PPI policy seminar: How complex are the decisions that pension savers need to make at retirement?

The Pensions Policy Institute (PPI) held a policy seminar on 27 November 2014 to launch its latest report *How complex are the decisions that pension savers need to make at retirement?* The research was sponsored by Fidelity. The PPI's research on Transitions to Retirement is also sponsored by Age UK, the Investment Management Association (IMA), Partnership, The Pensions Advisory Service (TPAS), The Pensions Regulator (TPR), The People's Pension and State Street Global Advisors.

This first report in the series explores the range of potential decisions people have approaching, at the point of, and after retirement. It sets out the likely income and savings portfolios people might reach retirement with now and over the next ten to fifteen years, and sets these against the behavioural and psychological factors that affect the decisions people could make at and during retirement. The research investigates implications for the retirement income product industry, employers, trustees, providers, consultants and services.

The seminar was attended by around 80 people representing a broad range of interests within Government, the investment industry, the pensions industry and the third sector.

Lawrence Churchill, Governor of the PPI, chaired the seminar.

Daniela Silcock, Senior Policy Researcher, PPI and Mel Duffield, Deputy Director, presented the findings of the report.

- The decisions that people face at retirement can be grouped under five headings; work and retirement transitions, accessing state pension, accessing Defined Benefit (DB) pension entitlement, accessing Defined Contribution (DC) savings and accessing other income and assets. These can be combined in a number of different ways while there are some strong defaults, such as the normal pension age for DB pensions. After April 2015 decisions around accessing DC savings will be more complex. Skills and knowledge necessary to make an informed decision about accessing DC savings include knowledge of the available options, understanding of longevity risk, potential future needs and an understanding of economic factors such as inflation, market risks and compound interest.

- Annuity sales were 56% lower in the third quarter of 2014 than they were in the third quarter of 2013. However, these individuals may later purchase a retirement income product or some type of risk protection.
- In a workshop held by the PPI, it was judged that decisions around accessing DC pensions were harder when compared with benchmark decisions around areas such as buying a house, buying life assurance, accessing state pensions and decisions regarding work and retirement.
- Both internal and external factors can influence work and retirement transitions, including cognitive factors, affective (emotional/feeling) factors, behavioural factors, attitudes towards external stakeholders and structural factors. In some cases it is not clear whether decisions are voluntary or involuntary while issues around trust can have a strong influence on the extent to which individuals engage around their pension decisions. Numeracy is correlated with the ability to make "good" decisions about accessing pension decisions.
- The remainder of the presentation considered what the next ten to fifteen years of retirees look like, using data from English Longitudinal Study of Ageing (ELSA) Wave 5. Some of the findings are as follows:
    - When today's 50-SPA year olds reach SPA, 60% of those with DC savings will have pots of £27,500 or less. Even when these figures were considered at the household level, it was found that 60% of households with DC savings and a member aged 50-SPA in 2014 have total savings of £31,100 or below
    - As more people reach retirement, the average of DC savings will increase, rising between £13,800 and £23,800 between 2015 and 2024. At the 90th percentile these could increase by around 75% from £79,800 to £140,700 –however, there could be a dip in 2018 as many more pots are introduced as a result of automatic enrolment but have not had very long to mature
    - Those with high levels of DC savings are less likely to have DB entitlement
    - With risk being associated with dependence on DC and low levels of financial skill and engagement, 12% of people reaching SPA with private pension savings over the next ten to fifteen years are at high risk of making poor decisions with their DC savings. A further 29% will be at medium risk of making poor decisions.
    - As the proportion of those reaching SPA with DC savings increases so could the proportion of those at medium to high risk of making poor decisions around their DC savings.

The PPI presentation can be accessed (to be added)

Alan Higham, Retirement Director, Fidelity Worldwide, provided a view of the findings from the adviser perspective. He highlighted the fact that decisions around pensions are extremely difficult, despite efforts to make language around pensions simpler, because no-one knows what will happen to them. He added that customers do not understand complexity, and they value ease and simplicity.

Alan argued that the Financial Conduct Authority has been lukewarm in its support for advice and highlighted that the cost of advice is broadly equal to the cost of commission on the purchase of an annuity. He also argued that it is not fair to expect the Guidance Guarantee providers to act as lifeguards under the new flexibilities.

Alan said that there is a role for the advice industry to continue to educate consumers after they have made decisions and to double check decisions that people have made. Finally, he stated that the FCA should close any regulatory gaps, that guidance should link to reliable expert help, and that consumers should know that it is safe to seek advice.

