Pensions and Debt Advice – Bridging the Advice Gap

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Foreword

This paper was originally written in February 2017 with updates in summer 2017. The analysis primarily applies to England and Wales with possible variations to Scotland and Northern Ireland. However, the imperative for advisers and creditors to consider the implications of Pension Freedom and Automatic Enrolment applies across the UK.

This project was funded by the Money Advice Service to generate debate and discussion in the sector. The contents of the report do not necessarily reflect the views of the Money Advice Service.

Introduction

The last few years have seen seismic changes in UK pension policy. Pension Freedom (or Freedom and Choice in Pensions) introduced from April 2015 means that those over the age of 55 now have far greater flexibility to take lump sum payments from their pensions.

At the same time, automatic enrolment requires that increasing numbers of employees are automatically enrolled into pension saving with future planned increases in their contributions.

Meanwhile, the level of consumer debt in the UK continues to increase at a worrying rate. Bank of England figures[1] show that the amount owed by individuals at the end of January 2017 was £1,520 billion. The amount is increasing by £0.8 billion or £800 million every month.

The result is that consumers face the increasingly difficult challenge of how to choose between adequately providing for their later life and repaying their debt. Both are vital parts of financial planning but the optimum choice for the individual and their family involves a complex interaction of financial and personal considerations.

This paper sets down how the recent changes in UK pension policy impact on consumers' liability to repay debt. It explains the challenges for younger consumers in choosing between pension saving and debt repayment and how those reaching the age of 55 and eligible to use Pension Freedom need more help in determining how their financial and personal future is affected by the new option of using pension savings to repay debt.

More specifically, the paper aims to set out how the pension changes impact on debt advisers, creditors, and debt collection companies, and it offers recommendations for a change in approach. It takes as its basic premise that doing the best by the client/customer is essential for meeting regulatory and best practice principles.

In some areas, the paper raises wider questions that go beyond the boundary of debt advice. This is inevitable given the complexity of the subject and that the discussion of the pension changes so far has not fully considered the combined challenge of providing for later life while also repaying record amounts of debt. Hopefully the paper will be a useful contribution to wider discussion and action.

[1] bankofengland.co.uk/statistics/Documents/mc/2017/jan/moneyandcredit.pdf

Chapter One

This chapter explains how indebted consumers are affected by the recent and future developments in Pension Freedom. It covers:

- What has changed
- How many indebted consumers have been affected by the changes
- How many future indebted consumers are likely to be affected by the changes
- The impact of the changes on indebted consumers
- The information and advice needs of consumers affected by the changes

Pension Freedom

Pension Freedom was introduced in April 2015. It provides much more choice for those over the age of 55 to access any savings within a defined contribution pension.

1.1. A defined contribution pension is a savings scheme designed to provide income in later life, although the savings are currently accessible from the age of 55. The savings accumulate through a combination of contributions from the individual and from their employer (if applicable), and tax relief. Enhanced by investment growth, the hope is that the eventual savings pot will help provide adequate retirement income for the individual and any dependent family.

1.2. Until April 2015 most of those with defined contribution pensions were required to exchange 75% of their savings fund for an annuity - a stream of income normally paid for the recipient's lifetime. Unfortunately for many, the combination of a relatively small pension pot with which to buy an annuity and reduced annuity returns, made for a lower pension income than was hoped for or needed.

1.3. Since April 2015, all those over 55 with a defined contribution pension have had new options. Rather than taking an annuity (although that remains an option) the pension pot can now be seen as a savings account where money can be taken as and when desired.

1.4. The new rules have led to a significant increase in the number of consumers over 55 choosing to take money from their pension savings. The actual increase since April 2015 is difficult to assess because it's hard to know how many people would have accessed their defined contribution savings anyway had the rules not changed.

1.5. The original estimate in March 2014 from Her Majesty's Treasury (HMT) was that the new rules would encourage around 130,000 individuals a year, in defined contribution schemes, to drawdown their pensions at a faster rate than would have been possible via an annuity.[2]

1.6. We now know that consumers have been much more enthusiastic about Pension Freedom than Her Majesty's Treasury (HMT) expected. The most recent figures[3] show that from April 2015 through December 2016, 549,000 individuals accessed their pension pots taking out a total of £9.2 billion. In the last three months of 2016 alone, 162,000 people took £1.56 billion from their defined contribution pension savings.

1.7. Whilst still relatively early days, there is a lack of substantive intelligence on what consumers have done with this additional money. A Citizens Advice survey[4] of 521 individuals who had used Pension Freedom showed a potentially worrying intention to use their pension money to meet short-term needs such as funding daily living costs (29% of those surveyed), repaying debt (16%), or paying for one-off essentials (14%).

1.8. Pension Freedom offers more choice on accessing pension savings but it comes with other consequences. Most importantly, pension savings are intended to provide for income in later life. Consumers who access and use these savings before retirement will obviously no longer have the savings for use in future years.

1.9. More immediately, and dependent on the way the pension savings are accessed and the amount taken, the individual may face an unwelcome tax bill. In general, the first 25% of the savings are tax free but the remainder is subject to income tax.

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[2] gov.uk/government/uploads/system/uploads/attachment_data/file/295067/PU1638_policy_costings_ bud_2014_with_correction_slip.pdf page 11

[3] gov.uk/government/uploads/system/uploads/attachment_data/file/584292/Pensions_Flexibility_ January_2017.pdf

[4] citizensadvice.org.uk/Global/CitizensAdvice/Families%20Publications/LifeafterpensionchoicesPDF.pdf

At the age of 55, Joanna Smith decides to cash in all her pension savings. She has £30,000 in pension savings and has plans to spend all the money.

Joanna can take 25% of her pension savings as a tax-free lump sum. The remaining 75% (£22,500) is taxable as additional income. So, depending on her other taxable income, Joanna will pay income tax of either 20% or 40% on the £22,500. This means that up to £9,000 of the pension savings will be taken in income tax.

1.10. Another consequence is that those cashing in a defined contribution pension and taking more than the 25% tax free lump sum are restricted in how they can replenish their pension pot through new saving. This is because of the 'Money Purchase Annual Allowance (MPAA)'.

1.11. The MPAA is currently £10,000 a year; those affected are limited to saving £10,000 a year into new pension savings. The Government proposes that the MPAA will reduce to £4,000 from the start of the 2017/2018 tax year.

1.12. The tax consequences of taking pension lump sums and the working of the MPAA can be complex. They are examples of relatively technical points that could trap the unwary consumer who is otherwise tempted to access their pension pot.

Fraud and Pension Scams

1.13. Inevitably fraudsters have latched on to the ability of consumers to access large amounts of money, and pension scams have become a major problem. The Department of Work and Pensions (DWP) and HMT issued a consultation paper in December 2016 with proposals for countering the problem.[5]

1.14. Pension fraud comes in various forms but essentially the consumer is encouraged to access or change their pension savings in a way that seems financially attractive but actually results in the loss of some or all of the pension savings. The magnitude of the problem is worryingly high. Citizens Advice has calculated that 10.9 million consumers have received unsolicited contacts (calls, emails etc.) about their pension since April 2015[6], and industry estimates suggest that fraudsters could be behind as many as one in 10 pension transfer requests.[7]

Defined Benefit Pensions

1.15. Some consumers hold their pension savings within a defined benefit pension scheme. These savings are not subject to the uncertainty and fluctuation of investment returns, but promise a specified amount of future lifetime income from the age that the individual accesses their pension benefits.

1.16. To take advantage of Pension Freedom, holders of defined benefit pensions must first transfer their savings to a defined contribution scheme. This will not always be possible. For example, those enrolled in 'unfunded' defined benefit schemes (notably the civil service scheme) do not have the option to make such a transfer.

1.17. The promise of a specified amount of lifetime pension income greatly helps an individual plan for their later life. The Financial Conduct Authority (FCA) rules recognise this value when they set down that regulated advice should start by assuming that holders of defined benefit pensions should not transfer to a defined contribution scheme. FCA rules then provide additional consumer protection in requiring that regulated advice must be taken from a suitably qualified financial adviser if the cash equivalent transfer value of a defined benefit pension exceeds £30,000.

1.18. These rules are designed to protect consumers who might otherwise not fully understand the valuable safeguard of a promised lifetime pension income or who might be encouraged to unwisely give up this income in exchange for an immediately accessible lump sum.

1.19. Since the introduction of Pension Freedom there has been a noticeable increase in the number of consumers who have opted to transfer their defined benefit pension savings to a defined contribution scheme. The Pensions Regulator estimates that around 80,000 such transfers were made between 1st April 2016 and 31st March 2017. Whilst there seems to be no evidence that directly links the increase to Pension Freedom, it must be probable that it is at least partly associated with the growing awareness of the options offered by Pension Freedom and the increasing numbers taking advantage of these options.

[5] gov.uk/government/consultations/pension-scams/pensions-scams-consultation

[6] citizensadvice.org.uk/about-us/policy/policy-research-topics/pensions-policy-research-surveys-and- consultation-responses/pensions-policy-research/too-good-to-be-true-understanding-consumer- experience-of-pension-scams-a-year-on-from-pension-freedoms/

[7] xafinity.com/c_m_s/posts/view/Xafinityconsulting/2016/05/25/Possible_scams_in_11_of_pension_ transfer_cases_finds_Xafinity

Impact of Pension Freedom on Indebted Consumers

1.20. Pension Freedom offers indebted consumers over the age of 55 the option to access their pension savings to repay debt. Rather than have to exchange 75% of their pension pot for what was often a small amount of lifetime income through an annuity, anything up to the entire value of the pension fund can now be used to improve their immediate financial situation through the repayment of debt.

1.21. This introduces dramatic new options for indebted consumers. Consider the example of a 55-year-old with credit card debt of £20,000 and pension savings of £32,000. Before Pension Freedom, the only option in accessing the pension savings was to take a lump sum of 25% (£8,000) and covert the remaining savings into a small amount of additional regular income. Now there is the option to take the entire £32,000 (before tax) to repay the debt.

1.22. The level of consumer debt in the UK must make it highly probable that increasing numbers of people over the age of 55 will at least want to consider using their defined contribution pension to repay debt. Whether using the pension pot in this way turns out to be a good decision depends on a complex interaction of financial and personal issues. These include:

- What tax liability is incurred in taking the £32,000
- What interest rate is charged on the credit card debt
- The level of financial and/or personal pressure the debtor is under to repay the debt
- The loss of future investment return on the pension savings
- How the loss of the pension savings impacts financially and personally on the debtor and family in future years
- Whether the debtor and any spouse/partner has other savings to meet their later-life needs and the amount of such savings
- How the debtor will replace the withdrawn pension savings and the scope to do so considering the reduction in the Money Purchase Annual Allowance
- Whether the debtor has a current need to claim a means tested welfare benefit or is likely to have in future
- Whether the debt can be repaid or refinanced in an alternative way
- Whether creditors might agree a partial lump-sum repayment of a debt in full and final settlement
- Possible future changes to the rules on pensions, tax, benefits, or perhaps some other variable that has not yet been considered by policymakers.

1.23. Clearly, the importance and weighting of these issues will vary from person to person and the unwinding of others will not be known for many years. However, what is almost certain is that at some future point the individual will look back and come to some conclusion about the wisdom of their original decision to use their pension to repay debt.

1.24. Slightly younger indebted consumers will also be well advised to consider whether the prospect of accessing pension savings at age 55 changes their financial options. For example, debtors entering a Debt Management Plan, Individual Voluntary Arrangement, or Bankruptcy that is likely to be still in place when they reach 55 will need to think through how the new rules impact on options to best resolve their debt problem.

1.25. The following example shows how two debtors with the same debt problem and with the same option to use Pension Freedom might rationally consider different approaches.

Mr Adams is 55 and single. He has no dependents. He earns £22,000 a year but is in poor health and fears that he may be forced to give up work well before his state pension age of 67. He lives in local authority rented accommodation. He has credit card debt of £35,000 which he is struggling to pay given the minimum repayment of £850 per month. He has a defined contribution pension with a current value of £50,000. He seeks advice about the advantages and disadvantages of using Pension Freedom to repay his debt.

Mrs Brown is 55 and married. She earns £22,000 a year and hopes and expects that she will continue working for as long as she wants. She lives with her husband in local authority rented accommodation. Her husband, who is 58, has a long-standing defined benefit pension which is projected to pay him a lifelong index-linked pension of £12,000 a year from age 60 plus a tax-free lump sum of £36,000. Mrs Brown has credit card debt of £35,000 which she is struggling to pay given the minimum repayments of £850 per month. She has a defined contribution pension with a current value of £50,000. She seeks advice about the advantages and disadvantages of using Pension Freedom to repay her debt.

