotiated so that the annuity purchase process is workable – for example, 'real time' annuity quotes and consistent guarantee periods for the quotes."

Association of Consulting Actuaries

"Rates offered by all panel providers need to be competitive (perhaps with a guarantee that the difference between the lowest and highest price is no more than a certain percentage). Good automation, service levels and solvency levels are also important." **Friends Provident**

"A price guarantee safeguard would be required – for instance, all members would have to offer annuities within X% of the highest rate available via the Open market option."

Hargreaves Lansdown

"As part of a transparent purchase process the most important factor will be the availability of simple product information which is provided to an agreed timetable in a consistent format by all members of the panel."

National Association of Pension Funds

"For Account members: Sufficient choice of providers with consistently competitive rates for their circumstances, efficient service with attention to Treating Customers Fairly principles across all aspects of the process."

Just Retirement

Making a panel work effectively continued

“There needs to be a simple robust e-commerce solution with the appropriate governance in place [...] If PADA proceed with a panel approach as currently envisaged, they should not allow providers to offer different rates depending on fund size.”

Standard Life

“Ultimately if providers are discouraged from participating in the panel the effect will be to reduce competition and member choice. Therefore the process of joining the panel, and the administrative operation of the panel, cannot be too onerous or costly otherwise providers may not engage with the process [...] It will also be important to ensure that participants are not able to ‘cherry pick’ only the most commercially valuable cases from the membership pool. Participants should therefore be required to offer competitive quotes across the whole range of member ages and fund sizes.” **Prudential**

“[...] providers should be required to meet initial and ongoing minimum criteria defined by the trustee including:

- reliability and financial strength;
- capability to build and maintain direct interfaces with the scheme administrator’s systems to facilitate straight-through processing;
- adherence to minimum service level standards; and
- agreement to a standard e-process way of working and standard levels of information that will be provided by the scheme administrator.”

Canada Life

“Another key consideration would be the need to provide incentives for members of the panel to provide annuities from small funds [...] It will therefore be important to devise other means of attracting providers onto the panel, for example by a guaranteed minimum tenure or a particularly cost-effective method of processing business from the scheme to the annuity provider.” **Society of Pension Consultants**

“There must be enough providers to ensure that the rates are competitive but not too many resulting in a great spread of business that makes the volumes unattractive, particularly in the early years when pots are likely to be small.”

Xafinity Paymaster

“The process of joining the panel must not be too onerous otherwise providers may not engage with the process.”

Association of British Insurers

“[...] a binding declaration that members will not price against small considerations, development of common procedures so that the process is transparent to the member regardless of provider choice, a specified level of technological capability, and an agreement to operate an 14 day guarantee of the annuity rate quoted.” **Legal and General**

“[...] ensuring standardised communication (content and format) between the scheme administrator and current members of the panel will be essential to the efficient operation of the panel approach. We also believe that it will be necessary to set up the panel in such a way that the choice of annuity provider is clearly financially neutral to the member (e.g. all panel members to agree on applicable charges, etc.)” **International Financial Data Services Limited**

Selecting panel members

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

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

What you told us in response

4.9 Around two thirds of respondents addressed this question with almost all of them believing that the members of any panel should be selected through either bidding or registering interest; respondents did not feel that an invitation only approach was appropriate and some respondents felt this would appear biased.

Selecting panel members: some comments from respondents

“We think it should be by an open bidding process.” **AXA**

“In order to ensure that selection is fair and transparent, potential panel members should be given the opportunity to bid or register interest.” **Mercer**

“We believe that PADA should draw up criteria to illustrate how the scheme should operate for the consumer and invite any firm who is prepared to meet those criteria to bid.”

Financial Services Consumer Panel

“[...] potential panel members should just be asked to register interest or tender for membership. PADA will obviously need to check that the firm is reputable but if they are authorised by the FSA then they are already bound by a raft of regulations.” **HBOS**

“There should be an open tender.”
Friends Provident

“This should be done through an open tender process, in the normal way.” **Scottish Widows**

“Selection should be through open competition.”
The Pensions Management Institute

“Our preference is for a competitive tender process. An invitation-only approach may be perceived as favouring particular insurers.”
Association of Pension Lawyers

“The number of firms providing annuities in the UK market is relatively small and therefore the panel could initially include any annuity provider which meets PADA’s criteria as outlined in the paper. As the market grows potential new entrants may prompt PADA to invite bids from any interested parties which could be selected on the basis of value/return to customers, efficiency, innovation, brand recognition and stability. This would ensure the panel remains vibrant, customer focused and recognisable.” **Norwich Union**

Selecting panel members continued

“Potential members should be allowed to register their interest.”

Investment and Life Assurance Group

“Providers should be given the opportunity to register interest and then assessed against a consistent set of benchmarks”

Just Retirement

“All panel members who are prepared to meet the standards should be given the opportunity to bid.”

