PENSIONS POLICY INSTITUTE

PPI

PPI response to HM Treasury consultation *Freedom and choice in pensions*

Please find attached the Pensions Policy Institute's response to HM Treasury's consultation: *Freedom and choice in pensions,* comprised of this letter and the following attached Briefing Notes:

- Freedom and Choice in Pensions: comparing international retirement systems and the role of annuitisation (PPI Briefing Note 66) – most relevant to question 2 in the consultation document.

- Freedom and Choice in Pensions: the minimum pension age (PPI Briefing Note 67) - most relevant to questions 3-5 in the consultation document.

Also enclosed is a write up of the contributions and comments made at the Supporting Members event hosted by the PPI on Monday 12th May, where Exchequer Secretary David Gauke MP summarised the proposals in the consultation.

Summary of conclusions

Comparison of international retirement systems and the role of annuitisation

- In the absence of compulsion some people with DC pension savings may still choose to use part, or all, of their DC savings to purchase an annuity. For example, those who are risk averse may still opt to purchase lifetime annuities, those who qualify for an enhanced annuity may still consider the annuity rates they are offered attractive, and those who wish to secure a guaranteed lifetime income later on in their retirement may opt to purchase deferred annuities or purchase an annuity (perhaps in their seventies or eighties).

- If the UK annuity market builds products with new features, for example guarantees which can allow bequest options, different forms of insurance (against health, disability, and care costs), and long-tail annuities alongside drawdown products, annuities may remain popular.

- Partial annuitisation could play a bigger role in future if people wish to use only part of their DC savings in order to secure a guaranteed income or underpin whilst holding the rest of their savings in riskier investments.

- If UK pension schemes and providers encourage nudging and decision-making during the saving period, for example by building an option for savers to pre-select income drawdown or fixed/lifetime annuity options then there could be lower take up of the full lump-sum withdrawal option by DC savers in future than would otherwise be expected if these decisions were delayed until the point of retirement. These options may also prove to be more tax efficient for those who would otherwise be pushed into a higher tax band by taking a lump sum.

Changes to the minimum pension age

- The minimum pension age of 55 is lower in the UK than in a number of other comparable countries, and the proposed gap between the minimum pension age and State Pension Age (of 10 years) is significantly greater. This appears inconsistent with other areas of Government policy, for example the DWP's Extending Working Lives agenda, which is actively encouraging older workers to work and save for longer, up to and beyond SPA.

- However, these other countries generally allow early withdrawal from private pension saving for a wider range of reasons than in the UK (for example for financial hardship, or support with a housing deposit, or on leaving an employer later in working life).

- One consequence of the removal of restrictions on how individuals can access their DC pension savings is that there will no longer be an incentive for individuals to purchase an annuity at age 55 simply in order to access their tax-free lump sum, regardless of whether an annuity is in their best interest in the long-term.

- A significant proportion of annuities are currently purchased by people under SPA, suggesting that private pension savings are being used to provide income during the period between individuals stopping paid work, or reducing their hours, and receiving the state pension. Retaining the ten-year difference between minimum pension age and SPA would enable individuals to continue to do this. It might also enable them to pay down some debts some years before their SPA, something that might improve their overall financial position in retirement.

- While the Government believes that the new single-tier pension should avoid many future pensioners falling back on the state there may still be some groups who become eligible for means-tested benefits if they have exhausted their sources of private retirement income. However, while increasing the minimum pension age from age 55 will prevent some individuals from accessing their private pension savings at an early age, it is not clear to what extent this would then lead to fewer individuals exhausting or running down their private pension income during retirement.

I do hope you find the enclosed documents informative.

Mel Duffield,
Deputy Director
Pensions Policy Institute
June 2014

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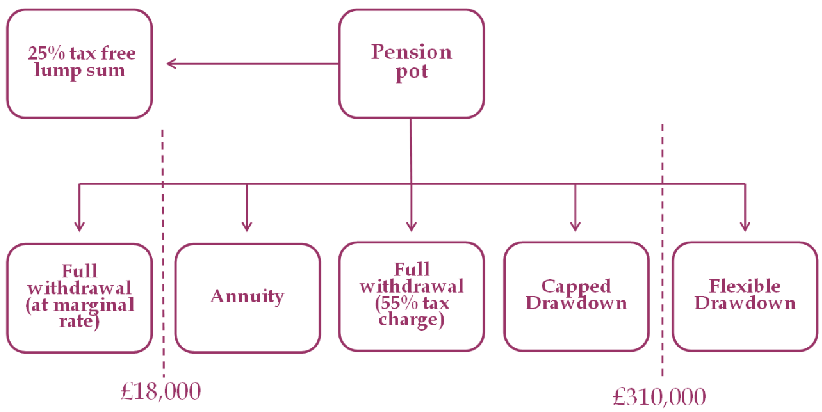
Freedom and Choice in Pensions: comparing international retirement systems and the role of annuitisation

Introduction
At Budget 2014 the Chancellor announced radical changes to how Defined Contribution (DC) pension savings can be accessed at retirement.

This Briefing Note explores how DC savings are accessed in other countries, how this interacts with wider government policy, and what international experience might mean for how DC savings are accessed in future in the UK.

Currently, around three quarters of those reaching retirement with DC pension savings use them to buy an annuity. The high take-up of annuities (which provide a **guaranteed income for the entire lifetime of the holder**) is partly attributed to tax rules which, until April 2014, only allowed those over minimum pension age (currently 55) to draw their pension savings as a lump sum without an additional tax charge if its value was below a certain limit (£18,000 or lower for a single pot). Two additional pots could be taken as lump sums provided they were worth less than £2,000 each. This is known as "trivial commutation".

Chart 1: Current tax system for accessing defined contribution pensions at retirement



Source: Chart recreated from HM Treasury (2014) *Freedom and choice in pensions* Cm 8835 p. 21 Diagram 3.A

As an alternative to annuities, those over minimum pension age could invest their pot in an income drawdown product (Chart 1), but there were restrictions on how much could be drawn down in a given year ("Capped Drawdown") unless the saver had a secure retirement income for life of at least £20,000 a year ("Flexible Drawdown"). In practice, income drawdown has tended only to be available to those with larger pension pots (well above the median DC pot size at retirement of £20,000)[1] and, because of the risks involved and the complexity of investment choices that need to be made, has typically gone hand-in-hand with the receipt of regulated financial advice, which must be paid for.

Prior to Budget 2014, people could "trivially commute" a single pension pot up to the value of £18,000 by taking it as a lump sum and could take two further pots up to the value of £2,000 as lump sums. In the Budget it was announced that, between April 2014 and March 2015, the trivial commutation rules would be relaxed, so that a single pot up to the value of £30,000 could be taken as a lump sum, and up to three further pots of £10,000 or less could also be taken.

In addition, the maximum amount that could be taken under "Capped Drawdown" was increased from 120% of the equivalent value of an annuity per year to 150% and the Minimum Income Requirement for entering "Flexible Drawdown" was reduced from £20,000pa to £12,000pa.

