Strategy

Money and Pensions Service Listening Document

Response from Nest Corporation

About Nest Corporation

Nest is a critical pillar of the government's automatic enrolment programme, with a public service obligation to accept any employer wishing to use the scheme to discharge their automatic enrolment duties.

Since we were set up in 2010 we have delivered a high quality, low cost pension scheme open to all which has not only delivered on its mission, but helped to drive up standards and best practice across the industry. Now with over 8 million members, Nest is playing a critical role in helping people save for their retirement - many of them low to moderate earners who may be saving for the first time and moving jobs frequently.

Nest now occupies a place in the market as a major Master Trust, a sector that has grown following the introduction of automatic enrolment, and that we believe has great potential for delivering pensions to mass market consumers for many years to come, leveraging scale to offer low cost, modernised services in the context of strong Trustee governance.

Introduction

Nest welcomes the collaborative approach that the Money and Pensions Service (MAPS) has taken to developing its Corporate Plan and National Strategy for Money and Pensions. We have engaged with the listening phase at events in Peterborough and London, including participating in a MAPS pensions deep-dive. We are pleased to offer this response to the questions set out in the Listening Document and to share our views about MAPS' work in the pensions and retirement income sector.

We fully support MAPS' goal of empowering consumers to access help when they need it, by improving their motivations, knowledge, skills, behaviour and engagement. However, we believe engagement must be accompanied by good scheme governance and product design, with the right regulatory protections applied, and taking into account the information asymmetries and behavioural biases that consumers encounter in relation to pensions.

In particular, we welcome MAPS' focus on a life-long approach. With over 10 million people now automatically enrolled into pension saving, MAPS is well placed to build a better understanding of how short-term resilience and long-term pension saving interact to achieve good outcomes over the course of a consumer's financial life.

Thematic questions

We have responded to question 1, 2, 8 and 11

1. What are the top priorities the Money and Pensions Service should focus on over the next three years?

There are three priority areas that we would highlight.

First, an urgent priority must be building on support for consumers as they transition from working into retirement.

Consumers face an increasingly complex set of choices as they make the transition into retirement. The majority of retirees will be reliant on defined contribution (DC) pensions for their income in future years. Due to the pension freedoms, they will have to choose a means of drawing an income from their savings which allows them to sustain a good quality of life whilst ensuring that they have enough money for all of their future years. In doing so, they will have to consider a range of uncertain factors: whether and how long they will continue to work; their health expectancy and costs of long-term care; their expected longevity.

There is a great deal of evidence that consumers find these decisions hard to make. As the Financial Conduct Authority's (FCA) Financial Lives Survey reports, 46 per cent of all UK adults say that they have low knowledge about financial matters, and 24 per cent have little or no confidence in managing their money.[1] More worryingly, of those aged 55-64, around a quarter with a DC pension do not know how much is in their pot and only half have given how they will manage in retirement a great deal of thought.[2]

With the majority of people due to be reliant on their DC pensions in the future, MAPS must ensure it has the operational and technical capacity to support consumers in navigating the journey into retirement. Pensions guidance must take account of the complexity of peoples' financial lives, and be sufficiently broadly drawn to allow them to consider the interactions between pensions and other forms of assets; and between pensions and state benefits. We expect a growing number of retirees to be accessing benefits at the point of drawing on their pension saving in future, and the interactions between DC saving and benefits can be complex. It is critical that Pension Wise advisers have as full as possible an understanding of how being in receipt of benefit may alter the choices available to people about how they manage their money in retirement.

We are also clear that information and guidance on its own is unlikely to be enough to enable consumers to reach good retirement outcomes. We would therefore call on MAPS to help make the case that large automatic enrolment schemes should be encouraged to deliver governed retirement pathways, in order that mass market savers can easily convert their savings into a sustainable income, without having to access repeated formal financial advice. Our response to question 27 provides more details on this point.

Second, as stated in the Listening Document, a significant proportion of the UK's population has low financial resilience. 9 million people are over-indebted, and 11.5 million have less than £100 in savings to fall back on in times of hardship.[3] In contrast, as a result of auto enrolment, consumers are building up greater levels of illiquid long-term savings, improving projected retirement outcomes.

