



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

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Your ref:

Toby Nutley
PADA consultation team
4th Floor
St Dunstan's House
201-211 Borough High Street
London SE1 1GZ

By email PADA.CONULTATIONS@DWP.GSI.GOV.UK

Dear Toby

BUILDING PERSONAL ACCOUNTS: SECURING A RETIREMENT INCOME

The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your request for comments on *Building personal accounts: securing a retirement income*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Liz Cole
Manager, Business Law
T +44 (0)20 7920 8746
F +44 (0)20 7638 6009
E liz.cole@icaew.com



**THE INSTITUTE
OF CHARTERED
ACCOUNTANTS**
IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 28/09

BUILDING PERSONAL ACCOUNTS: SECURING A RETIREMENT INCOME

Memorandum of comment submitted in March 2009 by The Institute of Chartered Accountants in England and Wales, in response to Personal Accounts Delivery Authority consultation paper Building personal accounts: securing a retirement income published in December 2008

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the discussion paper *Building personal accounts: securing a retirement income* published by the Personal Accounts Delivery Authority (PADA).

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 750,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

GENERAL COMMENTS

4. The UK pension, tax and benefits system is excessively complex and fragmented. The Social Security system and tax regimes and the private sector pension system are not co-ordinated. We believe that the approach taken by the Government in respect of the introduction of auto-enrolment into personal accounts tends to confuse social objectives with commercial insurance provision.
5. The ICAEW believe there should be a sensible flat-rate old age pension, so that everyone starts from the same base. Those who have worked and saved toward their retirement should benefit in full from such savings and should be entitled to benefit from the full amount they have saved in addition to any enhanced flat-rate pension. The Government will benefit from this as they will receive additional tax revenue. The Government cannot look at policies in isolation and, therefore, to be successful, employer auto-enrolment into any scheme must fit within an overall, integrated system for retirement provision.
6. We consider the failure to introduce compulsion represents a fundamental weakness in the proposed (auto-enrolment) regime, both because of the administrative burden that opting out will have on employers and because (especially with the fear of loss of other benefits) lower earners will tend to opt out and thus not save for their retirement. To some extent these issues could be mitigated if people have confidence that they will be able to retain their savings and not lose means-tested benefits, thus removing the perception that people are no better for having saved.
7. A significant proportion of the target population will be in the marginal territory of means tested benefits. The government must address this key issue otherwise the scheme is likely to fail, adding yet more complexity to an already overly complex and fragmented system.

8. Regarding decumulation, as we explain in more detail (at 2b) below, we believe there should be a simple citizen's default annuity designed to cater for less financially-literate savers (eliminating choice from the rump of the members). An open market option (OMO) should be made available for those with more sophisticated needs.
9. We understand that the regime is to be reviewed 5 years after inception. We believe it is essential to keep the rules as simple as possible from the outset, in particular as initially pots will be very small, and it would be easier to add provisions and choice at a later stage than to remove choice and/or change awkward legislation.

General issues that PADA needs to address

- As a first step PADA should approach the industry to assess which providers would be interested in providing annuities for savers with Personal Accounts. It is likely that the value of Personal Accounts will be low, which implies that decumulation will be disproportionately expensive to administer. Simplicity, economies of scale and the effective use of modern technology will all therefore be essential for the success of the scheme.
- We think that PADA is proposing too much choice in annuity selection. There are three primary issues to consider – level annuity, escalation and dependants' pension. We believe PADA should offer a standard default annuity on a level, single life basis. If scheme members want dependants' pension, inflation linking, impaired life and /or other variants they should exercise the open market option outside the scheme. We anticipate that a large proportion of personal accounts members would require a simple solution and would tend not to opt for OMO, meaning that the default option would be more likely to achieve the critical mass needed to make involvement of the commercial sector within the regime feasible.
- The low level of financial literacy in the UK population clearly represents a key challenge and the general perception that annuities provide poor value poses a further significant challenge to the success of these proposals. The government needs to consider how it can communicate key ideas in simple terms, including explaining that annuity purchase is a sensible proposition as insurance for longevity. The Government and the FSA need to work on a collaborative basis with all key stakeholders on an appropriate education campaign.
- Consideration also needs to be given to the likely effect on the annuities market, as high demand could mean worse rates for everyone else.

RESPONSES TO SPECIFIC QUESTIONS

We have introduced question numbers to aid cross-referencing within our answers.

Chapter one

Q1 Are lifetime annuities the best way to provide a guaranteed lifetime income for our members?

10. Yes. As referred to above, a simple annuity default option should provide the most appropriate mechanism. The limited sums that are likely to be accumulated

and the nature of the target market for personal accounts, means that drawdown is unlikely to be appropriate.

Chapter two

Q2a Does our research into the way our target market views the process of buying annuities reflect your own views and experience? What other factors do we need to consider that will help us better understand our audience?

