Written evidence submitted by Royal London and Scottish Life

1. Royal London is the UK's largest mutual life and pensions company, with funds under management of £77 billion. Figures quoted are as at 30 June 2014. The Royal London Group's specialist businesses provide pensions, protection and investment products. Scottish Life is Royal London's specialist pensions business. Products are distributed through intermediaries.

Executive summary

2. Small employers and their workers must receive the same quality of service as large employers at implementation and throughout the lifetime of the scheme. A poor experience will further damage the perception of the financial services industry and won't engender support for increased long term saving.
3. While opt out from auto enrolment schemes has been low so far, many contributions are at minimum levels. As contributions are increased throughout the phasing period we may see many more employees opt out. Equally we have not begun the process of educating employees that an 8% contribution of band earnings is insufficient to secure an adequate income in retirement.
4. We believe that the best way to ensure a good deal for members is to align the interests of the employer and the employees. This can be achieved by creating a new duty on employers to periodically review the quality of their scheme.
5. The financial industry needs confidence in the future direction of legislation for it to fully support this market and the uncertainty around future reductions in the charge cap need addressed. We propose the establishment of a "Commission for Later Life Provision" to bring the many related challenges together (e.g. long term saving & income in retirement, long term care, IHT) into a coherent strategy allowing business to invest in developing solutions.
6. We support the freedom and choice agenda signaled in the budget but this increases the risk of consumers making poor decisions. It is essential that we get clarity quickly on a number of key issues and have the appropriate regulatory framework to help bring affordable financial advice to the large number of consumers who will benefit from this.
7. The ability to deliver an experience that increases good customer outcomes and generates an increased level of trust is under threat due to the sheer volume of change required. It is imperative that we have a period of stability to deliver the change successfully.

Lessons learned from auto-enrolment implementation to date

8. The key lessons learned are around engagement:
    - 8.1 The right people within the employer must be engaged early
    - 8.2 It is essential for the provider to understand the employer and what it is trying to achieve
    - 8.3 We can then help ensure the project is delivered effectively and meets employer and worker needs
    - 8.4 There is a danger that if you try to cut down or skip this step the work must be done again. This leads to disillusionment of the employer and workers and has the potential to undermine the reforms.
9. It is also essential for providers to be able to deliver on promises given to customers by keeping inflow of new business in line with capacity, bearing in mind obligations to existing customers.
10. There are lessons to be learned in the way data is managed. Customers don't care how we pass information between the various parties in the chain as long as it is secure and efficient. We have however struggled to get all the parties together to agree a common set of standards to which all can adhere. Payroll organisations (through PAPDIS), pension providers (through ORIGO) and NEST have all produced standards for AE data. Although there has been some involvement between the various bodies, much more should be done to bring the standards together.

Issues arising from the extension of auto-enrolment to smaller employers

11. There must be a settled legislative environment and time spent on mandatory regulatory change has to be minimised to allow AE to be delivered successfully to small employers. It is essential that providers can invest and focus on delivering new product solutions and innovative ways to provide service to customers. However in a market where a price cap applies, smaller employers are likely to have a narrower range of providers and services on offer.
12. Although AE opt out rates are currently low and contributions levels have shown only a small decrease[1] (employer contributions down from 6.6% to 6.1% and member contributions down from 3.1% to 2.9%), this positive position may not be maintained without further efforts by Government, providers and advisers. Opt out rates will come under pressure for 3 reasons:
    - 12.1 Smaller employers are unlikely to be able to invest in communicating AE messages to the same degree as larger employers
    - 12.2 Employer contributions are likely to be lower. There is an established relationship between employer size and average wages[2]. This means that those that work for smaller firms are likely to be less able to withstand lower take home pay due to the introduction of AE contributions

13. Employer contributions are likely to fall further because:
    13.1 Small businesses are less likely to have had an existing pension scheme. They have therefore been unconvinced in the past of the merits of providing a scheme for staff and therefore are more likely to fund the scheme at the minimum level.
    13.2 Many small employers will rely on payroll systems to manage their AE duties and contributions. This is likely to lead to lower contributions because many systems make it simple to choose "AE minimum contributions" as a default for staff.
14. While the opt-out rates experienced to date are good this has been achieved at minimum contribution levels. As contributions are phased upwards we may see an increase in employees opting out. Properly on-boarding and servicing an organisation takes time and the cost of this activity is not proportionate to the size of the employer. This makes providing pension schemes for smaller employers more costly. This is exacerbated by potential higher opt-out and lower contribution levels mentioned above. Provider's upfront costs can be reduced by not providing an onboarding service or scaling back on this activity. This leaves all of the work on the employer and will result in frustration, costly rework and disengagement.
15. Although the costs are proportionately higher, smaller employers and their workers still have the right to a quality scheme and service.
16. It is essential that waste is minimised and we concentrate efforts where they add value to customers. Often time is spent focusing on regulatory requirements rather than having a clear focus on customer needs. The rules governing how and what we communicate with customers at both inception and on an ongoing basis must be brought under review.
17. We will soon have to begin the process of educating employees that an 8% contribution of band earnings is insufficient to secure an adequate income in retirement.