Age Concern and Help the Aged

“We believe any provider who meets appropriate quality standards should be able to bid to be on the panel.” **TUC**

“Apart from the usual financial strength and other hygiene factors, we believe the focus for selection should be on customer service, ease of use, online capability, ABI Options membership, simplicity of product literature, ease of process, and simplicity and shortness of forms.” **MGM Advantage**

“We suggest potential panel members are given the opportunity to bid or to register interest through a fit and proper procurement process.” **Aegon**

Reviewing panel membership

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

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

What you told us in response

- 4.10** Responses to this question were very mixed, with suggestions ranging from a regular yearly review process through to considerably longer arrangements where reviews took place every 10 years.
- 4.11** Those respondents favouring regular reviews felt these would be necessary in order to ensure that the members of any panel operated consistently in the scheme members’ best interests and that pricing, providers’ financial security, service levels and products could regularly be checked, with underperformance dealt with through changes to the composition of the panel.
- 4.12** Respondents who favoured longer review periods concentrated on the need for the members of any panel to make a reasonable return on their investments in new systems and business processes required to work effectively with the scheme. These longer term arrangements would help them cater for the large number of smaller, less profitable, pension funds that the scheme is likely to generate, particularly during its early years.

Reviewing panel membership: some comments from respondents

“The “panel” should probably be appointed in the first instance for a 5 year run at least, because the initial volume of business will be very small, as will the “pot” sizes.”

Institute of Directors

“We recommend that the membership of the panel is formally reviewed regularly, but no later than at least every three years. However, constant monitoring of the competitiveness of the rates on offer must be carried out. It is important that members of the public are confident that panel providers will provide them with value for money and a good service.”

The Pensions Advisory Service

“Given the low average value of annuities which is likely, and the low numbers of people reaching retirement age in the early years of personal accounts, providers should have an initial contract for a period of ten years. This will allow companies time to recoup the initial outlay which will be required to build the necessary systems and infrastructure to enable the personal accounts scheme to seamlessly interact with annuity providers. Membership can then be reviewed at five yearly intervals thereafter.” **Standard Life**

“The panel of providers should run for an initial period of 10 years so long as the selected providers continue to meet the minimum qualifying criteria defined by the trustee. This is in line with the scheme administration contract and will give annuity providers the opportunity to write larger annuities later in the contract. There is likely to be a reasonable amount of development effort required by the annuity providers in order to interface with

the scheme administrator and offer scheme members straight-through functionality. Providers are unlikely to want to invest significant time and money if panel members are reviewed and changed/replaced regularly.”

Canada Life

“We suggest that from a cost control point of view, the minimum review period should be annual.” **Society of Pension Consultants**

“This is a delicate judgement. Panel members will want to see an initial term of sufficient length to justify the costs of any technology or system developments they have to undertake in order to achieve membership. On the other hand, too long a term may result in a barrier to entry for potential future panel members. We suggest ten years.” **Legal and General**

“On a bi-annual basis as a minimum with immediate review if any of the panel providers should experience any specific business problems within the proposed two year period between formal reviews.”

National Association of Pension Funds

“To ensure that it works effectively, we would suggest that the Trustee Corporation be supported, in terms of selection of panel members and regular panel review (at least, yearly), by an independent financial adviser with considerable experience of the annuity market.”

HSBC Actuaries and Consultants Limited

“The personal accounts scheme would need to regularly review the membership of the panel to ensure that it offers the best possible annuity rates to personal accounts members.”

Which?

Technology to make the panel work effectively

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

- What technologies are available or are being developed that would facilitate the interface between the personal accounts scheme and providers?

What you told us in response

- 4.13** Just over half of respondents addressed this question, with responses most commonly coming from the pensions industry.
- 4.14** The Origo Options system was by far the most frequently mentioned technological advance, and it was widely felt this could facilitate links between personal accounts and annuity providers.
- 4.15** The Origo Options initiative is designed to facilitate the secure electronic data exchange of information necessary to enable annuity purchase to be completed. Other areas being addressed within Options are the standardisation of application forms, giving providers the confidence to rely on each others' information and improving the flow of information to HM Revenue and Customs.
- 4.16** Other respondents also mentioned online quotation, application and policy issuing systems used by companies such as Webline, which could also facilitate whole market annuity brokerage services, effectively opening up an assisted *open market option* route.
- 4.17** There was a general feeling that most of the appropriate technological solutions are already available and that this should not prove a significant barrier to successful operation of any panel of providers.

Technology to make the panel work effectively:

some comments from respondents

“Origo messaging standards provide a good indication of what can be achieved in this area.” **AXA**

“It is critically important that PADA discusses the development of these interfaces with Origo, which is responsible for developing the industry level standards for electronic services and interfaces.” **Prudential**

“The Origo Options system, sponsored by the ABI, is already live. At the moment, it is being used for insurance company-to-insurance company transfers for annuity purchases only, but it is envisaged that this will be extended to other product lines in the future.