Before Pension Freedom, the normal debt advice approach in both cases would have been to ask the credit card companies to accept payments based on the ability to pay of Mr Adams and Mrs Brown plus a freezing or reduction in interest payments.

Consideration would also have been given to the advantages, disadvantages, and implications of Mr Adams and Mrs Brown applying for Bankruptcy or an Individual Voluntary Arrangement.

Pension Freedom means that both Mr Adams and Mrs Brown can now access their pension savings to repay their debt. If they elected to take the whole pot, they would each receive, using 2016/17 tax rates, £39,200. This would more than clear their debts, despite paying £10,800 in income tax.

Mr Adams and Mrs Brown might be attracted by the option of repaying their debt immediately and being better off by £850 per month. They would both resolve their debt problem without any discussion with their creditors or any adverse impact on their credit file.

However, Mr Adams will need to be aware that he is giving up the pension savings that were meant to help him in later life. He will also be potentially vulnerable if he does become unable to work in the near future as he will have a restricted entitlement to means tested benefits because of his residual savings after repaying his debt. Using his pension savings to repay debt might also disqualify him from future benefit entitlement (see chapter five). He has the option of saving some of the £850 per month no longer required to repay his credit cards, but he would be unable to put all of this into re-establishing his pension saving because of the MPAA (Money Purchase Annual Allowance) especially once it is reduced to £4,000 per year.

On the other hand, if Mrs Brown cashes in her pension she knows that she and her husband can still look forward to a defined amount of lifetime pension income from her husband's pension. She will also be able, should she wish, to allocate part of the £850 per month no longer used for debt repayment into new pension saving in her husband's name once she has used all of her MPAA.

1.26. This analysis does not mean that Mr Adams should not access his pension to repay his debt, or that Mrs Brown is well advised to cash in her pension.

1.27. If Mr Adams feels that clearing his debt and having £850 per month more disposable income will allow a dramatic change in his life, and he fully understands that accessing his pension savings leaves him potentially vulnerable as and when he no longer works, then he may consider it in his best interests to access his pension. Whilst the MPAA will restrict his ability to replenish his pension he will still have a range of other options to build his savings.

1.28. Similarly, Mrs Brown has the alternative pre-Pension Freedom option of seeking a reduced payment and interest arrangement with her creditors and perhaps asking her husband to use his tax-free pension lump sum to repay the debt. From a purely financial perspective, this is a better option because it does not result in Mrs Brown losing a large amount of her pension saving in income tax. But Mr and Mrs Brown will need to think through whether the resultant impaired credit rating could be something they regret given whatever life plans they have for their future. As ever, effective debt advice will not just consider the short-term financial outcome.

1.29. Comprehensive debt advice would also assess the options and implications of an insolvency remedy and the possible alternative of seeking the credit card companies' agreement to a partial payment of the £35,000 in full settlement. For example, if the companies were prepared to accept £25,000 in full and final settlement then both Mr Adams and Mrs Brown would only need to take around £28,000 from their pension pots. The credit card companies might be persuaded to accept the offer because there is the option for both Mr Adams and Mrs Brown to petition for bankruptcy where the pension savings would not be available as an asset (see chapter five for more discussion of the interaction of Pension Freedom and insolvency)

1.30. This simple example shows how Pension Freedom complicates debt advice for clients over the age of 50 and how those complications involve consideration of a wide range of personal and financial issues.

1.31. The assessment of whether to access pension savings to repay debt also needs to consider whether the indebted consumer has 'problem' or 'non-problem' debt.

1.32. Providers of debt advice generally only advise on 'problem' debt, which, for the purposes of this paper, we can define as debt which is causing financial stress that seriously adversely impacts on the debtor and family.

1.33. Using Pension Freedom to repay 'problem' debt is likely to be attractive simply because it has the potential to remove the stress of the debt problem immediately. Raiding pension savings may turn out to be a poor decision for both financial and life reasons but the perceived short-term benefit may well be uppermost in the mind of the debtor faced with problem debt.

1.34. Advising on whether to use Pension Freedom to repay 'non-problem' debt is both less of a challenge than with 'problem' debt advice and yet more difficult.

1.35. It is less of a challenge because the absence of financial stress makes the decision more weighted to financial analysis only. There is little or no need for consideration of whether repayment of the debt would have significant non-financial benefits on the well-being of debtor and family.

Mr and Mrs Coombs feel financially secure. They have both just reached the age of 55, each earns £40,000 a year and they live in their home which is valued around £600,000 with a mortgage of £100,000. They have no other debt. Mr Coombs has a defined benefit pension which promises him a lifetime index-linked income of £25,000 a year from age 60. Mrs Coombs has a defined contribution pension valued at £400,000. They wonder whether to take advantage of Pension Freedom to use Mrs Coombs' pension to repay their mortgage debt.

Here, Mrs Coombs could use Pension Freedom to access a tax-free lump sum to immediately repay the mortgage debt. Whether this makes financial sense will depend on factors such as how the mortgage interest rate compares with the anticipated investment return on the defined contribution pension, and whether mortgage repayment triggers an early repayment charge. Because there would be no need to take more than the 25% of the pension savings allowable as a tax-free lump sum, Mrs Coombs is not restricted by the MPAA. Therefore, she could continue to pay up to, and get tax relief on, £40,000 a year of future pension contributions.

1.36. The more difficult element is who Mr and Mrs Coombs turn to if they want advice on what they should do. The current 'debt advice' sector cannot help as it already has insufficient capacity to advise those with 'problem' debt. Suggesting that Mr and Mrs Coombs speak to a financial adviser seems the most appropriate option. Yet most financial advisers do not hold the necessary FCA permission to provide debt counselling which is required to advise on whether a consumer should repay a consumer credit debt. Chapter four discusses this regulatory conundrum.

The Information and Advice Needs of Indebted Consumers who can take Advantage of Pension Freedom

1.37. The importance and potential complexity of the Pension Freedom decision means that FCA rules require that consumers are provided with information to help them make their choice. The rules, last reviewed in April 2016[8], provide, amongst other requirements, that pension firms provide timely, relevant, and adequate information to enable consumers to make an informed choice. Readers who want to know more about the information rules will find them mainly set out in the FCA Handbook at COBS 19.4.[9]

1.38. It should be noted that the FCA rules make no reference to any need to provide information or guidance about the advantages, disadvantages, and implications of using pension savings to repay debt.

1.39. Consumers are also able to access the services of Pension Wise[10], the free and impartial guidance service established specifically to help consumers understand and make the best use of the options of Pension Freedom. The service is available for those aged 50 or over who have one or more defined contribution pension pots that they are planning to access. Other consumers may still contact The Pensions Advisory Service(TPAS) for information and guidance on any pension matter.

1.40. When Pension Wise was established, some commentators were concerned that the generic nature of 'guidance' would be insufficient for consumers to make an informed decision on whether and how to use Pension Freedom. The main concern was that pension guidance is unable to answer the question: 'given the various options and given my specific situation, what do you advise I do about accessing my pension savings?'

1.41. The initial (October 2016) evaluation of Pension Wise[11] users suggest that this concern has not been borne out. More than 90% of those surveyed were satisfied with the guidance. Half said that one of their main reasons for using Pension Wise was to get a specific recommendation on what to do with their pension pot, but fewer than 4% were dissatisfied on discovering that the advice was not personalised with a specific recommendation.

1.42. The evaluation shows high satisfaction with Pension Wise, yet the numbers using the service have been lower than expected. The Work and Pensions Committee[12] and others are concerned. The latest January 2017 HMT figures[13] state that while there have been more than 100,000 Pension Wise appointments made in the twelve months to the end of 2016, this compares poorly with the 162,000 people who have accessed their pension savings during the last 3 months of 2016 alone.

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[8] fca.org.uk/publication/policy/ps16-12.pdf

[9] handbook.fca.org.uk/handbook/COBS/19/4.html

[10] pensionwise.gov.uk

[11] gov.uk/government/uploads/system/uploads/attachment_data/file/560163/pension-wise-service- evaluation-wave-1-interim-findings.pdf

[12] publications.parliament.uk/pa/cm201516/cmselect/cmworpen/371/37107.html#_idTextAnchor034

[13] gov.uk/government/news/over-92-billion-released-by-pension-freedoms

1.43. When collecting information about an enquirer's financial and personal circumstances, Pension Wise does include an explicit question on whether the individual has any debt. However, the subsequent discussion does not provide guidance or advice on debt. The only reference to debt on the Pension Wise website says 'You should think carefully about taking money from your pension pot to pay off debts. Money you take from your pot now could leave you with less to live on in the future'.[14] The website then refers the reader to the Citizens Advice and Money Advice Service websites. However, the challenges for debt advice explained in this paper means that the Citizens Advice and Money Advice Service websites are silent on how a consumer should decide whether to use Pension Freedom to repay debt. Similarly, the Money Advice Service booklet for consumers 'Your pension, it's time to choose' makes no reference to the advantages, disadvantages and implications of using pension savings to repay debt.

1.44. The result is a clear advice gap. Consumers with debt problems, who are eligible to access Pension Freedom, have a decision to make where full consideration involves complex financial and personal variables. Not only are these consumers not taking advantage of the information and guidance which is available, but they are unable to access the guidance and advice that they truly need which would bring together the issues of pension rules and options, tax, benefits, and resolution of debt problems.

1.45. Chapter three discusses how providers of debt advice, creditors, and debt collection companies are affected by clients and customers having access to Pension Freedom.

1.46. Another government initiative offers an option for advice on Pension Freedom. From April 2017 those with defined contribution pensions are able to withdraw up to £1,500 tax free (£500 in three different tax years) from their pension savings to pay for regulated financial advice on their pension savings. This Pensions Advice Allowance will be available to all ages.

1.47. £500 is a relatively small sum to pay for regulated financial advice and it is generally considered that at least £1,500 is needed to pay for regulated financial advice. However, the initiative acknowledges the need to bridge the gap.

[14] pensionwise.gov.uk/debt

Chapter Two

This chapter explains how indebted consumers are affected by the recent and future developments in automatic enrolment. It covers:

- What has changed
- What further changes are planned and when
- The impact of the changes on indebted consumers
- The information and advice needs of consumers affected by the changes

Automatic Enrolment

2.1. Automatic enrolment is the arrangement by which most UK employers are required to enroll their workers into a workplace pension. The process started in October 2012 with the largest employers and has since been extended across smaller firms. All eligible workers are to be automatically enrolled by February 2018. Employers are obliged to automatically enroll all workers who are:

- at least 22 years old and
- under State Pension Age and
- earning over £10,000 a year and
- work, or usually work, in the United Kingdom.

2.2. From the date of automatic enrolment, the worker has a month to choose whether to 'opt out' of the pension scheme. Those who do not opt out will make pension contributions from pay for as long as they are employed or until they retrieve their money. They also retain the right to stop making pension contributions although this is known as 'ceasing active membership' rather than 'opting out'.

2.3. The DWP (Department for Work and Pensions) estimates that automatic enrolment covers around 11.2 million eligible workers, of which 10.1 million will be saving for the first time or saving more by 2018. This amount of additional saving is substantial; the DWP estimates that £17 billion more will be saved each year into workplace pensions by 2019/20, with employees contributing £8 billion of the additional saving.[15]

2.4. The minimum employee contribution to their pension fund through automatic enrolment is currently set at 1% of qualifying earnings, which means payments of just 0.8% of qualifying earnings after basic rate tax relief. However, the employee contribution rate is scheduled to increase to 3% of qualifying earnings from April 2018 with a further increase to 5% from April 2019. The following table shows how these increased rates impact on a range of wages.

Annual Qualifying Earnings	Current Monthly Minimum Contribution	Current Monthly Minimum Contribution with tax relief at 20%	Minimum Monthly Contribution from April 2018	Minimum Monthly Contribution from April 2018 with tax relief at 20%	Minimum Monthly Contribution from April 2019	Minimum Monthly Contribution from April 2019 with tax relief at 20%
£11,000	£9.17	£7.33	£27.50	£22.00	£45.83	£36.67
£15,500	£12.92	£10.33	£38.75	£31.00	£64.58	£51.67
£22,500	£18.75	£15.00	£56.25	£45.00	£93.75	£75.00
£30,000	£25.00	£20.00	£75.00	£60.00	£125.00	£100.00

2.5. Automatic enrolment requires that the employer also contributes towards pension saving. The employer's payment is currently set at a minimum of 1% of qualifying earnings, increasing to 2% in April 2018 and 3% in April 2019. This additional payment is sometimes described by advocates of automatic enrolment as additional 'free money' for the employee. However, there is a counter argument that the obligation on employers to contribute more towards pensions might limit their ability or willingness to increase the employee's current or future wages.

