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20 December 2019

Pensionstatements.consultation@dwp.gov.uk

Department for Work & Pensions
Automatic Enrolment Policy Team: Simpler Statements
Zone C, First Floor
Caxton House
London SW1H 9NA

Dear Sir/Madam

Response to Simpler annual benefit statements for workplace pensions consultation

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to the above-named consultation issued by your Department.

The ACA welcomes the opportunity presented by this consultation to radically re-design statutory annual benefit statements as part of a wider industry drive to encourage members to think about their retirement and the outcome they want at an earlier stage in their working lives.

In order to successfully achieve the twin ambition of consistency and simplicity we believe that full legislative standardisation of annual benefit statements would be required. To the extent any guidelines and/or principles are subject to interpretation, there is the risk that consistency is not achieved. Ultimately, we are supportive of change that reduces the degree of confusion and apathy in pensions and empowers members to take control of their savings for retirement.

With Pension Freedoms, we believe that this is an opportunity to consider the relevance of the information that is presented to members through the annual benefit statements, as this is also a driver to better engagement. As such, consideration should be given to how different members are likely to use their savings at retirement and illustrations developed accordingly.

We are also strongly in favour of this communication delivering more value to members by focusing on what members really need to know and providing them with the tools to enable them to take action to improve their retirement outcomes.

Our comments on specific questions raised in the consultation are set out in the **Appendix.**

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact either the ACA author of this response, Maddie Cain (madalena.cain@aon.com) on 020 7086 9040, or me on 0207 495 4619 (hugh_nolan@spenceandpartners.co.uk).

Kind regards.

Yours faithfully

Hugh Nolan

Hugh Nolan
Chair
ACA DC Committee

On behalf of the Association of Consulting Actuaries Limited

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Appendix

Simpler annual statements: Helping members engage

1a. Is it one that you recognise as offering benefits in terms of an individual's understanding of – and better engagement with – their workplace pension saving?

We do recognise this twin ambition as offering benefits to members in terms of better understanding. However, how they are presented, including the relevance of the information to the member and the ease at which the member can act upon the information, are likely to be contributors in the quest for better member engagement and retirement outcomes.

1b. In what ways could consistent workplace pension annual benefit statements offer an opportunity to improve engagement with and understanding of pension provision?

We have set out below some of the key advantages to members of industry adopting a consistent approach to annual statements:

- Members only have to 'learn' how to understand an annual statement once, so there is less difficulty in, and effort with, interpreting the information.
- Members are likely to be more willing to spend time reading the statement and focus on the key facts and not have the 'dread' of opening the envelope.
- Members are more likely to take action, as the biggest hurdle is understanding what the statement means to them.
- Members could more easily make comparisons of the benefits they have across different pension schemes, enabling them to feel more in control and take ownership of their retirement savings.
  If consistency, in order to aid understanding, is the main driver our strong belief is that this will only be achieved with full standardisation (i.e. length and structure, format, content, language) such that there can be little variation in these elements between schemes.

2a. Views on how annual statements are positioned within your broader member engagement strategy

The annual statement is the most regular ongoing communication that a member will receive about their own pension savings up until their retirement, however they tend to be considered more of a tick box regulatory requirement. This is partly as a result of the following:

- regulatory principles that constrain innovation
- not being relevant to the member (eg assumption that an annuity of a particular form will be purchased) or sufficiently engaging
- contains information that does not correlate with other pension information that members can access or are provided with
- very little industry promotion as to their benefits
- unclear what actions members can take off the back of the information

For schemes/providers that have embraced the member engagement challenge the annual statements are considered more of a legislative tick box exercise adding little value to their wider engagement strategy.

2b. Views on the implications of requiring trustees and scheme providers to have regard to principles; descriptors or a simpler statement template on other communication materials, including the need for and cost of redesigning approaches.

Some schemes/providers are already trying to improve the shortcomings of the annual statements by issuing supplementary statements that are shorter, more engaging and give a clear call to action – for instance, showing members how their retirement outcome could change if they paid an extra 1% pa of pay to their retirement pot, other options (such as retiring early or late) or by using video/on-line communications to support messaging in the statements and improve the "click to act" rate.

Well-run schemes with strong governance in place recognise that the DC landscape is changing rapidly, and that DC has historically inherited much of the requirements, without tailoring, from the DB landscape. For many we expect that this type of change will be expected, if not welcomed, and long overdue.

