Comments on Financial System Inquiry Final Report

submitted to The Treasury of the Government of Australia

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2) Both contributors have a long experience in researching and publishing on retirement benefit issues in a comparative perspective. Bernard Casey has worked as a senior economist at the OECD and is a frequent consultant to the European Commission on the implications of societal ageing. Hazel Bateman has been a consultant on retirement income issues to a range of Australian and international organisations and was a member of the Australian Government's Superannuation Roundtable.

3) Both contributors are happy to elaborate on the information presented in this commentary.

1. Introduction

4) These comments refer to two issues raised in the Final Report – viz: **Chapter 2: Superannuation and retirement incomes**, and in particular the section entitled **The retirement phase of superannuation**, and **Chapter 4: Consumer outcomes**, particularly the section entitled **Strengthen product issuer and distributor accountability**. The former cross references the latter insofar as it concludes *High-quality advice may be useful to some individuals to help them manage their financial affairs in retirement (p126). "Chapter 4: Consumer outcomes" contains recommendations to improve the quality of financial advice.*

5) The comments are motivated by recent changes in the rules determining decummulation in the UK. As is well known, in its March 2014 Budget, the UK government removed final restrictions on how tax-privileged pension savings could be liquidated, allowing full withdrawal from the age of 55 at, effectively, the saver's marginal tax rate. In recognition that this "Pension Freedom" might present challenges to savers, the Chancellor of the Exchequer (Treasurer) accompanied his announcement with a commitment that the government would *introduce a new guarantee, enforced by law, that [ensures] everyone who retires on these defined contribution pensions will be offered free, impartial, face-to-face advice on how to get the most from the choices they will now have*. The process by which this "guarantee" of "advice" has been unfolded contains lessons that the government of Australia might profit from learning.

6) The remainder of this commentary is divided into two parts. The first considers the sort of assistance the UK government proposed to offer pension savers seeking to make decisions about how to exercise their new rights. The second looks at the costs of providing such assistance and the costs savers themselves might incur if they decide to they need further assistance.

2. The assistance offered by the government

7) The consultation paper **Freedom and choice in pensions** that accompanied the 2014 Budget did not speak of "free advice" but of free "guidance" (the Guidance Guarantee). The difference between "advice" and guidance" is not merely one of semantics. According to the Oxford English Dictionary, "advice" is an *opinion given or offered as to what action to take; counsel; recommendation*, whilst "guidance" is *the action of guiding; guiding or directing agency; leadership*. According to the UK's Financial Conduct Authority (FCA), in an explanation it issues to financial service providers, *Advised sales (where you give advice) are where you give the customer 'advice'. Broadly, this means that you give a potential customer a recommendation*. By contrast, *Non-advised sales (where you don't give advice) - This is where no recommendation is made. You only give information to a potential customer, leaving them to decide how they wish to proceed. "*Advice" implies a liability. The giver of "advice" has a fiduciary duty, and can be made responsible if the recommendation is inappropriate. The FCA refers to such advice as "regulated advice", and it distinguishes between it and "generic advice", under which it includes the giving out of information or the making available of decision trees.

8) The vocabulary used in the discourse around "Pension Freedom" is highly confusing. It is certainly open to suggestion that the Chancellor was being disingenuous when, before the Treasury Committee of the UK parliament; he said, *There is a technical distinction between advice and guidance. The Budget document exists, I don't get up and read it out because it contains all the technical details of the Budget and we publish it at the same moment. … The speech needs to also communicate in English so people watching it can understand what is meant.* Here one is minded to think of "Through the Looking Glass" and the conversation reported therein

> *"When I use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean- neither more nor less." "The question is," said Alice, "whether you can make words mean so many different things." "The question is," said Humpty Dumpty, "which is to be master-that's all."*

The confusion was not reduced by the Prime Minister continuing to use the term "free advice" some months later (18/10/14 on BBC Radio 4MoneyBox), or by the fact that the bodies charged with delivering the "guidance guarantee" all contained the "A word" in their name – viz: the Money *Advice* Service (MAS), The Pensions *Advisory* Service (TPAS), and the Citizens *Advice* Bureaux (CAB).

9) Consumers have not been helped by a further profusion of words used to describe what might be available to them. One term frequently heard was "conversation". A concept that featured often in the discourse of pertinent actors – both from government and industry – was that of a "journey", whereby guidance was supposed to provide "signposts", a "navigation tool", and a "means for checking [one is] on course".