Short and long-term savings have tended to be considered by policymakers as distinct and separate objectives. However, we believe that it is increasingly important that they are considered together, in order to improve consumers' overall financial resilience and give them the best chance of "making the most of their money and pensions" over the course of their lifetime.

[1] 2018, FCA 'Financial Lives Survey', p. 14

[2] 2018, FCA 'Financial Lives Survey', p. 21

[3] 2019, Money and Pensions Service 'Listening Document', p. 9

We would encourage MAPS to prioritise a whole-of-life approach to advice and guidance, in which considerations about short-term financial resilience are integrated with long-term pension saving to achieve good outcomes over the course of a consumer's life. For instance, a consumer interaction regarding a short-term financial consideration may actually be a very effective means of engaging consumers to build up financial capability in longer-term pensions saving, depending on the consumer's other characteristics. We would like to see this theme reflected in MAPS' forthcoming National Strategy.

Third, we would encourage MAPS to consider their role in engaging the small employer community. The advent of automatic enrolment has given all employers a link to the broader financial lives of their employees through the provision of a pension. For many on both sides of this arrangement, this is a change in relationship. We know from talking to our members that pensions are increasingly valued by mass market savers, and expectations around pension provision are likely to grow over time.

MAPS should help harness this shift in relationship in ways that promote better long-term financial outcomes for all employees. Large employers are increasingly building their employee benefits packages. MAPS should invest in digital tools and other means to reach the small employer community, and help them to find ways to support their staff with both pension saving and broader financial wellbeing.

2. We are required to help 'those most in need' and those who are 'in vulnerable circumstances'. How can we best identify and reach them? What evidence do you have to help us target these groups effectively?

We support MAPS' proposal to use the FCA's definition of vulnerability as a starting point to identify consumers. We would also encourage MAPS to consider how to reach and engage with groups that are currently excluded from auto enrolment, like the self-employed or those working multiple jobs - as not saving for the long-term could cause financial vulnerability later in life which could be prevented through early engagement and behaviour change.

8. How can we achieve our target outcomes at scale by working with difference sectors (e.g. employers, financial services firms)?

We would emphasise the importance of MAPS continuing to support test and learn initiatives that help people balance short- and long-term savings through product innovation, the workplace, and default structures, as well as more traditional forms of guidance and support. This has been a focus of the Money Advice Service What Works programme and there should continue to be space to support this kind of initiative. MAPS is likely to achieve more at scale by supporting the industry and the funded sector to develop interventions.

11. What more could we do to make best use of the different channels through which consumer could access information and guidance about money and pensions?

It will be important to have a multi-channel approach to customer engagement, so that information and guidance can be provided to consumers accessibly. 'Rules of thumb' or heuristics, and 'teachable moments' can offer opportunities to increase engagement in money and pensions.

Technology and digital engagement channels potentially provide opportunities to bring rules of thumb to bear on choices relating to money and pensions. Technologies such as video enable content to be personalised to consumers en masse, with rules of thumb used to provide accessible information. According to the Fogg behaviour model the right level of motivation, ability and the right trigger are needed for an action to occur. Personalised information may increase motivation, and therefore increase the propensity of consumers to act following the information or guidance they have been given.

There is extensive evidence from other spheres that life events and other 'teachable moments' can present opportunities for encouraging behavioural change. In pensions specifically, this might be especially true for events that are known to encourage a more long-term outlook, such as applying for a first mortgage, or life insurance product. This again illustrates the importance of MAPS integrating short and long-term financial considerations in its approach to engaging with consumers: the life events that might bring consumers into contact with MAPS for a specific financial product may be a very effective means of engaging on a much broader range of financial capability issues.

Pensions and planning for retirement

27. Do you agree with our analysis of the issues?

MAPS has rightly identified the range of challenges that consumers face when they seek information, guidance or advice with saving into a pension and planning for retirement. In the context of retirements, we would emphasise the body of evidence that shows low financial capability has more to do with consumers' behavioural biases than their lack of information or knowledge. Auto enrolment has been successful in increasing pension savings based on understanding how people really make decisions and by harnessing the power of inertia. MAPS must consider the best options for those consumers that are neither equipped nor willing to make decisions about their retirement.