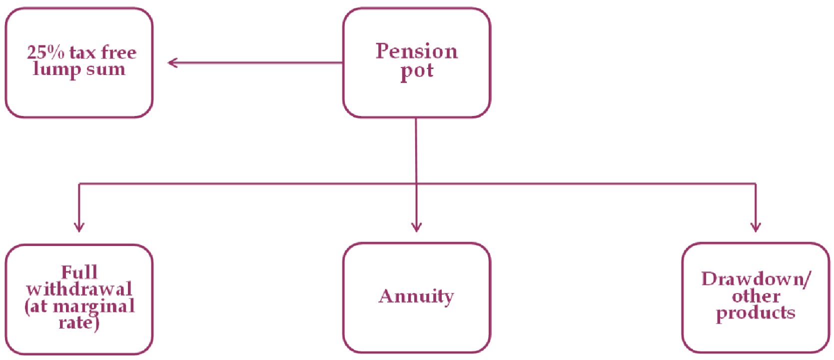
The Budget also announced that, from April 2015 onwards, all restrictions on accessing private DC savings would be removed, so that anyone from age 55 onwards could access their DC savings as a lump sum without facing any additional tax charge over their marginal rate. This constitutes a significant liberalisation of the pensions tax regime and is partly facilitated by the new single-tier state pension which, the Government believes, should avoid pensioners falling back onto the state in future and should reduce the risks of moral hazard (though people in receipt of full single-tier may still fall back on the state for Housing Benefit, Council Tax Reduction and other means-tested benefits.) The Budget changes have wide ranging implications for the retirement landscape in the UK.

Those approaching retirement with a DC pension pot may now choose to access their DC pension using one, or a combination, of three options (Chart 2):

- Full withdrawal (at marginal income tax rate);
- Annuity purchase; and
- Drawdown/other phased income products.

All DC savers over age 55 still have access to a 25% tax-free lump sum.

Chart 2: Future tax system for accessing defined contribution pensions at retirement



Source: Chart recreated from HM Treasury (2014) *Freedom and choice in pensions* Cm 8835 p. 21 Diagram 3.A

Implications for the wider DC retirement landscape

The impact of these changes is potentially far-reaching and at this early stage in policy development there is a lot of uncertainty about how individuals will behave and how employers, pension providers, insurers and asset managers will respond in terms of developing new products and processes.

One key issue, identified in the Budget proposals, is how to support DC savers with the choices they need to make before, at and during retirement. The Chancellor announced that a new duty would apply to pension providers and trust-based pension schemes to provide members with "face-to-face advice" at retirement. However, in the consultation document, the Government clarified that this would be a "guidance guarantee" rather than fully regulated financial advice.

Another key issue is how pension schemes design default investment strategies for those approaching retirement given the wide range of options that will now be available to them from age 55 onwards. Currently, a typical default investment fund in a DC scheme being used for automatic-enrolment would invest in a range of asset classes and "de-risk" these assets in the run up to an assumed retirement age, on the assumption that the majority of members will choose to take a 25% tax-free cash lump sum and annuitise the rest of their DC pension pot.

This may no longer reflect an appropriate default assumption for the majority but there is no, as yet, established consensus within the UK pensions industry as to what an appropriate alternative default glidepath to retirement might be. One possible response is to require greater engagement from savers in DC pension schemes ahead of retirement or to try and nudge or guide them towards their preferred retirement age and investment strategy.

The future of annuitisation in the UK

In the absence of clear evidence on how the DC retirement landscape might evolve in the UK in response to the Budget changes, it may be illustrative to look at the experiences of other countries with well developed DC markets, particularly in respect of the choices savers make about how to use their pension pots at and during retirement, and the cultural, institutional and regulatory features that may drive these choices.

The UK is recognised as having one of the most dominant and established annuity markets internationally (relative to the size of the economy)[2] and so it could be argued that, culturally, UK retirees might expect their pensions to deliver them a secure income in retirement, particularly given the history of Defined Benefit provision in the UK.

There are some notable advantages to annuitising over taking a pension as a lump sum or using other forms of drawdown. In particular an annuity is the only product for those with DC pension savings that pools their longevity risk and provides them with a guaranteed income for life. Depending on the type of annuity selected it may also provide protection against future inflation although that additional protection comes at a significant cost in terms of a lower starting level of annuity income.

However, rising life expectancy, low gilt yields, and increasing regulatory and capital requirements have seen annuity rates fall significantly in recent years, to the extent that their value for money has been questioned.[3] The low understanding of many DC savers of the options available to them and the lack of shopping around for the best product and price has also led to concerns about consumer detriment in the annuities market and inertia selling.

Against that backdrop, the Chancellor's announcement to remove restrictions around how DC pensions are accessed has received a warm reception from the general public.

The annuities market in the UK is characterised by a wide range of annuity products (including conventional, fixed-term, investment linked, enhanced and impaired annuities) and a shrinking number of active annuity providers. With the annuities market estimated to be worth some £11bn[4] annually, radical changes in retiree's behaviour could have significant implications both for the annuities market but also the wider retirement income landscape in the UK.

There are a number of other countries with established DC markets where annuitisation in its different forms has played, or still does play, a role in the retirement landscape. Those countries include Australia, Canada, Chile, Denmark, Ireland, Israel, Singapore, Switzerland and the United States. The rest of this briefing note examines these countries in more detail and draws out some potential lessons and implications for the development of new products, guidance and processes in the UK retirement market.

What factors contribute to higher levels of annuitisation?

Switzerland[5]

Switzerland has a state pension which provides up to 36% of average salary and a further layer of means-tested benefits for pensioners. Membership of an occupational pension scheme is mandatory for employees and the vast majority of these schemes are cash balance, meaning they deliver a pre-agreed salary-related amount as a lump sum on retirement.

Despite Swiss savers being permitted unlimited access to their private pension savings (though some schemes restrict access), annuitisation levels in Switzerland are high; around 80% of DC assets are put into lifetime annuities. This is attributed to cultural attitudes; Swiss workers are described as being "financially conservative" and "preferring guaranteed incomes for life" over taking lump sums.

Swiss annuities are funded by hosting pension schemes and their rates (which are regulated by the Government) are considered to be very generous given the current low interest rates in the Swiss market and low mortality rates amongst annuitants. While high rates are likely to account for some of the popularity of annuities, there is concern that employers may face solvency concerns in the future.

Swiss annuities are, in the majority, joint-life. Indexation is at the discretion of the provider and subject to its financial position. Deferred annuities, fixed-term annuities and drawdown are not available for savers in the mandatory schemes. The private annuity market is relatively small, partly because annuities offered by mandated schemes offer such generous rates.

Chile[6]

Chile's annuity market is relatively young, dating from policy changes in 1981 in which Chile replaced its universal and earnings related state pensions with a mandatory private pension system. A minimal contribution-linked state pension and means-tested benefits for pensioners remain.

On reaching retirement, Chileans who wish to access their DC pension savings must opt either for a lifetime (deferred or immediate), index-linked annuity or for phased withdrawals from a pension fund. Married DC savers are required to purchase joint-life annuities. The fund providers must guarantee a minimum rate of return, which is backed by the Government. The number of DC savers purchasing an annuity in Chile has risen from 3% of pensioners in 1985 to just under 70% of DC savers for whom annuities were an option in 2007. This also equates to around 70% of DC assets.

There is a high demand for lifetime annuities in Chile, attributed to the restrictions on accessing savings and on the lack of a sufficient universal state pension to fall back on. The annuities market in Chile is highly competitive and developed. Around 30% of annuities purchased are deferred, though the majority of these are deferred only for a year. The small take up of the phased withdrawal option may be linked to the relatively high charges levied on these products.

Singapore[7]

Singapore's pension system is single pillared and is intended to fund all retirement expenses (including healthcare and housing) for pensioners. The contributions from employers and employees are mandatory and costly (up to 36% of salary for younger workers) but the corresponding pay-outs in retirement are high as well as being subsidised by the Government.

As a result of increasing longevity among Singaporeans, the Government introduced a policy requiring the purchase of a retirement income product, for all pension pots over a minimum size, at age 55. Singaporeans are given the choice between a deferred lifetime annuity or the slightly more expensive, "longevity insurance" which is, in effect, a deeply deferred annuity that begins to pay out at age 90 coupled with a standard annuity which pays out until age 90. Joint-life and index-linked or escalating annuities are not available.