A number of whole market internet annuity broking solutions are already available in the market place such as Weblines. As well as online quotations and sales documentation, these are increasingly automating the online application and policy issue processes.”

Capita Hartshead

“An extension of ABI’s ‘Options’ process might be ideal, although it accepted that this is in its early stages and has yet to prove itself.”

Investment & Life Assurance Group

“Insurance companies are currently piloting an automated process (known as Options) which should be usable for Personal Accounts.”

Scottish Widows

“We understand that leading annuity providers have just developed a system called “Options” in conjunction with the software firm Origo, and we recommend that you investigate this further.” **Pensions Management Institute**

“[...] providers’ initial experience of Options has been extremely positive. It could easily be used to expedite the transfer pension funds between the Personal Accounts scheme and the chosen annuity panel member, and would result in greater efficiency.”

Association of British Insurers

“We are supportive of the proposed suggestions contained in the consultation paper and strongly agree that a technological solution is vital to make the process viable. Key points that need to be addressed include providing investors access to;

- clear educational information covering the question of annuity shape,
- an interactive annuity retirement planner that incorporates a facility to email questions,
- real-time annuity quotes (that allow the investor to bespoke their annuity to their own circumstances)
- a final stop facility allowing investors telephone access to a guidance helpdesk
- and crucially, the functionality to complete the transaction online”

Hargreaves Lansdown

Technology to make the panel work effectively continued

“During 2008, Origo worked closely with 15 Providers and ABI to develop Options, a Provider Data Exchange, the purpose of which is to make the process of carrying out an OMO Pension Transfer quicker and more efficient, with beneficial outcomes for the customer [...] Early results from the operation of the service suggest that Options is having a significant effect on OMO transfer times.” **Origo**

“ABI Options initiative has created a slicker process for OMO transfer and thing like this should be considered to ensure the time to process the annuity purchased is minimised.” **MGM Advantage**

“We recommend Origo is consulted in the design of the transfer process of funds between the personal accounts scheme and annuity providers, to increase efficiency [...] We strongly recommend PADA joins options as a ceding provider.” **Aegon**

Alternatives to the panel of providers

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

- What alternatives to the panel of providers model should we consider to address these issues?

What you told us in response

4.18 Around two thirds of respondents addressed this question. Many felt that a panel was the best option, but a variety of alternatives were suggested, including:

- members using the *open market option*, potentially with some support via an annuity brokerage to do so
- a ‘white label’ panel, where several annuity providers offer identical products and receive a share of the total business, potentially via a carousel arrangement that operates without members’ choice
- a single annuity provider
- self-annuitisation, where the scheme provides its own annuities
- bulk annuity purchase.

Alternatives to the panel of providers:

some comments from respondents

“We can see no other alternative.”

The Pensions Advisory Service

“The only alternative would be that members will be required to access the annuity market themselves, either through an adviser or through direct contact with annuity providers. This could be through online access, telephone or through face to face advice. While this is achievable technically, given the anticipated low levels of engagement with the retirement process of many Personal Account holders, such a requirement is unlikely to be appropriate as the only option available to members.” **Prudential**

“We believe using a panel of providers is a suitable format. However, we would suggest that instead of the member being given multiple options of provider, a member is given one annuity price depending on their choices. This can be achieved by using a white-labelled carousel system with various providers operating in the background.” **Standard Life**

“We cannot think of a better option to the panel which is why it is so important that it is made to work.” **HBOS**

“An open market option supported by a portal would seem to be an attractive alternative. It would also make the open market option a more attractive and convenient alternative – otherwise very few members are likely to go to the trouble themselves of contacting a provider to arrange the OMO.” **Friends Provident**

“[...] we prefer to see a ‘broking’ type model rather than a defined panel of providers.”

Buck Consultants Limited

“An alternative suggestion is PADA considers a carousel solution for the focused choice panel. Under this suggestion, each provider will be allocated a fair share of business, on both size and membership, instead of the member being forced to make the decision.” **Aegon**

“Possibly a composite fund operated by several main annuity providers, who would all offer exactly the same product/flat rate. However, this could cause issues regarding comparison with their open market rates.”

Investment & Life Assurance Group

“The alternatives are using a single annuity provider, attempting to go for whole of market and the personal accounts scheme becoming an annuity provider in its own right. Compared to the panel model none of these is satisfactory in terms of competition and efficiency or treating customers fairly.”

Legal and General

“Given the volumes involved and the nature of funds we believe that a panel is an appropriate method of working or a whole of market process using a simplified advice process.”

Just Retirement

“Although we appreciate that self-annuitisation may not be possible at present, we recommend that PADA does not rule it out for the future. PADA may also want to consider contracting out the whole operation to a specialist independent bureau if the economies of scale that presented meant that specialist support could be offered to those that need it at minimum cost without prejudicing the interests of other members.”

Age Concern and Help the Aged

Alternatives to the panel of providers

continued

“PADA could reconsider its position – set out in the consultation document – on providing annuities to the target group via the scheme (self annuitisation) or the purchase of bulk annuities from the insurance market which it believes to be outside the scope of the Personal Accounts scheme.”

