

NEST: EVOLVING FOR THE FUTURE - FAIRNESS, SIMPLICITY AND CONFIDENCE

A CALL FOR EVIDENCE

Introduction

The Financial Inclusion Centre is a non-profit organisation which undertakes research and develops policy on financial markets. We are pleased to make a brief submission to the DWP's Call for Evidence on the evolution of NEST.

Chapter 1 – Introduction

- **Do you agree these are the right principles to help Government weigh up proposals for changing NEST's policy framework?**

Yes. But, we would include confidence and trust as separate principles. The '*freedom and choice*' reforms we believe will result in consumers facing greater insecurity in the decumulation phase of retirement and a choice of worse value, riskier products¹. There will be an increased risk of misselling and consumers experiencing a wider variation in retirement outcomes – not just inter-generational but intra-generational. This will affect consumer confidence and trust in pension vehicles as the main means of providing for retirement. Therefore, in the post freedom and choice world, developing new solutions to maintain confidence and trust in pensions should be seen as a priority.

Moreover, we would downplay 'choice' as an important factor. Complexity and too much choice engenders consumer inertia not empowerment and effective decision-making.

Chapter 2 – A Changing Pension Landscape

- **Is there other evidence or factors about how the pensions landscape is changing that we should take into account in considering NEST's future policy framework?**

The main factors that should be given further consideration are:

- Changing demographics/ post-retirement experiences;
- The future risk profiles of households saving for retirement;
- The changing face of the UK labour market; and
- Low future investment returns.

¹ For an explanation of the risks with 'Freedom and Choice' see [Funding income in retirement and asset decumulation products at http://inclusioncentre.co.uk/wordpress29/2015-and-beyond-financial-services-priorities/major-public-policy-issues](http://inclusioncentre.co.uk/wordpress29/2015-and-beyond-financial-services-priorities/major-public-policy-issues)

We support the view expressed that improving longevity and serious levels of pension underprovision amongst certain groups – such as the self-employed and others in non-standard/ non-permanent employment – means that growing numbers of people will end up having hybrid retirement patterns. That is, they will be forced to supplement poor pensions with part time/ temporary employment if they want to generate a reasonable income in retirement. This means the policy framework should ensure that the decumulation options available are flexible enough to accommodate hybrid retirement plans of these groups.

In the post defined-benefit world, more households will be reliant on DC-type provision for accumulating assets pre-retirement. By definition, this means that these households will be exposed to greater market risk while saving for retirement. As mentioned, the *'freedom and choice'* reforms will create greater insecurity in the decumulation phase and a choice of worse value, riskier products². Therefore, unless we find a way of mitigating these decumulation risks, consumers will be faced with greater risk during the accumulation *and* decumulation phases.

One of the most important factors relating to NEST's future policy framework is the changing face of the UK labour market particularly the growth in non-standard/ non-permanent employment such as self-employment and zero-hours contracts. The business models of mainstream private sector pension providers have generally not sufficiently adapted to this new labour market structure and are still predicated on the ideal of pension contributors looking forward to progressive earnings growth. This means that the future policy framework for NEST should take into account the reality of this new labour market for those accumulating *and* decumulating assets. This suggests to us that NEST should play an even bigger role in helping those with uncertain and unpredictable income patterns access a good value, flexible, trusted retirement vehicle.

The final point to emphasise is the new economic and financial reality characterised by low economic growth and investment returns. In this new reality, it is even more important that costs be kept to a minimum to avoid unnecessary value being extracted.

Chapter 3 – Areas for Potential Change

Pension Freedoms

- **Should NEST be able to develop and offer a full range of decumulation services for its members?**

As a result of the pension 'freedoms', we believe greater inefficiencies will be introduced into the pensions market as a result of new layers of products and costs. Consumers will end up paying higher charges as well as being exposed to greater market and longevity risk. Consumers will have to save more for retirement to offset higher costs. This will need to be monitored very closely by regulators.

Robust consumer protection and access to the right financial guidance/ advice are short term priorities to protect consumers from the risks of misselling and from the wrong decisions. But, as well as dealing with immediate risks, longer term reforms are needed.

To address these risks, we agree that a good solution would be to introduce a NEST style default decumulation option to act as a beacon of good value for consumers to help them make better decisions and promote some real competition in the market. Collective and/ or regulatory

² For an explanation of the risks with 'Freedom and Choice' see [Funding income in retirement and asset decumulation products at <http://inclusioncentre.co.uk/wordpress29/2015-and-beyond-financial-services-priorities/major-public-policy-issues>](http://inclusioncentre.co.uk/wordpress29/2015-and-beyond-financial-services-priorities/major-public-policy-issues)

interventions such as NEST and, prior to this, stakeholder pensions and the RU64 rule introduced real value into the pensions accumulation market where competition and choice conspicuously failed to do so. We believe that a NEST decumulation version would have the same impact on the decumulation market.

Another potential solution would be to explore whether the state can play a bigger role in providing a low risk, good value alternative especially for the self-employed.

- **What would be the impact on individuals, employers, NEST and other pension providers of this approach?**

We believe this would be of significant benefit to individual consumers as it would provide them with a beacon of good value and reduce the risk of misselling if advisers were required to comply with an updated form of RU64. It would also enhance the ability of employers to provide better options for employees. As for pension providers, we expect the main impact would be to force them to offer better value options or else exit the market.

Extending access

- **Should access to NEST be more flexible?**

Yes. As we explain above, growing numbers of people are not conforming to the conventional pattern of employment and face much greater labour market uncertainty and unpredictability. We see no evidence that the market itself is responding sufficiently well to accommodate this new economic reality. Therefore, there is an important role for NEST to play in providing more flexible options.

- **What would be the impact on individuals, employers, NEST and other pension providers of this approach?**

Clearly, more flexible access to NEST would benefit people underserved by the market, and would aid employers who wanted to support employees. Again, we believe that NEST acting as a beacon of value and innovation would drive improvements in the commercial market. We are not in a position to comment on the impact on NEST.

This marks the end of The Financial Inclusion Centre submission