Reinforcing the high rates of annuitisation in Singapore is the fact that all DC savers are restricted to making a simple choice between two standard products at age 55. Benefits can be drawn down from these annuities after the minimum pension age which is rising from 62 to 65. The annuities have flexible features such as bequest options for those who die at younger ages.

Israel[8]

Israel operates a flat-rate universal state pension based on residency which provides around 30% of average working-life salary.

Since the 1940s, Israeli private pensions consisted mainly of DB occupational pension schemes.

In 2008, the Government made membership of a pension scheme mandatory for all employees. Israelis not already covered by an occupational pension scheme can now choose between different types of savings vehicles, some of which require, at or after age 60, purchase of a lifetime annuity (paid out by their pension scheme) up to a certain minimum income amount. Annuities are designed to insure people against disability, death and inflation while allowing savings over the minimum required for this to be withdrawn.

Israelis also have the alternative option of saving in life insurance policies which cover risks such as death or disability and can also include a savings component for later lump-sum withdrawal.[5]

The proportion of savers who purchase an annuity is high among those who save in an annuity-linked vehicle. Israeli annuities are considered to have very good rates as they are partially subsidised by Government bonds.

Israel has made more use of index-linked annuities than other countries with mandatory annuitisation. The system is heavily focused on the "insurance" aspect of annuities and pension saving.

What factors contribute to medium levels of annuitisation?

Denmark[9]
Denmark operates a state pension, subject to a means-test for those over a certain income, as well as a supplementary pension for low-income pensioners.

Most Danish employees are required to contribute to a DC pension scheme (either the collective, earnings-related ATP or an individual "special pension"). Voluntary DC plans are available for workers not covered by either of these.

The provision of a lifetime annuity (direct from the scheme) is mandatory for those saving in an ATP pension. For those in other voluntary pension schemes there are different options available at retirement which include life annuities, fixed-term annuities and access to lump sums. Each pension scheme has different rules regarding how pension savings can be accessed.

It is during the savings process that many of the decisions around annuitisation are made, as employees can opt to have their savings used to purchase deferred annuities. In Denmark, 50% of DC pension savings are allocated to purchase lifetime annuities, 35% is used for fixed-term annuities and 15% is taken through lump sums.

The relatively high level of annuitisation could be partly attributed to the decision to annuitise being made earlier, during the accumulation period.

Ireland[10]
Ireland operates a state pension payable from age 66 (rising to 68) and a means-tested pension, payable from age 66.

Until 1999 Irish savers in DC pensions were required to purchase an annuity if they wanted to access their saving. Under new regulations introduced in 1999, Irish savers who meet the Minimum Income Requirement (MIR) (of €12,700 per year equal to around £10,500) have the option of purchasing an "Approved Retirement Fund" (ARF), similar to income drawdown, or withdrawing their entire savings pot as a lump sum.

The minimum income must be secured through state pension and a combination of an occupational pension, an annuity or purchase of a more restrictive income drawdown product an "Approved Minimum Retirement Fund" (AMRF) similar to Capped Drawdown. From age 75, AMRFs convert to ARFs and people can withdraw funds from them without limits, regardless of whether people meet the MIR. (Those with occupational DC pensions are still required to take their pension through an annuity.

Around 30% of those retiring with private pension savings currently purchase an annuity (the majority of which are flat-rate, lifetime annuities), though this figure includes individuals with an occupational DC pension who are still effectively obliged to purchase an annuity. Therefore it is difficult to assess how many people are making an active choice to purchase an annuity.

A 2007 review of the annuities market notes that those with a choice between an annuity and an ARF generally chose an ARF because of the flexibility they offer and because Irish annuities are perceived as giving poor value. However, the review showed that people purchasing an ARF and withdrawing from it in the same amounts that they would receive from an equivalent annuity, had a 50%-60% chance of exhausting their fund before they died.

The annuities market in Ireland is small. The 2007 review suggested that this could be attributed to:

- poor understanding by consumers;
- the reluctance of consumers to sacrifice capital;
- the lack of flexibility in available products; and,
- faults in the marketing and distribution strategy of annuity companies.

What factors contribute to lower levels of annuitisation?

Australia[11]
Australia's pension system involves two main pillars: a means-tested "state" pension and a system of mandatory saving into "MySuper" DC pension schemes (with minimum employer contributions of just over 9% rising to 12%) or occupational pensions.

Australians can access their DC pension savings after the minimum pension age, which is between 55 and 60 depending on the saver's date of birth.

There are very low levels of annuitisation in Australia. Around half of DC assets are paid out as lump sums. The other half provide an income stream; mainly through "pension accounts" similar to Flexible Drawdown.

Estimations of level vary; between 2% and 10% of DC pension assets are used to purchase a lifetime annuity.

There is low demand from the public for annuity products, but also a clear gap in understanding of longevity, income needs in retirement and how savings can best be used to meet those needs.

There are also incentives within the structure of the means-testing system for people to spend down their private pension savings to a certain level. For example, pensioners who qualify for even $1 of state pension are then entitled to other benefits such as healthcare, medicine and other living expenses.

The Cooper review of the retirement income market in 2010 found that the retirement income product market was "under-developed" and it attributed this partly to the small pot sizes being accumulated by the current cohorts of retirees.

The Cooper review recommended that Australians saving in pensions should be given more advice about retirement needs. It also recommended members be given regular projections of future fund value and the potential income which could be generated in retirement.

Canada[12]
Canada operates a contribution and residency based state pension system which is also subject to a means-test.

Private pension membership is voluntary though there are restrictions on accessing DC pension savings in retirement. Annuitisation of DC savings at retirement was once mandatory, but since the late 1980's the restrictions have been loosened. The rules governing accessing savings vary now between provinces, and range from requiring annuitisation at age 80 or requiring annuitisation of 50% of DC savings to allowing free access to lump sums.

The majority of pension plans offer several options to employees including annuities, savings accounts, and drawdown style arrangements which allow withdrawal (between a maximum and minimum amount) and require people to begin taking income by the age of 71. Lifetime annuities are reportedly the least popular option for those who have a choice.

Some pension providers have subsidised the cost of financial advice in order to help scheme members make good choices when they come to access their DC savings, however, other providers have expressed concerns about the fiduciary risk involved in providing advice.

The Canadian trade body for pension funds has issued guidelines on the information which should be provided to scheme members about their options for accessing DC savings.

USA[13]
The USA operates an earnings-related state pension. The USA has experienced a decline in private sector DB pension provision over the last few decades and an increase in saving into DC pensions particularly 401(k)s. Some employers voluntarily opt to auto-enrol their employees into their 401(k) schemes.

Savers in the USA are permitted to access their DC savings from retirement age without restriction. The purchase of lifetime annuities is minimal in the USA, estimated to account for less than 2% of pensioner income in 2009.

The lifetime annuities market in the USA is small and there is a lack of interest from consumers attributed to the lack of bequest options, large fund sizes, "adverse selection" and consumer concerns about developing health problems in later life.

However, Americans are not necessarily making the best decisions about how to use their pensions savings in retirement; researchers predicted that around half of those in or close to retirement in 2010 were in danger of exhausting their private pension savings before their death.

There is more flexibility in available annuity products in the USA than in some other countries with low annuitisation levels because, though take up is low, the large US population means that the numbers of people purchasing annuities is sufficient to create a relatively sizeable market. Most types of annuity products are available, in particular "variable annuities" (which in the USA are savings vehicles which allow the saver to withdraw lump sums in any amount at or during retirement as well as leave a bequest). These are growing in popularity as tax-effective, flexible ways of saving.

People in the USA are more likely to use annuities during the accumulation phase as well as in retirement because products such as "deferred" or "variable" annuities allow flexible, tax-advantaged ways to save.