National Association of Pension Funds

“[...] PADA should establish a consortium/ pool of providers through which they broker annuities for members who do not opt for OMO.” **The Institute of Chartered Accountants in England and Wales**

Other issues

4.19 A few further issues were raised as a result of responses to the questions in this chapter, principally:

- Some annuity providers may require minor system changes to allow them to pay tax-free cash on behalf of personal accounts, since currently their systems could treat transfers (where they pay the tax-free cash) differently to *open market option* purchases (where the tax-free cash is paid by the ceding provider), for example triggering production of different documentation.
- Whether the scheme would accept the member’s fund back if the member cancelled their annuity purchase after their funds have been transferred to the annuity provider.

- Whether the scheme would accept the member’s fund back if the member dies between the date of annuity selection and the date the annuity is set up and whether the scheme would then treat that member in accordance with the scheme’s death before retirement provisions.

How PADA will take this forward?

Designing personal accounts

4.20 The responses to some of these questions have raised interesting issues that will require further exploration.

4.21 Many respondents suggested that PADA should engage in further discussions with the market in advance of deciding on how to provide annuity options to its members and we will pursue these meetings in order to decide on the most appropriate method to serve our members.

Other issues

4.22 We will work with annuity providers that members will have access to through the *focused choice* process, to establish efficient ways of working when a member cancels the annuity they have chosen.

4.23 We acknowledge that we face similar problems to other pension schemes where members choose an annuity by way of the *open market option* and then change their mind during the cooling-off period. We are keen to work with the pensions industry to identify how best to deal with those cases.

Chapter five

Taking small pension funds as cash

Personal accounts scheme members are likely, at least in the early years of the scheme, to have small pension funds. Currently they could struggle to find an annuity provider willing to deal with them and so it is important that we design the scheme to ensure that they have a range of good value choices available and they are not penalised as a result of their fund size.

We considered why members could have small funds and what options were available to support them in accessing their retirement savings. Generally respondents believed that we had identified the correct issues and felt these applied to all defined contribution schemes rather than just personal accounts. However, some respondents felt we had underestimated the difficulties these issues presented. Examples, include legislative or administrative barriers that make transfers out of the scheme to consolidate pensions problematic.

Some responses felt that the annuities market would start to cater for smaller funds if costs could be reduced and processes made simpler since they would become more viable for providers and advisers to deal with. Other responses felt that a change in legislation would be required, however, this is outside the scope of our consultation.

Why members are likely to have small funds

- 5.1** Personal accounts members are likely, at least in the early years of the scheme, to have small pension funds because of a number of scheme features, including:
- short periods of contributions
 - in general, no transfers into the scheme
 - a cap⁸ on contributions
 - a focus on moderate-to-low income earners.

The key issues with small funds in personal accounts

The availability of annuities for small funds

- 5.2** Currently it is difficult to buy an annuity on an *open market option* basis with a low fund value. Availability varies depending on market conditions but relatively few providers will accept amounts lower than £10,000 and even fewer take funds under £5,000. Other retirement income products such as drawdown tend to require far higher amounts than this, generally £50,000 and upwards.

⁸ Set at £3,600 in 2005 earnings terms and to be updated by average earnings.

5.3 Many existing occupational pension schemes deal with this issue by having a default annuity provider who agrees to accept all funds regardless of size. However, this can often leave the member with only the default provider prepared to offer them an annuity, which might be on relatively poor terms.

5.4 While there are good reasons to believe the market could move towards being able to provide annuities for smaller pension funds, for example, if electronic transactions and electronic verification of member details reduced set up costs, the personal accounts scheme cannot plan on the basis that all members will necessarily be able to access a choice of good value options without the scheme making some arrangements to help members.

Taking small funds as cash

5.5 Members with smaller pension funds may also have the option to take these as cash rather than converting them into an income. This is subject to the member's fund meeting certain legislative constraints:

- Where a person's total savings in all their pensions are below one per cent of the lifetime allowance,⁹ the member can take the full amount as cash, 25 per cent of which is tax free and the rest taxable – this is known as trivial commutation. Members must be aged between 60 and 75 and can only take this option once in their lifetime and within a 12-month period.

- The Registered Pension Schemes (Authorised Payments) Regulations 2009 will allow people in larger occupational pension schemes, with individual occupational pension funds not exceeding £2,000 to take these as cash.¹⁰

The questions we consulted on

5.6 We sought in Chapter five of *Building personal accounts: securing a retirement income* to consider the options for ensuring that members with smaller fund sizes were not disadvantaged as a result of their fund size.

5.7 We considered a range of options to ensure that our scheme members did not have stranded pensions, including:

- information to help members be aware of the consequences of having smaller funds
- increasing fund sizes by allowing the funds to remain invested until they reach a viable level
- combining funds via transfers out of the personal accounts scheme from age 55
- the scheme making arrangements with annuity providers for them to offer annuities to smaller funds.

