Retirement income and assets: the implications of ending the effective requirement to annuitise by age 75

On 14 April 2011 the Prudential hosted a seminar to launch the Pensions Policy Institute's fifth report in the Retirement income and assets series: *the implications of ending the effective requirement to annuitise by age 75.*

Tarek Hayfa, Senior Policy Adviser at HM Treasury outlined the Government's policy objectives in ending the effective requirement to annuitise by age 75 and gave an overview of the Government's new policy.

He set out the rationale behind the policy changes proposed by the Government: the Government aims to provide more simplicity and flexibility in the pension system, and allow more choice in order to make pension saving more attractive while ensuring that the new rules do not create opportunities for abuse of the tax system.

Chris Curry, Research Director at the Pensions Policy Institute presented some key results from the PPI's report *Retirement income and assets: the implications of ending the effective requirement to annuitise by age 75.*

He set out the PPI's estimates of how many people may be able to make use of capped or flexible drawdown. He also considered how many people may be able to use such facilities in the future.

He noted that the future levels of annuitisation will be affected by provision of products, advice and individuals' behaviour and attitudes. The impact of the legislation may be different for individuals depending on their level of savings and assets. For many people annuitizing will remain the safest and most appropriate option for accessing pension savings. But as pension saving increases, there may be more demand for flexible options of accessing retirement savings. In the future more people may be able to take advantage of flexible options.

Barry O'Dwyer Deputy Chief Executive at Prudential UK & Europe gave an overview of some of the implications of the Government's reforms for the annuity industry.

He felt that the Government has struck a sensible balance when designing the rules that give flexibility to those with the largest funds, while recognising that annuities still have an important role to play for many people.

The main difficulty for annuity providers is in the middle income market. Here, consumer sentiment is often driven by the fact that pension pots which appear to the consumer to be large, generate pensions which appear modest. To the consumer this does not intuitively feel like a good deal. The industry must therefore work to better position annuities as a fundamental part of retirement planning given the longevity and investment risk that consumers face.

The challenge for the industry is to encourage consumers to see annuities as a sensible form of insurance, and asking people <u>when</u> they want to annuitise rather than <u>if</u> they want to annuitise. The result may be that consumers will buy annuities later in life, in effect self-insuring up to the point that it is uncomfortable to do so, then purchasing an annuity.

Jonathan Lipkin, Head of Research at the Investment Management Association gave a perspective on the implications of the new reforms for the potential use of income drawdown.

He said that while the average size of DC pension pots today are low, the introduction of auto-enrolment will likely produce larger pension pots in a mature DC environment in the future, which could lead to greater use of the new flexibilities. As it becomes the norm for people to have different types of incomes in retirement they may wish to have flexibility over how they access some of that income.

IMA modelling demonstrated that it was possible for individuals to achieve better outcomes from drawdown than annuities in some circumstances, but that it was risky if the drawdown product was a sole source of income other than state pension. If an individual survives to a very high age, there are significant challenges in matching the mortality credit available from an annuity.

Some form of longevity risk pooling will be necessary for many people, but there should be flexibility in the decumulation phase for DC benefits so that the right product is purchased for the right reasons rather than as a result of compulsion.

Jane Vass, Programme Manager, Private Sector Policy at Age UK gave a perspective on what the new policy might mean for individuals.

She noted that the change, though attractive in principle, will make retirement planning appear more complex even for those who are not able to take advantage of the new options. There is a concern about possible misinformation and the high costs of drawdown, and there may be unintended consequences, for example if people are so attracted to the flexibility of drawdown that they transfer out of good occupational schemes to take advantage of it. It will be important to ensure that the new freedoms lead to the development of products that work in consumers' interests and that there should be good quality advice in order for consumers to make appropriate choices.

For the majority of people annuities are still the best option. There should be help with shopping around but also increased transparency by publishing benchmark rates for all annuity providers, even those not operating in the open market.

People with smaller pension pots often have the most complex needs. They are in the most need of advice and often the least able to get it. Reform of the rules and operation of trivial commutation is required.

Matthew Annable, Chairman of the Pensions Policy Institute then chaired a question and answer session.

There was discussion as to whether the new rules may lead to people with defined benefit pension savings transferring out some or all of their benefit in order to take it more flexibly and what impact that may have. This could impact on scheme funding and levels of retirement income.

The role of lifestyling investment strategies was questioned given the new policy. Such strategies are designed to give more security for people who will be buying an annuity by transitioning from a higher risk growth phase to less volatile investments when nearing retirement. They may not be appropriate for individuals who will remain in invested products until later in retirement.

There was discussion around the availability of advice to middle income people who may be those with the greatest need. It is not clear who will provide, or pay for, this advice. It was noted that the need for advice among the middle income level is a feature of many of the reports in the PPI's *Retirement income and assets* series.

There was also a wish to ensure that annuities continue to be sold to those individuals for whom they remain the most appropriate option.

There was some concern that the tax levied on lump sums withdrawn under the new policy may be high in comparison to the tax relief given in the accrual phase.