For schemes/providers, their primary concern will be the cost of change, which we address in our response to Question 11c. An additional cost will be the embedding of the simpler annual statement into the wider member communication and engagement strategy, and these costs will vary significantly between schemes depending on their strategy.

The costs could be mitigated by mandating an approach so that standardisation is adopted across the industry and so driving economies of scale, and phasing in the changes over a period of time and/or planned as part of the regular review cycle that schemes and providers have. Standardisation is likely to also support savers in smaller, and less well governed, schemes that have not fully embraced the drive towards better DC governance and as such, undertake no more than the absolute minimum required under legislation. An off the shelf solution which equates to little or no extra cost would be expected to have more success. This approach would also ensure there is no 'capacity crunch' of resource to make the changes or an artificial increase in the costs of doing so, due to demand/supply.

3. Our intended scope – does this make sense or should the scope be broadened, or narrowed?

We believe that the scope should be extended to DC schemes that are not used for automatic enrolment purposes as these benefits will form part of a member's overall pension savings, including AVCs and also for point-of-sale projections issued under FCA rules.

5. Do you agree with these principles, or are there other or additional principles that you think we should consider?

Yes, we agree with these principles.

6. What do you think are the advantages or disadvantages of this simpler statement?

The potential advantages are set out under 1b.

The potential disadvantages are that members miss useful information because there are too many links to further information, which are then not accessed. In addition, the annual statements continue to show an annual income via annuity purchase. However, in practice we are seeing more and more members going into drawdown. Consideration should be given to optional inclusion of illustrations based on entering drawdown and the assumptions and methodology that can be used for this purpose.

We do not see an immediate need to show a transfer value on the annual statements (except where there would be a material difference, for example with-profits funds). Instead a focus on potential retirement income and steps to improve member outcomes would be of more value and more engaging.

Annual statements may lead to members wanting to make changes but they won't necessarily know where to go or what tools are available to them. The annual statements could reference scheme tools for modeling purposes.

There could also be a lost opportunity in encouraging certain good practice behaviours, such as reminders about reviewing investments or the age of retirement, which is crucial for any member in a lifestyle strategy where de-risking commences X years from the stated retirement age. These reminders are likely to support better member outcomes.

10. Is there any information you think is currently not included, or signposted, in the statement attached at Annex A that would support the ambition to inform members and enable them to make retirement planning decisions? If so, what additional information do you think needs adding or signposting

Whilst the annual statements provide members with information about their pension savings they should also enable members to act on the information. We believe that members should be directed towards tools that are available to them (eg showing the outcome of an extra X% paid in contributions, or the level of income required in retirement), or industry guides, such as the PLSA Retirement Living Standards, to help members firstly understand how much they may need in their retirement. According to their research 77% of savers don't know how much they will need in their retirement, and so providing a projected annual income without this prior understanding is arguably meaningless.

They could also be used as an opportunity for trustees to communicate with members on one or two key aspects related to the scheme where this is relevant to the information in the annual statement (for instance, for members within, for instance, 5 years of their selected retirement age, the at-retirement support the trustees and company have made available). This can help further personalise, and make relevant, the annual statements and add an extra dimension to the communication that could drive better engagement.

Members may also appreciate brief commentary on the reasons why their projection has changed from the previous year. This context should help drive better understanding of the factors affecting their retirement outcomes, whether this is due to investment performance, change in contributions, change in the date a member intends to retire or any other factor. It should also bring credibility to the information presented.

Please also refer to our response to Question 18 regarding drawdown and illustrations.

11a. To what extent would such an approach deliver both simplicity and consistency?

We agree with the broad conclusion drawn in the consultation that this approach is unlikely to achieve the consistency ambition given that the principles are largely open to interpretation and the information can be displayed in multiple ways. With the (greatly) reduced length and guidance on content this should help deliver the simplicity ambition. However, this could be stifled if there is over-use of links and/or too much additional information provided with the annual statement.

In summary, our view is that this approach would not deliver the twin ambition of this consultation.

11b. Given what we say about the aim to drive simplicity and consistency, are the principles described above the right ones? If not, how could they be improved? Are there alternative or additional principles that would better achieve our aims?