Progress towards implementation of automatic pension transfers

18. AT is an exceptionally important policy. If it can be made to work well and is introduced in a way and timeframe that does not interfere with the main rollout of AE it will do a great deal to engender customer engagement and improve efficiency.
19. We do still have some reservations. These are:
    19.1 AT will move enormous amounts of data and billions of pounds of customer money through IT systems without their consent. It is essential that the whole process is tightly controlled and strongly governed. The Government and regulators must take the lead in this regard. There will be a need to fund and maintain customer contact for enquiries, capability to manage disputes and put right any failure, to impose standard and sanction poor practice to name but a few key issues. It is not clear as it stands how this going to be done. It is worth considering whether the new Payment Systems Regulator which commences regulation from April 2015 could bring AT within its remit.

19.2 We understand from a market competition perspective why a federated model for the delivery of AT register is being taken forward. We do, however, have reservations and urge that the Government bring restrictions on who can operate in this space. Having a large number of registers will only add cost, confusion and put the policy at risk:

19.2.1 Where there are multiple registers, the users of each register i.e. the scheme/provider (and ultimately the customer) will have to fund the cost of their system interacting with the exchange/translator. This will add cost across the system.

19.2.2 The policy will only be as credible as the weakest provider's capability. Having to oversee many delivery agencies will add regulatory cost and make standards more difficult to enforce.

19.3 It is essential that those who put information into the register and can interrogate it are fit to do so and those that are to be able to pull money from other providers through AT must be strictly controlled. We have seen how much damage that can be caused by pension liberation (scams) and AT has the potential to make matters significantly worse if we do not control entry properly. The TPR have a crucial role in this.

Progress with improving workplace pension governance and administration, including charge levels

Charge cap

20. Significant time and money is being spent engaging with this policy, communicating with customers and making the changes. It is important that having gone through this change we have a significant period of price and legislative stability. This is essential to ensure that we can invest in helping to deliver the AE program successfully. Making further changes as soon as 2017 when we will be going through the peaks of employer staging would not be sustainable.
21. To ensure sustainable development, we propose the establishment of a permanent Commission made up of Government, industry and consumer bodies which would develop the strategy necessary to deliver long term improvements in the provision for later life. There are a range of interrelated issues in dealing with the challenges citizens now face in later life (e.g. long term savings and their conversion into an income, long term care, IHT) and removing short term political focus is essential. A "Commission for Later Life Provision" would bring these related challenges together into a coherent strategy allowing business to invest in developing solutions.
22. Introducing the charge cap has created a significant challenge for the industry and is a significant distraction during this crucial time for AE. Whilst the DWP have engaged well with the industry to discuss the very complex issues that this intervention creates there is still uncertainty on key points. The draft regulation will not be delivered by mid October and

1 http://www.ons.gov.uk/ons/dcp171778_328287.pdf
2 Employer Size-Wage Effects: Evidence from Matched Employer-Employee Survey Data in the UK – Clive R Belfield 2001

final regulations will not be in place until 2015. Product providers must engage with customers, employers and advisers now to help them understand what is happening and what action they will need to take. Without clear rules it is difficult to give these key stakeholders and our project teams a clear steer.

Improving governance and administration

23. Scottish Life formed an Investment Advisory Committee in 2004 to oversee every aspect of the running of our Unit Linked fund range. Critically the committee operates independently of Royal London Asset Management (RLAM), who have day-to-day responsibility for running of the Scottish Life funds and the committee has 2 independent members, one of which is the chair. We also have an industry leading reputation for delivering first class service to customers. Although we agree there is a need to improve governance of workplace pension schemes and scheme administration we believe we are starting from a strong position.
24. We fully support the requirement for Independent Governance Committees to be implemented within the providers of workplace personal pensions. Again we do have reservations that the rules are coming late and have had to make assumptions about the likely final rules as recruitment of IGC members had to start to meet the deadlines set.