Chart 3: Features in case study countries with different levels of annuitisation

		Restrictions on accessing DC savings	Flexibility of annuity products	Variety of other products: e.g. drawdown	High annuity rates/ MWRs	Annuities perceived as a "good deal"	State pension	Means-tested pension
High annuitisation	Switzerland (80%)				●	●	●	●
	Chile (70%)	●	●	●	●	●		●
	Singapore (not available)	●			●	●		
Medium annuitisation	Israel (not available)	●	●	●	●	●	●	
	Denmark (50%)	●	●		not available	not available	●	●
	Ireland 30%	●		●			●	●
Low annuitisation	Australia (2-10%)			●				●
	Canada (not available)	●		●				●
	USA (<2% pensioner income)		●	●			●	

Common themes in countries with higher levels of annuitisation

Countries with higher levels of annuitisation all offered higher annuity rates than would have been expected given market conditions (Chart 3). This is because the annuity markets were price regulated or because underlying investments were backed in some way by the Government. Annuities were perceived in these countries as a "good deal", even in Switzerland where purchasing an annuity with DC savings is not mandatory. There appears be a strong correlation in the countries examined between high levels of annuitisation, good annuity rates and a positive attitude towards annuities.

Though restrictions around accessing DC savings was a present factor in all but one of the countries with high annuitisation levels, some with lower levels, such as Ireland and Canada, also had some restrictions around accessing DC savings. So restrictions on access is clearly not the only determining factor.

Having a large range of annuity products did not seem to impact on annuitisation levels, though annuities in countries with high annuitisation levels were more likely to offer annuities which contained insurance elements such as inflation proofing (Switzerland), protection for dependents (Chile) and longevity insurance (Singapore).

Common themes in countries with lower levels of annuitisation

Within countries in which annuitisation levels were medium to low (30% or under) annuities were not perceived as a "good deal". Annuities in these countries were less likely to involve any form of Government backing or other intervention to ensure that annuity rates looked attractive when compared to other retirement income products.

Countries with lower levels of annuitisation also tended to contain a wider range of other available products that allowed drawdown of income as well as savings and the potential for bequest. These products tended to be more developed in these countries, while annuity markets were reported to be under-developed (e.g., Australia) or small (Ireland, USA). Popularity is growing in the USA for annuities which can be used during the accumulation period and during retirement for tax-advantaged saving and draw down, while still allowing access to lump sums and the possibility of bequests.

The understanding among consumers of the potential benefits of annuities, needs in retirement, and current life expectancy rates were reported as low in countries with low levels of annuitisation (e.g., Ireland, Australia, USA).

A key feature of countries with lower levels of annuitisation was that they tended on the whole to have fewer restrictions on accessing DC savings, though it cannot be assumed that this is the deciding factor in the light of the finding that in Switzerland, which allows free access to lump sums, around 80% of DC savings is used to purchase a lifetime annuity.

Countries with low levels of annuitisation all had a state pension or a means-tested pension. The Australian means-tested pension, and corresponding passported benefits (such as health care), were identified as an incentive for some people to spend down their private pension savings in order to qualify for a portion of state benefits.

However, most of the countries with high levels of annuitisation had either a state or means-tested pension, excepting Singapore, so it is not clear how much of a determining role a "fallback" pension plays.

What does international experience mean for the UK?

The Government estimates that as a result of the new freedoms, annuity purchases will decline from current levels of 75% of DC savers to around 50%.[14]

However, international experience suggests that people's reactions to the Budget changes and their corresponding impacts on levels of annuitisation will depend on several different factors.

Countries with high levels of annuitisation all have high annuity rates, regulated, backed or secured in some way, such as through underlying investments by the Government. Annuities are perceived as a "good deal" for annuitants in these countries.

In the UK, enhanced or impaired life annuities can offer higher rates (up to 50% more than a standard annuity) to those with shorter life expectancies arising from health problems or disability. Up to 60% of annuitants would currently qualify for some level of enhancement in their annuity rate.[15] If annuity providers are able to communicate to consumers that the uplift in annuity rates makes enhanced annuities a "good deal" for them, this could support the market for these products.

The Government has already announced a new source of secure income for pensioners through making new savings bonds available to people aged over 65, which will offer a fixed rate of return, from January 2015 (announced in Budget 2014).

DC savers who are given a choice as to how to access their fund seem to navigate towards products which allow tax-advantaged saving, with access to lump sums and bequest opportunities. For example, the use of what are known as "variable annuities" is becoming more popular in the USA because they offer these flexibilities. In Israel, annuities are popular because they contain a savings element, access to lump sums, protections against inflation, and insurance for disability and death.

There is clearly an appetite among consumers for annuities in other countries, some who value security such as Switzerland, and others who use annuities as a tax-advantaged, flexible way to save or as part of a portfolio offering security and insurance features as well as access to lump sums and bequest opportunities, such as the USA. If the industry is able to work with UK consumers to determine what they value from a retirement income product, then annuities which meet those needs could continue to play a substantial role in the more flexible landscape for DC savers.

Many DC savers in countries which do not require annuitisation, such as Australia and Ireland, opt for income drawdown style products rather than annuities. If these products are to play a greater role in the UK in future, then the industry will have to review their income drawdown product design to see if a range can be offered which is appropriate for people with smaller pension pots, who may not be able to afford high management charges and regular advice. However, for savers to benefit from using these products, providers, the Government and regulators will need to ensure that savers understand the potential risks and benefits associated with drawdown and other retirement income products.

The lack of understanding about financial issues was a source of worry in countries with low levels of annuitisation. The Cooper review urged the Government to ensure that Australians were given more advice and information about retirement needs as well as regular projections of future fund value. Canadian trade bodies are working to ensure that Canadians are given better information and guidance when they come to make decisions about retirement.

There is a poor understanding of annuities in Ireland, where the majority of savers opt for the drawdown style ARF option instead of an annuity, despite the 50%-60% chance of exhausting funds in ARFs if withdrawals are taken at the same rate as those available from an annuity.

Half of Americans in or close to retirement are in danger of running down their pension savings before their deaths.

The guidance and advice that is given to UK individuals at the point of and during retirement will play a critical role in the decisions retirees make about how to use their DC savings. It is clear from the international evidence that in countries with more flexibility such as Ireland and the USA, savers have a poor understanding of retirement needs and longevity, and are at a greater risk of running out of savings before their deaths.

Guidance and advice provided by schemes, government programmes and other agencies will need to be designed with the potential pitfalls for savers who do not purchase an annuity in mind. Clear, regular information before, at and during retirement about how needs might change and about how to insure against disability, long life and inflation will be essential if savers are to be given the knowledge to make informed decisions and protect themselves from financial difficulty in retirement. Savers are particularly in danger of under estimating how long they will live. In England, men aged between 50 and 60 under-estimate their life expectancy by two years on average, and women do so by four.[16]

The Government must ensure that pension schemes and advice and guidance bodies are equipped with the resources to provide the necessary advice and guidance to everyone who retires with DC pension savings.

Conclusion—who, in future, might purchase an annuity in the UK?

There are concerns that once the new flexibilities are in place, people with DC savings will no longer choose to purchase an annuity and that this could cause wider damage to the annuity market and increase the risk of DC savers depleting their pension savings before their deaths. According to one consumer survey, only 16% of DC savings will be used to purchase an annuity in future, though an alternative consumer survey found that 58% of savers still said they preferred a “regular income for life” over risking running out of money.[17]

International experience indicates that in some countries, people still choose to annuitise even in the absence of restrictions on accessing DC savings.