[15] gov.uk/government/uploads/system/uploads/attachment_data/file/560356/workplace-pensions-update- analysis-auto-enrolment-2016.pdf

Opting Out of Automatic Enrolment

2.6. Eligible workers are automatically enrolled into a workplace pension but they can choose to opt out. Opting out within the first month means that any money paid by the employee will be refunded; leaving it for more than one month means that the contributions will remain locked in the pension scheme.

2.7. A decision to opt out is normally valid for three years where the employee continues to work for the same employer. After three years, the employer has to automatically enrol the worker back into the pension scheme again. The employee can again opt out if they wish.

2.8. The DWP's original estimate was that up to one third of employees would opt out of automatic enrolment[16]. This estimate has been reduced to 15% in the light of the actual figures reported by employers.

2.9. There is little evidence and analysis of why employees have so far decided to opt-out. A DWP study in 2014[17] identified affordability as a significant factor but this was based on a sample size of just 50 workers.

Future Changes

2.10. Planned changes plus further adjustments to the wider pension savings environment will impact on automatic enrolment.

Further Increase in Contribution Rates

2.11. The planned increase in contribution rates from April 2018 and April 2019 may cause some employees to review their workplace pension. Also, industry and political commentators, notably the Work and Pensions Select Committee,[18] have called for employee contributions to be increased further after 2019 to provide for a higher level of retirement income.

Age at which pension savings can be accessed.

2.12. The current rules provide that pension savings through automatic enrolment can be taken from the age of 55. An increase to age 57 is already planned for 2028 when State Pension age rises to 67. The Work and Pensions Select Committee has recommended[19] that eventually the minimum age for accessing pension saving, except on ill health grounds, should rise to five years before any future State Pension age.

Exit Charges

2.13. From 31 March 2017, early exit charges from pension policies will be capped at 1% of the value of a member's benefits being taken, converted or transferred from a scheme after age 55. It may be beneficial for some members to wait until age 55 before transferring their benefits and at the age of 55, it may be beneficial for some members to transfer from an old contract to a new contract that has lower charges.

LISA

2.14. The Lifetime Individual Savings Account (LISA) was introduced from April 2017. This is a savings product for those between 18 and 40 who want to save to buy their first home or for their retirement. The LISA allows for contributions of up to £4,000 a year with the Government adding a 25% bonus, i.e. up to £1,000.

2.15. Industry commentators already predict that the introduction of the LISA will inevitably increase the number of younger people who opt out of automatic enrolment. The prospect of saving in a product which can help to buy a first home, through a generous Government bonus, will outweigh the longer-term goal of saving for retirement.

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[16] Page 32 gov.uk/government/uploads/system/uploads/attachment_data/file/193454/rrep803.pdf

[17] gov.uk/government/uploads/system/uploads/attachment_data/file/288530/rrep862.pdf

[18] Para 25 publications.parliament.uk/pa/cm201415/cmselect/cmworpen/668/66806.htm

[19] Paragraph 112 publications.parliament.uk/pa/cm201415/cmselect/cmworpen/668/66809.htm#a34

Impact of Automatic Enrolment on Indebted Consumers

2.16. Few would argue against the intentions of a policy that encourages and requires consumers to take more interest in, and make better provision for, their retirement income. Depending on the terms of the pension scheme, the employee may also benefit from life cover and additional benefits.

2.17. However, the inevitable consequence is that the additional employee contributions to pension saving reduces take home pay. This is likely to become an increasing issue with the planned rise in employee contributions.

2.18. Many workers will be able to manage their new or additional contributions to pension saving by adjusting their financial approach. For example, those who already save on a regular basis can choose to allocate less to short-term saving. Others will think it necessary and/or appropriate to reduce their discretionary spending.

2.19. The challenge of new or additional pension saving will be more difficult for those who are under financial pressure with no obvious way to re-order their finances. Typically, this will be where all disposable income is already taken up by essential household bills and wider contractual payments. Even more difficult is the situation of the over indebted consumer who already has a deficit of income over expenditure and who is now faced with automatic enrolment.

2.20. These consumers are likely to need advice and guidance on how to manage the challenge of making new or additional pension savings whilst struggling to meet their current commitments.

The Information and Advice Needs of Indebted Consumers

2.21. Consumers who are being automatically enrolled will receive or can access a range of information:

- The Pensions Regulator requires that employers tell their workers that they are being automatically enrolled and that they have the right to opt out
- The Pensions Advisory Service and the Money Advice Service have useful website information for employees about automatic enrolment (but without any requirement that employers publicise this information)
- The Pensions Advisory Service provides independent telephone and webchat guidance by pension specialists for those who want to receive information and guidance on the advantages, disadvantages, and implications of automatic enrolment.

2.22. However, as with Pension Freedom, there is a lack of information or guidance for consumers concerned about how they will afford to make pension contributions. Neither The Pensions Advisory Service nor the Money Advice Service websites make any reference to the challenge of new or additional pension saving for indebted consumers. Further, the pension specialists at The Pensions Advisory Service are not trained in debt advice and do not hold FCA permissions to provide debt advice (or indeed other regulated advice).

2.23. Indebted consumers being automatically enrolled or facing future higher pension contributions would ideally be able to access information and advice to enable them to weigh up the impact of automatic enrolment on their immediate and future financial situation. This would include factors such as:

- the pressure of their debt problem
- interest charges on debt
- options to reduce their debt payments to help pay for increased pension contributions
- the personal and financial impact of prioritising debt repayment over future pension provision
- potential investment return within their pension
- value of employer pension contributions
- value of pension tax relief
- impact on any current and likely future entitlement to welfare benefits.

Chapter Three

This chapter explains the impact of Pension Freedom and automatic enrolment on the work of:

Providers of Debt Advice

- not-for-profit agencies
- commercial companies

Creditors

- consumer credit firms
- mortgage firms
- debt collection companies

3.1. Chapters one and two set out how Pension Freedom and automatic enrolment present both challenge and opportunity for those who are under financial pressure. The additional options to access pension savings after the age of 55 offers a possible new solution to a debt problem but at the expense of using resources previously set aside for retirement income. Similarly, whilst the requirement to save more into a pension will likely be of long-term advantage to the individual it reduces their ability to fund shorter term needs, including repayment of debt.

3.2. The previous chapters have also explained how the current provision of prescribed information and access to guidance on Pension Freedom and automatic enrolment does not discuss the interaction of pension saving and debt repayment. There is therefore an information and advice gap for consumers with debt problems.

3.3. This information and advice gap has significant implications for providers of debt advice. At the same time, the pension changes also potentially impact on lending decisions by consumer credit and mortgage firms, and on how firms collect debt. Firms lending money will need to consider whether and how the increased contributions required under automatic enrolment will impact on future ability to repay borrowing whilst debt collection departments and companies should reflect on how they will respond where customers use Pension Freedom to repay debt.

3.4. Historically, pension saving has rarely been a significant factor for debt advice providers, lenders or creditors when considering the ability of consumers to repay existing debt or future borrowing. The historic low level of UK pension saving has meant that those in financial difficulty have rarely had the option to reduce pension contributions to increase ability to repay debt. At the same time, consumer credit companies and mortgage lenders have tended to only ask for details of net pay (i.e. after deduction of tax, national insurance and other – including pension payments) when determining ability to pay existing or future borrowing.

3.5. As UK pension policy changes to nudging increasing numbers of employees to pay higher pension contributions whist offering more options for older individuals to access pension saving, this historic approach must surely come under pressure.

3.6. Some debt advice providers, notably Money Advice Scotland, have been looking for some time at this challenge. One suggestion from a recent debt advice conference was for a starting assumption that pension saving is crucial for the financial and personal future of the individual and family. Consequently, all assessment of ability to repay current and future debt would normally assess that the client/customer is best served by continuing to make pension contributions, and money saved within a pension should be disregarded where an individual has debt problems. The option to reduce pension contributions or use Pension Freedom to clear debt would only apply if there was no other option to resolve a debt problem that was acceptable to and clearly in the best interests of the debtor.

3.7. This exceptions-based approach would make it simpler for debt advice agencies and firms to offer advice and guidance about Pension Freedom and automatic enrolment. It would also support the Government's policy that consumers should allocate more to pension saving and that such saving is primarily designed for later-life income.

3.8. However, introducing this or other high-level policy is not within the gift of the debt advice sector. Any approach requires consultation and joint working between debt advice providers, consumer credit and mortgage firms and their trade bodies. Any changes would also need the consideration of the FCA and possible incorporation within the FCA Handbook.

3.9. The Money Advice Liaison Group brings together many of the stakeholders within the debt advice and consumer credit arena and is one suggestion as a venue for further discussion and exploration of an exceptions-based approach. However, others may also be interested in also taking up the challenge.

3.10. Meanwhile, in the absence of an agreed policy approach, this chapter assumes that some of those eligible to use Pension Freedom will want to consider using their pension savings to repay debt and that some making on-going pension contributions will question whether they should stop these payments. Providers of debt advice, creditors, and debt collection agencies must therefore think through their new responsibility in future dealings with these clients or customers.

Impact of Pension Freedom on Providers of Debt Advice

Advising indebted consumers who hold Defined Contribution Pension Savings

3.11. As set out above, Pension Freedom introduces a new option to all debt advice clients and customers over the age of 55 who have defined contribution pension savings. Providers of debt advice must consider the implications of this new option.

3.12. The requirement that debt advice includes consideration of the options offered by Pension Freedom comes from two obligations.

- It is an essential feature of high quality and effective debt advice that all providers should give full and tailored advice that meets the needs of the individual client; and
- Debt advice is a regulated activity covered by FCA (Financial Conduct Authority) rules. Amongst other FCA requirements, not taking account of a change in the client/customer's financial circumstances is likely to be in breach of principle two ('A firm must conduct its business with due skill, care, and diligence') and principle nine ('A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment').

3.13. The FCA rule for debt advice at CONC 8.3.2 is then even more explicit. A firm must ensure that all advice given and action taken by the firm or its agent or its appointed representative:

a) has regard to the best interests of the customer

b) is appropriate to the individual circumstances of the customer and

c) is based on a sufficiently full assessment of the financial circumstances of the customer

Customers receive sufficient information about the available options identified as suitable for the customers' needs and it explains the reasons why the firm considers the available options suitable and other options unsuitable.