The single most effective measure to improve scheme quality that could be introduced would be a far greater alignment of the interests of employers and scheme member. An employer duty to review the quality of their scheme on a periodic basis would strengthen overall governance over and above the work of the IGC.

Changes to pension taxation arrangements announced in Budget 2014, including the ending of the requirement to annuitise

25. We support the freedom and choice agenda signaled in the budget. This is however a significant change to pension landscape and therefore requires a great deal of work to deliver effectively.

Guidance guarantee

26. It is essential that the focus remains on ensuring consumers can achieve a sustainable income in retirement; this could be centred around ensuring basic needs are covered. There are lessons to be learned from Australian experience where pension saving has been depleted rapidly. The interim report of their recent Financial Systems Inquiry[3] noted that "around one-quarter of people with a superannuation balance at age 55 have depleted their balance by age 70. Aligning incentives with desired outcomes would tend to reduce the longevity risk borne by the Government". Their Government is therefore considering whether people should be compelled to convert all or part of their superannuation benefits to purchase retirement income products or providing incentives to encourage retirees to do this.

27. Customers also need help to avoid decisions which could be seriously detrimental to their financial outcome, for example withdrawing all their money resulting in a higher rate tax being due or taking a standard annuity when in poor health.
28. The Guidance Guarantee is crucial in delivering this. As well as the freedom provided, the consumer will have a great deal of information and choices to weigh up, many of which are complex. There is a significant opportunity for consumer and societal detriment if this is not well used or delivered effectively. It is essential that:
    - 28.1 we get clarity on the signposting requirements as we are already within the period where we communicate with customers about forthcoming retirements from April 2015.
    - 28.2 those that deliver the guidance have the appropriate training and monitoring to ensure effective and consistent service. The CII's response[4] to the HMT is helpful in highlighting some of the key issues.
    - 28.3 information that is collected through the guidance process should be able to be reused by those providing the next steps e.g. within the regulated advice process. It is important to keep costs down that we don't duplicate data collection work.
    - 28.4 providers are not involved in providing the guidance. It is essential for the reputation of the industry that there can be no perception of bias in this process. We already know from experience that it is difficult to overcome inertia and to get customers to shop around, even when it is in their best interests to do so. The role of the existing (accumulation) provider should be on providing clear information to customers and on signposting to the guidance guarantee/regulated financial advice as appropriate.

<u>The retirement process</u>

29. Thinking about retirement should not be seen as a one off event that happens in the lead up to drawing funds nor should retirement be seen as one homogenous period when ones needs and income requirements remain constant. There is a danger that the guidance guarantee becomes the focal point for making retirement decisions. It is important that the Government, regulators and industry think about the whole of the customer journey. This can be seen in 4 key stages:
    - 29.1 **Start Saving** - the important first step. The AE program is starting to address this step.
    - 29.2 **Taking Stock** - this stage is not currently getting the attention it deserves. The budget freedoms (and other social changes such as the trend toward later working lives) mean that current investment thinking and the way we engage with customers must change. Currently investor fund holdings are often moved to less risky assets as a fixed retirement point approaches. This is based on the assumption that the majority of customers will buy an annuity at retirement; this is no longer likely to be the case. It is important therefore that customers are encouraged to think about

key questions some 10/15 years from retirement and to keep this under review. Key questions include:

- What are my circumstances now? How may this impact my future retirement decisions?
- When can I realistically retire and am I saving enough toward this goal?
- What am I likely to do with my money and what are the risks associated with my choices?

Investor strategy may need to be altered from the “default path” set for the scheme (in the case of AE) to a “personal path” more aligned with their circumstances and how they are likely use their funds.

It is essential Government, financial advisers and providers understand the new challenges in this stage and take steps to ensure customers get the best outcome. In particular the DWP should consider updating the default fund guidance for AE to ensure this step gets due attention.

29.3 **Retirement** – the Government’s budget reforms have given greater freedom to flex income to suit needs and hopefully to allow more efficient ways to take income to develop. It is exceptionally important to be able to flex retirement income as income needs vary throughout the typical retirement.

29.4 **Late retirement** – often income requirements increase later in life as health and long term care needs increase demand on funds. We believe there is significant opportunity for innovation in this stage to ensure that customer needs are met.

30. Regulators need to deliver a framework which helps bring affordable financial advice to the large number of consumers who will benefit from this support across the 4 stages we have outlined above.