The Listening Document captures some of the challenges on the supply side, including a confusing landscape which is neither impartial nor accessible. We would extend this further by emphasising the ongoing limited innovation for mass market retirement solutions that would be suitable for much of Nest's membership approaching retirement over the next decade. The challenge of delivering a good quality pensions guidance service in this context will only increase without substantive change to the options available to people at retirement.

Following the introduction of pension freedoms consumers face a much more complex set of choices about how to access their pensions savings as they transition towards retirement. Pension freedoms pose specific challenges to the automatic enrolment generation who are not well prepared to engage with the retirement market.

The FCA Retirement Outcomes Review recognised that that consumers are increasingly choosing drawdown; and that within drawdown, choices need to be constrained to provide greater protection to non-advised consumers. The FCA found that more structured investment options in retirement are needed to reduce harm for non-advised consumers. Investment pathways should help by limiting detriment as members keep funds invested for longer periods that would otherwise have sat in cash. However, given the reality of consumer behaviour, we believe that fully governed retirement pathways are needed to support consumers in making good retirement decisions.

Governed pathways involve not only a structured investment approach, as the FCA has proposed for contract schemes, but also the setting of sustainable drawdown rates and provision of longevity insurance on behalf of the consumer.

By 2025 Nest will have nearly 2 million members aged 55+ who will be looking to convert their pots into an income in retirement. Nest's 2015 Retirement Income Blueprint, in which we propose a comprehensive guided retirement pathway, describes how this could be achieved. Nest cannot currently deliver the full blueprint within our existing legal vires. We are continuing to engage with Government and industry on how we can deliver a full retirement solution for our members in the future, and have strong support in this from stakeholders in industry and the third sector

As the DC market grows and consolidates, MAPS is well-placed to encourage government and regulators to consider whether the delivery of fully governed retirement pathways should be something to actively encourage or even eventually require (as became the case in Australia with Comprehensive Income Products for Retirement). There is a weight of evidence from both the UK and abroad that this type of product will help both deliver on savers' expectations of what a 'pension' should provide, and limit detriment to them.

28. Are we focusing on the right outcomes?

MAPS has set a target of 2 million more working age adults understanding enough to make informed decisions about their retirement by March 2023. This is a laudable aim but it is premised on the assumption that consumers are necessarily willing or able to engage with pensions choices. Without innovation from a propositional perspective, ‘more of the same’ on advice and guidance is unlikely to protect consumers from the spectrum of risks that they face when making decisions about retirement, including:

- Criminal scams;
- Excess charges and/or tax;
- Choosing unsuitable investment strategies;
- Missing out on appropriate governance;
- Being penalised by the frictional trading costs associated with moving from one scheme of assets provided by accumulation into another for the purposes of decumulation;
- Missing out on valuable benefits or investment growth; and most worryingly
- Running out of money too soon, underspending or losing means tested benefits and being unable to enjoy retirement as they otherwise would have been able to.

With over 10m people now auto enrolled into an occupational pension, a more ambitious approach is needed to protect consumers. We must acknowledge the evidence that advice and guidance alone won’t meet the needs of millions of savers approaching and entering retirement. As was the case with auto enrolment, ‘smart defaults’ that get most people to the right answer most of the time are also essential.

Research shows that members like ours expect to be able to derive an income from their retirement savings. However, currently there are very few suitable options available for those with pension pots of less than £100k. Those there are require people to take very complex decisions, or access financial advice which for those with small pots is disproportionately expensive. Without simple, straight-through routes from saving to taking an income millions of savers will suffer poor outcomes. MAPS’ outcomes should take into account the opportunity to reduce the risks set out above.

29. Have we highlighted the right priorities for action?

MAPS is prioritising the delivery of default guidance via Pensions Wise when people access or transfer their DC pension. The point at which members begin to access their retirement savings is a distinct moment at which consumers become vulnerable. Default guidance could have a role in helping people to make appropriate decisions at retirement - however we would caution against seeing information and guidance as the answer in itself.