5.8 Around two thirds of respondents addressed at least one of our questions on small funds, though the first and second questions more commonly attracted responses than the third. The responses came from a range of organisations, mainly those involved in administering pension arrangements.

⁹ The lifetime allowance is the maximum value of pension savings that can normally benefit from tax relief (£1.75 million in the tax year 2009/2010, rising to £1.8million in the tax year 2010/2011). Sums above this are taxed at 25 per cent where the excess is taken as a pension and 55 per cent where the excess is taken as a lump sum.

¹⁰ The Registered Pension Schemes (Authorised Payments) Regulations 2008 SI 2009/1171 were published on 8 May.

5.9 Generally those organisations that responded believed PADA had identified most of the main issues around small pots, but there was less agreement with regard to whether the market would successfully cater for small funds or what other mechanisms could be used to resolve the issues.

5.10 There was also a widespread recognition that many of the issues raised were not unique to personal accounts, but instead would affect most defined contribution pension schemes. Therefore, many responses urged consideration of a solution that could be applied universally to all affected pensions.

Have we identified the right issues?

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

- Have we identified all the issues that affect personal accounts scheme holders who have small pension funds?

What you told us in response

5.11 Generally most respondents believed that PADA had identified the right issues around small funds. The main issues identified that respondents felt PADA had not adequately dealt with were:

- *Building personal accounts: securing a retirement income* suggested that when members have other pension savings elsewhere that prevent them from taking their small personal accounts fund as cash, one solution could be to transfer their fund from personal accounts and use the larger combined total to secure their retirement income. Several responses, particularly those from the insurance industry, felt that PADA had underestimated the difficulty of consolidating funds and therefore members may not readily be able to transfer out
- maintaining up-to-date contact details in order to be able to reunite members, particularly those of non-UK origin, with their small fund
- the potential inability, or unwillingness, of the annuity market to fill the gap between the £2,000 scheme triviality limit and the general minimum annuity purchase price of £5,000, which led many respondents to suggest an increase in the scheme triviality limit. This is out of scope for this consultation since it is not a personal accounts specific issue but rather one related to wider Government legislation around retirement incomes
- the availability of financial advice that could help guide members towards the best solution, with respondents noting that advisers would generally not be interested in low value business.

Have we identified the right issues:

some comments from respondents

“We believe that PADA has given this matter full and thorough consideration.”

The Pensions Advisory Service

“Yes, we believe the document identifies the issues surrounding small pension funds.” **Mercer**

“We believe all the issues have been identified [...]” **HBOS**

“In general, we do not believe there are any issues specific to Personal Accounts that are unique to its members. Therefore any solutions developed for the Personal Accounts scheme need to be capable of universal application for all types of pension schemes.”

Association of British Insurers

“The work that PADA are undertaking, the findings of this consultation and the recommendations that are put forward should not be limited to those saving in Personal Accounts, the Government needs to also consider the process for those in alternative schemes [...] Whilst it is proposed that transfers out are allowed for decumulation purposes this is pointless if the individual’s other schemes do not allow transfers in.”

Equality and Human Rights Commission

“No, the biggest issue will be keeping accurate contact details for these individuals (especially for non-UK residents).” **Friends Provident**

“The suggestion that individuals be allowed to combine various small pension funds is reasonable in itself, but there could be practical problems [...] It is also not clear to us who will be responsible for any necessary tracing at retirement...” **Society of Pension Consultants**

“Given the target market for personal accounts, PADA is correct to consider this issue. Given the overall aspirations of PADA as regards personal accounts it seems appropriate to ensure that there will be some solution for these members, even if not as broad a range of options as might be available to those with larger pots.”

International Financial Data Services

“One result of the new law may be that many employees will end up with a number of small pots in workplace-based DC schemes [...] If the current rule prohibiting transfers into the personal accounts trust stands, there is no obvious central place into which these pots can be transferred when it comes time to annuitise”

Association of Pension Lawyers

“PADA should consider how to facilitate aggregation for customers who have several pension pots.” **Norwich Union**

“The Government has decided that members of the personal accounts scheme will be able to transfer their investments into a different pension fund for the purpose of securing a retirement income. However, we can envisage a number of problems with this arrangement. In particular, there is no guarantee that insurance companies will be willing or able to accept small value transfers from the personal accounts scheme. Insurance companies may not accept non-advised transfers from occupational schemes to personal pensions. Advisers may be unwilling to offer advice because of the small amounts involved. Once consumers have consolidated their pension arrangements outside personal accounts they would still need to negotiate the open market option or risk being left with a default annuity which could represent poor value.” **Which?**

The ability of the market to absorb small funds

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

- Do we need to consider further arrangements to rescue stranded funds, or should we be confident that the market will absorb them?