These case studies show that even without compulsion, those who are financially conservative and risk averse are still attracted to the security offered by annuities. A consumer survey found that guaranteed income was one of the top priorities for consumers in investment decisions, alongside tax efficiency.[18] The high rate of annuitisation in Switzerland shows this particularly. **In the UK in future, those who are risk averse may still opt to purchase lifetime annuities with their DC savings.**

In Singapore, annuities and life insurance products are valued because they offer bequest options for those who die at younger ages, and longevity insurance options for those who live a long time. **If the UK annuity market builds guarantees into annuity products which can allow bequest options and long-term guarantees of payouts in later life (longevity insurance) annuities may remain popular with those who have DC savings.**

The industry may want to explore product development for people who might wish to use part of their DC savings to provide security for themselves and take the rest as a lump sum or invest it in other products. **Partial annuitisation could play a bigger role in future if people wish to use only part of their DC savings in order to secure guaranteed income or insure against longevity.**

In Denmark, decisions about annuitisation are made earlier during the saving process. **If UK pension schemes encourage decision-making during the saving period and build an option into schemes to pre-select income drawdown or annuity options then there could be lower take up of the full withdrawal option by DC savers in future than would otherwise be expected. These options may also prove to be more tax efficient for those who would otherwise be pushed into a higher tax band by taking a lump sum.**

Annuities which provide protection for disability are valued in Israel where annuitisation levels are relatively high. **Those qualifying for higher annuity rates (e.g. enhanced annuities) but who are still risk averse and might be uncertain how long they will live for could still find annuities attractive in future. Alternatively, new elements of health or disability insurance could be built into annuities to make them more attractive.**

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Freedom and Choice in Pensions: the minimum pension age

Introduction

At Budget 2014 the Chancellor announced that, from April 2015 onwards, restrictions on accessing private Defined Contribution (DC) savings from age 55 would be removed. Further to this, the Government published a consultation document *Freedom and choice in pensions* providing details on how these proposals might work in practice.

In this consultation document, the Government proposes increasing the age at which individuals can access their private pension saving, known as the minimum pension age, in line with planned increases to State Pension Age (SPA). To enable people to plan for this change, the Government has announced its intention to wait until 2028, when the SPA will increase to 67, to increase the minimum pension age from 55 to 57. The consultation document also seeks views around whether the difference between the SPA and the minimum pension age should be decreased further in future so that, for example, it is only 5 years lower than the SPA.

This Briefing Note considers the rationale for increasing the minimum pension age in line with the SPA. It then explores the extent to which the current minimum pension age influences saving and retirement behaviour, the differences in minimum pension ages and SPAs between the UK and other countries, and some practical implementation issues that might arise as a result of future increases to the minimum pension age.

Background

The minimum pension age is one element of a private pensions system that aims to ensure that pension savings are used to provide income and security in retirement while also incentivising pension saving. Therefore, the minimum pension age is designed not to be set so low that private pension saving acts like other easy to access tax-advantaged savings vehicles, such as ISAs, and does not contribute to individuals having an adequate retirement income. At the same time, it is designed not to be set so high that it deters people who may have concerns about not being able to access their savings when they need it because it is locked up in a pension.

This issue is complicated by retirement increasingly being a gradual or phased process rather than a single cliff-edge event that takes place around their SPA.

The current minimum pension age was increased from 50 to 55 in 2010. Any withdrawals before age 55 are now subject to a 55% rate of income tax. This means that men can currently access their private pension income up to 10 years before they can receive their state pension. The difference is smaller for women (around 7 years) but will eventually be the same as for men. However, schemes are still able to pay out benefits to a member under the age of 55 on the grounds of ill-health.

Until April 2015, individuals are required to use any pension pots accessed between the ages of 55 and 60 to purchase an annuity or enter income drawdown, after they have taken 25% of this as a tax-free lump sum. Trivial commutation rules, however, only apply from the age of 60 onwards. These rules allow individuals with total private pension pots worth up to £30,000 to withdraw their entire pension pot as a lump sum. In addition, up to three small pension pots worth no more than £10,000 each can be taken as a lump sum from age 60 onwards.

From April 2015 all restrictions on accessing private Defined Contribution (DC) savings from age 55 will be removed. This means that, in the future, reaching the minimum pension age at 55 will allow individuals full access to their private pension DC savings without any tax penalty.

Early access to private pension DC savings has previously been suggested as a way to provide flexibility for individuals facing financial hardship before they reach retirement. However, in 2011, the Government concluded that early access to pension saving should not be considered at the time as there was not sufficient evidence that this would increase overall pension contributions or provide significant help to individuals in financial hardship.[1]

In addition, early access to pension saving might not be consistent with the Department of Work and Pensions' objective of people remaining in paid employment for longer. However, for most people, starting to receive private pension income and retiring from employment do not happen at the same time. Data from the English Longitudinal Study of Ageing (ELSA) found that, between 2004 and 2011, around two thirds of people were in work immediately prior to accessing their DC pension, and only 45% of this group left work when they first started to draw their pension income, with the remainder continuing to work.[2] Many individuals may therefore wish to access their DC pension in a more flexible way that allows them to take a partial income or gradually phase in their retirement.

Rationale for increasing the minimum pension age in line with the SPA

Increases to the SPA are intended to reflect changes in the life expectancy of the general population. As life expectancy increases, the state pension would be paid to people for an increasing number of years if the SPA remained unchanged, and so planned increases to the SPA are intended to ensure the state pension system remains sustainable. Delaying the age at which individuals can first access their state pension has a direct impact on the amount paid out by the state to individuals over the course of their retirements but may also encourage individuals to work and save for longer before they retire.

The relationship between any increase to the minimum pension age and sustainability of the state pension and means-tested benefits in retirement is less direct. The minimum pension age sets an age at which individuals have the option to access their own private pension savings, should they choose, which in some cases may include drawing income some years before SPA. While it might be assumed that, the earlier the minimum pension age, the greater the risk that some individuals may exhaust their private pension savings before they die, some will still choose only to their access their private pension savings at, or even after, reaching SPA.

The impact of the current minimum pension age of 55 on behaviour

The minimum pension age is only one of the factors that may influence the age at which an individual draws their private pension income. The normal retirement age for workplace pensions, usually 60 or 65, appears, as might be expected, to have an impact on the age at which individuals start to draw down their private pension income. Defined Benefit (DB) workplace pension schemes, in particular, can incentivise individuals to work until the scheme's normal retirement age and then retire, as benefits continue to accrue up until this age and then are generally capped at a maximum number of years of accrual.[3]

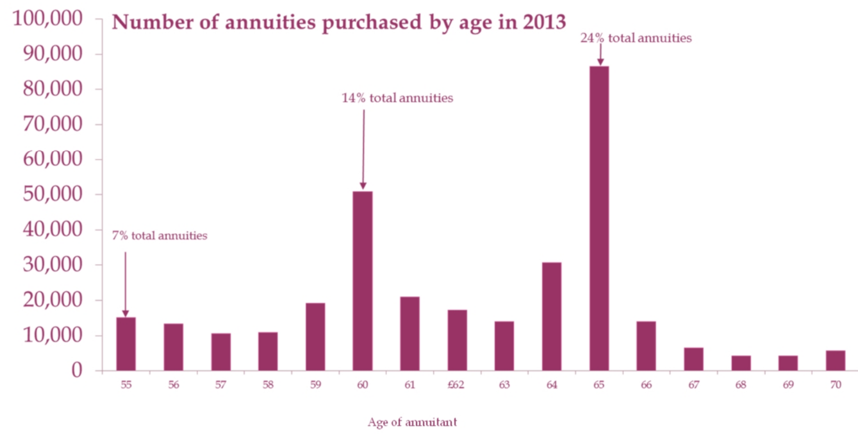
Impact on age that individuals currently access pension funds

Chart 1 shows the number of annuities purchased in 2013 by the age of the annuitant, based on data collected by the Association of British Insurers (ABI). This shows how the number of annuities purchased peaks at 65 and 60, in line with the normal retirement age for many workplace pensions schemes and, to a lesser extent, at 55, the minimum pension age.

