



OFFICE OF FAIR TRADING

Report of the Director General's Inquiry into Pensions

Volume Two

Research undertaken by the OFT
for the Pensions Inquiry:

- ◆ Consumer Survey
- ◆ Structured Interview Process
- ◆ The Potential for Minimising Consumer Detriment in Pensions
 - ◆ International Comparisons

July 1997

APPENDIX B

United Kingdom Structured Interview Process

July 1997

B.1 Response to structured interview questionnaires

The following analysis is based on generic structured interview questionnaires. Thirty organisations were interviewed. A list is attached (see Table 1, page 80).

- 1 *Would you say that the industry regrets its involvement in the transfer from SERPS and occupational schemes into Personal Pension products?*

75% (11) of industry participants responded to this question. Only one organisation, an insurance company, expressed no regrets. The rest regretted getting involved to varying degrees.

- 2 *Much discussion worldwide centres on the ageing of the population as a stimulus for countries to reform their pensions? Is xxxx concerned with the United Kingdom's position, in terms of this issue?*

60% (18) of the sample responded to this question. There was universal agreement that the problem in the UK was not as significant as that faced in Europe or Japan, and that the UK was better prepared. It was acknowledged that potential demographic problems influenced government policy; SERPs would have been unsustainable in its old form. One respondent said that government action in the mid-1980s was, in hindsight, appropriate.

- 3 *There is anecdotal evidence suggesting that consumers have suffered from undervalued transfer values when moving from one scheme to another. Does industry accept that this does occur and should industry place pressure on actuaries to limit or minimise this practice?*

86% (26) of the sample responded to this question. Almost all agreed that consumers have suffered from undervalued transfer values when moving from one scheme to another. This was usually the result of over-conservative valuations by actuaries. The Faculty and Institute of Actuaries Guidance Note 11 is observed by most actuaries, but can be interpreted in many different ways; this has, in the past, led to some large differences in transfer values for example, 50% differences were not unknown and 20-

25% were not uncommon. The Pensions Act 1995, which came into effect in 1997, requires disclosure and that transfer values should take account of all benefits and be consistent with the new minimum funding requirements. Some respondents felt that the issue of transfer values needed to be examined further.

- 4 *Anecdotal evidence suggests that worldwide, there is a shift from DB to DC benefits? This shift results in a risk transfer to consumers. Is such a shift of risk significant for consumers? Does industry favour the shift in DC schemes and why?*

90% (27) of the sample responded to this question. All agreed that there had been a shift from DB to DC schemes, although not all felt that this was necessarily against the public interest. The burden of risk has shifted from employers to consumers, but these concerns were at least partly covered by the Pensions Act 1995. Benefits to employers were reduced costs, benefits to consumers included portability and a pension that was not dependent on final salary. However, one respondent felt that women, and other groups with interrupted careers and contribution patterns, lose out massively with the move from DB to DC; the loss of the employers' right to insist on membership of a compulsory occupational scheme was seen as a mistake by some. It was generally agreed that DC schemes were easier to understand than DB. There is a risk of lower payouts on DC due to lower contributions; public education is important in this regard, as is the need for effective regulation. One respondent pointed out that members of DC schemes had yet to experience a significant inflationary period.

- 5 *Much discussion has taken place about the pension mis-selling activities of intermediaries in the late 1980s. What lessons can be learnt from these events and does the design of pension products need to be improved to take these complaints into account?*

73% (22) of the sample responded to this question. Respondents felt that changes in the industry were due to demographic factors, and that mis-selling had little impact on the changing structure of the industry. A number of respondents felt that the complexity of pensions products made it difficult to get unbiased advice, and that mis-selling was a result of a lack of public education and poor management and training of IFAs. There is

a product to suit all circumstances; there are over 32,000 products in the market place (*Financial Times*, 12 January 1996), but not all providers offer all product types, and most IFAs offer only a limited product range. This has led to consumers buying inappropriate products for example, those with interrupted employment patterns buying products with heavy front-end loading of charges. One respondent queried if IFAs were qualified to advise on pensions, but another felt that personal pensions were no more complicated than unit trusts. The problems of mis-selling have largely been corrected by regulation, now that the disclosure regime and training and competence rules are coming into effect. The Pensions Act 1995 was significant in this regard. A number of respondents felt that a standardised product might be appropriate, but this would reduce consumer choice.

- 6 *Would you agree that the level of understanding by members of both occupational and personal pension schemes is low and needs to be addressed by a more co-ordinated effort of public education by government and regulators?*

86% (26) of the sample responded to this question. There was universal agreement that public understanding of pensions was low, but there was no consensus on who should be responsible for public education. One respondent felt that media comment was influenced by the potential loss of advertising revenue from the providers of financial products. Another respondent felt that government was not a good public educator and that market forces would determine the level of public education, but also said that the insurance industry had failed to educate the public. All who expressed a view agreed that a public education programme was a difficult undertaking, and in general agreed there were benefits to a co-ordinated approach, but no consensus was reached on who should be responsible for such co-ordination. The Australian model was quoted as a good example of public education on pensions.

- 7 *Are women and minority groups, such as ethnic and the self-employed, disadvantaged or discriminated against by the current design of pension products or the broader pensions framework? Is industry developing products specifically to meet the challenges of these groups in relation to flexibility, charges, etc?*

90% (27) of the sample responded to this question. The majority of respondents did not feel that women, as a group, were particularly discriminated against, but faced the same problems as others with low incomes and interrupted employment patterns. Was bias in pensions products in-built? Women could incur front-end loaded charges every time they change jobs or restart work; some respondents felt that DC schemes with premium holidays and low charges were the most suitable for those with interrupted employment patterns and low pay. Consumers from ethnic minorities who do not speak English had trouble getting information in languages they could understand. The tax treatment of pensions contributions was considered an issue; should contributions be made from sources other than income?