11. Financial capability in the UK is generally low, and the target cohort of lower earners is more likely to have an especially low level of understanding. Simplicity and straightforward language are important and we do not believe that choice is necessarily a good thing. We acknowledge that one size will not necessarily fit all. However, we believe the scheme's default annuity product should be a 'utilitarian vehicle', suitable for the less financially-literate as sophisticated savers with more complex needs can choose other products. The simpler the scheme and fewer choices offered, the better for efficiency and cost. The investment benchmark should be inflation plus a reasonable/modest margin.

Q2b Are the levels of choice we are offering to enable members to buy annuities the right ones? Should we be offering others?

12. No. This should be a simple low cost Money Purchase scheme, and offering too much choice would create complexity. In fact, we believe the choice should be eliminated. There are three key variables – level annuity, escalation and dependant's pension. We believe that Personal Accounts should only offer a level, single life annuity. A member wanting anything else should use the OMO.
13. As a matter of principle, we believe the default annuity should not cater for a dependant's option. The new regime is intended to provide "personal accounts", rather than to provide protection for spouses, and to include a spouse's option in the default product would be to confuse the *purpose* of such a dependant's pension – again confusing social objectives with what is provided in the private sector. We also note that the spouse/partner is likely to be in the PADA scheme as well, and that there are alternatives for the spouse/partner in the form of a means-tested safety net.
14. There would also be some practical advantages of a single life basis, especially for low paid members, because:
 - they would be starting with very small pots, and a dependant's pension would reduce their income even further;
 - there are likely to be additional complications for identifying 'dependants' within the target socio-economic group.
 - the single life model would be simpler and therefore more efficient to operate.
15. The simpler the scheme and fewer choices offered, the better for efficiency and cost, and the key to obtaining the best rates for annuities is to ensure competition between the providers. We believe that pensions mis-selling arises from giving choice/options to people who didn't really understand the issues. The greater the choice offered by personal pensions, the greater could be members' disappointment when they see what they'll get. It should therefore be made very clear to prospective members that, for example, this is a single person scheme only.

16. Members with larger pots could be given more options as to annuity profile and provider. Members who want to forfeit some of their own income to protect their spouse can opt to do so via OMO.
17. In practice, this approach should enable PADA to simply share out each month's default annuity purchases coming due, amongst the Panel providers. PADA could broker this by simply informing the Panel of the postcode, date of birth and sex of the prospective retirees. The panel would tender and negotiate a rate for a block of annuities, and the choice of provider would then be made solely on grounds of price. For example, it may be possible for PADA to 'auction' funds off each month, informing the panel that there are £xm of assets for age 65 men, requesting bids by way of annuity prices. Especially in relation to smaller pots, it is essential to automate the process, which will also reduce time delays and admin costs.
18. This would eliminate the need for a 2 stage choice/form filling process - firstly answering questions that would identify what annuity would best fit their personal needs, and then choosing the provider, from the PADA panel - as we believe it will be difficult or impossible to achieve this level of engagement.
19. We also believe this will be of greater interest to providers, and reduce costs as it would increase efficiency in market if providers are competing on 'plain vanilla' products.
20. Members who have special needs (health, disability, etc.) should not be penalised or disadvantaged. However, including these in the default option would increase the cost of the default option (both in terms of the additional administration involved and also because providers would adjust their rates accordingly), and so we believe the default option would be kept cost effective if these options were excluded. Such members should instead be dealt with by sufficient education/communication to ensure that those eligible opt for OMO rather than the 'default' annuity.
21. Personal Accounts should deliver a simplified product with a straightforward outcome. We understand that currently, 60-70% of savers remain with their insurer, and these represent the more sophisticated end of the financial literacy spectrum, and we believe removing choice from the default option is essential for this scheme to work due to the likely levels of financial illiteracy and disengagement.
22. We understand that the regime is to be reviewed 5 years after inception. We believe it is essential to keep the rules as simple as possible from the outset, as it would be easier to add provisions and choice at a later stage than to remove choice and/or change awkward legislation.

Q2c What could the personal accounts scheme do to minimise enquiries from employees to employers about the process of securing a retirement income?

- Comprehensive information on the website
- Leaflets in Citizens Advice Bureau, available from the Pensions Advisory Service and local libraries
- Make it clear that employers are only responsible for payment of contributions and nothing else
- Distribute information through trade unions
- See also 3d for other ways of distributing information with payslips and tax codes.

Chapter three

Q3a Have we identified the right type of information to give to scheme members, and are we providing this at the right points in the process?

23. Yes, but we consider that PADA should emphasise to people that, if they do not 'tick the box' either for the default option or OMO when they reach 'normal retirement age' for the scheme, they will suffer a delay in pension payment. PADA also need to emphasise that, when making this decision, members need to take account of other pension benefits they may have from other schemes. It should also be made very clear who is paying the lump sum and accounting for the tax on trivial commutations.

Q3b To what extent have we identified the key components, and key questions, that will need to underpin our processes for helping members access retirement income products?

24. As noted at 2b above, we believe that there should be a default option with no choice, accompanied by information enabling members to make the decision as to whether they should instead opt for OMO (for example, if they are eligible for enhanced benefits – see 2b).

Q3c Given the objective of delivering low-cost products that are easy to arrange, are there other types of annuity products we should be considering via the panel of providers?