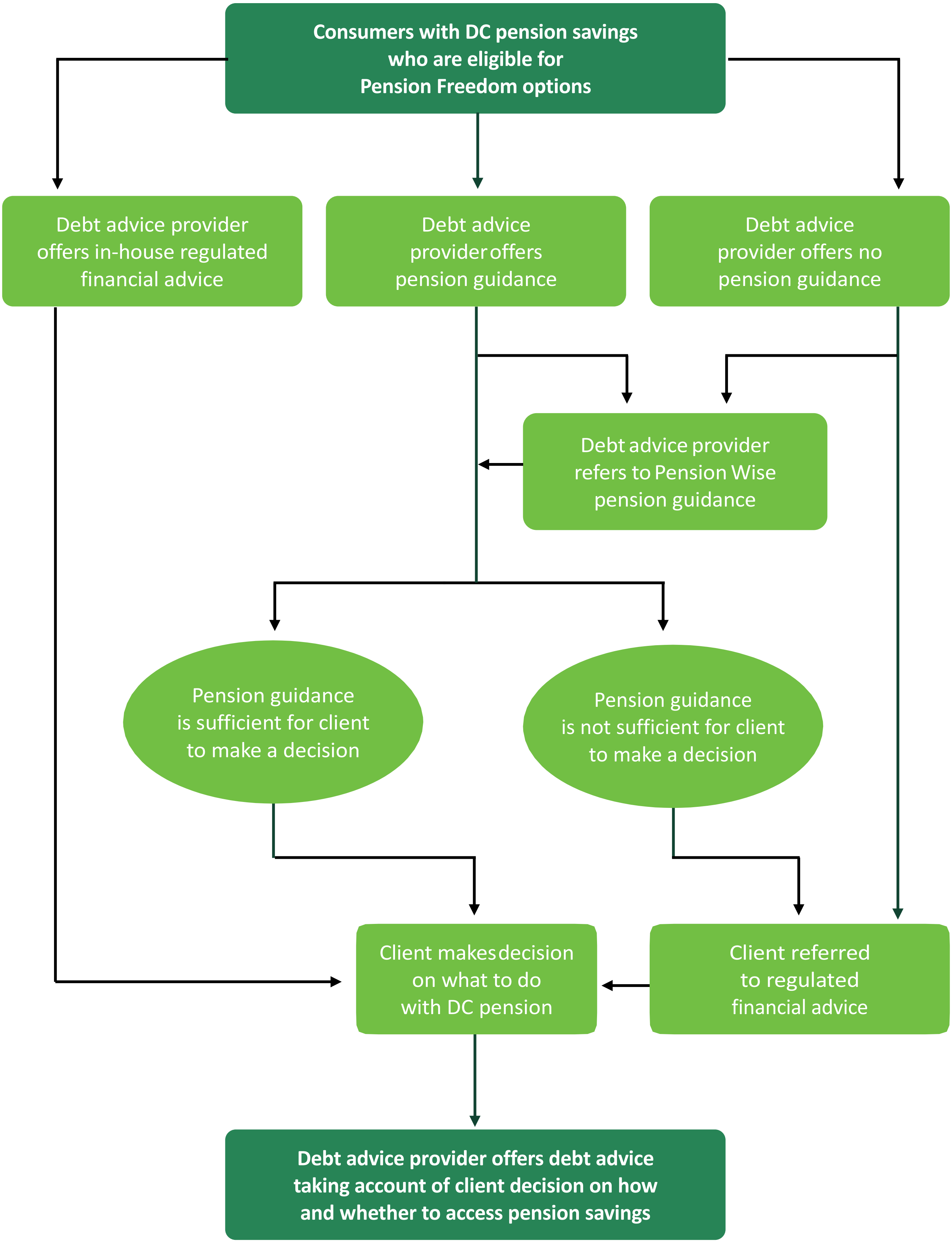
3.14. It is therefore essential that all providers of debt advice, whether not-for-profit or commercial, consider how they can meet the challenge of incorporating Pension Freedom options within their advice model. This potentially affects clients and customers over 55, or those who will reach 55, who are likely to be still dealing with their debt problem.

3.15. The initial decision needed from providers of debt advice is how they will ensure that their clients and customers can access information and advice on Pension Freedom. There is then a further decision on how this information and advice is reflected in the provision of debt advice.

3.16. In ensuring that clients and customers can access information and advice on Pension Freedom, providers of debt advice have three main options. They can look to:

- Provide regulated financial advice
- Provide pension guidance
- Provide no pension guidance

3.17. Each of these three options is potentially valid. The implications are shown in the following flow chart and discussed in subsequent paragraphs:


Consumers with DC pension savings who are eligible for Pension Freedom options
Debt advice provider offers in-house regulated financial advice
Debt advice provider offers pension guidance
Debt advice provider offers no pension guidance
Debt advice provider refers to Pension Wise pension guidance
Pension guidance is sufficient for client to make a decision
Pension guidance is not sufficient for client to make a decision
Client makes decision on what to do with DC pension
Client referred to regulated financial advice
Debt advice provider offers debt advice taking account of client decision on how and whether to access pension savings

Providing Regulated Financial Advice

3.18. Some providers of debt advice may wish to move to offering in-house regulated financial advice around the area of Pension Freedom. The costs to the client or customer of the regulated financial advice could potentially be met from the new Pensions Advice Allowance from the pension pot should the client or customer decide to access their pension savings.

3.19. Providing in-house regulated financial advice has potential advantages for the debt client or customer. A 'one-stop' combination of regulated financial advice and regulated debt advice offers seamless advice on the best way to include pension savings in the resolution of the debt problem that is most appropriate for the financial and personal needs of the individual and family.

3.20. However, there are significant costs and risks in this approach;

- There will be substantial setup, regulatory, and compliance costs in offering regulated financial advice
- The FCA and others will (rightly) be on watch for situations where debt clients and customers are wrongly advised or encouraged to take a pension lump sum to repay debt. The regulator's concern is likely to be intensified if there is a business relationship between the provider of debt advice and the provider of pension advice.

3.21. Providers of debt advice who also wish to offer in-house regulated financial advice will therefore want to be extremely careful that all of their regulated advice is beyond reproach and fully meets all requirements of regulation and best practice.

Providing Pension guidance

3.22. Pension guidance offers information and guidance but stops short of providing recommendations on whether the consumer should take specific steps to take advantage of Pension Freedom.

3.23. Chapter four discusses the regulatory issues where providers of debt advice offer pension guidance on Pension Freedom.

3.24. There are two main options for debt advice providers when arranging for their clients and customers to access guidance on pensions:

- Signpost clients and customers to Pension Wise
- Provide generic guidance on pensions as an integral part of the process of debt advice.

3.25. The availability of, and consumer satisfaction with, Pension Wise offers providers of debt advice one easy way to facilitate pension guidance. This would involve little additional work and make for a clear signposting for the client or customer.

3.26. However, this approach introduces an inevitable delay in the debt advice process. This may not be in the best interest of those who need or prefer more immediate progress in resolving their debt problem. Also, the interaction of the multiple options of accessing pension savings and resolving the debt problem may lead to the client/customer being serially referred between the debt advice provider and Pension Wise. The following example illustrates the challenge.

Mr Eber is thinking of taking a lump sum from his defined contribution pension to repay his loan debt. The generic guidance from Pension Wise will explain the advantages, disadvantages and implications of using Pension Freedom. It will identify the access to a lump sum, which can be anything up to the full amount held in pension savings, but with significant tax and perhaps benefit implications depending on the amount taken. Mr Eber then takes debt advice which explains the options for using the lump sum to help resolve the debt problem. These options may suggest the possibility of taking a different amount of lump sum, for which he is referred back to Pension Wise for explanation of the impact of tax and benefit consequences.

3.27. Some providers of debt advice may be willing and able to go further by incorporating guidance on Pension Freedom within their debt advice. This means they can facilitate contemporaneous discussion of the debt problem alongside guidance on Pension Freedom.

3.28. This combined service promises a potentially better outcome for the client/customer than a possible 'ping-pong' referral between debt advice and pension guidance.

3.29. A combined pension/debt discussion requires that either:

- Debt advisers are trained and competent to give guidance on Pension Freedom or
- Pension Wise guiders are trained and competent to give regulated debt advice or
- Debt advisers and Pension Wise guiders are located in the same venue for face to face advice, or that there can be an immediate and seamless telephone transfer between the debt adviser and the Pension Wise adviser, which can, if necessary, be repeated to ensure that all debt and pension savings options are covered.

3.30. It is debatable whether it would be easier to train debt advisers to give pension guidance or vice versa. The experience of The Pensions Advisory Service is that pre-existing pension knowledge is essential to deliver pensions guidance because most consumers do not know what pensions they have. However, it could also be argued that there is a greater range of options to resolve a debt problem than there are pension options and so it is easier for debt advisers to train to give pensions guidance than for those experienced in pension guidance to train to give regulated debt advice.

3.31. Whatever the answer, training of either group would require time and resources to establish. There are also regulatory issues to consider. Debt advice is regulated by the FCA whereas pensions guidance is not regulated under current legislation. Pension Wise is not mandated to provide debt advice.

3.32. However, there could be merit in a pilot which joins a debt advice provider with Pension Wise to test out a combined service for indebted consumers aged over 50 who have defined contribution pension savings. This might involve an exchange of debt advice and Pension Wise staff to provide face to face advice and guidance, or an immediate transfer of telephone clients from debt advice to pensions guidance and vice versa, or a conference call involving the debt and Pension Wise adviser and the debt client or customer.

3.33. Another option to provide pension guidance alongside debt advice would be to consider the merits and practicalities of extension to the 'Moneyplan' service currently facilitated by the Personal Finance Society and Citizens Advice. This introduces financial advisers to their Local Citizens Advice to give professional pro bono guidance to consumers who would not ordinarily be able to access financial advice. There is a benefit for all involved. The consumer receives free 'guidance' from a qualified financial adviser; the financial adviser qualifies for continuing professional development points while expanding their professional knowledge in other areas of personal finance, such as state benefits / managing debt etc; and the Local Citizens Advice is able to offer an improved holistic advice service.

3.34. Extending the Moneyplan or similar service to a wider range of providers of debt advice with a specific remit to provide pension guidance seems a potentially attractive way to help indebted consumers navigate the complex interaction of debt and pension options.

Referring indebted consumers for regulated advice on Pension Freedom

3.35. As set out above, some providers of debt advice may move to offering in-house regulated financial advice on Pension Freedom. However, it seems reasonable to assume that others, probably the large majority, will decide that this is a step too far.

3.36. It is important that all providers of debt advice consider the options for when their clients and customers need regulated advice on Pension Freedom. Such advice will be necessary where the client/customer requires specific personalised advice on how and whether they should access their pension savings. These clients or customers may feel unable to make a decision based on guidance alone, or there may also be situations where providers of debt advice consider it important that specific regulated advice is taken before the provider is willing to provide debt advice.

3.37. Regulated advice is also a regulatory requirement if the client/customer wants to transfer pension benefits with a cash value of more than £30,000 from a defined benefit scheme to a defined contribution scheme in order to access Pension Freedom.

3.38. However, regulated advice comes at a cost. This varies considerably according to location, adviser, and complexity of the matter, and consumers seeking regulated advice on whether or not to use Pension Freedom should expect a bill of at least £1,500.

3.39. Unfortunately, this cost will be beyond the reach of most debt clients or customers. Chapter one discusses how those with defined benefit pensions are able to take £500 from their pension savings in each of any three years to access regulated advice but this will still leave a large shortfall.

3.40. There is no easy answer to this problem (although chapter six suggests some options for a longer-term approach) and the debt advice provider may have no choice other than to explain the limits of the service that they can provide and leave the client-customer to access regulated financial advice as best they can.

3.41. The wider issue of how consumers face barriers in accessing financial advice is currently under consideration following the final report of the recent HMT Financial Advice Market Review.[20]

[20] fca.org.uk/publication/corporate/famr-final-report.pdf

The impact of Automatic Enrolment on Providers of Debt Advice

3.42. Automatic enrolment impacts on the majority of employees above the age of 22. It affects a wide range of current and future clients and customers of debt advice agencies and thus presents a wider challenge than Pension Freedom to both not-for-profit and commercial providers of debt advice.

3.43. As set out in chapters one and two, pension saving is necessary and appropriate for most adult consumers and it has attractive tax advantages. Yet such saving inevitably reduces current income. As more employees are automatically enrolled into pension saving, debt advice providers must be able to provide or facilitate advice or guidance on how automatic enrolment impacts on current and future options in repaying debt.

3.44. Indebted consumers will need advice or guidance on whether:

- to opt out of automatic enrolment at the initial stage so as to maintain their ability to repay debt
- to withdraw from automatic enrolment as contributions increase so as to maintain their ability to repay debt
- to increase pension contributions because of the tax savings and the long term need to provide for retirement income, even though this will reduce the short-term ability to repay debt.

3.45. Opting out of automatic enrolment will mean that the client/customer reduces their commitment to a regular outgoing and so has more disposable income. Generally, providing advice on whether and how an indebted consumer can reduce spending commitments is an essential 'budgeting' part of competent debt advice. For example, advising on how and whether a debt client/customer can reduce spending on utility costs, housekeeping, or car insurance is bread and butter work for debt advisers.

3.46. It could therefore be expected that advice on how and whether an indebted consumer should choose between pension saving and repayment of debt would also form part of the debt advice process. Indeed, not discussing the option to reduce pension saving to increase ability to repay debt could be in breach of best practice and FCA requirements.

3.47. However, and as explained in more detail in chapter four, advice on whether a debt client/customer should start, stop, or vary payments into a defined contribution pension is likely to be a regulated activity under FCA rules. Since very few debt advisers are authorised to give regulated financial advice, there is a clear challenge in ensuring that the client/customer is helped to consider their options in a way that does not breach the regulatory boundary.

3.48. As with Pension Freedom, providers of debt advice must carefully consider what advice they can and should provide when their clients or customers are saving or want to discuss varying their contributions within automatic enrolment.

