

Are defaults at-retirement really in members best interest?

Jonathan Watts-Lay highlights the problems of defaulting members upon reaching retirement

There has been a growing concern since freedom and choice in pensions came in that individuals are making sub-optimal decisions, which are resulting in poor outcomes at-retirement. For example, the FCA has found that individuals are fully cashing in their pension pots and that accessing them early has become 'the new norm'. Alongside this, the Treasury has reported that the tax taken from pensions has been bigger than what they actually forecast, suggesting that individuals are often paying tax when it could have been avoided.

In recognition of this and as part of its measures to protect savers who are disengaged with their pensions, the Work and Pensions Select Committee recommended that every pension provider should be required to offer a default decumulation pathway. This means that if someone doesn't make an active decision at-retirement, they will automatically go into the default option and will draw their retirement income from that.

I find the idea of defaulting members into something without a positive choice being made extremely worrying for a number of reasons.

Firstly, it raises questions over if it is actually within the providers or the member's best interest? Because if the default is with the members existing pension provider, then their assets will

stay with the provider – and it's clearly in a provider's interest for those assets to stay with them.

Additionally, if individuals don't make active decisions around the choices they have and are defaulted at-retirement, there's a danger that freedom and choice will be destroyed. We have seen similar situations before and history tells us that it doesn't end well.

For example, before the pension changes many retirees purchased an annuity from their existing pension provider – in essence the default position, albeit the majority could have received better levels of income elsewhere. Similarly, with defaults at pension decumulation, we are effectively discouraging shopping around, which again suggests the winners are the providers putting the default solutions in place and not the member.

The effects of not making active choices at-retirement could be extremely costly. For example, if a member doesn't respond to the 'wake-up' pack and is defaulted, there may be a number of consequences such as triggering the money purchase annual allowance or affecting means-tested benefits.

In addition, as many people will have more than one pension pot, if they all default based on individual pots rather than the collective value, the likely outcome for many will be sub-optimal and actually reduce income. Partly because many will end up paying

more tax than is necessary or because they haven't considered their changing income needs throughout retirement.

In reality, I don't believe anyone can be defaulted at-retirement without some type of guidance and a proactive decision being made. The solution lies in getting employees and members to take advantage of support services that already exist, in particular professional financial education and guidance and regulated advice where appropriate.

For example, although Pension Wise take up is relatively low, the user satisfaction is high and a more confident, knowledgeable individual is the result. Members who access financial education programmes and workplace financial guidance services are equally satisfied. Our experience is that they too emerge more confident, knowledgeable and more able to make informed decisions; it has been no surprise to see significant numbers of members changing their retirement plans, increasing pension contributions and seeking out regulated advice as a result.

In summary, we should be talking about 'guidance pathways' not 'default pathways'. So before more defaults are created, let's have more effort to make financial education and guidance the norm.

Do you believe that employees with a defined contribution scheme should be defaulted into a decumulation pathway at-retirement without financial guidance? Please let us know your view by completing our poll www.wealthatwork.co.uk/corporate/your-say/



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