25. As we explain above, some people could be eligible for an enhanced annuity, but we believe that there should simply be information available (eg by way of a factsheet which includes information on enhanced annuities), and that such products should only be available by way of the OMO.

Q3d How can we identify the numbers and groups of people who will need alternative communication channels to using the internet? What alternatives may be appropriate?

26. This is very difficult as many staff will not have internet access – most people are not in office-based jobs, and many will not have internet access at home either.
27. Other alternative methods of communication include HMRC, as HMRC gives everyone a coding notice (and so factsheets could be included with those). Also, many employers contract out their payroll, so payroll providers could distribute information with people's payslips. TV is another suggestion as most people have one (although see our comments at 3f below).

Q3e What technological innovations are likely to make internet transactions more attractive?

28. We think the technology is already available, but security and simplicity are key issues for success.

Q3f What views do you have on the potential to use other electronic media, such as digital TV, in helping members choose annuities?

29. We have already suggested that choice should be limited. This would make the choice for members much more straightforward. Most people have TV but the digital switchover will not be completed in several regions until 2012, and we are also not yet sure of what facilities it will have.

Q3g What are your views on our proposal for the trustee to buy an annuity for members who reach age 75 and don't get around to choosing an annuity?

30. Provided that the trustee gives the appropriate notice (for example, 6 months), we believe the trustee should have the power to go ahead and purchase an annuity by default as there will always be people who do not respond to correspondence. The trustee should simply check that the relevant member is still alive before they buy one. The monies could then be held in trust for an appropriate period of time (for example, 30 years) after which it could be reabsorbed into the Scheme for the benefit of other members.

Q3h What good practice can you share regarding how to deal with making payments to members who have not provided bank account details?

31. The annuity provider will either need to retain the money until bank details are provided, or issue cheques if addresses are known. The state pension is paid into bank accounts by the DWP, and so there may need to be an information sharing agreement (although this would need to apply to all occupational schemes, not just personal accounts). This should be seen as a cost cutting opportunity, although there may be Data Protection Act issues that would need to be addressed.

Q3i How should we address any issues raised by the need to support non-UK residents through the process of securing a retirement income?

32. We would recommend that actions (and resources) are not diverted to consideration of non-UK residents, as this would add to the cost enormously. PADA could consider highlighting in the information/literature regarding default vs. OMO that the default option will be provided by a UK insurer and that, if residence is an issue, OMO should be considered. However, any measures to address this issue should not compromise the principle that simplicity should prevail.
33. Also, overseas transfers could be permitted. This is a matter for discussion with HMRC, as the answer relies on HMRC and HM Treasury establishing a mechanism to deal with international responsibilities (for example, under Article 49 of the EC Treaty (freedom of movement of people), HMRC should allow people from overseas to transfer their money to their home country).

Chapter four

Q4a What factors do we need to consider to ensure that the panel of providers approach works effectively?

34. As we mention in our general comments above, we believe that PADA should approach providers now, to find out how they think the regime should work.

effectively. The system should have sensible procurement processes and robust independent monitoring. Liaison with the FSA and other regulatory authorities will be essential. See also our answers above, for example, regarding automation of the processes, and 2(b) regarding removal of choice.

Q4b How should panel members be selected? Should it be by invitation only or should potential panel members be given the opportunity to bid, or register interest?

35. The invitation only route is too limiting. We believe that potential panel members should be given the opportunity to bid. This opportunity should be extended to insurers in countries in the Middle and Far East for example, as well as the EU. This might help address some of the issues relating to non-UK residents. PADA will need to establish proper processes for assessing, for example, the solvency of potential panel members.

Q4c How frequently should the membership of the panel be reviewed?

36. The panel should be constantly under review. As we have seen, circumstances in the financial world can change very rapidly and clear performance measures should be required in respect of both parties. However, once a provider has signed up, they should commit for a minimum period, for example, 12 months, although the practicalities of imposing a minimum period would need careful consideration as providers could simply up their rates to get out of the market.

Q4d What technologies are available or are being developed that would facilitate the interface between the personal accounts scheme and providers?

37. We already have the technology for people to access their personal accounts at insurers. This should not be an issue.

4e What alternatives to the panel of providers model should we consider to address these issues?

38. As we explain above, PADA should establish a consortium/pool of providers through which they broker annuities for members who do not opt for OMO.

Chapter five

Q5a Have we identified all the issues that affect personal accounts scheme holders who have small pension funds?

39. Yes but note that members can create a small fund by taking tax free cash. Also, see 2b above for our suggestion of removing choice (eg dependant's option and escalation), which should to some extent mitigate this issue in respect of 'default' annuities.

Q5b Do we need to consider further arrangements to rescue stranded funds, or should we be confident that the market will absorb them?

40. PADA should think about further arrangements in conjunction with HMRC.

Q5c What other approaches should we consider to resolving issues outlined in this chapter?

41. We believe that PADA should advise the government to amend the relevant legislation, as it is a scandal that people cannot access money they have saved. Contributions paid by employer are pay and therefore HMRC and government rules should not prevent access to member monies - it is pay the member is contractually entitled to.

Email: liz.cole@icaew.com

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