Consultation Response

HM Treasury

Freedom and Choice in Pensions

Comments from StepChange Debt Charity

StepChange Debt Charity London Office
6th Floor, Lynton House, 7-12 Tavistock Square, London WC1H 9LY
Policy Contact: Francis McGee, Director of External Affairs
Tel: 0207 391 4591
Email: francis.mcgee@stepchange.org

Background

StepChange Debt Charity is a leading provider of independent debt advice and the country's largest charitable provider of free-to-client debt management plans (DMPs).

In 2013, we were contacted by over 500,000 people. The advice and support we provide is free, independent and impartial. In 2013, the charity helped clients to repay around £300 million of debt. We currently manage around £4 billion of unsecured problem debt.

Introduction

This brief response does not cover all the issues in the Government's consultation. Our focus is on specific issues that affect people in and at risk of problem debt. Based on the number of people becoming eligible to access their pension each year, recent estimates of the total numbers of people facing problem debt, and StepChange Debt Charity client data, around 10,000-20,000 people a year could approach the retirement guidance with problem debt. This is a conservative estimate, and numbers will rise as more people with problem debts acquire pension rights by not opting out of auto-enrolment schemes.

We understand that the FCA will consult shortly on how the "guidance guarantee" might work in practice. We have already been in touch with the FCA and look forward to working with them as they develop their thinking to make sure that the link between any retirement guidance and existing debt advice agencies is as seamless and effective as possible.

Key points

The main points of this response are:

1. there are some specific risks that individuals with debt problems might face when they come to take their pension. The Government should explore these further to see whether legislation needs to be changed, or other protections put in place.

2. before the guidance is designed, there needs to be clarity about the public policy intention around pension assets and outstanding debts.

3. the Government would be wrong to proceed on the basis that the "guidance guarantee" should be offered "face-to-face" for all. Face-to-face guidance should be available, but it is significantly more expensive than other channels. StepChange Debt Charity helped over 500,000 people in 2013 over the phone and online. Alongside other organisations, we have proved that non-face-to-

face advice is successful and preferable for large sections of society. The complexity of pensions and retirement decisions are also no barrier to successful non-face-to-face guidance and advice. The Pensions Advisory Service has proved this over the years, and StepChange Debt Charity offers fully regulated Equity Release advice over the phone.

4. The retirement guidance needs to be designed to make a good “fit” with debt advice services, otherwise the result could be poor outcomes around the balance between using a pension pot to pay down debts and using it to secure an income. StepChange Debt Charity would be pleased to work with FCA and others to ensure this fit.

Specific risks facing people with problem debts

We have identified 3 areas of specific risk to people who find themselves with an accessible pension asset, but who also have debt problems. Some of these risks exist now, but will be exacerbated by the proposed reforms:

1. a pension pot arriving into a bank account over which creditors have right of set off. Under FCA rules, creditors have to give reasonable notice before exercising their right, and some choose not to. Government should consider how pension assets might be protected from right of set-off;

2. the duties of the Official Receiver (Trustee in Scotland) in cases of bankruptcy could force people to pay all their pension wealth over to creditors. Currently, if someone will become eligible to access their pot within 3 years (4 years under new legislation in Scotland) the OR/Trustee requires them to pay the maximum accessible portion (the 25% tax free cash) to creditors. The Government should examine the legislation to see whether under the new rules, this will automatically rise to 100% of the pot.

3. third party debt orders[1] could be used by creditors to require pension companies to pay people’s savings over to creditors rather than to the client, or to obtain pension assets that people have already accessed. With this new class of asset potentially available, we might see a sharp increase in the use of third party debt orders by creditors[2]

Building on these specifics, there is the general risk that pension assets will be seen as money available to creditors, either as part of collections or other activity, or under the enforcement framework. For example, creditors may put people under pressure to withdraw bigger lump sums to pay debts. Or a market might emerge for loans ‘secured’ against a future pension lump sum – if this is a ‘distressed sale’ it could be

[1] In England and Wales, a third party debt order is a way of enforcing a County Court Judgement. It can be a creditor’s ‘next step’ if they don’t get payment after judgment, or the debtor defaults on instalment payments.
[2] There were 845 such orders in 2012.

quite detrimental. These risks ought to be addressable by appropriate FCA supervisory activity, leading to rules and enforcement if necessary.

Furthermore, the enforcement and debt relief frameworks do not treat pension assets consistently. When debt relief orders were introduced, the principle was recognised that pension assets are "different" and they were excluded from the £15,000 asset test that determines eligibility for a DRO. Yet there is bankruptcy case law both in England and Scotland where a pension asset to which a debtor is entitled but which they have not yet taken, is captured in its entirety for creditors.

These considerations raise a wider point about what public policy intends to achieve in this area. Whatever view policy takes on the desirability of individual choice against the benefits of securing long term income, there is a separate set of considerations around the possible restrictions on choice – and access to their assets – that people with debts might face. One traditional argument for promoting retirement saving, including through tax-incentives, and for the accumulated fund being used to guarantee an income, is that people might otherwise have to rely on tax-funded benefits in old age. This outcome is inevitable if retirement saving can automatically be transferred to creditors.

There are other important issues which the Government will no doubt be considering, such as whether pension funds are adequately protected by FSCS provisions around "high transient balances" in the event of a depositor failure, and the treatment of pension capital in the calculation of benefit entitlements.

Ensuring the right "journey" for people with problem debt

We expect that it will be common ground among stakeholders that identifying debt issues is one of the first things the guidance should help people to do. We also hope that it will be common ground that whoever offers it, the retirement guidance should refer customers to <u>free</u> debt advice. StepChange Debt Charity believes no one with problem debts should have to pay for help to sort those debts out.

The issue is where in their journey people will get advice on the amount of pension wealth they should use to pay down any debts, and the trade-off between less debt and more income in future years. To what extent will those giving the retirement guidance want to (or feel able to) probe debt questions, and to what extent will expert debt advice agencies have the expertise to deal with retirement income questions? Either way, advice/guidance structures that are designed to be focused will be pulled towards undertaking full financial reviews. Whichever side of the "regulated boundary" this activity lies, this will add to cost.

We propose that a specific working group be set up to consider the hand-off between retirement guidance and debt advice. StepChange Debt Charity is used to working with a wide range of partners (banks, utility companies, other charities, the Money

Advice Service, local authorities etc) to ensure the smoothest possible client journey and most efficient and effective resolution of debt issues.

Issues that might be examined by the working group include:

1. the mental “frame” of customers, and the behavioural barriers to making choices about debt and retirement income

2. the regulated boundary

3. whether it is appropriate to set criteria for “problem debt” either in absolute terms, in subjective terms (ie what feels problematic to an individual) or relative to pensions or overall assets

4. different concepts for what “best advice” should be around the trade off between resolving debt and securing future income

5. the treatment of secured debt, particularly mortgages. This issue will take on greater importance given the prospect of a upturn in the interest rate cycle, and the rising number of interest only mortgages held by retirees for which there is no repayment vehicle in place

6. what ready reckoners, models, and other diagnostic/”what if?” tools could be developed either to help advisers guide customers, or to help customers help themselves to judge the key trade-offs

But the working group will stand the best chance of success if there is a clear expression of the public policy intention around resolving debt, including creditor rights, and funding retirement. StepChange Debt Charity would welcome the opportunity to work with Government, FCA and others in further developing this thinking.