MAPS’ targets in this space focus on the quantum of uptake of guidance appointments, but we have yet to see compelling evidence of the impact on outcomes that the provision of guidance is having. We would encourage MAPS to invest in longitudinal analysis of the impact of pensions guidance, in order to track where it is having a positive impact, and where it is less impactful. We would suggest that whilst guidance can be a very helpful tool in guarding against obvious vulnerabilities – including to fraud and scams – the complexity of choices that consumers are required to make throughout their retirement cannot be supported by a single guidance appointment.

The bulk of academic research in this area shows that behavioural biases mean that advice and guidance do not necessarily improve outcomes for consumers. Academic research has shown that interventions improving financial literacy has a negligible effect on behaviour and that increased information can actually increase confusion in financial decision making.

Moreover, inbuilt behavioural prompts in the retirement system like wake-up packs, the availability of funds at 55 and the 25 per cent tax free lump sum can read as calls to action where a better course for the consumer would have been to do nothing. MAPS could challenge some of the social norms that have developed following the pension freedoms. For example, the Money Advice Service’s Pension Calculator defaults to members taking 25 per cent of their pot as a cash free lump sum. This is not the best option for all members, and we would like to see MAPS doing more to support industry in challenging these norms.

We would therefore encourage MAPS to:

Invest in longitudinal research to measure the impact of guidance on consumer outcomes

Consider whether pensions system design is prompting behaviour that can be detrimental to the consumer and advocating for change where it believes improvements can be made.

For many people, mechanisms which work regardless of individual ability or motivation, such as guided retirement pathways, will provide good outcomes without the need to significantly overcome barriers to engagement.

Finally, occupational pensions are a critical link between employees and their future pensions and people often see their employers as a trusted source of information. We agree there is scope for greater partnership working between MAPS and employers on both the benefits of saving into a pension and more broadly on workplace-based solutions to financial resilience. However, we believe it is short-sighted to focus only on larger employers who are already engaged with employee resilience.

The challenge for MAPS is reaching those small employers where there is greater risk of detriment. 98 per cent of employers using Nest are small employers with an average of 3 employees. More than 50 per cent of Nest members work for small employers. Our research shows that members increasingly value their pensions, but many receive little support or information in the workplace.

Small employers in particular are often concerned that helping their employees could be misconstrued as giving advice. So, even when employers are engaged, this concern inhibits their willingness to support employees at key points in their lives. We would encourage MAPS to invest in finding new approaches to engaging the small employer community, including through digital tools and communications. We would also encourage MAPS to work with the regulators to provide resources to employers that wish to support their employees. This could be achieved by developing ready-made guidance for employees at key life events, such as starting a new job or getting married or divorced.

Whilst agree that life events are an opportunity to connect consumers with relevant information and guidance, we would also add a note of caution here. There is a need for better evidence on whether life events increase active, rather than just attitudinal engagement with retirement saving; especially given the much higher salience of short-term financial solutions at those life events.[4] Subject to better evidence on this point there remains an argument for stronger defaults and nudges around pensions where people engage with these short-term products. There is a risk that the power of short-term bias and discounting gets lost in the conversation about life events.

30. Should we seek to influence the wider policy and regulatory context, and in what areas?

As we have stated above, we would encourage MAPS to:

Invest in longitudinal research to measure the impact of guidance on consumer outcomes

Consider whether pensions system design is prompting behaviour that can be detrimental to the consumer and advocating for change where it believes improvements can be made.

Considerations about system design could encompass:

- The need for guided retirement pathways to support the mass DC market
- The behavioural impact of ‘calls to action’ at 55, and the tax-free lump sum
- The balance between liquid and illiquid saving in lifelong savings products

We would also encourage MAPS to seek to influence policy initiatives which aim to improve women’s pension outcomes and to see this theme prominently reflected in the forthcoming National Strategy. A first step towards this would be to close the gender gap in the MAPS evidence base. For example,

[4] 2017, Nest Insight, Life Events and Pension Engagement. p. 11

future financial capability data collections and analysis of the use of MAPS services and channels should be disaggregated by gender.