3.49. Providers of debt advice should also consider whether and how the planned increases in employee pension contributions impact on their advice to current debt clients and customers. This is particularly important where the recommended debt solution will still be in place when the planned increases come into effect and thereby will reduce the available income of the client/customer.

3.50. Of course, increased pension contributions are just one of numerous financial and personal variables that will inevitably impact on workers and their families over the next few years. Some might argue that it is practically impossible to take these variables into account until they happen.

3.51. However, the future increases in pension contributions are 'known' changes which will inevitably impact on the debt client/customer who remains automatically enrolled. It therefore seems reasonable to expect that best advice would at least consider the impact of the future increased contributions when discussing debt solutions.

Providers of Debt Advice – Additional Implication for Commercial Companies

3.52. Not-for-profit and commercial providers of debt advice are both required to meet the relevant requirements of the FCA rules and principles as set out in the FCA Handbook. However, commercial providers of debt advice are additionally subject to the FCA Approved Persons Regime.

3.53. An approved person is an individual who is specifically identified as having several important regulatory responsibilities. These include a duty to be aware of, and comply with, FCA requirements.

3.54. Failure of the approved person to meet FCA obligations has potentially serious consequences. The FCA can impose a fine or suspension, or make a public statement where it finds that the approved person has not met their regulatory requirements. If the person is no longer considered fit and proper to perform their role, the FCA can also withdraw approval and prohibit the individual from holding a controlled function in the future.

3.55. The Approved Persons Regime makes it arguably more important that commercial providers of debt advice meet FCA requirements. The failure of a not-for-profit debt advice agency to keep to FCA rules would be a damning indictment of the management of the agency with reputational risk that extended to any national association. But there would be no individual person to take responsibility. Where a commercial firm breaches FCA requirements, one or more of the approved persons could be at personal risk.

3.56. The Approved Persons Regime for commercial providers of debt advice is scheduled to be replaced by the Senior Managers and Certification Regime from April 2018. This will provide the FCA with more options for sanctions against named individuals where a commercial debt management company breaches FCA rules.

3.57. Therefore, approved persons within commercial providers of debt advice should consider how there could be a future personal impact if their firm fails to incorporate advice appropriately to indebted consumers on Pension Freedom or automatic enrolment.

Impact of Pension Freedom on Creditors and Debt Collectors

3.58. Pension Freedom presents creditors and debt collectors with both opportunity and threat.

3.59. The opportunity lies with the new option for borrowers aged 55+ to use Pension Freedom to access pension savings to repay debt. Clearly, this is of potential financial advantage to creditors and debt collectors where the borrower is in arrears and would otherwise be unable to repay the money owed.

3.60. The threat comes from any assertion that a creditor or debt collector has encouraged a debtor to access their pension savings and the debtor has consequently suffered detriment.

3.61. The FCA is alive to possible consumer detriment in this area and has already added guidance (paragraph 7.3.10A of the CONC rules) that firms should not pressurise customers to use pension lump sums to repay debt.

3.62. However, more nuanced is the situation where a creditor or debt collector accepts money to repay a debt in the knowledge or suspicion that this has been made available under Pension Freedom. Creditors and debt collection companies may wish to consider whether they should have policies that answer questions such as:

- Does the creditor or debt collector have a responsibility in this situation under Principle 6 (A firm must pay due regard to the interests of its customers and treat them fairly), to suggest that the borrower takes advice before taking money from their pension pot to repay debt?
- Could the responsibility go further? Where any borrower over 55 makes an unexpected lump sum payment in full or partial settlement of a debt, should the creditor or debt collector actively ask whether the payment is financed from a pension lump sum and suggest that advice is taken if the answer is affirmative?
- Or is this all putting too much responsibility on a creditor or debt collector where the obligation should be on the borrower to take advantage of readily available information before deciding whether to access their pension?

3.63. It will be interesting to see if and how the FCA raises Pension Freedom as an issue within their supervising of consumer credit firms. At the least, even only as a defensive measure, it seems appropriate and necessary that creditors and debt collectors can show that they have considered the impact of Pension Freedom on their borrowers. Board directors and senior managers of creditors and debt collectors will also no doubt be aware of the impact of the future Senior Managers and Certification Regime.

Impact of Automatic Enrolment on Creditors and Debt Collectors

3.64. Automatic enrolment seems to offer a clear challenge to creditors and debt collectors. This is because eligible employees who do not opt-out of automatic enrolment will be steadily allocating more future income to long-term savings. The figures in chapter two set out the already planned impact on take home pay.

3.65. This leads to the question: to what extent it would be reasonable to expect lenders to reflect these planned changes in their assessment of creditworthiness and ability to pay.

3.66. FCA rules are not prescriptive in setting out how unsecured creditors and debt collectors should assess credit worthiness for future customers and ability to pay for existing arrears customers. The CONC rules at 5.3.2 and 7.2.1 require the establishment and implementation of clear and effective policies and procedures in both situations. Beyond this, the only reference to future changes is the guidance at CONC 5.2.3 (8) which states that the credit worthiness assessment 'may' include 'any future changes in circumstances which could be reasonably expected to have a significant financial adverse impact on the customer'.

3.67. Nevertheless, responsible creditors and debt collectors will want to consider if and how their customers will be affected by automatic enrolment.

Impact of Automatic Enrolment on Mortgage Lenders

3.68. FCA mortgage rules are noticeably stronger than consumer credit rules in setting down how mortgage lenders should look ahead to changes in a customer's ability to pay. MCOB 11.6.14 sets down that mortgage lenders must take account of known or likely future changes in income or expenditure when assessing the affordability of mortgage repayments.

3.69. The roll out of automatic enrolment and the known increase in future employee contributions clearly put mortgage lenders on notice of known and likely changes to the expected income of their current and future borrowers. Whether these changes will materially affect the ability to pay a mortgage will of course depend on the borrower's wider circumstances. But mortgage lenders will no doubt wish to consider whether and how automatic enrolment requires consideration within their mortgage lending and recovery procedures.

Chapter Four

This chapter discusses the regulatory aspect in communicating with consumers who seek or need help in deciding whether to access Pension Freedom or withdraw from automatic enrolment in order to repay debt. It identifies the main FCA rules that affect this area and the impact on debt advisers, creditors, and debt collection companies. It also looks at how FCA rules impact on the option of providing only information and guidance.

4.1. The previous chapter discusses how best practice and FCA rules require that providers of debt advice, creditors and debt collection agencies reflect the impact of Pension Freedom and automatic enrolment in their future contact with clients and customers.

4.2. This means that providers of debt advice, creditors and debt collection agencies must consider how and what their staff can reasonably do and say when discussing pension issues with clients and customers. Much of this will be a decision about whether, and how, staff can and should be trained to offer information or advice, and how clients/customers can be referred or signposted to other forms of information and advice. Another important element will be the identification of any regulatory constraints that prescribe what can and cannot be said.

Regulatory Issues for regulated Advice and Guidance with regard to Pension Freedom and Automatic Enrolment

4.3. Chapters one and two explain how advice and guidance on Pension Freedom and automatic enrolment require considerations of the merits and implications of consumers holding a defined contribution pension.

4.4. A defined contribution pension is a specified investment within the Financial Service and Markets Act. Therefore, as a general principle, FCA authorisation to give investment advice is required where advice on a defined contribution pension is offered to an individual and is provided 'by way of business'.

4.5. It is a criminal offence to provide unauthorised advice where authorisation is required. Further, and perhaps even more important for the practical purposes of this paper, breaching authorisation rules may lead to wider action by the FCA against a regulated firm and/or its approved persons.

4.6. It is therefore crucial that debt advisers, creditors, and debt collection companies who do not hold the necessary FCA permissions do not stray over the boundary into giving regulated financial advice when discussing Pension Freedom and automatic enrolment.

4.7. However, as often with regulation, the devil is in the detail and there is much that can helpfully be discussed with the consumer without breaching the regulatory boundary. We need to delve deeper to determine what can and cannot be said.

4.8. It must be noted that the boundary between regulated and unregulated advice can be remarkably blurred. What follows is intended as a helpful pointer but it should not be read as a definitive statement. Interested readers will find more information and guidance in the FCA Perimeter Guidance Manual.[21]

The Business Test

4.9. The first complexity of the regulatory boundary comes with the fact that pension advice (like all FCA activities) only requires authorisation if it is 'carried on by way of business'.

4.10. Section 2.3 of the FCA Perimeter Guidance Manual[22] is the starting point for those who want to read up on the detail of the business test. However, readers who follow the link may quickly conclude that the matter is not straightforward.

4.11. As PERG 2.3.3 explains, 'Whether or not an activity is carried on 'by way of business' is ultimately a question of judgement that takes account of several factors (none of which is likely to be conclusive). These include the degree of continuity, the existence of a commercial element, the scale of the activity, and the proportion of the activity in relation to other activities carried on by the same person but which are not regulated. The nature of the particular regulated activity that is carried on will also be relevant to the factual analysis'

4.12. The question therefore arises as to whether a provider of debt advice, creditor, or debt collection agency which offers pension advice does so by way of business.

[21] handbook.fca.org.uk/handbook/PERG.pdf

[22] handbook.fca.org.uk/handbook/PERG/2/3.html

4.13. One aspect of the business test was considered by HMT before the FCA took over responsibility for consumer credit. The particular question was whether not-for-profit debt advice agencies were 'in the business' of providing debt advice. These agencies made no charge for their advice and many were charities who relied heavily on volunteers. So, there was no commercial element in the advice with debt advice being sometimes just one part of a much wider provision of advice and information on a range of topics.

4.14. In 2013, HMT decided to settle this question by amending the regulated activities section of the Financial Services and Markets Act.[23] The Act now provides that a not-for-profit body regularly carrying on debt adjusting, debt counselling or providing credit information services is to be regarded as doing so 'by way of business'.

4.15. This amendment provided helpful clarity in clearly bringing not-for-profit debt advice agencies within the business test. However, the same question now arises with pension advice. Does a not-for-profit debt advice provider which offers pension advice in association with debt advice do so by way of business? How about creditors, debt collectors, and commercial providers of debt advice? Are they in the business of providing pension advice if this is offered in the course of any discussion about a consumer's debt problem?

4.16. In reality it is difficult to think that any otherwise regulated firm or advice agency would want to try to provide tailored financial advice to individuals and argue that doing so was unregulated because the advice was outside the business test. Any attempt to go down this route is very likely to cause wider concern for the regulator and raise awkward questions from any professional indemnity insurer about the regulated advice.

4.17. So while the business test illustrates that the regulatory environment for regulated financial advice is not as simple as it may at first seem, debt advice providers, creditors and debt collection agencies should assume that they are caught by the test.

Individual Advice

4.18. Assuming that the business test is met, advice is then only regulated if it is providing advice on whether an individual pension holder or prospective holder should start, stop, or vary pension contributions, or take money from their specific pension.

4.19. The advice must relate to a specific pension. So, advice to Mrs Smith that she should start, stop or vary contributions to her pension with company ABC is clearly regulated.

4.20. However, the regulatory boundary can become blurred where the advice is not related to a specific pension. For example, if a debt adviser suggested that Mrs Smith should stop making contributions to her pension to help repay her debts, but did not know that Mrs Smith had a pension with company ABC then it is arguable that the pension advice did not relate to an identified specific pension and so the adviser did not require FCA authorisation to provide that advice.

4.21. But whilst the debt adviser may not know the specific details about Mrs Smith's pension, all Mrs Smith has heard is the suggestion that she should stop paying into her pension, which she knows is with company ABC. So, the outcome is that the discussion with the debt adviser results in Mrs Smith ceasing payments to her ABC pension.

4.22. Moreover, even if the pension advice did not require FCA authorisation, the associated and more specific debt advice is regulated. There must be a question of whether the advice to stop making pension payments has fully considered all of the short and long term implications for Mrs Smith and so whether the debt advice complied with FCA CONC rules and principles.

4.23. Another illustration of the blurred regulatory boundary lies within the range of questions that need to be addressed within pension advice. Tax is a good example. Mrs Smith will need to know how much income tax she will pay if she elects to use Pension Freedom to access her pension savings. Advising Mrs Smith on the specifics of her tax liability if she accesses her pension with company ABC is not regulated advice because the FCA does not regulate tax advice. So from a regulatory perspective, the debt adviser or the collections employee can discuss the tax consequence of Mrs Smith taking money from her ABC pension so long as they do not give advice on whether she should take the money in the first place. Whether the debt adviser or collections employee is competent to give this advice and whether the advice agency or the collections firm would want their staff to offer such advice is a different matter. The FCA has also previously made it very clear that it can and will look at non-regulated activities in reviewing how regulated firms operate.