What you told us in response

5.12 There were widely contrasting views on the market's capacity to handle small funds. Some respondents asserted that a market based solution was feasible particularly if the annuitisation process could be made self-service, electronic and low cost so smaller funds would become profitable. However, other respondents felt that without intervention to move the market towards a solution, it would not provide an adequate answer and smaller funds would not be adequately catered for.

5.13 This range of contrasting responses was spread across all organisations. Even annuity providers had widely varying degrees of confidence in the market's ability to deal adequately with small funds.

The ability of the market to absorb small funds:

some comments from respondents

"We do not believe that it should be assumed that the market will absorb small or stranded funds." **AXA**

"We believe that the market will be capable of absorbing such funds although all parties will need to ensure that unnecessary costs are avoided." **Just Retirement**

"Assuming that most small funds will be processed on a self-service basis through the Panel, we believe that these funds will be absorbed by the market, in the same way that providers write annuities already for small funds from existing pension customers." **Prudential**

"Research suggests the market at present cannot effectively absorb small funds below £5,000, particularly on the open market

option. Therefore, the focused choice option and the providers on the panel have to meet this issue as one of the business criteria. The ability of panel providers to annuitise small funds is likely to make the market more competitive in this area if the numbers are significant." **Capita Hartshead**

"An important criteria for panel membership should be a willingness to accept, and indeed to offer keen terms for, accounts that fall between the £2,000 standalone commutation limit and £10,000 the level at which OMO perhaps becomes reasonably practical." **The Pensions Management Institute**

"The market should be able to absorb stranded funds."

National Association of Pension Funds

The ability of the market to absorb small funds continued

“We are not confident that the market will absorb stranded funds. Wider Government action is needed to resolve issues round small pension funds.”

Age Concern and Help the Aged

“The use of cutting-edge IT solutions alongside experienced, knowledgeable staff and continually evolving processes can enable companies to profitably set up and administer small annuity pots.”

Standard Life

What alternative solutions are available?

The questions we asked

What the consultation paper *Building personal accounts: securing a retirement income* asked

- What other approaches should we consider to resolving issues outlined in this chapter?

What you told us in response

5.14 A commonly suggested alternative solution for dealing with the issue of small funds was to suggest changes to the legislation on trivial commutation, which is outside the scope of this consultation as it is not a personal accounts specific policy or design issue but instead part of wider Government tax and retirement legislation.

5.15 Other solutions proposed were:

- the use of an ISA or a Pensions ISA (PISA) to hold small funds that could not economically purchase an annuity, where this would have a conservative investment strategy to provide capital protection and rules around withdrawal of funds. This would require legislative changes and is therefore outside the scope of this consultation
- paying out small funds as an unauthorised payment. However, it is not legally permissible to design a pension scheme that has a right to make unauthorised payments as a product feature
- provision of information to help make members aware of the issues associated with small funds
- using a ‘clearing house’ or ‘assisted purchase model’ to provide members with support, guidance and information, the ability to conduct low-cost transactions through a variety of channels, such as, telephone and online, and aggregation facilities to help less engaged members, members with smaller funds as well as members with larger funds or more complex needs
- the trustee could provide a low-cost income drawdown facility for members below age 75 and permit them to take income from their funds rather than annuitise. This would allow members to defer buying an annuity until the scheme is more established. At which point, annuity providers would have a greater number of retirees from the scheme and a wider range of fund sizes on which they could be prepared to offer better annuity rates.

What alternative solutions are available:

some comments from respondents

“[...] it would be worth investigating an approach of moving small amounts into another vehicle such as a PISA (Pensions ISA). Sums accumulated are likely to be similar to cash ISA amounts and there are many companies which are used to managing these small funds in both administrative and investment terms. Clearly different rules regarding encashment would be required compared to cash ISAs but a requirement to hold the vehicle for a fixed term of 5 years could be appropriate.” **Xafinity Paymaster**

“Where a member has saved for their retirement, but those savings cannot yield an annuity, it might be appropriate for such balances to be transferable into an ISA account. A Cash ISA (either pure cash or based on bond investment) would provide significant capital protection while preventing any tax on the income obtained. If this approach were favourable to PADA it would require the Government to make the necessary amendment to the ISA Regulations.”

International Financial Data Services

“Information directed to members about small funds has to be carefully drafted, because if not it may encourage significant opt-outs, which would impact on many other aspects of the personal accounts scheme [...] In certain circumstance, for instance where non trivial, but still small funds have accrued for members now residing overseas, it might [...] be worthwhile considering discharging benefits by payment of an unauthorized lump sum.”

Capita Hartshead

“We would like to see information support provided to employers, who will often, as you acknowledge, be the first port of call for information.”

Association of Pension Lawyers

“A collective central brokerage can drive lower cost in annuity provision due to its scale, and ability to use common processes which would streamline administration and annuity set up. Engaged customers with larger funds could use this for a fuller service but it would also provide suitable support for less engaged customers or those with lower pots.”