MAPS' financial capability research should also extend to product and systems designs, and how they interact with women's financial outcomes. We would also like to see greater flexibility built into MAPS' retirement planning calculators so that people can better understand, for instance, the impact of extended part-time work on pension accumulation. Research suggests that women tend to favour helping family members at the cost of converting pension pots to retirement income. MAPS could examine particular decisions that affect women's retirement options and prioritise more interventions for women based on those moments.

31. How do we get consumers to engage actively in pensions and planning for retirement?

It is vital that as we seek to build engagement with pensions and retirement planning, we simultaneously address the issue of trust in pensions as a product, and in the industry itself.

Too often when consumers do engage with pensions they make choices that are detrimental to them: they may enter products they do not understand and cannot afford to manage actively through seeking regular advice (e.g. drawdown) or seek to actively manage investment choices when they do not have the understanding to do so in a way that will deliver the best outcome for them. We know that consumers are price-insensitive when it comes to pensions – and that when they do engage with charges they can struggle in interpret what they mean.

Technology is increasing the ability of firms to capture pensions assets in easy, single-step processes. Firms like Pensions Bee offer attractive mobile apps that enable people to easily consolidate their saving into a single pot. Whilst this can add to consumers' sense of control and indeed overall level of engagement with their saving, these firms often charge significantly above the market rate to manage those assets: so, all else being equal, outcomes for those shifting their pots across will be poorer.

We believe that MAPS should play a role in actively helping the industry consider how to communicate price and value to consumers, in order that they can make informed choices. This extends to the dashboard, which will add to the infrastructure that will make quick pot consolidation an increasingly simple process. This will only be net positive for the consumer if they have the right information to make informed choices.

It is critical that the dashboard is both built and governed within a framework of trying to drive positive consumer outcomes. Nest is keen to play an active role in the Independent Delivery Group in order to ensure that the needs of our 8m+ members are represented.

As MAPS has correctly identified, encouraging engagement in pensions is a lifelong task: delivering timely, relevant and personal information is key to achieving this. To encourage different actions from 20-year olds compared to someone going through a divorce or another significant life event, MAPS will have to deliver personal information at scale by adopting a data-driven approach. Personalisation may have a role to play in eliminating the gap between intention and action which could help people engage with pension saving in a productive way.

But most fundamentally, we need to ensure that when people do engage, they are given information that they can trust, and that enables them to make choices that are in their long-term financial interest, in ways that we can evidence.

People in retirement

32. Do you agree with our analysis of the issues?

MAPS has captured the range of unfamiliar decisions and complex trade-offs that people in retirement encounter. Often these are compounded by fear of making the wrong decision. Managing pension income is just one of these responsibilities and there is a growing understanding that people will need support in making optimum decisions.

Many consumers are opting for drawdown products, which can be complex in their structure and require repeated decision making well into retirement. The proportion of consumers accessing non-advised drawdown products has increased from 5 per cent before the introduction of pension freedoms to 30 per cent today. As this figure is expected to rise, we would like to see better options in retirement for non-advised consumers which offer a better degree of predictability about income in retirement whilst retaining flexibility to meet future changes in needs.

The loudest concerns tend to be about those withdrawing too much and running out of money in retirement. We would also encourage MAPS to keep detriment from underspending in mind too. Research by the Institute for Fiscal Studies shows that the cost of later life social care for approximately 1 in 10 people will exceed £100,000; though these costs are very unevenly distributed between retirees. Uncertainty over the costs of social care can lead people to 'self-insure' and there is currently little that MAPS can do to guide members in this respect.

Whilst many DC customers retiring today may not be using their pot as their main source of retirement income, this is set to change as a new generation of automatically enrolled savers retire with pots of a size that is appropriate as either a sole or supplementary income, in addition to the state pension. Evidence from Australia suggests that in this scenario the risk to the consumer can be one of under- rather than over-consumption. Unable to judge what drawdown rate constitutes a sustainable income, Australian consumers have tended to keep large proportions of their savings invested, for fear of running out of money.