4.24. This complexity of the regulatory boundary should make providers of debt advice, creditors and debt collection agencies extremely cautious when discussing Pension Freedom and automatic enrolment with clients and customers. It may be possible to delicately dance around the regulatory boundary, but there are various ways in which the boundary can be breached, even though this is done trying to meet the best interests of the client/customer.

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[23] Chapter 13, The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013 legislation.gov.uk/uksi/2013/1881/article/13/made

Generic Advice (Guidance)

4.25. Generic advice, or guidance, is a broad term that covers information or advice which does not provide a personal recommendation about what an individual should do in respect of an FCA regulated product. It can be a powerful tool to help clients and customers understand their financial options better.

4.26. There has long been a debate about the appropriate role of generic financial advice within debt advice. More recently the term 'guidance' has replaced generic advice and this report will follow the new terminology.

4.27. Giving guidance about pensions, or indeed any other financial matter covered by FCA rules, does not require FCA authorisation. Guidance therefore offers another way for debt advice providers, creditors and debt collection companies to help their clients or customers understand the implications of Pension Freedom and automatic enrolment.

4.28. Examples of pension guidance include:

- Using pension savings to repay debt may help your immediate financial position but will inevitably reduce your future pension income
- If you are going to take money from pension savings to repay debt, you need to take account of the potential tax liability
- You should consider whether paying into a pension will unhelpfully reduce your ability to repay your debt.

4.29. Guidance can be very useful in helping a consumer understand their pension options better and take a decision that best suits their needs. But it does mean that the advice cannot answer the question of whether a client/customer should use Pension Freedom to access their pension with company ABC, or whether they should or should not opt out of automatic enrolment.

4.30. It is also important that guidance is sufficiently expansive so that it does not inadvertently signpost the indebted consumer to a particular outcome. For example, as set out above, the advice that 'you should consider how paying into a pension will unhelpfully reduce your ability to repay your debt' is generic – it does not advise that the client/customer should stop paying in to their specific pension. But it could be interpreted as weighted towards the outcome that the person should stop paying into their pension which happens to be solely held with company ABC. If so, then the outcome for the consumer is the same as if there had been specific and regulated advice.

4.31. To avoid this, guidance should always avoid any advice about a specific product and set out the advantages, disadvantages, and implications of a particular course of action. So rather than 'you should consider whether paying into a pension will unhelpfully reduce your ability to repay your debt' the better approach is 'the advantages of stopping your pension payments to repay your debts are …, the disadvantages of stopping your pension payments to repay your debts are…, and the implications of stopping your pension payments to repay your debts are…'

4.32. It is further important that the client/customer is told that the advice is 'only' generic and guidance and is therefore unregulated. It is probable that many client/customers will not be interested in such detail, and there is always a possibility that providing ancillary information detracts from or reduces the clients/customer ability to assimilate the more important advice. But having a policy which ensures that the generic nature of the advice is clearly specified is important to provide clarity for the client or customer as well as a sensible precaution for the firm or agency should there be a subsequent complaint about the 'advice'.

Referring Indebted Consumers to other Providers of Regulated financial advice

4.33. Providers of debt advice, creditors, and debt collection companies need to be aware of the regulatory implication if they make arrangements for clients or customers to receive specific advice on whether they should access their pension savings or change their contributions. Making referrals or introductions to regulated advice may sound straightforward but it has potential pitfalls. This is because making referrals or introductions to regulated advice may be considered to be 'arranging deals in investments' under article 25 of the Regulated Activities Order of the Financial Services and Markets Act. Arrangements caught under article 25 are a specified activity which requires the firm or person making the introduction to hold the appropriate FCA authorisation.

4.34. Article 29 of the Regulated Activities Order provides an exclusion to article 25. It provides that making the referral does not require FCA authorisation if it is clear, in all the circumstances, that the client/customer is not seeking and has not sought advice from the referral agency or firm on the merits of starting, stopping, varying or accessing their pension (or, if the client/customer has sought such advice, the referral agency or firm has declined to give it but has recommended that the client seek such advice from an authorised person).

4.35. For article 29 to apply, it is also necessary that, in return for making the arrangements, the referral agency or firm does not receive payment or other advantage from anybody other than the client/customer, for which it does not account to the client, arising out of his making the arrangements.

4.36. In summary, therefore, providers of debt advice, creditors and debt collection firms should be on safe regulatory ground in referring clients/customers for regulated financial advice so long as they offer no opinion on whether the client should start, stop, vary or access their pension savings and they do not receive any third party payment for making the referral which is not fully disclosed to their client/customer.

4.37. However, there is one further complication when referring clients/customers for regulated advice.

4.38. Where, by way of business, advice is given to an individual on whether they should repay a debt due under a credit agreement, such advice requires FCA permission for debt counselling. Many financial advisers do not hold debt counselling permission and it is therefore a potential concern that clients/customers might be referred to advisers who may be in breach of FCA rules.

4.39. Breach of FCA rules in this regard is primarily a matter for the FCA but providers of debt advice, creditors, and debt collection companies should at least be aware of the issue. Any formal or regular informal arrangement to refer debt clients/ customers for regulated financial advice should ask how the pension adviser will answer any questions about repayment of debt and whether there is a regulatory problem in providing such advice.

Chapter Five

This chapter considers how Pension Freedom impacts on:

- Entitlement to Income Based Welfare Benefits and Tax Credits
- Insolvency remedies

Pension Freedom and Entitlement to Welfare Benefits

5.1. Recipients of income-based welfare benefits are obliged to inform the DWP (Department for Work and Pensions) or Local Authority if they or their partner use Pension Freedom to take a lump sum payment or on-going income. This will lead to a review of the customer's future entitlement to benefit income.

5.2. Research conducted by ComRes for Citizens Advice in March 2016 found that 6% of those surveyed who had taken advantage of Pension Freedom had faced unexpected issues with their benefits, such as a change in the amounts received.

5.3. It is therefore essential that clients and customers who receive income-based welfare benefits are encouraged to investigate and understand how accessing their pension will impact on their future entitlement.

Impact on Clients and Customers

5.4. Clients and customers affected will be claiming one or more of the following 'income-based' welfare benefits;

- Employment and Support Allowance (income-related) Housing Benefit (paid by the Local Authority) Council Tax Reduction (paid by the Local Authority
- Income Support
- Jobseeker's Allowance (income-based)
- Pension Credit
- Universal Credit
- DROs

5.5. Entitlement to these benefits depends on the claimant and their household having income and savings that fall below prescribed limits. Taking a pension income and/or lump sum will therefore potentially reduce or even disqualify entitlement to future benefit income.

Impact of Taking a Pension Lump Sum

5.6. Customers and clients who take a pension lump sum whilst receiving income-based welfare benefits must inform the DWP or Local Authority of their change in circumstances. The pension lump sum will be treated as new savings and the increased total amount of savings will be tested against the maximum allowed level of £16,000. Exceeding the maximum level will mean withdrawal of the benefit income.

Tom is 55 and receives Housing Benefit to help him pay his rent. He has pension savings of £75,000 and opts to take 25% as a tax-free lump sum. Tom is obliged to inform his Local Authority of the consequent payment of £18,750 and he is consequently disqualified from future Housing Benefit until his savings fall below £16,000.

5.7. Benefit income may also be reduced even if the pension lump sum does not increase savings above £16,000. Where the increased savings are more than £6,000 (or £10,000 for Housing benefit claimants over state pension age), the savings are assumed to provide an income of £1 for every £250 or part of £250 above £6,000/£10,000. Benefit income will be reduced accordingly.

Tom decides to take only 10% of his pension savings as a tax-free lump sum. He receives a tax-free lump sum of £7,500. Tom is obliged to inform his Local Authority and his Housing Benefit is reduced because he is assumed to have increased his income by £6 per week.

Impact of Using Pension Lump Sums to Repay Debt

5.8. Using pension savings to repay debt means that the some or all of the money realised through Pension Freedom will quickly leave the bank or savings account. However, the benefit claimant is still obliged to inform the DWP or Local Authority of their change in circumstances which will include the full amount taken from the pension. It is then possible and, indeed, in some cases probable that the DWP or Local Authority will determine that the customer or client has deliberately reduced their savings in a way which restricts their entitlement to income-based welfare benefits.

5.9. The 'deprivation of capital' rule states that if benefit recipients spend, transfer or give away any capital, they can be considered to have deliberately deprived themselves of that money in order to maintain their entitlement to benefits. They will then be treated as still having that money in 'notional capital' and it will be taken into account in calculating the future benefit entitlement.

5.10. Capital is widely defined to include all type of savings, including investments in personal pensions. However, pension savings left in place (i.e. not accessed) are not treated as capital until the benefit recipient reaches State Pension Age.

5.11. As yet, there are no reports of how the DWP and Local Authorities are interpreting the deprivation of capital rule when faced with a claimant who has used their pension lump sum to repay debt. However, the DWP has provided guidance on how the matter should be approached.

5.12. In March 2015, the Decision Making and Appeals Department of the DWP issued Memo 12/15 entitled 'Pension Flexibilities and Income-Related Benefits.[24] Paragraph eight of this memo states:

Money withdrawn from a pension pot and then spent may lead the Decision Maker to consider the notional capital rules. The advent of pension flexibilities does not change the guidance on deprivation of capital for the purposes of income-related benefits. Each case must be considered on its facts. The guidance on the deprivation of capital is in DMG Chapters 29, 52 and 84'

5.13. A virtually identical memo was issued to Housing Benefit offices as HB Circular A7/2015[25] but signposted Decisions Makers to the Housing Benefit Guidance Manual at BW1 para W1.700 and onwards, and Chapter BP1 para P1.700 and onwards.

5.14. The DWP Decision Makers Guide Chapter 29[26] discusses how capital affects entitlement to income-based benefits. The section from 29805 covers situations where claimants may have deliberately deprived themselves of savings or other capital. Of relevance to this paper, the Guide sets down that:

- The law says people are treated as having capital they do not have if they deprive themselves of their capital for the purpose of getting (benefits)
- The meaning of deprive is not a question of law and should be given its normal every day meaning. So, claimants have deprived themselves of capital if they no longer have it even if they use it to get other capital, personal possessions, or pay debts
- Decision Makers have to show the claimant's or partner's purpose was to get benefit or more benefit if they decide claimants or partners have deprived themselves of capital. Getting benefit or more benefit may not be the claimant's or partner's predominant purpose but it must be a significant one
- The Decision Maker has to decide why claimants or partners chose to deprive themselves of capital when they did if they had a choice in the matter
- Claimants or partners have a choice if they:
  - pay back a debt before the agreed date, such as when they pay off their mortgage and the agreement says it is not due to be paid back for another 15 years
  - pay more than the amount due on a debt, such as when they pay more than the minimum payment on a credit card debt, unless the payment has been made to remove the threat of high interest payments and the Decision Maker decides it was reasonable for the claimant to act in the way that they did
  - pay back a debt which is not a legal debt capable of enforcement
  - make payments to a flexible current account mortgage which reduce the outstanding balance on the mortgage

5.15. The wording of the relevant sections in Chapters 52 and 84 of the Guide simply repeats the information contained in Chapter 29.

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[24] gov.uk/government/uploads/system/uploads/attachment_data/file/419053/m-12-15.pdf

[25] gov.uk/government/uploads/system/uploads/attachment_data/file/424144/a7-2015.pdf

[26] gov.uk/government/uploads/system/uploads/attachment_data/file/470848/dmgch29.pdf

5.16. The Housing Benefit Guidance Manual states (W1.732[27]) that ‘When capital has been used to repay a debt give careful consideration as to whether the debt needed to be repaid at that time. If there was no legal obligation to do so then it may be that part of the claimant’s purpose was to obtain or increase the amount of benefit.’

5.17. This guidance is likely to be of little practical help to Decision Makers where claimants have taken advantage of Pension Freedom to repay debt. Decision Makers, rarely trained or experienced in debt or financial advice, will struggle to determine whether a choice to use Pension Freedom to repay debt was one that would reasonably have been made irrespective of any current or likely future claim for income-based benefits. The determination will be particularly difficult where a claimant has chosen to repay consumer credit or mortgage debt which was not charged at a particularly high rate of interest and where the account was up to date.