We believe that the principles set out are the right ones. Additional comments as follows:

- Principle 3 could capture the 'relevance' requirement as members will only engage with material that is relevant to them. For instance, displaying information on the assumption of annuity purchase at retirement will not be correct for the majority
- Principle 4 should ideally identify actual figures from estimates, with the former being shown in pounds and pence (as currently stated) and the latter being rounded so as not to deliver misleading messages.
- Principle 4 should reference the language used in other communications that is issued to the same members – either ensuring consistency in order to aid understating or review of all communications to ensure language used is consistent with that used in the annual statements.

11c. What barriers exist to adoption of the principles, and to what extent can they be mitigated? For example: design cost; member preferences; regulatory implications?

The perception that this could lead to additional costs for schemes/providers is likely to be the main barrier to the successful re-design of the annual statements using the stated design principles. Additional costs could arise in the following areas:

- administration implementation costs
- use of Communication specialists – in order to deliver creativity and better meet the engagement objective
- user testing and corresponding amendments

The adoption of an industry-wide standardised template with the ability to amend where necessary for the particulars of the scheme, is likely to reduce the above costs. User testing can then be undertaken at national, rather than scheme level. However, this approach is unlikely to fully deliver the twin ambition of consistency and simplicity.

Another barrier is likely to exist with those schemes that do not see the value of annual statements (perhaps, historically treating them as a tick box regulatory exercise) and are unconvinced that the design principles will lead to improved understanding and better engagement. If annual statements are considered in isolation of the wider communication engagement strategy, that is, as a standalone activity, the risk is that schemes continue to spend little time and effort on them.

12a. (Descriptor-based approach) to what extent do you think such an approach would deliver both simplicity and consistency?

This approach provides more clarity than the design principles approach and is more likely to achieve the consistency ambition but there is still room for different presentation of the same information.

With the (greatly) reduced length and guidance on content this should help deliver the simplicity ambition. However, this could be stifled if there is over-use of links and/or too much additional information provided with the annual statement.

In summary, our view is that this approach would not deliver the twin ambition of this consultation.

12b. given what we say about the aim to drive simplicity and consistency, are the descriptors described above the right ones? If not, how can they be improved? Are there alternative or additional descriptors that would better achieve our aims?

We believe that the principles set out are the right ones, with the same additional comments as set out under Question 11b plus additional comments on possible improvements:

- Overall structure, statement and length: Clarity is required in connection with "Information should be provided in a way which reflects the needs"
- Section 1: this could give the impression that links would only be included on statements for those who are engaged so we suggest removing " for those who are more engaged" and other descriptors that are similarly worded.

12c. what barriers exist to adoption of descriptors? For example: design cost; member preferences; regulatory implications?

We believe that the same considerations as set out in our response to Question 11c apply.

13a. the advantages/disadvantages of reliance on the voluntary adoption of a simpler statement template; design principles; or descriptors

We believe that voluntary adoption of a simpler annual statement (template and descriptors) is unlikely to lead to widespread timely change for DC members and improve engagement with retirement savings. There is the risk that we end up with a two-tier annual benefit statement system with those in the better governed arrangements/more sponsor support/more paternalistic delivering communications that enlighten, educate and empower their members to achieve a good retirement outcome, although many large schemes and master trusts will have given a good deal of consideration to these communications without using the simplified template.

Given the above, voluntary adoption is unlikely to meet the consistency or simplicity ambitions. Members need to be able to understand their retirement savings in aggregate in order to make the right decisions for them. This is especially important as the workforce becomes more transient with savers having pension pots with several organisations by the time they retire.

13b. where responsibility for maintaining a template; design principles or descriptors for voluntary use should lie: with government or industry

We believe that the design principles and descriptors could work together as opposed to being "either/or". As such the design principles could be set out in guidance by the Pensions Regulator (template and descriptors would not be adopted voluntarily).

13c. the advantages/disadvantages of mandating an approach through statutory guidance

We consider the advantages to greatly outweigh the disadvantages for members of pensions schemes, providing consistency in the industry, less risk of confusion and either the wrong decisions being taken, or no actions taken due to difficulties in interpretation. A consistent approach would help improve trust in the industry as a whole and Government has a role to play in this respect.

For schemes/providers, the key disadvantage is likely to be related to the additional costs associated with the change, as highlighted earlier. However, equally any attempt to make this change more simplistic is likely to be welcome. As statutory guidance will impact all schemes in scope around the same time, administrators and providers will be making the same changes for their entire client portfolio and therefore these costs can be spread.

