

# ASIA-PACIFIC REGULATORS' AND INDUSTRY DIALOGUE

## *Session 1*

### International Directions and Issues in Private Pensions

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*The views expressed here are personal and do not necessarily represent the views of NAB since they refer to Mr Garbutt's pre-NAB career in the UK*

### **SUMMARY PAPER**

#### **Lessons from the United Kingdom**

##### *Pension Mis-selling and Subsequent Regulators' Pensions Review*

- Advice from financial advisers or financial planners only a limited part of Private Pensions e.g. only 20% of Australians take advice?
- But when it goes wrong can have a material impact
- UK Private Pensions were widely mis-sold 1988-1994 with advisers moving clients out of (or advising not to join) lucrative defined benefit schemes based on years of employment service and into new private pensions
- Detected by regulators and major regulatory papers in 1994
- Regulators required all sales 1988-1994 reviewed, called the "Pensions Review." Had two phases, first being priority and second being non-priority. Also followed by a review of sales of Free Standing AVCs (see below.)
- Significant proportions of sales failed to meet the compliance tests of Pensions Review and firms paid out pounds sterling 11.8 billion customer compensation. The Pensions Review was not finalised until 2002 and a total of 1.6 million sales were reviewed
- Around one third of all firms conducting a review were fined by regulators for issues such as their slow pace of progress with the review and compensation levels
- It was a very painful episode for all concerned. Regulators published one press release that covered the moral and reputational damage to the industry - 6,000 customers had died before being compensated
- Must have had a major impact on pensions take-up by investors i.e. the reputation of the private pensions industry was so damaged as to discourage investors from private pensions and it had an adverse impact on some financial services firms, casting an eight year shadow over the industry whilst the Review was underway

##### *Background Issues to the Pensions Review*

- The mis-selling was undetected for a period – there had been much regulatory reform following the implementation of the new Financial Services Act in 1988

- Training and supervision of advisers arguably poor
- Certainly advice standards and outcomes poor
- Incentive systems poor – commission only salesmen, no salary – big upfront commissions paid out of early policy premiums such that distributor had less financial incentive for the pension policy to continue
- Products hard to understand – personal pensions, additional voluntary contributions AVCs both for company scheme and free standing AVCs, opt out policies from part of government pensions – State earnings related pensions scheme (SERPs)

#### Lessons from the Pensions Mis-selling and the Pensions Review

- **Regulators:** Prevention is better than cure but regulators applied long term discipline to resolve the Pensions Review and are still addressing the underlying structural issues of the industry – see [www.fsa.gov.uk](http://www.fsa.gov.uk) “Retail Distribution Review” (RDR) where the Pensions Review is quoted as one legacy driver for the RDR
- **Policy makers:** Encourage simple transparent products
- **Compliance officers and firms:** Balance incentive systems, strong training and supervision, good advice standards

#### Other UK Issues

- One problem was access – could only take 25% of funds of personal pension on retirement, had to buy annuity with 75%, could lose all if the pensioner died the next day
- Performance of private funds an issue – UK FTSE at similar levels now to year 2000 and reduced from 6,000 to 3,600 early 2000s
- Stakeholder pension (with charges capped) launched to target low earners etc with no pension – but also used in practice as wealth accumulation vehicle for non-working spouses and children of higher earners
- Launch of Individual Savings Accounts (ISAs) 1999 – not a pensions product but nothing to stop proceeds being used for retirement – invest up-to pounds sterling 7,000 in equities each year and proceeds free of capital gains tax – unlike pensions no access restrictions
- State pensions arguably small – need to be supplemented
- For some years a growing problem with defined benefit schemes. Schemes fund pensioners on the basis of years employment service. Longevity has challenged the actuarial assumptions and most moved to money purchase some years ago i.e. proceeds flow from amounts invested not employment service. Liabilities of those who joined before money purchase was introduced remain. UK Stock market performance since 2000 has not helped. One top ten bank shows a small surplus in 2006 but if the scheme wound up, there would be a material shortfall in buying benefits from an insurance company, known as the “buy-out position.”