PENSIONS POLICY INSTITUTE
PPI

# Pensions Policy Institute response to the Personal Accounts Delivery Authority's consultation, Building personal accounts: securing a retirement income

**Submitted by Niki Cleal, PPI Director on behalf of the PPI**

## Introduction

### The role of the Pensions Policy Institute

1. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.

2. This document provides the PPI's response to the personal accounts delivery authority's (pada) consultation on the issues around how members of personal accounts will secure an income in retirement. The process by which pension scheme member's assets are converted into an income is sometimes referred to in the pensions industry as decumulation.

3. This response is limited to providing comment on the major policy decisions that are proposed by pada in the proposed approach for how members of personal accounts will secure an income in retirement. We have outlined where we feel the available research and evidence supports the proposed approach and in some cases have also highlighted issues for further consideration. This response does not cover all of the questions outlined in pada's consultation document. Many of these questions are detailed implementation questions that are outside the PPI's area of expertise.

4. The response focuses on three major policy decisions:

   (1) The proposal to offer members of personal accounts lifetime annuities and limit access to drawdown to those who transfer their pension out of personal accounts into an alternative pension that permits drawdown.

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(2) The proposal to offer personal accounts' scheme members access to the open market option or to a focused choice process using a (possible) limited range of lifetime annuity products offered by a panel of providers.

(3) Comment on the proposed distribution channels and the needs that scheme members may have for information and advice to help them to make appropriate choices in securing a retirement income.

**Summary on the overall proposed approach**

5. Overall the approach that the personal accounts delivery authority is proposing for scheme members to secure a retirement income seems to strike a reasonable balance between enabling scheme members to shop around on the open market to get the best retirement income that they can and recognising that not all scheme members will wish to shop around on the open market and providing a focused choice alternative.

6. Given the nature of the target market, the overall approach to securing an income in retirement seems to be reasonable and appropriate. However, there are one or two specific issues that will need careful consideration (e.g. the perceived fairness of the approach to transfers and drawdown, the issues around potential detriment if impaired life annuitants use the focused choice process.)

7. Given the fact that the personal accounts scheme is not yet up and running it may make sense to review some of the key policy decisions in the 2017 review when better data should be available on the scheme members of personal accounts and the size of their accumulated pension pots.

8. The PPI is undertaking a number of pieces of research into different aspects of how pensioners convert a wide range of assets into an income in retirement during 2009. We will keep pada informed of that research as it progresses and will highlight if any of the issues thrown up in the research have a bearing on the proposed approach to decumulation in personal accounts.

9. The rest of this response provides detailed commentary on the three policy decisions outlined in paragraph 4 above.

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**Lifetime annuities versus income drawdown**

10. The consultation document seeks views on pada's proposed approach to offer lifetime annuities as the means by which personal account scheme members will secure a retirement income. Pada propose that individuals who wish to use income drawdown will have the option to transfer their pension out of the personal accounts scheme and into an alternative pension, which permits income drawdown.

11. The thrust of the argument behind this decision is that income drawdown is only suitable for individuals with fairly large pensions pots. The Pensions Commission estimated that pension pots of at least £50–100,000 are needed to make income drawdown worthwhile. The PPI broadly agrees that, within the current framework of options, a lifetime annuity is probably the best way for personal accounts scheme members to secure an income in retirement given:
    - the nature of the personal accounts target market (low to moderate earners) and
    - the fact that, at least initially, pension pot sizes in personal accounts are likely to be relatively small.

12. It may be sensible to review the lifetime annuity approach in the 2017 review once more data is available on the characteristics of personal accounts scheme members and the size of typical pension pots that are being built up in personal accounts. If a large number of personal accounts scheme members are starting to build up substantial pension pots this decision may need to be revisited.

13. There are however, some issues that will need to be thought through regarding the approach to offering income drawdown to those scheme members who transfer their pension out of personal accounts and into an alternative pension that offers an income drawdown facility.

14. Not all personal accounts scheme members will necessarily have an existing pension product that will permit a transfer from personal accounts and will enable income drawdown. Some scheme members may have pre-existing defined benefit pensions in either the public or private sector and some personal accounts scheme members may have no other pre-existing pension product into which they could make a transfer from their personal account.