The chart shows that many annuities are purchased by people under SPA, suggesting that private pension income may be used to provide income during the period between individuals stopping paid work, or reducing their hours of paid work, and receiving the state pension.

Of annuities purchased in 2013, 24% were purchased by an individual aged 65 while 14% were purchased by an individual aged 60. This suggests that factors other than the minimum pension age have influenced their decision. However, there is also a smaller peak at age 55, with 7% of annuities purchased by individuals of this age, suggesting that the minimum pen-

Chart 1: Purchase of annuities peaks at ages 60 and 65 and, to a lesser extent, 55



Source: Data provided by the Association of British Insurers

sion age has an impact on the behaviour for some people.

The peak at age 55 is slightly higher for annuities purchased with smaller pots—for instance, 9% of pots up to the value of £10,000 that were used to purchase annuities in 2013 were for by an individual aged 55.[4] If the total value of an individual's funds was less than £18,000, they would have been able to withdraw their entire pension as a lump sum if they had waited until the age of 60 to access their funds under the trivial commutation rules up until March 2014.

As annuity rates offered to individuals with small pension funds are generally lower than those offered to individuals with larger funds,[5] purchasing an annuity may not have been the best course of action for some individuals in this group. It may be that some individuals chose to purchase an annuity in order to access the 25% tax-free lump sum. However, the data does not allow us to observe the wider circumstances of this group in terms of their other assets and income. Some of the smaller value annuities, for example, may have been bought from Additional Voluntary Contributions (AVCs) alongside a DB scheme.

While the removal, from April 2015, of limits to amounts that individuals can draw down will mean that individuals will no longer need to annuitise their funds just to gain access to their lump sum, this suggests that the minimum pension age does have an impact on the behaviour of some individuals. It also suggests that some individuals may wish to, or may feel that they need to, access their pension funds as early as possible.

Understanding around life expectancy

One of the concerns around the new flexibilities is that individuals might exhaust their sources of retirement income before they die. This risk is exacerbated by the fact that people tend to underestimate their own life expectancies (by 2 years for men and 4 years for women aged 50-60) compared to the official estimates.[6]

While, under the current system, life annuities can remove this risk by guaranteeing a secure income for life, individuals may be exposed to this risk if they manage their own sources of retirement income. Increasing the minimum pension age may decrease the average number of years to be funded by individuals' retirement income if it prevents some individuals from accessing their pension at younger ages. However, some may choose instead to take more income in the early years of their retirement.

Despite this, like the SPA, the minimum pension age may be used as a signal of expected increases in life expectancy and the need for private pension savings to support longer retirements.

Incentivising pension saving

One of the objectives of the pensions system is to incentivise pension saving. If a low minimum pension age were an effective incentive to pension saving, this might support keeping it at age 55. However,

Chart 2: Features in countries with different annuitisation levels

	State pension	Minimum age for accessing private retirement income	Early withdrawal allowed from private pension fund
Australia	Means-tested only Paid from 65 increasing to 67 by 2024	Between 55 and 60, depending on individual's age	Yes - health, financial hardship, changing employer after age 60
Ireland	Yes Earnings-related and means-tested Paid at 66 increasing to 68	60	Yes - health, if worked in particular occupation, leaving employer after 50
Chile	Means-tested only Paid from 65	65 for men, 60 for women	Yes - if fund has a sufficient balance accumulated, if worked in particular occupation
New Zealand	Yes, based on number of years of residency Paid from 65	65 (or after 5 years, whichever is later)	Yes - health, purchase first home, financial hardship, emigration
USA	Earnings-related only Paid from 65 (though available on a reduced basis from 62) increasing to 67 by 2027	59.5	Yes - medical expenses, disability-related, changing employer after age 55

there is very little evidence around the impact of the minimum pension age on incentives to save. In addition, other factors may be more important—for instance, employer contributions are a key factor in take up of pension saving among eligible employees.[7] As more employees become eligible for employer contributions as a result of automatic enrolment, this factor, and the returns they expect to see on their contributions, may become more important for a growing number of employees. Building up more substantial pension pots may also change how choose to use those pots to support them in their retirement.

Relevant changes in the UK pensions landscape

The single-tier state pension will be introduced in April 2016 and will be set at a rate above the Guarantee Credit which is £148.35 in 2014-15. It is designed to help lift pensioners out of means-tested benefits and, in particular, Pension Credit. This has implications for the interaction of how individuals access their private pensions with means-tested benefits in future.

Pension systems in other countries

Chart 2 shows state pension ages and the ages at which individuals can access their private pension savings for five countries, as well as some other attributes. These countries have been selected because their pension ages and the interaction of these with other attributes provide some insight into the differences in approach around setting the minimum pension age.

Differences between state pension ages and ages at which individuals can access private pension saving

Unlike the UK, in Chile[8] and New Zealand[9], the age at which pensioners can access state support (65) is the same as the age at which individuals can access their own private pension income (65, although women in Chile can still access retirement savings at the age of 60).

Like the UK, rules in Australia[10], Ireland[11] and the United States[12] allow individuals to withdraw their private pension income at an earlier age than they first qualify for the state pension. However, the difference between the ages is smaller in these countries than the ten year difference that is proposed for the UK.

For instance, while the age at which individuals in the United States can access their full state pension is increasing from 65 to 67 by 2027, the age at which they can first access their private pension income is 59.5. In contrast the Treasury consultation document outlines a proposal for the UK where the SPA will increase to 67 while the minimum pension age increases to 57.

However, all of these countries under consideration allow early withdrawal from pension funds for a wider range of reasons than in the UK, where this is limited to the grounds of ill-health. While it is difficult to estimate how the different policies of a younger minimum pension age versus wider grounds for early access influence retirement outcomes, this is something to take into account when making international comparisons. A number of countries (Australia, Ireland and the United States) also allow access when an older worker changes employer, which may mean in practice that many older workers do access their private pension savings sooner.

Patterns of behaviour around withdrawals

While it is possible to observe certain patterns around withdrawals of lump sums from pensions in the UK, the high level of annuitisation, partly due to the tax and regulatory framework, means that only limited conclusions can be reached. In contrast, in New Zealand, individuals are able to access the whole of their pension funds accumulated under KiwiSaver.

While the funds accumulated under KiwiSaver tend to be relatively small (as KiwiSaver was only introduced in 2007), observed behaviour in New Zealand provides some interesting insights. The first KiwiSaver members who were 65 years of age became eligible to withdraw their savings in 2012. Research estimated that, around three quarters of KiwiSaver members will have made a full withdrawal within five years.[13] In addition, members with lower levels of Kiwisaver savings were more likely to have made a full withdrawal at the time of the research. Similarly, members with higher levels of other savings and investments were more likely not to have withdrawn any of their KiwiSaver savings.

Individuals with no other savings or lower levels of other savings were more likely to spend their KiwiSaver savings or use them to pay off their mortgage or other debt. In contrast, individuals with savings/ investments of higher worth were more likely to reinvest them. This suggests that some individuals who access their KiwiSaver savings do so because they have immediate financial needs and lack the other assets to meet these.

It is not possible to make a direct comparison with what behaviour might be seen in the UK as the two countries have different characteristics including a lower relative state pension in the UK and a stronger legacy of DB and DC private pensions. However, this could suggest that, as a result of the flexibilities, there might be higher levels of full withdrawal from pension funds at the minimum pension age or at individuals' workplace retirement age, particularly for those with smaller funds and limited other assets.

Retaining the ten-year (or greater) difference between the minimum pension age and the SPA may mean that individuals will use their private pension to provide income during the period between individuals stopping paid work, or limiting their hours of paid work, and receiving the state pension. Similarly, it is possible to foresee cases where it may be financially beneficial for individuals to be able to access some or all of their fund at a younger age. For instance, if individuals are able to pay back their mortgage or other debt at age 55 or 57 this could result in savings to the individual in terms of interest payments to financial institutions that they are no longer required to make. However, any savings would need to be measured against the expected investment interest foregone on their pension funds.