5.18. It is therefore important that claimants of income-based welfare benefits understand the implications on their future benefit entitlement should they decide to take advantage of Pension Freedom. If a combination of debt and pension advice suggests that using Pension Freedom to repay debt is a sensible option, the advice should consider whether the client/customer should make a proactive approach to the DWP or Local Authority to seek agreement that there will be no impact on entitlement to means tested benefits.

5.19. It would also be helpful if Decision Makers were provided with more substantive guidance and the debt advice sector may wish to make representations on this to the DWP.

Impact of Taking Pension Income

5.20. The impact on income-based benefits of taking pension income (as distinguished from a lump sum) depends on whether the claimant has reached State Pension Age. This age is currently 65 for men and it is gradually increasing for women to reach 65 in December 2018. It will increase for both men and women to reach 66 by October 2020. The Government is planning to raise the state pension age again from 66 to 67 between 2026 and 2028.

5.21. A claimant or partner is expected to use their pension to provide income once they reach State Pension Age. The income figure used in benefit calculations will be the higher of the pension amount they receive or the amount they are assumed to have received had they opted to buy an annuity with the money left after any cash lump sum.

5.22. Those under State Pension Age who receive an income-based welfare benefit must inform the DWP or Local Authority of their new or increased pension income. In most cases, the additional income will reduce their benefit on a pound-for pound basis. This will mean that the customer or client is no better off.

5.23. For some benefits, for example Housing Benefit, the additional pension income will reduce benefit income on a tapered basis the effect will be that the customer/client is somewhat better off but will still not receive the full financial benefit of the additional pension income.

5.24. It is also possible that those claiming some ‘contributory’ benefits will lose benefit income if they opt to take new income through Pension Freedom. Contributory benefits are not means tested and entitlement depends on the claimant having paid sufficient relevant National Insurance contributions.

5.25. The contributory benefits affected are Employment and Support Allowance (contribution-based) and Jobseeker’s Allowance (contribution based). Customers and clients receiving these benefits will be unemployed or unable to work due to illness or disability.

5.26. These benefits have no capital limits and so the taking of a pension lump sum will have no impact of benefit entitlement. However, taking pension income will reduce the amount of benefit paid once the pension income exceeds prescribed amounts.

5.27. Again, the complexity of these rules means that clients or customers who receive benefit income must ensure that they understand the overall financial impact of taking money from their pension.

[27] gov.uk/government/uploads/system/uploads/attachment_data/file/365782/hbgm-bw1-assessment-of- capital.pdf

Pension Freedom and Entitlement to Tax Credits

5.28. Tax credits provide another way in which the Government provides financial assistance to lower income groups. Tax credits can be payable to those in work and customers and clients may be eligible for tax credits even though their income is significantly above entitlement to income-based welfare benefits.

Impact of Taking a Pension Lump Sum

5.29. Tax Credits have no capital limit. Therefore, taking a pension lump sum will not affect the entitlement.

Impact of Taking Pension Income

5.30. Pension income is taken into account in full when calculating Tax Credits. Whether and by how much the additional income will reduce the Tax Credits will depend on the wider circumstances of the claimant and family.

Impact of Pension Freedom on Insolvency Remedies

5.31. Pension Freedom gives the indebted consumer more options to draw down on their pension savings at their sole discretion from the age of 55. The new rules led to debate on whether this discretion had potential implications for insolvent consumers. For example;

- Could a Bankruptcy Trustee now require that a bankrupt aged 55+ takes their pension income?
- Could applications for Debt Relief Orders proceed where the debtor had the option to immediately access pension savings to repay some or all of their debt?

Impact on bankruptcy

5.32. The bankruptcy question was settled in October 2016 by the Court of Appeal in the case of Horton v Henry) [2016] EWCA Civ 989

5.33. Mr Henry had petitioned for his own bankruptcy. He had several pension policies but wanted to leave these in place to benefit his children after his death. The trustee in bankruptcy preferred that the pensions should be immediately accessed for the benefit of creditors. After an initial decision in the High Court, the Court of Appeal was asked to determine whether the trustee had the power to decide how and whether a bankrupt could be forced to take advantage of Pension Freedom.

5.34. The Court of Appeal found in favour of Mr Henry. Lady Justice Gloster, giving the lead judgment noted:

‘It would drive a coach and horses through the protection afforded to a bankrupt’s pension rights by the Insolvency Act and pension legislation if a trustee were able, in effect, to require a bankrupt to make the entirety of his pension available for satisfaction of his creditors’ claims, by the simple expedient of a request under section 333 or a court order under section 363(2), thereby converting excluded property into ‘income’ (paragraph 38).

5.35. Following Horton v Henry, bankrupts can now assume that the bankruptcy trustee cannot require that a bankrupt uses Pension Freedom to release their pension savings

5.36. This is not the same as saying that the pension savings are always out of reach of the bankruptcy trustee. For example, the trustee may look to reclaim any excessive contributions made in pension savings in the years before the bankruptcy. Specialist advice is always important in this area.

Impact on Debt Relief Orders

5.37. The question of how Debt Relief Orders (DROs) are affected by Pension Freedom is less certain.

5.38. In March 2015, the Insolvency Service provided guidance to Official Receivers and Debt Relief Order intermediaries[28] on the impact of Pension Freedom. The guidance sets down that whilst debtors applying for DRO's are not obliged to take income from their pensions, it is appropriate to ask whether those aged over 55 could choose to take pension benefits to repay their debt.

5.39. Where the available pension fund (presumably the 25% lump sum plus the after-tax additional amount) is 'considerably higher' than the outstanding debt, the DRO intermediary is asked to contact the DRO Team to establish whether the Official Receiver will in the circumstances grant the application. The implication is that the Official Receiver will need to consider whether the debtor is solvent because the option to cash-in the pension would more than repay the outstanding debt.

5.40. The Insolvency Service figures[29] show that 44,158 Debt Relief Orders were made in England and Wales between April 2015 and December 2016. Whilst there is no breakdown of how many of these related to debtors aged 55+ it seems reasonable to assume that some proportion would have fallen into this category and then another proportion of that group would have had savings in a defined contribution pension.

5.41. The Insolvency Service reports that 'fewer than 50' cases have been referred by intermediaries for consideration of whether a defined contribution pension impacts on the making of a Debt Relief Order. This seems a remarkably low number and there must be a concern as to whether intermediaries are aware of and following the guidance from the Insolvency Service.

5.42. It would help debt advisers if the guidance from the Insolvency Service is updated in light of Horton v Henry. However, it seems that this is more likely to happen if DRO intermediaries refer more cases for consideration.

Impact on individual voluntary arrangements

5.43. The impact of Pension Freedom on an Individual Voluntary Arrangement (IVA) will depend on whether the pension fund is included as an asset within the arrangement.

5.44. Following Horton v Henry, it seems that pensions that are not offered within an IVA will continue to be excluded as an asset. However, it might be that more creditors will now take account of the debtor's option to access a defined contribution pension after the age of 55 when deciding how to vote on future proposals.

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[28] gov.uk/government/news/undrawn-pension-entitlements-summary-of-guidance-for-insolvency- practitioners-and-debt-advisors

[29] Table 4A https://www.gov.uk/government/statistics/insolvency-statistics-october-to-december-2016

Chapter Six

6.1. The previous chapters have explained the challenge for providers of debt advice, creditors and debt collection agencies when engaging with clients or customers who:

- Are over the age of 50 and can either immediately, or within five years, use Pension Freedom to access their pensions
- Face new or increased pension contributions through automatic enrolment

6.2. In summary, the challenge is:

- More clients and customers are able to access their pension savings after age 55
- More clients and customers will be automatically enrolled into a pension with increasing contributions
- At the same time, the level of individual and household debt continues to rise
- Therefore, more clients and customers will consider using their pension savings to repay debt or question how to allocate their income between repaying debt and contributing to pension savings
- Making an informed decision on whether to access the pension or contribute more to pension savings requires that the client/customer considers an often-complex interaction of various financial and personal factors
- Best practice and interpretation of FCA (Financial Conduct Authority) rules require that providers of debt advice take account of these new pension options when advising their clients or customers
- But providers of debt advice are not authorised by the FCA to give advice on pensions, and existing information and guidance on pensions is likely to be insufficient to enable consumers with debt problems to make an informed decision
- FCA rules also imply or require that credit companies, mortgage lenders, and debt collection companies take account of the impact of Pension Freedom and automatic enrolment when discussing and determining affordability in debt collection and requests for new borrowing.

6.3. This chapter offers recommendations for providers of debt advice, creditors, and debt collection companies. It also offers some recommendations on wider policy issues.

Providing Information and Advice for Indebted Consumers on Pension Freedom

6.4. Chapter one explains the importance of consumers being able to access impartial information and guidance on Pension Freedom and how this is available through the government supported initiative, Pension Wise.

6.5. It is important that consumers fully understand all implications of accessing their pension savings. This will help them avoid the risk of making a decision they will subsequently regret or falling victim to pension scammers. Yet there has been a lower than anticipated use of Pension Wise.

6.6. Whilst there is very limited intelligence on how consumers are using monies released through Pension Freedom, the extent of consumer borrowing makes it highly probable that debt repayment will feature. Providers of debt advice, creditors and debt collection agencies therefore have a potentially important role in ensuring that consumers access information and guidance to help them make a good decision.

6.7. Where providers of debt advice identify that any client/customer over the age of 50 has a defined contribution pension, they should always signpost the availability of Pension Wise. Pension Wise should further be recommended when the client/customer indicates that they are considering using Pension Freedom to access their pension savings.

Recommendation One: **Providers of debt advice should always signpost the availability of Pension Wise where the client or customer is aged over 50 and has savings in a defined contribution pension.**

6.8. Collections departments and debt collection companies should also help ensure that debtors thinking of using Pension Freedom to repay debt are signposted to Pension Wise. Creditors and debt collection companies need to tread carefully here given the recently added CONC rule at 7.3.10A. They must ensure that any signposting is not seen as an encouragement for the debtor to access their pension to repay debt. However, they should equally consider their obligation under FCA Principle Six and so encourage the debtor to take guidance from the free and impartial service established by the Government.

Recommendation Two: **Where creditors and debt collection companies become aware that debtors are thinking of using Pension Freedom, they should signpost the customer to Pension Wise.**

6.9. Historically, the debt advice sector has paid little attention to the existence of defined contribution pension savings. Even where the client/customer has been over 55, the limited options in accessing the savings would generally have added insufficient income to change the options for repayment of debt. At the same time, clients and customers normally had little knowledge about their pension and had given little thought to how they would eventually turn this into income.

6.10. This also meant that written information provided to those with debt problems made little if any mention of how pension saving impacted on the options for repaying debt. Generally, the only reference to pension saving was within information about bankruptcy.

6.11. Pension Freedom requires a change in this historic approach. A defined contribution pension is now more flexibly accessible after the age of 55 and more consumers than expected are taking advantage of the new rules. As public awareness of Pension Freedom increases, in part through the activities of fraudsters and scammers, it will be important that debt advice providers take account of the changed approach.

6.12. A good starting point would be written information setting out the advantages, disadvantages, and implications of using Pension Freedom to repay debt. This could then be used by debt advisers and provided to clients and customers. Creditors and debt collection companies may also wish to use this information to help their customers better navigate the challenge of whether to use pension savings to repay debt.

Recommendation Three: Written generic information should be produced to explain the advantages, disadvantages, and implications of using pension savings to repay debt.

6.13. Chapter three explains the challenge for providers of debt advice when giving advice to Pension Freedom consumers who have debt problems. This has so far resulted in a varied reaction from the debt advice sector, with some providers of debt advice seeming to have given little or no thought on how to reflect Pension Freedom within their work. Other providers are aware of the challenge but are understandably struggling to determine the best way forward.

6.14. Incorporating Pension Freedom within debt advice is difficult because of the complex interaction of financial and personal issues when the client/customer looks to take pension income. However, it is not in the interests of consumers, providers of advice, national associations, trade bodies, or the regulator that this approach continues. The current approach risks consumer detriment and leaves debt advice firms at risk of breaching FCA requirements. It should be addressed as soon as possible.

6.15. As a matter of best practice, and to ensure regulatory compliance, providers of debt advice should proactively determine how they will advise and inform clients and customers who can use Pension Freedom.

Recommendation Four: Providers of debt advice should have a clear policy on how they offer or facilitate the provision of advice to indebted consumers who can access Pension Freedom. The policy should set down how far debt advisers can and will go to provide 'in-house' guidance about Pension Freedom and/or how clients and customers will be referred or signposted to other advice.