15. While in theory there is nothing to stop a personal accounts scheme member from opening a new personal pension that would receive a transfer from personal accounts and permit income drawdown, in practice, there may be issues about the perceived fairness of a system that permits some people to have what may seem to be easier access than others to additional flexibilities (i.e to use of income drawdown).

**Open Market Option and Focused Choice**

16. The consultation proposes that personal accounts scheme members will be able to purchase an annuity on the open market using the open market option. This is welcome as there is evidence that pension scheme members who do shop around for an annuity on the open market can increase the income available to them. As noted in the consultation document, a Which? survey in February 2008 revealed that for a man aged 70 purchasing a level annuity with £100,000, the difference between the best and worst annuity rates was £1,332 a year.[1]

17. The consultation document cites FSA evidence that roughly 1/3rd of existing purchasers of annuity products use the open market option and actually switch providers. However, it notes that more consumers have shopped around and decided to remain with their existing provider – so the 1/3rd figure under estimates the current extent of shopping around in the annuity market.

18. It should also be noted that some of those individuals who did not shop around may only have made relatively small gains through switching provider, which may have been eroded by the costs of switching. So for some people it may be a rational choice not to spend time shopping around on the open market.

19. Given the evidence above it seems reasonable to assume that not all personal accounts scheme members will necessarily want to shop around or may not understand the full range of options available through the open market. The proposed focused choice process operated via a panel of providers seems to strike a balance between acknowledging that in an ideal world all scheme members would exercise their right to use the open market option to maximise their retirement income and recognising that in the real world, some scheme members may neither want nor value the extra time involved in the open market process and may prefer to be presented with a limited set of options from which they can choose.

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[1] Which? Money June 2008.

20. The implication of the focused choice process is that some scheme members may forego some retirement income as a result of using this approach (because they may be unaware that a better income could be secured from a provider not on the panel). Further work will need to be done to ensure that the extent of any such detriment is not significant. There may be a particular issue for individuals who could access impaired life annuities on the open market but will not have that option via the focused choice process. There may need to be clear communication that for individuals with ill health/ short life expectancy the gains of using the open market option over the focused choice process may be significant.

21. The decision about which lifetime annuity product features should be offered as part of the focused choice process is a difficult one. Given the different characteristics of personal accounts scheme members (single people, couples, etc) and the different levels of other assets that they may have to draw on a minimum level of basic choice around single v joint life, and level v escalating annuities would seem desirable.

22. Whether the focused choice process should also offer a choice between guaranteed annuities and non-guaranteed annuities seems more open to question. The inclusion of this option will increase the number of decisions that an individual will have to consider as part of the focused choice process. It may simplify the focused choice to exclude guarantees unless there is evidence that it is a feature that is likely to be very important for the target market. Scheme members who want guarantees would still be able to get them on the open market.

23. The proposal for the ultimate default in the event of non-decision by scheme members by age 75 to be a single-life level annuity seems reasonable as according to ABI research currently 85% of consumers purchase a single-life level annuity.[2]

**Distribution Channels**

24. The consultation document proposes that online information/ the internet will be a major means of distributing information to personal accounts members on their retirement income options. However, the market research pada have conducted does sound a note of caution in over reliance on online/ internet as a means of communication for this decision.

[2] ABI Research Paper No 8, Pensions Annuities, by Dimitri Gunawardena, Christopher Hicks and David O'Neill

25. The consultation document notes that currently around 65% of the UK population have access to the internet. However, internet penetration is likely to vary by age and the market research also suggested that while some people may feel comfortable making short-term reversible financial decisions (eg bank accounts, credit cards etc) online they feel more hesitant about making long-term decisions like pensions without actually talking to someone face-to-face about their options.

26. We agree that it is not pada's role or the personal accounts scheme's role to directly provide this type of independent financial advice to scheme members but it will be important that personal accounts scheme members can access this type of advice at reasonable cost. At the current time it is not entirely clear to whom scheme members will be able to turn for this type of advice and guidance.

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