14. Do you agree with this proposal and its scope? If not, why?

We do not agree with this proposal. We believe that costs and charges should be kept separate from the annual statements in order to avoid complexity and detraction from the key messages – which are around saving enough for retirement.

Costs and charges would not be able to be incorporated without context, as we have seen with Chair Statements and guidance on the production of cost and charge illustrations in order to aid understanding. Adding context, which we believe means including benchmarking information as well, is likely to lead to longer and more disengaging statements.

15a. What preparation is necessary by schemes to display information in this way? Would a phased approach, starting with large schemes, be beneficial?

We are not supportive of costs and charges being shown on annual statements for the reasons stated earlier.

Other issues include lengthy delays with sourcing this information and it possibly being incorrect.

15b. Do you think there are any risks to members by doing this? If so, do you have any evidence or suggestions of how these have been or could be mitigated?

As above, we are not supportive of costs and charges being shown on annual statements, however we have provided a response to this question in the event the direction taken by government is to include them.

As the consultation has noted, one risk is the potential impact of cost disclosures on member opt-outs. In a similar vein, members could take “low cost” as a criterion when evaluating investment options within a scheme. This risks inappropriate investment strategies being adopted (e.g. a young member opting for a cash fund for long term investment purely because it is the lowest cost option).

Costs and charges need to be put into context of total funds managed and / or the level of contributions paid alongside the “pounds and pence” illustration, as well as clearly showing “what your fees pay for” (often missing in cost illustrations on financial products) in order to demonstrate the benefits of a scheme. For example, messaging around “you receive x% of pay from your employer and x% as tax relief, and for that you pay only x% in charges”.

16a. Do you agree with separate reporting of charges and transaction costs? Do you think other data, such as the percentage of funds under management these charges represent, should be presented alongside?

We agree that costs and charges should be transparent to members, but we also recognise that this information could be meaningless if the member does not know how this compares to other investments (benchmarking) and what steps they can take to lower the costs and charges they are paying and the implications that changing investments could have. For instance, cash is expected to have the lowest costs however it is unlikely to deliver good member outcomes over the medium to long term. Any information presented on costs and charges therefore needs to be accompanied with context. For a simpler annual benefit statement this could add complexity.

The drive in recent years has been about delivering Value for Members. Trustees disclose their Value for Members assessment outcome in the annual Chair's Statement, which in turn is published in the Trustee Report & Accounts and a publicly accessible website. Unless signposted this information is unlikely to be viewed by many, therefore providing members with the outcome of the Trustees’ Value for Members assessment in the annual statement may increase transparency and understanding of the impact of cost and charges, and give comfort that this is being considered on an annual basis by the Trustees. In addition, a link to the Chair's Statement could be provided as this will include the Value for Members assessment, set out the costs and charges for each fund and lifestyle strategy for the scheme year and also provide at least one illustration of the impact of costs and charges. Our expectation is that suitable caveats would appear alongside the illustration, especially where comparisons with other funds are made.

16b. Do you think approximate or averaged charge and transaction cost figures should be permitted for charges as well as transaction costs. Could this impair saver confidence and decision-making, and if so, how would that risk be mitigated?

We believe in the consistency of pension information that is made available to members to aid understanding, engagement, enable the right decisions to be taken at the right time and re-build confidence in the pensions industry.

The Chair's Statement requires disclosure of actual costs (eg TERs) and an average of transaction costs over a 5 year period (or less until a scheme reaches 5 years). As members have access to the Chair’s Statement we believe that the same information should be shown in the annual statements if this route is pursued. It will also reduce risk of errors, as well as the associated costs, as the information should only need to be collated once by the scheme and can serve several purposes for reporting in that year.

If this framework were to extend to DC arrangements other than those used to meet auto-enrolment requirements, more flexibility may be appropriate for them.

17. Do you agree with these proposals? If not, why not?

We agree with the proposals for ownership, alignment and regulation.

18. Do you think these are the right assumptions for providing simple, comparable estimates? If not, why not?

Annuity assumption, adjustment for tax-free cash, number of projections

Where annuity purchase is illustrated in annual statements

We believe that the annuity should be calculated on reasonably recent calculated market conditions similar to the approach currently used by AS TM1. Indeed, it would be appropriate for any replacement to AS TM1 to be clear on the assumptions that should be used to determine annuity rates.

We also believe that the base illustration for the annuity is an important guide because this is the figure that the members will focus on; they may not consider how the annuity has been constructed and whether it reflects how they intend to take their benefits. As such there is a risk that the wrong decisions could be taken by the member.