10) The same lack of terminological clarity is to be found in the FSI in its Final Report (especially Ch. 4). Here, too, the "A" and "G words" are used interchangeably, - e.g., *Consumers should have access to competent, good-quality, customer-focused advice and guidance* (p197). It is only in an appendix (Appendix 1, p271) that the distinction between "personal advice" and "general advice" is made – whereby the former requires the provider to consider one or more of the person's objectives, financial situation and needs, and the latter is everything else. Where "personal advice" is given, advisers are required to act in the customer's best interest, and can be liable to civil action if they fail to do so.

11) Givers of Guidance in the UK are not givers of regulated advice, but in countless fora concerns have been expressed that, at a subsequent date, they might not be held liable for poor Guidance.

12) The obligations of a giver of “personal advice” under Australian regulations are expressed in very general terms. According to the relevant ASIC Regulatory Guide 175 (Licensing: Financial product advisers – Conduct and disclosure), *A person giving advice need not consider all aspects of the client’s relevant circumstances (e.g. the client’s objectives, financial situation and needs) for the advice to be personal advice. It is enough that either:*

> *(a) at least one aspect of the client’s relevant circumstances was actually considered; or*
>
> *(b) regardless of whether they were in fact considered, a reasonable person might expect the person giving the advice to have considered at least one aspect of the client’s relevant circumstance*s.

Moreover, these regulations are general to all personal advice about financial products; they do not make any special provisions with respect to superannuation (where participation is compulsory), let alone about decisions on how to decummulate from superannuation savings.

13) The UK regulator (the FCA) has, by contrast, been rather rigid, not so much about the content of “regulated advice” for those who are making choices about what to do with their retirement savings but about how these people should be treated at the initial stage of their “journey”. Here, procedures were introduced in late February 2015 to reduce the likelihood of ill- or under-informed choices being made once Pension Freedom became operative. Under these, all accumulators/pension providers are required to ask those seeking access to their savings a list of questions that might determine if they are “at risk”, and to outline the sort of “warning” that the accumulators/pension providers might be expected to give. Although the list is not “intended to be exhaustive or prescriptive”, the regulator does “expect firms to consider what they think is appropriate”.

14) The FCA’s listing is reproduced in Table 1 below.

15) Over and above this, providers are required to inform customers of the Pension Wise service (the name given to the service intended to deliver Guidance) and to keep records about whether they have received a retirement risk warning, regulated advice, or have made use of the guaranteed guidance facility.

Table 1: Financial Conduct Authority – approach to risk management

Risk factor	Examples of what the firm is trying to find out	Risk warning required?
Consumer's state of health	Are there aspects of the consumer's health or lifestyle that would make them potentially eligible for a better value annuity – for example, an enhanced annuity?	If yes or unclear, give risk warning
Loss of guarantees	Will the consumer lose any guarantees attached to the pension?	If yes or unclear, give risk warning
Whether the consumer has a partner or dependants	Does the consumer have a partner or dependents who might benefit from a joint life annuity (where they are not already purchasing one)?	If yes, give risk warning
Inflation	If the consumer is seeking to buy a level annuity, do they understand that inflation will erode the real value of the income they receive from their annuity?	If no or unclear, give risk warning
Whether the consumer has shopped around	Has the consumer shopped around different providers before choosing to buy the product?	If no or unclear, give risk warning
Sustainability of income in retirement	Is the consumer expecting the money they take from the pension to help provide an income in retirement?	If yes or unclear, give risk warning
Tax implications	Does the consumer understand the tax implications of taking money from their pension savings?	If no or unclear, give risk warning
Charges (if a consumer intends to invest their pension savings)	Has the consumer considered how the charges they may face when investing their pension savings elsewhere compare with those on their pension savings?	If no or unclear, give risk warning
Impact on means-tested benefits	Is the consumer aware that taking money from their pension may impact on any means-tested benefits they receive?	If no or unclear, give risk warning
Debt	Is the consumer aware that creditors may have a call on any money taken from pension savings?	If no or unclear, give risk warning
Investment scams	Is the consumer aware that investment scams exist, and that they should be careful where they invest money taken from their pension savings?	If no or unclear, give risk warning

3. The costs of assistance

16) There have been efforts to estimate the potential take-up of Advice and Guidance once Pension Freedom takes effect. The results are very mixed. FCA statistics reveal that, in recent years, rather over 40 per cent of sales of decummulation products were "advised" – whereby the latter indicates that "regulated advice" was taken. (Note: the denominator is people purchasing a decummulation product, so it excludes those with a small pension pot (i.e., superannuation accumulation) – under £18,000 = AUD35,000 – who were not, in any case, obliged to anuitise.) The Association of British Insurers, based on its own research, suggested that some 35 per cent of annuity purchasers made use of a "professional financial adviser / independent financial adviser", although it warned that *classification of financial advice is based on respondents' own perceptions. It is likely that many customers do not understand the difference between a service that offers advice and a service that offers information and requires the customer to choose*. By contrast, the insurer L&G reported that it had offered free advice to 9,000 customers and only 2 1/2 per cent took it up.