Norwich Union

Other issues raised

5.16 We explained in the introduction that many of the respondents raised issues that are out of scope for PADA because they are not related to the design of the personal accounts scheme but instead related to wider Government owned legislation on retirement income options. Those raised in response to how to deal with small funds will be forwarded on to the relevant organisations.

How PADA will take this forward?

Designing personal accounts

5.17 Personal accounts will make full use of the trivial commutation rules and the draft scheme order and rules contain provisions to facilitate this. In particular, the trustee corporation will have the ability to offer only commutation or an outward transfer rather than access to an annuity in those very limited circumstances where an annuity cannot economically be purchased, for example when a pension fund is exceptionally small and no annuity provider is prepared to quote. This would not prevent the member exercising the *open market option* to obtain a quote for themselves.

5.18 We will also ensure that the scheme is sufficiently flexible to take account of developments within legislation and the wider retirement income market that may help facilitate better solutions for smaller fund sizes.

Annex 1

Organisations submitting formal responses to the decumulation consultation paper

- AEGON
- Age Concern and Help the Aged
- Association of British Insurers
- Association of Consulting Actuaries
- Association of Pension lawyers
- AXA
- Barclays Global Investors
- British Chambers of Commerce
- Buck Consultants
- Canada Life
- Capita Hartshead
- Equality and Human Rights Commission
- Financial Services Consumer Panel
- Friends Provident
- Hargreaves Lansdown
- HBOS
- Hewitt
- HSBC Actuaries and Consultants Ltd
- Institute of Chartered Accountants in England and Wales
- Institute of Directors
- International Financial Data Services
- Investment and Life Assurance Group
- Investment Management Association
- Just Retirement
- Legal and General
- Mercer
- MGM Advantage
- National Association of Pension Funds
- Northern Trust
- Norwich Union
- Origo
- Pensions Management Institute
- Pensions Policy Institute
- Prudential
- Scottish Widows
- Society of Pension Consultants
- Standard Life
- Stephen Wynn
- Tax Incentivised Savings Association
- The Pensions Advisory Service
- The Pensions Regulator
- TUC
- UK Shareholders Association
- Which?
- Xafinity Paymaster

Annex 2

Organisations that PADA has met during the consultation period

We held meetings with:

- Association of British Insurers
- Financial Services Consumer Panel
- Hargreaves Lansdown
- Just Retirement
- Legal and General
- Norwich Union
- Origo
- Society of Pension Consultants
- The Boston Consulting Group
- The Institute of Chartered Accountants in England and Wales
- The Open Market Annuity Service
- The Pensions Advisory Service

We've provided presentations to the:

- PADA Consumer Representative Committee
- PADA Employer Representative Committee
- PADA Scheme Management and Trustee Advisory Committee

Annex 3

Consultation events in London on 22 January 2009 and in Edinburgh on 25 February 2009:

Points raised in discussions at the events

First session: Awareness, knowledge and attitudes regarding the retirement process for PADA's target audience

The questions we asked

- What factors do you think might make our target group particularly hard to engage at retirement; and is there anything that can help address this?
- What are the right points in people's lifetime to communicate with them about retirement?
- What additional questions about retirement within our target group would you like to see answered by further research?

Points raised during discussions

- 1 Engagement with pension schemes is a generic problem, not specific to personal accounts. Inertia during enrolment and accumulation makes this even harder.
- 2 Individuals need to understand that they are key to the whole process.
- 3 There is a need to focus resources on younger members to persuade them to engage with the scheme and take ownership of their funds.
- 4 As the size of pots and the profile of those retiring changes over time, the problem may change.
- 5 There is a need to maintain contact and keep details up to date throughout the life of the membership.
- 6 There is a need to successfully use electronic communications to keep members engaged.
- 7 The personal accounts target market could be those who use the internet least and the scheme should encourage members towards internet use.
- 8 Communication should be regular and simple, repeating key messages and getting people to start understanding the process of securing a retirement income.
- 9 Approaching the point of securing a retirement income the information should build up progressively.
- 10 Overseas members might be more financially aware if they are in the group of people who have made a decision to work overseas.

Further research was suggested on

- 11 What are people's reactions to being auto-enrolled into personal accounts compared to being auto-enrolled into other Defined Contribution schemes?
- 12 What is the purpose of the scheme from a member's perspective? Developing an understanding about prospective membership.
- 13 How the target market will engage with on-line solutions.
- 14 How the target market perceives what is required to make the process more interactive and what would improve engagement.
- 15 Testing with consumers the degree to which they wish to have choices limited or made for them.

The questions we asked

- How do we strike the right balance between keeping the focused choice process simple, which may require restricting the product range, and helping members to access the best product for them?
- Are there particular steps along the customer journey that will be difficult to deliver online or which members will find difficult to navigate? If so, how could this be remedied/what further support should be given?
- It is likely that we may not have up to date contact details for many personal accounts members by the time they reach retirement. What best practise can you share around procuring up to date contact details/tracing members?