Considerations should also be given to the 'power of suggestion' – an illustration based on a non-increasing annuity without an additional spouse's pension could be interpreted as an indirect recommendation that an annuity purchase of this type is fine for the average person and can drive behaviour towards this outcome. Historically it is likely that the reason that most annuities purchased have been single life because the average accumulated pot at retirement has been so low and purchases so little in the form of income through annuity that members just take the highest amount they can. With the industry evolving and DC becoming the main way that members save for their retirement the expectation is that the average size of those pots at retirement will continue to rise.

As the expectation is that the majority of members will take a tax-free cash sum, showing an illustration on this basis could be a scheme level decision, based on experience of their membership.

Where drawdown is illustrated in annual benefit statements

Many schemes have put in place lifestyles strategies that target drawdown in retirement. Annuity sales have plummeted since the introduction of Pension Freedoms and the expectation is that unless they are 'reinvented' in some way, drawdown will become the main way that savers access their retirement funds.

Annual statements that make reference (direct or indirect) to annuity purchase, where members are in a drawdown strategy, could continue to contribute to mixed and confusing messages being delivered. The annual statements therefore need to be relevant to members, which in turn would help change opinions about the value add that the statements provide.

Linking the presentation of projected outcomes with the way in which members are actually invested (and what they are targeting in retirement) will make it more relevant. For drawdown, the annual fixed income would be presented as a variable income eg if 3% or 4% (=£X pa) per annum is drawn in income, with a remaining fund of £Y. Reference to a spouse's pension could then be removed and reference to continued growth of investments post retirement could be incorporated.

We believe that illustrations for drawdown should be shown for members invested this way as it is more important that the illustration is relevant to the individual in order to drive engagement.

Inflation assumption

Inflation seems reasonable. This is also the Bank of England's long-term target.

Salary growth assumption

There is potentially a significant impact on outcome projections if salary growth is not reflective of actual progression. We believe that a range would therefore be more suitable than a single, static figure as across industries and indeed different roles within the same industry, as we see significantly varied levels of salary growth in practice.

Investment growth rates

We think the current approach in AS TM1 to setting accumulation rates remains reasonable, not leading in general to significant variations as evidenced by the FRC's most recent annual survey. However, if greater consistency is required, setting maximum rates for asset classes will not necessarily lead to more consistency in key areas (for example, where providers' views of projected returns on equities are at or below the proposed 'cap' already in the 2019 FRC survey, so the proposed cap will not lead to any greater consistency on this assumption and in other asset classes they vary and some are below and some above the 'cap', which merely skews the spread of assumptions). There is also the argument that understating potential growth is as potentially concerning as overstating it as it may lead to people regarding additional savings as a waste of money given the low level of return projected.

Furthermore, within DC, there is an industry push for innovative options, such as patient capital/illiquids and focus is on increasing investment diversification, through asset class, style, geography, currency, etc. As such, the fund and asset class list set out in this consultation is likely to be considered out of date relative to where DC is headed. We, therefore, believe that the current framework in AS TM1 for considering investment growth rates remains appropriate.

22a. The relationship between each of the options presented in this document, and the flexibility to respond to or harness future innovations in the way that people receive and access information, whether in hard copy or in digital form.

We believe other respondents, such as master trusts and other providers, are better placed than we are to comment on this.

22b. The relationship between each of the options presented in this document and the future development of Pension dashboards, including data standards.

We believe other respondents, such as master trusts and other providers, are better placed than we are to comment on this.

22c. The implications for schemes on a need to amend/update their data for Pension dashboards alongside any future requirement to simplify their pension statements.

We believe other respondents, such as master trusts and other providers, are better placed than we are to comment on this.

23a. what are the potential benefits or downsides of using a single, standardised, colour of envelope when sending statements to members in terms of driving engagement?

We believe other respondents, such as master trusts and other providers, are better placed than we are to comment on this.

23b. what the benefits of a 'statement season' would be in terms of raising awareness of the importance of statements and pension saving for individuals, and as part of normalising pension saving?

We believe other respondents, such as master trusts and other providers, are better placed than we are to comment on this.

24. We would welcome any further evidence or analysis which you would like to share about the issues under discussion in this consultation and which can inform the development of simpler annual benefit statements.

We do not have any further evidence or analysis to share for this consultation.

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

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