Anna Diebel-Jung, Head of Consumer Issues, Financial Services Group, HM Treasury (HMT) provided a view of the findings from the HMT perspective. She outlined the intended scope of the guidance, stating that it will be designed to help consumers to navigate options and to make informed, confident decisions in the light of their own circumstances. It will be designed to complement rather than to replace advice and should help individuals to understand the value of advice.

In terms of delivery of the Guidance Guarantee, the FCA has designed a standard while the Pensions Advisory Service (TPAS) will provide guidance over the telephone while Citizens Advice will provide face-to-face guidance – TPAS and CAB were chosen because they are trusted, experiences organisations.

HMT and MAS will provide the web content for the guidance and intend the process of guidance provision to reach a crescendo rather than constituting a big bang in April 2015. She described how, when they submitted the alpha version of the website to user testing, they realised that they had overestimated the level of individuals' understand around pensions. She indicated that there will be a new criminal offence where scammers pass themselves off as official guidance providers and there will be some key announcements by HMT over the next month. She pointed out that the FCA's rules make clear the obligations of pension providers to promote guidance and advice.

Michelle Cracknell, Chief Executive of the Pensions Advisory Service gave TPAS's perspective on the new flexibilities for accessing DC savings and what this will mean for consumers and the new Guidance Guarantee. She described how TPAS has already experienced three times the normal volume of calls with callers typically describing what they want to achieve from their retirement income arrangements and asking TPAS how they can achieve this. She highlighted the fact that individuals are already struggling to match their pension arrangements with their needs – in particular, she emphasised the fact that individuals do not understand that they will pay tax on withdrawals from their pension pots and, in particular, they do not understand marginal rates of tax.

There is a concern that the lack of regulation will mean that there will be scams with no easy way to close these down. There is also a risk that individuals will transfer their whole pension pots to a bank account, with tax implications, when they would achieve what they need while retaining their pot in a pension wrapper.

She emphasised that the requirement for advice does not fall by pot size, and there is a risk that people don't take up the guidance.

Jane Vass, Head of Public Policy, Age UK gave Age UK's perspective on how individuals will be affected by the new flexibilities. She asked whether it will really be possible for individuals to plan ahead or to diversify risk if they have limited resources. She highlighted concerns that there will be pressure felt by individuals to access their pensions pots if, for example, their son or daughter is in danger of losing their home.

Jane pointed out that individuals do not receive their state pension unless they claim it and that a third of pensioners are not claiming the means-tested benefit that they are entitled to. In light of the research findings, she described how people do not have the financial safety blanket to handle risking their savings and highlighted the fact that 20% of baby boomers have low readiness for retirement in financial terms.[1] In addition, even better off groups will need some help, e.g. finding a financial adviser.

With regards the use of pension pots, she described the concern that individuals will be lent on to use their pensions pots to pay off low priority

[1] Age UK (2014) *Financial resilience in later life*

debts, while 1 in 10 of those aged 40-70 with a mortgage are intending to use their pension pot to pay this off.[2]

In terms of safeguarding individuals' interests, it is important that any guidance is accessible, and that it doesn't make the issues seem too difficult or people will not engage. Age UK's test for the policy overall is that it should deliver a reasonable outcome even for disengaged consumers, and while it may be difficult to have any true defaults under the new flexibilities the industry and regulators should still consider how to nudge people into sensible decisions. She called for an inter-agency fraud squad to make scammers lives harder and for the state pension triple-lock to be enshrined in legislation.

The following points were raised during the questions and discussion section. They do not necessarily reflect the views of the PPI or the PPI seminar speakers.

- There was a discussion about the possibility of advisers checking with individuals that they have made the right decision for them. Alan Higham pointed out that this costs around £25 and recommended that it should be mandatory for advisors to conduct this type of check.
- There was concern around the potential level of fraud, under the new flexibilities, by organisations targeting over-55s.
- There was discussion around the interaction of housing wealth, mortgage debt and pension pots along with the possibility of mining data to look into this in the light of the new pension flexibilities.
- There was discussion around the role of defaults and, in particular, deferred annuities and other longevity insurance. Michelle Cracknell pointed out that individuals are not aware that they have to move their pension pots into a new product to draw them down.
- There was a question around how outcomes under the new pension flexibilities will be evaluated. In response to this, it was suggested that the interaction between pensions and care will be important, that annuitisation would be used as the counterfactual and that it might be possible to build on ELSA or WAS data.

[2] https://www.partnership.co.uk/home/press/press-releases/half-a-million-plan-to-repay-mortgage-borrowing-with-pension-funds/