Interaction with means-tested benefits

In Australia, where there are no restrictions on how individuals access their private pension savings, combined with a means-tested state pension, it is reported that some individuals draw down their private pension savings in a way that maximises their ability to access social security.[14] If the risk of moral hazard were considered to be significant in the UK pensions system, this might support the argument to increase the minimum pension age to reduce the number of years over which an individual can run down their private pension saving.

The UK state pension is different to the Australian system in that, while there are means-tested benefits for pensioners such as Pension Credit, Housing Benefit and

Council Tax Support, the state pension is contributions-based. The Government expects the new single-tier pension to prevent pensioners falling back on the state in future. However, as previous PPI research has shown, even individuals in receipt of a full single-tier pension may still in some circumstances fall back on the state for Guarantee Credit (including couple and disability elements), Housing Benefit, Council Tax Reduction and other means-tested benefits. There are still therefore some risks of moral hazard, particularly for people with relatively low amounts of private pension saving who are close to these thresholds.

Practical issues around changes and future increases to the minimum pension age

Many individuals have savings in contract– or trust– based pension schemes which may include rules around when individuals will access their funds. In some cases this may be linked to certain elements of protected or guaranteed benefits to be paid at retirement. If individuals do wish to access their funds sooner, or transfer out of their DC arrangement in order to do so, they may be at risk of losing those benefits. Therefore, some individuals may face a trade-off between exercising the new freedoms and accessing their private pension at age 55 and the benefits they expect to receive. If the minimum pension age is increased in future, schemes will need to amend their processes and member communications. This could create administrative burdens, particularly if the implementation of the increases is directly linked to the incrementally phased increases that are used to increase the SPA.

Conclusion

While the UK minimum pension age of 55 is currently lower than those of the other countries considered in this paper, and significantly below the SPA, these countries do allow some forms of early withdrawal from pension funds for a wider range of reasons than in the UK where early access is limited to those in ill-health. The extent to which the minimum pension age acts as a signal or incentive for individuals to access their private pension saving at an early age is not clear, though it is apparent from the available data that some groups will choose to access their saving as early as they can, and that they will have greater opportunities to do so with the new flexibilities in place.

One consequence of the removal of restrictions on how individuals can access their DC pension savings is that there will no longer be an incentive for individuals to purchase an annuity at age 55 just in order to access their tax-free lump sum, regardless of whether an annuity is in their long-term interest. This may improve retirement outcomes for some individuals.

However there is also a concern that an earlier minimum pension age would lead to some individuals exhausting their private pension savings too soon and living on reduced incomes or falling back on the state later in retirement. Even under the single-tier reforms there will be some groups who can still become eligible for elements of Guarantee Credit, Housing Benefit and Council Tax Support.

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PENSIONS POLICY INSTITUTE

PPI

PPI Supporting Member's Event: Freedom and Choice in Pensions

On 12 May 2014 the PPI held a Supporting Member's event to discuss HM Treasury's Budget consultation paper on Freedom and Choice in Pensions, which seeks views on changes to the taxation of DC pension savings and how they are accessed in retirement.

The event was attended by over 65 people representing a broad range of interests within Government and the pensions industry and exclusively comprised PPI Supporting Members and organisations who have commissioned research or otherwise supported the PPI during the last 12 months.

Chris Curry, PPI Director, introduced and chaired the seminar.

David Gauke MP, Exchequer Secretary to the Treasury, provided an overview of the Budget consultation paper and discussed the Government's vision for the future for savers and the retirement income market; the guarantee of face-to-face guidance at retirement; and Government expectations from industry.

Several minutes were allowed for discussion and questions from the floor. The following points were raised:

- The question was asked that, if the new flexibilities mean that annuities are to be no longer the default option for accessing DC savings, what will the new default be?
- There was a fair amount of concern regarding the guidance guarantee and whether people would be sufficiently enabled to engage with the guidance. There was a question around whether the guidance would be limited to retirement issues or would include discussion of other themes that the Government was keen to communicate with people about (such as health issues and long-term care needs). There was concern regarding how best to protect people from poor quality or partial guidance.
- There was discussion regarding the potentially conflicting philosophies behind auto-enrolment (which relies on inertia and the "nudge" principle) and the new tax regime (which is based on a philosophy of freedom, flexibility and personal responsibility). There was concern regarding whether these two philosophies could simultaneously be

applied to pension savings without creating confusion and difficulties for consumers.

Patrick Heath-Lay, Chief Executive of B&CE, provider of The People's Pension, shared the provider perspective on the Budget proposals and the potential implications for the DC market and automatic enrolment. He urged the industry to "get it right" through production of high-quality products which would help people to navigate the new flexibilities. He expressed concern that the current regulatory system was too heavy on industry and may stifle innovation.

Mel Duffield, Deputy Director of the PPI, presented new PPI research on how people access DC savings in other countries, and outlined the implications that international experience has for how the retirement income landscape may change after the new flexibilities are introduced, and the potential futures sources of demand for annuities.

Panel Session 1: "The implications for pre- and post-retirement product design and innovation" This session was chaired by **Chris Curry, Director of the PPI**

Panel members:

Nigel Barlow, Director of Product Development, Partnership
Maddi Forrester, Head of UK Institutional, AXA Investment Managers
Hugh Nolan, Chief Actuary, JLT Employee Benefits
Darren Philp, Head of Policy, The People's Pension

Darren Philp, gave an overview of his reaction to the 2014 Budget. He mentioned that, prior to the announcement, he had drawn attention to the fact that people were making decisions about how and when to access their DC pension savings in order to get hold of their tax-free lump sums, and that these decisions may not have been appropriate to their circumstances. He remarked that pension providers and the broader pensions industry are keen to improve the pensions landscape so that it meets individuals' needs. He highlighted the need for default funds to be fit for purpose in the new landscape and outlined how the Budget announcement marks an opportunity for some innovative and imaginative thinking by the industry.

Hugh Nolan, emphasised that it may no longer be relevant to refer to income in retirement as pensions – it may be better described as the process by which individuals withdraw cash from their funds. He highlighted the importance of having an effective investment strategy both before and after retirement. He also drew attention to particular challenges; including the negative portrayal of annuities by the press; people's tendency to underestimate their life expectancy; and the unpredictability of the random variation of life expectancy for individuals. He described contrasting attitudes around whether financial advisors offer value for money – there was no clear consensus, for example, about whether a financial advisor who charged a fee of 5% of the fund value but found an open market option that was worth 30% more in rates should be considered to have provided advice which was good or bad value.

Maddi Forrester put forward the view that the proposals do not represent a major departure from existing social trends towards greater flexibility around retirement. She reflected that the pensions and investment industry were already working towards the provision of more flexible drawdown products and that they will now be working on this with more urgency. She pointed out that the problems in this area are depressingly familiar: there is a lack of financial education around pensions and it is difficult for people to understand the risks they are facing. She was concerned that a general lack of trust in the pensions industry could mean that many people will be concerned that organisations are trying to make money from them rather than offering them products that are best suited to their needs, and that this could impede effective engagement from savers.

Nigel Barlow indicated that while people express a dislike of annuities, in practice they gravitate towards a guaranteed income. There is a challenge for the industry around meeting individuals' changing needs as they go through their retirement and may need access to cash sums in differing amounts, particularly if they need social care (although, he pointed out, most people do not currently believe they will need social care). He was concerned that many people did not understand how annuities work, pointing out that 60% of people who've purchased annuities are unaware that they have done so. He emphasised that in order for the new system to work effectively people must be given more choices, alongside high quality advice and guidance. Nigel also predicted that many people will still wish to purchase an annuity in the future, albeit at older ages.