33. What outcomes do you think we should focus on?

We agree that more work is needed to understand the different groups of people in retirement. MAPS will also need to remain mindful that the cohort accessing pension freedoms now looks very different to future cohorts.

Filling identified gaps in guidance and highlighting existing impartial guidance will undoubtedly be useful to the growing numbers of consumers accessing non-advised drawdown. Outcomes should also focus on reducing the poor consumer behaviours that we are currently witnessing; preference for non-advised drawdown; absence of shopping around; and withdrawing the entirety of a pot.

34. Have we highlighted the right priorities for action?

We welcome the approach MAPS has set out to prioritise research and evaluation, particularly on the interaction between longer working lives and pension freedoms.

We would encourage MAPS to collaborate with organisations such as Age UK, which undertake research on the financial capability of people in retirement.

35. Should we seek to influence the wider policy and regulatory context, and in what areas?

The Listening Document notes the problem of underclaiming of means-tested benefits amongst people in retirement. This is a challenge amongst vulnerable groups who have a high level of need but nevertheless choose not to access this support. We would also highlight the associated problem of those who have managed to save enough for a small income in retirement but face the prospect of means-tested benefits, such as housing benefit, being withdrawn pound for pound against their savings.

Currently, pensioners in this position face a choice between withdrawing their pot in one go, paying a tax penalty and falling back on state support, or withdrawing the money at a sustainable rate and facing a benefit withdrawal which ultimately results in a lower income over the course of a retirement. Adding to the complex interaction between pension savings and benefits is a lack of clarity on the 'deliberate deprivation of assets' rule which could affect means-tested benefit eligibility in the case of withdrawal.

Assets and income vary over time as withdrawals are made, meaning that entitlement to means-tested benefits will change over the course of retirement. We already know that making choices at retirement is difficult and those in this situation need support to manage both their tax and benefit situation as efficiently as possible.

As a consumer-facing organisation MAPS has a potentially influential role in informing the policy context around retirement and benefits. This could be beneficial to pensioners both by reducing the stigma around means-tested benefits and by ensuring that the least well-off maximise their income in retirement. MAPS could also bring some pressure to bear on clarifying the application criteria for the ‘deliberate deprivation of assets’ rule. It is also expected that growing life-time rentals will increase housing benefit costs leading to more intensive means-testing.

36. How can we ensure that people in retirement who are digitally excluded get the help and guidance they need?

Not everyone is confident using online services, nor in making difficult decisions about their financial future. There need to be ways that digitally excluded consumers can work with MAPS to navigate their way through different options in retirement. Standardised products such as simpler annual benefit statements are helpful in this context and should be ‘age-proofed’ as much as possible. This can be achieved through co-designing and testing communications with users to ensure they are compliant and in a language that can be understood.

Digital exclusion is just one of several barriers to entry for consumers accessing help and guidance in retirement. Peak cognitive ability is reached at age 53, with 50 per cent of the population suffering from significant cognitive impairment in their 80s. Low levels of financial literacy can also be a barrier to consumers using advice and guidance to improve retirement decisions. A Government survey in 2011 found that 49 per cent of the UK adult population have financial literacy levels equivalent to national school curriculum level for children aged 9-11 or below.

In our view, MAPS must consider the complexity of choices faced by consumers at and throughout retirement in the round and support the development of retirement options for those without the means, willingness or capacity to make those decisions in an informed way.

37. What are the merits and challenges associated with developing a Later Life Review?

We are interested to see the evidence of the effectiveness of a Later Life Review and the cost-benefit analysis of this approach.

We would welcome inclusion in a Later Life Review examples of smart defaults in financial services that have proven to be effective for older consumers.

MAPS may also want to consider in the remit of a Later Life Review an examination of trust-based governance in the context of people facing physical and cognitive decline. We see the role of the Trustee or other body acting in a fiduciary capacity as vital to safeguarding the interests of consumers saving into a pension. As more people expect the scheme they are saving with will be the scheme that provides them with an income in retirement, there is a strong and growing case for extending this model of governance to decumulation.