Second session: The customer journey

Points raised during discussions

- 16 Information could be provided in stages – not all at once. Information could use short video “experiences” from other members.
- 17 The process will need to cope with different members' needs.
- 18 Choice should be kept as simple as possible, e.g. a guaranteed annuity for all with options on *single/joint life*, level/escalating.
- 19 The process should be streamlined with limited choices – a filtering process could be used to narrow down options.
- 20 The process of securing a retirement income cannot be solely on-line – some help or guidance available through other routes will be required. There is a need to overcome the ‘trust’ issue with electronic data.
- 21 The scheme will need to remind members frequently of the need for them to notify changes in contact details and the schemes design must make it easy to notify these changes.

Third session: The panel of providers

The questions we asked

- What factors do we need to consider to ensure the panel works as effectively as possible?
- Should the panel offer other annuity types and would this allow for a straightforward process?
- Build or buy the panel – pros and cons of each?

Points raised during discussion

- 22** Providers will need to have some expectation of getting a volume of business to offset the outlay of becoming a panel member.
- 23** There is a need to deliver efficiency so that the cost of being involved in the panel is not more expensive than being involved in the *open market option*. There is also a need to make the process easy for both individual members using it and providers supplying annuities.
- 24** Panel members should accept a process that assists members. This may require clear responsibilities between panel members and the scheme.
- 25** The panel should be a bespoke model that meets the specific needs of the personal accounts scheme rather than being built on current models. The market is changing and PADA needs to be a forerunner. There is nothing currently available on the required scale.

Organisations represented at the London consultation event

- Age Concern
- Alliance-Bernstein
- Association of British Insurers
- Association of Independent Financial Advisers
- B&CE Benefit Schemes
- Barclays Global
- BASDA
- BidPartners Ltd
- British Bankers' Association
- British Chambers of Commerce
- BT
- Canada Life
- Capita
- Carers UK
- CashFac
- CBI
- Cicero Europe
- Clerical Medical
- CSC
- EDS
- Equality and Human Rights Commission
- Fidelity
- Financial Services Authority
- Friends Provident
- Fujitsu
- Gissings Consultancy Services
- Hewitt
- IBM
- International Financial Data Services
- Investment Management Association
- JPMorgan
- Lark Life & Pensions Limited
- Legal & General
- Logica
- London Stock Exchange
- Mercer
- National Association of Pension Funds
- Northern Trust
- Norwich Union Life
- Origo Services Limited
- Pensions Policy Institute
- Prudential
- PwC
- SAP
- Society of Pension Consultants
- Tata Consultancy Services
- The Parthenon Group
- The Pensions Regulator
- TUC
- Vanguard Investments
- Vertex
- Watson Wyatt Worldwide
- Xafinity Paymaster

Organisations represented at the Edinburgh consultation event

- Association of British Insurers
- Accenture
- AEGON Scottish Equitable
- Aon Consulting UK
- Bank Hall Investment Associates
- CashFac
- HSBC Actuaries and Consultants
- Just Retirement
- Kerr Henderson
- Mercer
- Punter Southall Financial Management
- Scottish Life
- Scottish Widows
- Society of Pension Consultants
- Standard Life
- SunGard Wealth Management
- The Actuarial Profession
- The Graeme Riddoch Consultancy

Feedback from the consultation events

“An open and receptive workshop environment, which was an excellent use of my time and which helped inform me of the some of the key issues PADA needed to address going forward.”

“This was a highly interactive and very informative event. Thought it might be a listening event – pleased that it was kept interactive and all our thoughts, challenges and questions were valued.”

“The opening session – very useful background and the discussions were a good way of sharing ideas. I hope all the information will be caught and used.”

“Very strong and clear introduction which was a positive theme carried throughout the day.”

“Group discussions/exercise were very informative.”

“Speed of day was good – got through a reasonable amount in short time due to short breaks/lunch very good.”

“[...] a large number of issues emerged which will need definitive answers to ensure the project is a success.”

“The round tables worked well – good chance to hear views of others – quite different to mine.”

“Overall, I think PADA are taking a sensible and appropriate approach with these sessions. Buy in will be vital and consultation should be supported by the industry. Good luck.”

“More detailed info would have been helpful to facilitate discussions.”

“It would have been useful to have a wider audience – at least for some aspects, e.g. employers, more advisers, pensioners, (or pensioner groups), employees.”

Ratings received*

| | London | Edinburgh |
|---|--------|-----------|
| Please rate the extent to which we met your needs | 4.1 | 3.8 |
| Introduction | 4.5 | 3.5 |
| Q&A session | 4 | 3.4 |
| Awareness, knowledge and attitudes regarding the retirement process | 3.7 | 3.3 |
| The customer journey | 3.8 | 3.8 |
| The panel of providers | 3.8 | 3.7 |
| How productive was the event | 4.2 | 3.8 |

*marked on a scale of 1-5



contact details and further information

Copies of this publication are available online at:
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We will consider any requests for other
alternative formats that may be required.

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