- 8 *Many industry participants argue that increased regulation has placed a high fixed cost on the pricing of pension products. Would you agree with this view and is there any supporting data?*

60% (18) of the sample responded to this question although few gave a full response. Opinion differed on whether the cost of regulation was significant, but only one respondent who believed regulation was expensive was aware of any supporting data. Some respondents felt that the Pensions Act 1995 had increased the cost of regulating DB schemes and was partly responsible for the shift from DB to DC. One respondent believed that the cost of compliance with regulation for IFAs was the same as the price of maintaining good practice and would be incurred if regulations did not exist.

- 9 *Can it be argued that the current distribution methods of pensions products do not take account of changing consumer behaviour, use of direct marketing systems and the fact that consumer confidence is low in relation to advisers and/or agents?*

The industry has not yet fully adapted to changing consumer behaviour. One respondent went as far as to say that many pension and life companies had not caught up with changing patterns in the workforce and were 50 years out of date. Some respondents felt that the IFA network was the most appropriate distribution system to deal with the complexities of pensions, but others had earlier expressed a belief that IFAs were unqualified to advise on pensions. A need for more salaried advisers and better public

education was identified. Under the current system the low/medium paid can afford only tied advice and, with the low commission available on the products they can afford, they are likely to get the worst advisers. Direct selling has historically accounted for 3% of the market; there has been no noticeable change in this market share recently. A general view came across that consumers, particularly women, prefer the telephone to meeting IFAs in their own home. Simpler, more standardised products, would lead to a growth in direct selling.

- 10 *Could you describe or speculate what the landscape of the UK pensions industry will look like in 20 years' time and would you acknowledge that the importance of the pensions industry exists today and will exist in future?*

67% (20) of the sample responded to this question. It was generally agreed that this was a difficult question to answer and few respondents gave a detailed response. There will be more compulsion to make personal pension provision, with a reduced role for the state; SERPs will decline or become extinct altogether. There will be a growth in DC schemes, and they will become more flexible. The Australian model was seen as a good example. The tax and regulatory systems are likely to be simplified. Long-term care was seen by some as becoming as significant an issue as pension provision.

TABLE 1
PARTICIPANTS IN THE INQUIRY

<i>Organisation</i>	<i>Type of Organisation</i>
11 Institute for Fiscal Studies	Academic
12 UMIST	Academic
13 Alexander Clay & Partners	Industry
14 Association of British Insurers	Industry
15 Association of Consulting Actuaries	Industry
16 Association of Unit Trusts and Investment Funds	Industry
17 Confederation of British Industry	Industry
18 Hammond & Suddard	Industry
19 Institute of Actuaries	Industry
20 Institute of Personnel Development	Industry
21 National Association of Pension Funds	Industry
22 National Mutual Life	Industry
33 NPI	Industry
24 Prudential	Industry
25 Sadler J	Industry
26 Society of Pension Consultants	Industry
27 Sun Alliance	Industry
28 Department of Social Security	Government
29 Department of Trade and Industry	Government
30 Government Actuary's Department	Government
31 Her Majesty's Treasury	Government
32 Inland Revenue	Government
33 Occupational Pensions Regulatory Authority	Regulator
34 Personal Investment Authority	Regulator
35 Personal Investment Authority Consumer Panel	Regulator
36 Securities and Investments Board	Regulator
37 Consumers' Association	Consumers
38 Equal Opportunities Commission	Consumers
39 GMB	Consumers
40 Trade Union Congress	Consumers

TABLE 2
ANALYSIS OF COMPLETED MEETINGS

<i>Academic</i>	<i>Industry</i>	<i>Regulator</i>	<i>Government</i>	<i>Consumers</i>	<i>TOTAL</i>
2	15	4	5	4	30

United Kingdom's pensions system (references for data in Appendix D)

Main economic indicators

Gross domestic product =	2.7%	Unemployment rate =	6.2%
Consumer prices =	2.7%	Wages/earnings =	4.9%
GDP in billions of US\$ =	1135.0	GDP per capita in US\$ =	18494
(current prices and current exchange rates)		(current prices and current PPPs)	

Pensions

Implicit replacement rate =	23%	Population in millions =	58.26
Population over 60 in 1990 =	20.8%	Population over 60 in 2030 =	29.6%
Public pension spending =	4.5% of GDP		
Net present value of public pension scheme =	-24% of GDP		

Major structural features

First tier:

Old-age, survivors' pensions (basic state pension)
Normal retirement age — 60f/65m to be equalised at 65
Contribution years required for full pension — approximately 90% of working life (44 years for men, 39 years for women)
Indexation variable — retail price index
Financing — PAYG
Relative value of benefits — flat rate

Second tier:

Compulsory — at least one of the following

State Earnings Related Pension Scheme (SERPS)
Financing — PAYG
Earnings-related pension based on value of contributions

AND/OR

Occupational pensions
Financing — private sector fully-funded
Earnings-related or money purchase scheme organised/sponsored by an employer

AND/OR

Personal pensions
Financing — fully funded
Money purchase pension organised by individuals

Third tier

Free Standing Additional Voluntary Contributions (FSAVCs) or Additional Voluntary Contributions (AVCs)
To increase the benefit received from an occupational scheme

Personal pension
In addition to compulsory state provision