Discussion
The following points were raised:

- There was discussion around the fact that, in the past, some individuals had bought products that did not meet their needs. There was also some discussion around the trend towards more flexible working lives, with increasing numbers of individuals over SPA now working part-time. It

was emphasised that providers will have to work harder and innovate more in the future to meet these changing needs.
- There was discussion around whether accessing retirement income should be described as decumulating or drawing down income. One view was that it should be described as accumulation, transition and decumulation while another was that it should be seen as joining up of accumulation and decumulation.
- There were some questions around how funds' investment strategies might change in future. There was discussion around the need for each fund to have a default investment strategy and the importance of knowing each employee's requirements.
- The importance of engaging people was discussed. Challenges to engagement include the difficulty individuals face in locating and considering information around their pensions. Linked to this was the importance of ensuring that any information provided under the Guidance Guarantee is easy to understand.
- It was felt that past experience had taught the industry that now it will be essential to: pare back complexity; provide a period of stability to enable changes to bed in; and, allow the pensions industry an opportunity to rebuild consumers' trust.

Panel Session 2: "Providing support and guidance for members post April-2015." This session was chaired by **Alan Woods, independent consultant and PPI Governor.**

Panel members:

Michelle Cracknell, Chief Executive, The Pensions Advisory Service
Alan Higham, Head of Retirement Insight, Fidelity
Kerstin Parker, Senior Policy Adviser, HM Treasury
Alex Roy, Manager, Life and Pensions, Financial Conduct Authority

Michelle Cracknell discussed the high volume of calls that TPAS had received since the Treasury's announcement, showing renewed interest in pensions due to the new freedom of choice. Though she noted that people did not seem to understand how much tax they would need to pay on money they had withdrawn. She highlighted concerns that too much choice would result in people defaulting into doing nothing e.g., taking all their savings as a lump sum, depositing it into a bank account and then leaving it there.

Alan Higham believed that the new flexibilities created great opportunities for industry and that new products could now be developed which would increasepeople's income in retirement. However, he was also concerned that consumers did not understand the implications of the new freedoms, particularly their implications for the tax position of pension savings and income. He reported that some people had already responded to the announcement by "spending" all their savings (e.g., through booking a holiday) before taking it out, in some cases only then discovering they were below the age of access, or could access their 25% tax-free lump sum but only if they purchased a retirement income product. He reported that some of these people were being defaulted into purchasing an annuity from their provider without taking any time to explore whether it was the best product for them.

The following points were raised:

- In Australia, where people are allowed unlimited access to lump sums after retirement age, a phenomenon has developed whereby people are accruing debt with the intention of paying it off with their pension savings when they reach retirement age and thereby potentially jeopardising their income in retirement.
- Concerns were raised about whether the guidance programme will be sufficient to support people through long and complex retirements which will include changes in both needs and circumstances. It was pointed out that the guidance would need to be extensive to cover the range of different products, circumstances and decisions an individual with DC savings may be faced with at the point of retirement and after.
- It was felt that the guidance would need also to fit within a broader "conversation" with industry and providers about how they were adapting to meet the new needs of consumers under the new flexibilities.
- It was queried whether £20m would be sufficient to generate a guidance programme that could support savers not only at the first point of accessing their DC pension savings but right through retirement.
- There was concern that investment in a sophisticated IT system may be required in order to ensure that the data of those seeking guidance could be stored for follow-up sessions during later retirement.
- There was general agreement that there was no clear picture of what a "good" outcome for consumers actually looked like.
- There was discussion regarding how to measure the quality of guidance and its outcomes. It was recognised that there would be difficulties in measurement because there may not be data on what decisions people made after receiving guidance.
- Several people felt that face-to-face guidance would be favoured by many consumers and there was concern that this would be the most expensive way to for providers to deliver guidance.

- There was some discussion regarding the role of the regulator. It was unclear who would be providing the guidance e.g., schemes, employers, advisory bodies. There was not yet a clear picture how the guidance would be regulated and how quality would be monitored.

Panel Session 3: "The Changing Retirement Landscape." This session was chaired by **Alan Woods, independent consultant and PPI Governor.**

Panel members:
Helen Forrest, Head of Policy and Advocacy at NAPF;
David Hutchins, Chair of IMA's DC Committee;
Barry O'Dwyer, Member of ABI's Long Term Savings and Life Insurance Committee

Helen Forrest spoke from the perspective of providers of occupational pension schemes. She said it is becoming harder to deliver a tailored service to scheme members who now experience a lot more variation in how they decumulate pension assets than previous generations did. She also pointed out that it was harder to anticipate member needs as many scheme members do not make decisions as to how they want to take their pension fund until they're close to retirement.

She commented that there is a lack of understanding of how the changes announced in Budget 2014 would work in practice within schemes, for example how using schemes into retirement as drawdown vehicles might work.

She suggested that with all the changes occurring within pensions, an appropriate guidance scheme is critical. She was concerned that there is a risk of more engaged employers who currently offer good guidance stepping back from what they currently offer and levelling down to the new standard introduced by the Budget changes.

David Hutchins noted that there has been a reversal in the approach to choice in respect of pre and post retirement choices. Under the old system joining a pension scheme was voluntary, but the way in which the pension fund was used at retirement was compulsory. Under auto enrolment and the reforms announced in the Budget, choice and compulsion have switched: being a member of a pension scheme is no longer an active choice, but the saver faces a choice as to how to use their fund at retirement.

He said that choice itself should be optional, and that there should be defaults in place for those who do not wish to make a choice.

He suggested that the expectation of advice being required at a single point in retirement is wrong. Pension savings and their use in retirement are a whole life journey. Decisions need to be made throughout both the savings phase and during retirement.

He believed that it would be essential for the stability of the pension saving system going forward that tax-relief on savings does not change. He pointed out that any changes would be especially damaging to public sector pension scheme members whose pensions have just been though a complete overhaul.

Barry O'Dwyer said that the traditional view of two phases, of accumulation and decumulation, no longer applies. He pointed out that, therefore, guidance is required over a longer period, not just once at the point of retirement. He believed that this would complicate matters for employers trustees and providers who were trying to deliver guidance.

He pointed out that the traditional view of tax relief was that relief on contributions and tax on the income during retirement acted to smooth tax over a person's lifetime. He suggested that if the pension savings do not have to be taken as a stream of income in retirement following the Budget announcements, then the traditional view of smoothing over a lifetime's income no longer holds.

He felt that annuities would still have a role to play for those who would need security and protection, but speculated that the average age of annuity purchase may raise to somewhere around age 70 or above.

The following points were raised:

- There was discussion around the possibility that savers may use new freedoms to seek to increase their returns. It was considered that, while people may like choice and flexibility in how they use their funds, that does not mean they like risky investments; strategies that promise to double your money may be less attractive to people when the risks are fully explained.
- It was noted that certainty of income is important to people and that annuities will likely still be sold to people who value certainty.
- There was some discussion around people's lack of understanding of retirement income products and how this lack of understanding may affect their decisions at retirement. It was suggested that, of the options available at retirement, taking cash was the easiest to understand (while

annuities and drawdown were complex and confusing) and may therefore be the most attractive option for many people, even if it isn't the most suitable option for everyone.

- It was noted that it is more likely to for consumers to achieve "good" outcomes in retirement if guidance or advice services engage with them at several points over a period of time rather than just once.
- There was discussion around how to encourage or trigger people to make a decision about what to do with their pension fund, noting that it is a natural human tendency to put off decisions about pensions for as long as possible and that cognitive ability declines with age. It was suggested that one potential trigger could be the potential interaction of pension saving/capital held and long-term care needs.