Pensions

If at first, you don't succeed

Tom Murray explains that the time to get to people with advice is before they begin making decisions

...maybe you need to reconsider your strategy. This may well be worth considering by those involved in devising the Government's current approach to ensuring that people are well-informed when making decisions about how to exercise their pension freedoms.

When pension freedoms were originally introduced, the fear was that many people would make poor decisions due to their lack of knowledge of the financial system. This was driven by research showing that most people expect to live shorter lives than is the case and need help understanding how to plan for their long-term future.

Getting this help became less easy because of the introduction of the Retail Distribution Review legislation. While it succeeded in meeting its aim of making the cost of advice clearer, it had the foreseeable effect of disincentivising many lower and middle-income earners from seeking financial advice.

One look at the fees convinced them they couldn't afford to spend so much getting advice on their small amount of savings. And so there was an increase in those taking a more DIY approach to their finances when faced with retirement planning decisions.

Guidance for all

To alleviate this, the Government launched the Pension Wise service to provide free guidance to those about to retire. So prospective retirees would have access to solid 'guidance' about their options as they neared retirement, at no cost to themselves. This Pension Wise interview is promoted to retirees by the pension schemes in wake-up packs sent out to all members nearing retirement.

Unfortunately, this has not been the runaway success it was promised to be. Despite the lack of cost to the individual, the take-up has been extremely low. Only one in 33 of those eligible have exercised the opportunity so far, barely over 3%. Given that only about 8% of people in the UK have an ongoing relationship with a financial adviser and another 24% consult one occasionally, about 65% of the population are currently making key decisions about their future finances without the benefit of advice or guidance. Based on those figures, Pension Wise should surely be much more successful.

Nudge harder

Faced with the fact that the strategy had less of an impact than initially anticipated, the FCA has introduced new regulations to double down on their approach. Since the start of June this year, they have been encouraging more people to attend guidance sessions with Pension Wise when making key decisions about their pensions.

As a result, more onerous duties have been placed on the shoulders of pension trustees and managers to encourage people to take up guidance and to insist on written opt-outs from those who don't wish to do so.

Too little, too late

The problem is that by the time individuals approach the pension company or trustees looking to make a drawdown or to transfer to another scheme in order to avail of its drawdown capabilities, it is generally too late to convince them of the need to consult experts. The retiree has been considering their options for some time and is not looking to delay the enactment of their decision by waiting to go through an appointment process with Pension Wise prior to proceeding with it.

Hence, I predict that opt-outs are likely to remain high.

Timing is everything

The original estimate for the number who would use Pension Wise has not been met. In fact, it has not even come close, and the feeling in the industry is that this stronger nudge won't improve the situation much either. By the time it arrives, most people have already decided what they want to do with their money and are not open to discussion. Even the Work and Pensions Committee of the House of Commons stated in their recent report on accessing benefits that the stronger nudges will not be enough to make receiving pension guidance the norm.

The time to get to people with advice is before they begin making decisions. Having spent time considering their options of what to do with their pension pots, those nearing retirement have already made plans before approaching their pension scheme or provider to access their savings. They are not going to be receptive to messages pushing them to reconsider, particularly as the guidance they receive will generally be to slow down their withdrawal rate, which will scupper whatever plans they have already made.

Is it enough?

The other problem is whether guidance is sufficient for these moments. The average person approaching retirement is facing a downgrade in their earnings capability. What they decide to do with their savings will be key to their lifestyle throughout their retirement, as most will be unable to increase their earnings later if they run through their savings too fast.

Yet guidance, by its very nature, is not going to be particular to the individual. It will set out the options in broad strokes and give people information about the key issues they need to consider when making decisions. It can't compete with the highly personalised advice independent financial advisers (IFAs) provide to the more well-heeled. Yet it is the lower income savers with smaller pension pots who can't afford to make any mistakes with their savings. As we know, those who have less need to be more careful about how they spend.

Little and often

To be really useful financial advice needs to be given on an ongoing basis throughout life, not just at the point of no return. A session with a financial adviser is often referred to as a financial health check, and the analogy is pretty good. If one wants to be in good health, one goes to the doctor regularly and doesn't wait until a major symptom strikes. That way, one can alter one's behaviour and improve the chance of avoiding a severe disease.

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Similarly, regular sessions to review your finances are needed to ensure you are in financial health. Just waiting until things go wrong and you need money means you have few options to protect yourself.

The better approach is to plan one's finances and review them regularly, ensuring that one understands the consequences of one's choices rather than firefighting at the point of crisis.

From the beginning

The Government needs to rethink its strategy by stepping back and focusing on how financial advice should be delivered to the population across their lives, not just at the point of retirement. The starting point is straightforward; improve education about money matters to kids in school.

Former US President Donald Trump said: “Not teaching your kids about money is like not caring whether they eat. If they enter the world without financial knowledge, they will have a much harder go of it.” For someone who has often generated controversy, this is one of the most non-controversial statements he has ever made; it is unarguably correct.

The strengthening of financial education in the curriculum would equip our children to manage money in the complex world of work they are about to enter once they leave school and embark on adult life.

Governments aren't magic

But what happens once people have left school and entered the world of paid employment? Sudden access to a regular income stream can turn young people's heads, and forcing them to consider the boring issues of long-term saving can be difficult. How can we ensure they will consume financial advice early; a trip to a Pensions Wise guidance meeting 30 years down the road is hardly the answer.

Governments can't solve this problem on their own. The financial services sector, particularly the life and pension industry, needs to be a part of the solution. Rather than just compelling the industry to engage with the nudging process for guidance, the Government should be pushing the industry to find ways to make personalised advice available to everyone throughout their working life. Only this will give people the tools to make the right decisions.

Digital technology has altered many areas of life. It has the potential to be harnessed to drive down the cost of financial advice, ensuring that it can be available to a broader audience. The industry needs to be incentivised to achieve this. In parallel, the public needs to be encouraged to realise the importance of regular financial health checks to increase take-up.

If needed, the Government should consider vouchers for the entire population to ensure that at least one professional financial review is carried out early enough to act as a wake-up call for retirees. This approach would ensure that people get at least one thorough review of their finances while there is still time for them to take some action to plan and build for their retirement. It may sound expensive, but with the ageing of the general population, total state support for large numbers of retirees on a shrinking tax-paying base is not a cheap alternative.

Spending now would ensure that the country is financially in a better position in the long run. It could turn out to be the best investment made in the UK.

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