6.16. Another possibility is to establish a pilot service which joins a debt advice provider with Pension Wise to test out a combined 'one-stop' service. This might involve an exchange of debt advice and Pension Wise staff to provide face to face advice and guidance, or an immediate transfer of telephone clients from debt advice to pensions guidance and vice versa, or a conference call involving the debt and Pension Wise adviser and the debt client or customer.

6.17. Any joint service will need to carefully navigate the regulatory boundary. The regulated debt advice provider can and should be able to give specific advice on the debt problem ('I advise that you do x, y, and z'). The pension guidance must be far more circumspect. This may seem strange to the client/customer and potentially difficult for the advisers. Nevertheless, a pilot service provides the opportunity to work through these challenging areas,

Recommendation Five: Debt advice providers and Pension Wise should consider a pilot service to test how they can best use their respective skills and experience to offer debt advice and pensions guidance within one discussion with the debt client or customer.

6.18. Some consumers using Pension Freedom will want or need to access regulated pensions advice. Paying for such advice will be a particular challenge for indebted consumers.

6.19. From April 2017, consumers of any age are able to access £500 a year tax free from their defined contribution pension to pay for pension advice. The facility is available for any three tax years to make for a maximum drawdown of £1,500.

6.20. £500 will normally be insufficient to pay for regulated financial advice. But the debt advice sector and financial advice trade associations could usefully discuss whether a debt advice client/customer who needs advice on Pension Freedom could be referred to regulated advice within the £500 limit. Such advice might have to be restricted in range and scope and would likely need the support of the FCA.

Recommendation Six: Debt advice providers should investigate whether and how the post April 2017 allowance for Pensions Advice can be used to signpost clients and customers for regulated advice on the impact of Pensions Freedom for debt clients or customers.

6.21. Some indebted consumers who have pension savings within a defined benefit pension scheme may be able to transfer these savings to a defined contribution scheme to take advantage of Pension Freedom.

6.22. The FCA has warned of the potential detriment when consumers are transferring out of defined benefit pensions[30] and has set down its expectations for advice in such areas.[31] The pension rules also require that the consumer must take regulated advice where the cash value of the defined benefit pension exceeds £30,000.

6.23. Even where the cash value of a defined benefit scheme is less than £30,000, it is likely to be appropriate that all debt advice providers signpost or refer the client/ customer for regulated advice. Providing even guidance on accessing a defined benefit pension is potentially dangerous given the FCA warnings.

Recommendation Seven: Debt advice providers should always signpost to regulated financial advice where clients/customers are interested in transferring defined benefit pension savings to take advantage of Pension Freedom

Providing Information and Advice for Indebted Consumers on Automatic Enrolment

6.24. Automatic enrolment presents a clear challenge to debt advice. It is important that most individuals save higher amounts for their retirement and the pension saving is enhanced through the employer contribution and tax relief. However, any money saved for the longer-term is not available to meet current needs. Whilst the minimum contributions required under automatic enrolment are currently small, they will increase in future years and influential commentators are calling for further increases.

6.25. Historically, debt advice has paid little attention to whether an individual makes pension contributions and the calculation of income has simply included the factual assessment of take-home pay after deductions. There has always been the option for every working individual to increase their net pay by reducing any pension contribution, but the option has rarely, if ever, been considered.

6.26. The accepted need for greater pension savings, and the Government policy to roll out automatic enrolment with future increased contributions, means that debt advisers need to pay greater consideration to the interaction of pension saving and debt repayment.

Recommendation Eight: Debt advice providers should set down policy and procedures that explain how automatic enrolment impacts on their clients or customers and how this will be discussed as part of the debt advice process.

6.27. It seems likely that most debt clients and customers will want to continue to contribute towards their future pension by not opting out of automatic enrolment. This approach would reflect the added advantages of tax relief and employer contributions. It would also support the Government's policy that individuals should save more for their later-life. There is therefore a strong argument that encouragement of clients or customers to remain with automatic enrolment should be the default position for debt advisers.

6.28. If agreed, this default position should be discussed with the FCA for agreement that the approach is in the consumer interest and compliant with FCA rules.

Recommendation Nine: Debt advice providers should generally assume that automatic enrolment is in the best interests of their clients or customers. This default approach should be discussed with the FCA.

6.29. However, some debtors, if fully informed on the advantages, disadvantages, and implications of pension saving compared with debt repayment, may still feel it is in their best interests to opt-out of automatic enrolment to increase their ability to repay debt.

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[30] fca.org.uk/consumers/pension-transfer

[31] fca.org.uk/news/news-stories/advising-pension-transfers-our-expectations

6.30. It is very important that a debt advice provider (unless authorised to give regulated financial advice) only generically discusses the advantages, disadvantages, and implications of pension saving compared with debt repayment. This is likely to be difficult. Even if the adviser makes it clear that the discussion is completely unrelated to the pension held by the client/customer, the reality is that the client/customer will relate the discussion to their specific individual pension to which they contribute through automatic enrolment. Debt advice providers must make it very clear that they have not provided advice on whether the client/customer should vary their pension contributions.

Recommendation Ten: Debt advice providers must ensure that training and support ensures that any discussion of the option of opting out of automatic enrolment does not breach the regulatory boundary.

6.31. Information on automatic enrolment must be provided by employers, and additional information and guidance is available from The Pensions Advisory Service. However, the information and guidance does not consider the trade-off between saving for the future and repaying debt.

6.32. As with Pension Freedom, the extent of consumer borrowing means that this lack of information is unhelpful. Automatic enrolment introduces a change in the financial circumstances of a large number of workers and it offers the opportunity to encourage individuals to consider the overall management of their finances. Within this, the management of debt, whether 'problem' or non-problem' is an important element.

Recommendation Eleven: Written generic information should be produced to provide specific information and guidance to indebted consumers who want or need to choose between pension saving through automatic enrolment and repayment of debt.

6.33. Automatic enrolment presents a similar challenge to creditors and debt collection companies as it does to debt advisers. In the future increasing numbers of customers will be paying more money into pension savings.

6.34. Clearly there will be a varied impact of higher pension contributions on the future ability of a borrower to repay debt. Some borrowers will be able to reduce their wider spending; others will receive wage rises or other increases in income that offset the additional pension saving.

6.35. However, the impact of automatic enrolment is a known factor that will have some effect on borrowers and debtors. Creditors and debt collection companies will need to proactively consider whether the effect will be sufficient to impact on their lending and collection policies.

Recommendation Twelve: Creditors and debt collection companies should consider how and when they will incorporate increasing automatic enrolment contributions within their lending and debt collection policies.

6.36. Mortgage lenders are already well aware that FCA rules require them to include known and likely changes to the expected income of their current and future borrowers when assessing ability to pay. There is therefore a greater obligation on mortgage lenders to consider the future known increases in pension contributions under automatic enrolment.

Recommendation Thirteen: Mortgage lenders should consider whether and how they need to incorporate increasing automatic enrolment contributions within their lending policy.

The Impact of Pension Freedom on Benefit Claimants

6.37. The number of consumers taking advantage of Pension Freedom increases the probability that Decision Makers on entitlement to income-based benefits will more often have to consider the deprivation of capital rule.

6.38. Decision Makers are likely to find it difficult to make such a determination based on the existing DWP guidance. It would be helpful to Decision Makers, claimants and advisers if this guidance was reviewed. One option is for the guidance to consider the circumstances where indebted consumers might rationally use Pension Freedom to repay debt without any consideration of future implications on claiming benefit.

Recommendation Fourteen: Debt Advice providers, creditors and debt collection companies should provide evidence to the DWP on how the deprivation of capital rule impacts on claimants who have used Pension Freedom to repay debt.

The Impact of Pension Freedom on Debt Relief Orders

6.39. Helpfully the Horton v Henry case has established that a bankrupt cannot be forced to access their pension savings by using Pension Freedom. However, the situation remains less clear for Debt Relief Orders (DROs).

6.40. The March 2015 guidance from the Insolvency Service is likely to be updated to reflect Horton v Henry. But the Insolvency Service will be helped to produce new guidance if its DRO team is asked for advice on more cases where debt clients over the age of 55 with defined contribution pensions are considering applying for a DRO.

Recommendation Fifteen: **DRO intermediaries should seek the advice of the Insolvency Service DRO team in all cases where debt clients or customers over the age of 55 have defined contribution pensions and are considering applying for a DRO. The advice of the Insolvency Service DRO team should be sought irrespective of the value within the defined contribution pension.**

High level approach to the interaction of consumer debt with pension freedom and automatic enrolment

6.41. Many of the challenges discussed in this paper would be easier to address if there was discussion and agreement on if and when indebted consumers should consider accessing pension savings or reducing pension contributions to meet current or future borrowing obligations. This 'standard' approach could then apply unless the consumer specifically wanted to pursue another approach and/or their financial and personal circumstances justified a different strategy.

6.42. Such discussion would have to bring together consumer credit and mortgage lenders, trade bodies, and the debt advice sector. Any agreed approach could then be further discussed with the FCA and interested Government departments.

Recommendation Sixteen: **Trade bodies and professional associations working within the field of consumer credit should consider whether and how to bring together lenders and debt advice providers to discuss an agreed approach on how indebted consumers should consider using pension savings or reducing pension contributions to meet current or future borrowing obligations.**

Annex 1:

Recommendations

One: Providers of debt advice should always signpost the availability of Pension Wise where the client/customer is aged over 50 and has savings in a defined contribution pension.

Two: Where creditors and debt collection companies become aware that debtors are thinking of using Pension Freedom, they should signpost the customer to Pension Wise.

Three: Written generic information should be produced to explain the advantages, disadvantages and implications of using pension savings to repay debt.

Four: Providers of debt advice should have a clear policy on how they offer or facilitate the provision of advice to indebted consumers who can access Pension Freedom. The policy should set down how far debt advisers can and will go to provide "in-house" guidance about Pension Freedom and or how clients and customers will be referred or signposted to other services.

Five: Debt advice providers and Pension Wise should consider a pilot service to test how they can best use their respective skills and experience to offer debt advice and pensions guidance within one discussion with the debt client or customer.

Six: Debt advice providers should investigate whether and how the post April 2017 allowance for Pensions Advice can be used to signpost clients and customers for regulated advice on the impact of Pensions Freedom for debt clients or customers.

Seven: Debt advice providers should always signpost to regulated financial advice where clients/customers are interested in transferring defined benefit pension savings to take advantage of Pension Freedom.

Eight: Debt advice providers should set down policy and procedures that explains how automatic enrolment impacts on their clients or customers and how this will be discussed as part of the debt advice process.

Nine: Debt advice providers should generally assume that automatic enrolment is in the best interests of their clients or customers. This default approach should be discussed with the FCA.

Ten: Debt advice providers must ensure that training and support ensures that any discussion of the option of opting out of automatic enrolment does not breach the regulatory boundary.

Eleven: Written generic information should be produced to provide specific information and guidance to indebted consumers who want or need to choose between pension saving through Automatic Enrolment and repayment of debt.

Twelve: Creditors and debt collection companies should consider how and when they will incorporate increasing automatic enrolment contributions within their lending and debt collection policies.

Thirteen: Mortgage lenders should consider whether and how they need to incorporate increasing automatic enrolment contributions within their lending policy.

Fourteen: Debt advice providers, creditors and debt collection companies should provide evidence to the DWP on how the deprivation of capital rule impacts on claimants who have used Pension Freedom to repay debt.

Fifteen: DRO intermediaries should seek the advice of the Insolvency Service DRO team in all cases where debt clients or customers over the age of 55 have defined contribution pension and are considering applying for a DRO. The advice of the Insolvency Service DRO team should be sought irrespective of the value within the defined contribution pension.

Sixteen: Trade bodies and professional associations working within the field of consumer credit should consider whether and how to bring together lenders and debt advice providers to discuss an agreed approach on how indebted consumers should consider using pension savings or reducing pension contributions to meet current or future borrowing obligations.

Annex 2:

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Yvonne MacDermid Chief Executive of Money Advice Scotland was, as ever, ahead of the curve in identifying the need for change. Her colleagues across the Scottish agencies who attended the Money Advice Scotland 2016 annual conference accepted and addressed the challenge in a roundtable later in the year.

In London, in October 2016, the Money Advice Liaison Group provided the opportunity to consider the issue from the perspective of consumers and firms without any distraction of vested interests. The Money Advice Service hosted a roundtable organised by MALG and Money Advice Scotland which brought together a wider group to discuss the way forward.

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