17) With respect to projected take-up of the Guidance Guarantee, findings are equally diverse. Thus, the UK Treasury is not expecting "the majority" to take "guidance", the National Association of Pension Funds (a body similar to AFSA) expects up to 85% take-up amongst eligible people aged 55 and over, and the FCA has generated estimates ranging from as low as 2.5-3 per cent to as high as 90

per cent. To quote one headline in the professional press *Wild disparity in takeup casts shadow on guidance pledge*.

18) Given such uncertainly, what even a Guidance service will cost to finance is unclear. The government made £20mn (AUD38mn) available over the first two years *to develop this new right to advice* (sic). The financial services industry has made its own estimates of possible costs – ranging from as high as £120mn (AUD 230mn) per annum to as little as £13mn (AUD25mn) per annum. (Note that the population of the UK is some three times the size of that of Australia, so total costs quoted here and below could be divided by three to approximate to their Australian equivalents.) In so far as these estimates are themselves contingent upon assumptions about take-up, the range is scarcely surprising. (Note: In late February 2015, the UK government refused a Freedom of Information request asking for its estimates of the take-up of Guidance.) More relevant are the assumptions about unit costs.

19) According to the specialist press, the government was assuming guidance costs of between £70 and £100 (AUD133 to AUD190) per person. However, this is an overall figure and covers those who access guidance via a website (the responsibility of the MAS), those who access it via a telephone service (the responsibility of TPAS), and those who use face-to-face guidance (the responsibility of the CABs).

20) Some estimates of the costs of each form of provision have been given. Thus, the cost of delivering some 35 minutes of Guidance by phone, such as TPAS will do, has been suggested to lie between £35 and £43, whilst the cost of providing a web-service, such as is available from the MAS, has been suggested to be under £1 per site visit. Face-to-face guidance, as given by the CABs, is, not surprisingly, the most expensive service, since the overall average cost per session across all three types of service was said to be under £100.

21) On the other hand, and as is continually emphasised, taking Guidance is merely the first step. The intention of the Guidance service is merely to give people "information" about what they might do. In so far as it merely starts people on a "journey", it might well involve directing them to an Independent Financial Advisor (IFA). Estimates of the cost of "advice" proved by the latter range from around £680 (AUSD1,300) per session to a more frequently cited £1,000 (AUD1,900) per session.

22) "Advice" is tailored to personal circumstances and it is recognised that advice from an IFA might be necessary if the tax implications of different options are to be understood. Moreover, it is recognised that draw-down is a complicated process for additional sessions of assistance, at successive, later stages, will be necessary. It is also recognised that where drawdown is being contemplated, the assistance necessary is more likely to involve "advice" than not mere "guidance". In other words, individual savers might well face substantial and multiple costs if they want to be secure in the decisions that they make. These costs will be borne privately – they are not part of the free Guidance Guarantee. However, and as the FSI Reports have recognised, there is a reluctance amongst those with only modest savings to pay for financial advice.

23) Even without having to go further to an independent financial adviser, customers of the Guidance service are likely to have to approach other sources of information. Again, those offering Guidance will not be able to deal with the implications of taking money from a retirement savings plan, or of having capital in a retirement savings plan, for entitlement to means-tested state benefits. All they will be able to do is to direct customers elsewhere. Whether savers accept the

costs in terms of time that they will have to bear, if they follow up such guidance, is something that is, as yet, unexplored.

24) Last, although the government has made resources available for the initial phase of the Guidance Guarantee, these resources will not cover the entire cost of delivery. These have been widely quoted as being in the order of £35mn (AUD67mn) per annum. They will be financed by an additional levy on financial service providers, and this levy will also recoup the seed-corn money put in by the government in the first two years.

4. Lessons for Australia

25) The Treasury needs to be aware that merely advocating better help for financial consumers – and, in particular, for those who have built up superannuation assets and are trying to work out how to use these to maximise their wellbeing in retirement – is not sufficient. There is a need:

a) to make clear what is meant by assistance, and to make sure that consumers understand what is being provided and what is not; and
b) to appreciate that the provision of appropriate assistance is costly and that a way be found whereby the necessary resources are made available such that those who need assistance can and do obtain it.

26) It should, of course, be obvious that, if superannuation assets are unwisely used, not only will wellbeing in retirement be decreased but also the costs to the government will be large. After all, it is the Age Pension system that will, ultimately, pick up the slack.